

Post Office Limited

POST OFFICE LIMITED
(Company Number 2154540)**Meeting of the AUDIT, RISK AND COMPLIANCE SUB-COMMITTEE**
to be held from 13.45 - 16.00 on 15 May 2014 in the Boardroom, 148 Old Street, London,
EC1V 9HQ

Members of the Audit, Risk & Compliance Committee (the "ARC") will be asked to declare any interest that could give rise to conflict in relation to any item on the agenda at the beginning of the item in question. All interests so disclosed will be recorded in the minutes of the ARC. If the chairman of the meeting deems it appropriate, the member shall absent himself or herself from all or part of the Committee's discussion of the matter.

13.45	1	Minutes of the last meeting and matters arising	Alasdair Marnoch
		<ul style="list-style-type: none"> • Minutes of the meeting held on 6 March 2014 • ARC Status Report 	
13.55	2	Presentation of draft Annual Report and Financial Statements for the year ended 30 March 2014:	Chris Day/ Mark Davies/ Sarah Hall
		<ul style="list-style-type: none"> • Draft Annual Report and Financial Statements • Briefing Book • Auditors' report 	
14.40	3	Data Centre Procurement	Chris Aujard
15.10	4	Project Sparrow Lessons Learned	Chris Aujard
15.40	5	Approval of the Internal Audit Plan	Malcolm Zack
	6	Papers for noting:	Alasdair Marnoch
		<ul style="list-style-type: none"> • IA activity report • Status of IA recommendations • BOI Capital and Liquidity Report • General Insurance – review recommendation • Treasury update 	
	7	Date of Next Meeting: 12 noon – 2pm 10 November 2014	
16.00		CLOSE	

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

SECRETARY: Gill Catcheside (Assistant Company Secretary)

IN ATTENDANCE: Alice Perkins (Chairman)
Paula Vennells (CEO)
Chris Aujard (General Counsel)
Chris Day (CFO)
Sarah Hall (Head of Financial Control and Compliance)
David Mason (Head of Risk Governance)
Malcolm Zack (Head of Internal Audit)
Mark Davies (Communications Director) (Item 2 only)
Angus Grant (Partner, Ernst & Young)

*by telephone

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POLARC14 (2nd)
14/4 - 14/17

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

**Minutes of a meeting of the AUDIT, RISK AND COMPLIANCE SUB-COMMITTEE held
on 6 March 2014 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:

Chris Aujard	General Counsel (GC)
Gill Catcheside	Assistant Company Secretary
Chris Day	CFO
Sarah Hall	Head of Financial Control and Compliance
David Mason	Head of Risk Governance
Malcolm Zack	Head of Internal Audit
Mark Davies	Communications Director (Minute POLARC 14/6-14/7 only)
Angus Grant	Partner, Ernst & Young (Minute POLARC 14/8-14/10 only)
Steve Lyon	Ernst & Young (Minute POLARC 14/8-14/10 only)

POLARC
14/4

INTRODUCTION

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

POLARC
14/5

MINUTES OF THE LAST MEETINGS AND MATTERS ARISING

- (a) The Committee approved the minutes of the meetings held on 19 November 2013 and 11 February 2014 for signature by the Chairman of the Committee.
- (b) The Committee noted the actions list dated 26 February 2014.
- (c) The Committee received a report on the Bank of Ireland's saving strategy. It was noted that balances had been actively reduced to £16.0bn so that the savings book could be grown in line with the mortgage book growth, and that it was anticipated there would be no further re-structuring of the balance sheet. CD advised that there was a statement of intent with Bank of Ireland to grow both sides of the balance sheet with the Post Office but that there was no contractual arrangement in place. Nick Kennett, Director of Financial Services, was asked to confirm (i) that there were no restrictions on Post Office by being tied to the structure and growth of Bank of Ireland's balance sheet; and (ii) details of the benchmark for competitiveness to ensure that customers were not disadvantaged.

ACTION: NK

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POLARC
14/6**ANNUAL REPORT AND ACCOUNTS 2013/14**

- (a) Mark Davies, Communications Director, was welcomed to the meeting.
- (b) The Committee noted the key messages and plans for the publication of the Post Office's Report and Accounts for the financial year 2013/14 ("R&A"). It was agreed that the work of the Post Office Advisory Service should be included in the public purpose section.

ACTION: MD

- (c) Mark Davies was asked to circulate a timeline for the production of the R&A, together with more detail for the high level themes to include "the most difficult words and issues". It was agreed that a balanced sensible approach was required as 2013/14 had been a tough year. It was agreed that the R&A should be consistent with the Post Office's corporate branding.

ACTION: CD

- (d) It was noted that the publication date for the R&A would be after that of Royal Mail due to the price sensitive nature of the reporting of Mails. Chris Day undertook to advise Matthew Lester of Royal Mail of Post Office's R&A timeline.

POLARC
14/7**ADOPTION OF NEW UK GAAP REGIMES**

- (a) The Committee received a report on the new UK financial reporting framework, and considered Post Office's response to the changes outlined.
- (b) Sarah Hall advised that, following consultation with the Company's Pension providers and corporation tax advisers, there would be no disadvantage to working towards early adoption of the new UK GAAP regimes.

ACTION: SH

- (c) The Committee asked Sarah Hall to raise the issue with the Shareholder Executive, and subject to their agreement, agreed that Post Office should early adopt the new UK GAAP regime and prepare the Company financial statements for the 2013/14 financial year end under FRS 101 (reduced disclosure).

POLARC
14/8**AUDIT PLANNING REPORT 2013/14**

- (a) Angus Grant and Steve Lyon of Ernst & Young ("EY") were welcomed to the meeting.
- (b) The Committee considered the Audit Planning report for the 2013/14 financial year. Angus Grant advised it would be a year of transition with new corporate governance rules being introduced, including the "fair, balanced and understandable" requirement. Chris Day suggested it would be helpful for EY to review Post Office's 2012-13 R&A in light of the new best practice and to provide examples of good reporting by other companies.

ACTION: EY

- (c) Angus Grant noted that the Fujitsu IT controls report had been received and had no issues of concern. The Committee discussed the independence of the report on Fujitsu's controls. It was noted that a separate team from EY prepared the report against defined standards,

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and underwrote its accuracy. The Committee was advised that the audit of the Fujitsu work had improved over the last two years with higher levels of engagement and oversight, and that lessons learnt would be implemented at the start of the re-platforming process to take place in 2015.

- ACTION: CA** (d) It was agreed that the Business share its top risks with EY.
- ACTION: EY** (e) It was also agreed that EY should be invited to provide a briefing to the Financial Services Sub-Committee on regulation under the FCA.
- (f)
- ACTION: GC** (f) The classification of exceptional items was discussed, including the impact of the change in RMPP terms and the utilisation of Government grant for transformation expenses. Counterparty risk was also discussed and it was agreed that Gill Catcheside would forward to EY the Terms of Reference for the Financial Services Sub-Committee which had oversight of the Bank of Ireland capital and liquidity for Eagle Contract requirements
- (g) The Committee discussed and noted EY's fees for the 2013/14 audit work which had been agreed with the CFO. It was noted that the inflationary increase had been mitigated by efficiencies but there was a 7% uplift in fees mainly due to the work required for the preparation of the interim consolidated accounts for the first time in 2013-14.
- POLARC 14/9** **REVIEW OF BUSINESS TOP RISKS**
- (a) The Committee received a paper on the Executive Committee's assessment of the key risks facing the Post Office in the achievement of its strategic objectives.
- ACTION: DM** (b) It was agreed that a note on the key risks should be circulated to the Board, and that a copy of the paper be sent to EY. It was noted that the Executive Committee Governance structure included a Risk & Compliance Committee, and that each committee within the structure had risk management incorporated into its Terms of Reference.
- (c) A paper was tabled on the insurance-related issues for Project Sparrow. The Committee was advised that the risks associated with Project Sparrow were being identified and action taken to mitigate those risks, and that this was being regularly monitored by the Board. The Committee discussed the position with regard to Professional Indemnity insurance ("PI"), and was concerned at the apparent lack of clarity on the current/historic levels of insurance which might cover Sparrow risks. Chris Day and Chris Aujard would provide a report to the 26 March 2014 Board meeting to provide clarity on the insurance position, including PI cover, in respect of Sparrow; and the legal liabilities in respect of claims made in connection with Sparrow
- ACTION:CD/CA**
- (d) The Committee reviewed the other eight key risks. It was noted that these risks had been discussed by the Board.
- (e) Chris Aujard advised that he was liaising with Nick Kennett regarding Project Titan and the implications of a potential FCA authorisation.
- ACTION: CA**

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- (f) It was noted that the ExCo owner of the People Capability was now Neil Hayward, and that Capability and Capacity to Change would be included in the risk description.
- (g) With regard to the Network Transformation programme, the Committee agreed that it was important to deliver a sustainable network.
- (h) The continuing trend of “red” mystery shops was discussed, and the Committee agreed that an understanding of the process together with an urgent remedial action was required. Nick Kennett would be asked to produce an update for the next Board meeting.
- ACTION: NK**
- (i) Lesley Sewell was asked to provide the Committee with an update on Data Security/Integrity at the next meeting, to include lessons learnt and what controls and processes were now in place.
- ACTION: LS**
- (j) The Committee was informed that the report from Price Waterhouse Coopers on risks, risk management best practice and assurance in relation to the IT Transformation programme would be considered by the Board.
- (k) Chris Aujard, Chris Day and Dave Mason undertook to incorporate the Committee’s feedback on the Business’ top risks.
- ACTION: CD/CA/DM**
- (l) The Committee noted the progress made in the management of the risks affecting the Post Office strategy.
- POLARC 14/10** **CORPORATE GOVERNANCE AND KEY ACCOUNTING STANDARDS BRIEFING**
- (a) Steve Lyon tabled a presentation outlining the changes to UK Regulatory and Corporate Governance requirements.
- (b) The Companies Act 2006 requirements for a Strategic report within the R&A, and the need for the Board to present a fair, balanced and understandable (“FBU”) assessment of the Company’s position and prospects within the R&A was discussed. Angus Grant advised that the Company did not have to make an FBU statement in the 2013/14 accounts, but should evaluate what work was necessary to be able to make an FBU statement in next year’s R&A.
- (c) Angus Grant would send through a model set of accounts reflecting the recent changes in Corporate Governance and Key Accounting Standards. EY would also advise what level of reporting other companies were considering for the current financial year.
- ACTION: EY**
- (d) Angus Grant and Steve Lyon left the meeting.
- POLARC 14/11** **INTERNAL AUDIT PLAN 2014/15**
- (a) The Committee received the proposed internal audit plan for 2014/15. Malcolm Zack advised that the plan incorporated the Business’ top risks.
- (b) It was agreed that an internal audit plan be recommended to the

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ACTION: MZ Committee at the next meeting, incorporating a prioritisation of work and the necessary resource requirements.

POLARC 14/12 **INTERNAL AUDIT ACTIVITY REPORT**

(a) A paper on Internal Audit activity since November 2013 including key outcomes, and proposed audit and advisory work for Q1 2014 was noted.

ACTION: LS (b) Lesley Sewell was requested to provide updates on the outstanding actions.

ACTION: MZ (c) It was agreed that Internal Audit should encourage management to complete outstanding actions.

POLARC 14/13 **MORTGAGE MARKET REVIEW & BUSINESS COMPLIANCE SCORECARD**

(a) It was noted that the Mortgage Market Review and Business Compliance Scorecard would be considered by the Financial Services Sub-Committee.

POLARC 14/14 **ITEMS FOR NOTING**

(a) The summary of 2013/14 IA activity was noted.

(b) The recommendations log updates was noted.

(c) The review of the regulatory risk framework was noted.

POLARC 14/15 **ANY OTHER BUSINESS**

(a) Chris Aujard advised that a report on the Data Centre procurement process would be given at the next meeting.

POLARC 14/16 **DATE OF NEXT MEETING**

The date of the next meeting is 12 May 2014. It was agreed that the timing of the meeting be altered so that Angus Grant was able to attend by telephone.

POLARC 14/17 **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 8 MAY 2014**

No.	REFERENCE	ACTION	BY WHOM	STATUS
A1	February 2013 POLARC13/3	Consider the need for Professional Indemnity cover as it moved into the area of financial services advice.	Chris Aujard	Paper attached for noting
A2	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.	Malcolm Zack	<i>UPDATE April 23rd 2014. IA plan includes programme assurance NTP and IT transformation and new Finance systems. Additional staffing now budgeted subject to approval of audit plan.</i>
A3	12 September 2013 POLARC 13/30(b)	Consider the Branch Audit function reporting line as part of the business support process review.	Angela Van-Den-Bogerd	This is one of 9 workstreams that make up the Business Improvement Programme. The proposed future policy and process is being developed. Timeline for completion is end Feb 2014.
A4	12 September 2013 POLARC 13/30(e)	Internal audit actions to be incorporated into the Board performance pack.	Malcolm Zack	Format and content to be agreed. 11/11 UPDATE No further progress. Actions continue to be summarised at ARCs.
A5	19 November 2013 POLARC 13/44(a)	Check again that we had the right controls in place for the Brands Database.	Martin George	Julie George (Head of Information Security) has confirmed that there are no outstanding issues with the Brands database and there are controls in place to ensure future issues are dealt with.

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A6	6 March 2014 POLARC 14/5(c)	Confirm there are no restrictions on Post Office by being tied to the structure and growth of Bank of Ireland's balance sheet.	Nick Kennett	To be reported to the FS Sub-Committee
A7	6 March 2014 POLARC 14/5(c)	Confirm details of the benchmark for competitiveness to ensure that customers are not disadvantaged.	Nick Kennett	To be reported to the FS Sub-Committee
A8	6 March 2014 POLARC 14/6(c)	Circulate timeline for the production of the Report & Accounts, together with more detail for the high level themes to include "the most difficult words and issues".	Mark Davies	Complete
A9	6 March 2014 POLARC 14/6(d)	Advise Matthew Lester of Royal Mail of the Report & Accounts publication date.	Chris Day	This was discussed with the RM Group Financial Controller. He shared it with RM's Communications team and confirmed yesterday that they have no issues if we report in early/mid June. Their preliminary announcement is due next week and they are happy as long as we are after that.
A10	6 March 2014 POLARC 14/7(c)	Raise the issue of early adopting the new UK GAAP regime with the Shareholder Executive.	Sarah Hall	Complete – approach to early adoption of FRS101 has been agreed by Shex
A11	6 March 2014 POLARC 14/8(b)	Review Post Office's 2012-13 Report & Accounts in light of new best practice, and provide examples of good reporting by other companies.	Ernst & Young	Guidance provided.
A12	6 March 2014 POLARC 14/8(d)	Share the Business' top risks with Ernst & Young. Provide a briefing to the Financial Services Sub-Committee on FCA regulation.	Chris Aujard Gill Catcheside/Ernst & Young	Complete To be added to the June agenda for the FS Committee
A13	6 March 2014 POLARC 14/8(e)	Forward Terms of Reference for the Financial Services Sub-Committee to Ernst & Young	Gill Catcheside	Complete
A14	6 March 2014 POLARC 14/9(b)	Note on key risks to be circulated to Board, and to Ernst & Young	Dave Mason	Complete
A15	6 March 2014 POLARC 14/9(c)	Provide a report to the 26 March 2014 Board meeting to provide clarity on the insurance position, including PI cover, in respect of Sparrow; and the legal liabilities in respect of claims made in connection with Sparrow	Chris Aujard/ Chris Day	Complete

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A16	6 March 2014 POLARC 14/9(e)	Liaise with Nick Kennett on Project Titan and the implications of potential FCA authorisation.	Chris Aujard	Complete
A17	6 March 2014 POLARC 14/9(h)	Provide a report for the next Board meeting on "red" mystery shops.	Nick Kennett	To be reported to the FS Sub-Committee
A18	6 March 2014 POLARC 14/9(i)	Provide the Committee with an update on Data Security/Integrity at the next meeting, to include lessons learnt and what controls and processes were now in place.	Lesley Sewell	Paper being presented to ExCo on the 15th April
A19	6 March 2014 POLARC 14/9(k)	Incorporate the Committee's feedback on the Business' top risks.	Chris Day/ Chris Aujard/Dave Mason	Complete
A20	6 March 2014 POLARC 14/10(c)	Send through a model set of accounts reflecting the recent changes in Corporate Governance and Key Accounting Standards. Advise what level of reporting other companies were considering for the current financial year.	Ernst & Young Ernst & Young	Provided guidance and examples to Finance which have been considered in preparing the draft.
A21	6 March 2014 POLARC 14/11(b)	Internal audit plan to be recommended to the Committee at the next meeting, incorporating a prioritisation of work and the necessary resource requirements.	Malcolm Zack	Reviewed by Chris Aujard and brought to May committee for noting.
A22	6 March 2014 POLARC 14/12(b)	Provide updates on the outstanding actions from internal audits.	Lesley Sewell	Noting paper attached
A23	6 March 2014 POLARC 14/12(c)	Encourage management to complete outstanding actions.	Malcolm Zack	Ongoing monthly review and regular reporting to ARC continues.

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POST OFFICE LIMITED AUDIT, RISK & COMPLIANCE SUB-COMMITTEE

Annual Report and 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 Annual Report and Financial statements for the 2013-14 financial year and to recommend their approval to the Post Office Limited Board.

2. Background

- 2.1 The report will follow the structure established in 2012-13, enabling a reader to follow the progress of the journey through a consistent layout and style. This format was well regarded, winning the Annual Report (public sector) category of the 2014 Business Finance Awards.

- 2.2 The following documents are attached to this paper:

- Annex 1 – Timeline to completion;
- Annex 2 - Draft Annual Report;
- Annex 3 - Draft Financial Statements;
- Annex 4 - ARC briefing book to aid understanding of the financial statements.

3. Annual Report and Financial Statements approach and plan

- 3.1 The messages in the Report and Accounts will align with the key themes and messages detailed in our Strategy 2020 communications.

- 3.2 The theme 'Heart of the Community' is being used to create a strong narrative thread throughout the report, lead the design agency brief and shape the style of photography used throughout the report.

- 3.3 The tone of the report should therefore be one of:

- clear purpose and direction with the Strategy 2020 and public purpose.
- good progress on modernisation – pleasing progress within the Network Transformation Programme and Crown performance which has improved year on year, despite on-going IR challenges.
- a tough year but a solid profit performance - notwithstanding the decline in our revenue performance, we have delivered a solid profit result which shows positive growth year on year through strong cost management.
- laying foundations for the future – investment both through the major programmes and in improvements such as roll-out of mortgage specialists.

- 3.4 Although there is freedom to deliver the messages we wish to, there are constraints within which we must work. The 'front half' must be consistent with the content of the financial statements and the text should be 'fair, balanced and understandable' as it describes our performance. Premium listed companies (those required to meet the

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UK's highest standards of regulation and corporate governance) are required under the new Corporate Governance Code to make the following statement:

"The board confirms that the annual report and financial statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the performance, strategy and business model of the company."

The Post Office is not required to make this statement but has aspired to act as a listed company so is following these principles. An assessment of the draft report against some indicators of whether the report is 'fair, balanced and understandable' is included in section 19 of the ARC briefing book. The ARC is asked to consider if the Post Office should make the statement above in order to make a recommendation to the Board.

- 3.5 The Financial Statements have been prepared by Finance and the EY audit work is largely complete. The full Annual Report and Financial Statements are still subject to further EY technical review and some additional changes may be required. As last year, the Post Office has prepared consolidated Financial Statements under International Financial Reporting Standards (IFRS) which is in line with a majority of listed plc's. Post Office Limited still has a statutory obligation to produce company accounts and these have been prepared in accordance with the Companies Act 2006 and UK Generally Accepted Accounting Practice (UK GAAP) and, this year, have transitioned to the new FRS101 (Reduced Disclosure Framework). A full ARC briefing book is attached. This provides a more detailed analysis of the results to aid understanding of the financial statements.

4. Timeline

- 4.1 An outline of the timetable is given at Annex 1. The intention is for the Board to approve the Annual Report in late May and for publication from mid-June.

5. Publication and promotion

- 5.1 We plan to produce our second annual report to build on our maiden report for 2012-13. It will support our communications strategy to promote our business, its strategy and its products and services and to protect the reputation of the business.
- 5.2 We propose that the primary delivery of the report is an interactive online version, supported by a pdf version to download and limited numbers of paper copies for sending to key stakeholders and placing in reception.
- 5.3 A full PR and stakeholder plan is being developed around the report which will depend on final results and will be subject to change depending on IR, product developments and network transformation.

6. Recommendation

- 6.1 The Post Office Limited Board Audit Risk and Compliance Sub-Committee is asked to:
- Review the Annual Report and Financial Statements and provide individual comments by email to Chris M Day and Mark R Davies by noon on Monday 12 May;
 - Recommend to the Post Office Board

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- i. That the Annual Report and Financial Statements should be approved;
 - ii. Whether the Board should voluntarily make the statement that the Annual Report and Financial Statements is 'fair, balanced and understandable'; and
 - iii. That authority is delegated for reviewing final amendments and completing the Annual Report and Financial Statements on behalf of Post Office Limited to a Sub-Committee, the quorum for which to be comprised of any three of Alice Perkins, Paula Vennells, Chris Day and Alasdair Marnoch.
- Note that the Chairman of the Audit Risk and Compliance Sub-Committee will be asked to provide a verbal update of this meeting to the Board.

Chris Day
May 2014

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Date	Activity
30 April	Board meeting – review of tone, key messages and initial content of the front half of the Annual Report
8 May	Draft Annual Report and Financial Statements circulated to ARC, Board members and ShEx and RM (word document format)
12 May	ARC and Board feedback – review and provide comments on ‘words and design’ of the front half of the Annual Report and back half Financial Statements.
15 May	ARC meeting - review of updated ‘words and design’ of the front half of the Annual Report incorporating Board comments. Review of back half Financial Statements.
15 May	Draft Annual Report and Financial Statements circulated to Board incorporating previous Board feedback (in final design format)
21 May	Board Meeting – presentation of full Annual Report and Financial Statements and – to approve the financial statements and delegate authority (i) to the sub-committee to undertake any further detailed review, as needed; and (ii) to a sub-committee of the Board to give final approval for publication
Early June	Announcement expected from RM
Early June	Board Sub-Committee – to give final approval for publication
Mid June	Announce results (subject to alignment and discussion with Royal Mail)

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The Post Office
2013/14 Annual Report and Accounts

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Post Office purpose (boxout)

The Post Office is unique: a commercial business set apart by its public purpose. We believe in the importance of connecting communities and enhancing the powerful role they play in all our lives. We will stay true to this commitment by meeting customer needs through our unrivalled local presence

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Chairman's foreword

(NB: Alice has reviewed her statement in detail and is comfortable with it.)

In this second Annual Report since the Post Office became an independent company, we describe the progress which we have made in the year 2013/14 towards our goal to achieve commercial sustainability.

We have made significant progress in four important areas. These are:

- Publishing our Strategy to 2020 and securing funding from our Shareholder, the government, through till April 2018
- Increasing our profit (including our Network Subsidy Payment) and maintaining strong operating cash flow
- Making big strides in transforming our network
- Working with the people who deliver our business and with our external stakeholders in new mutual ways to engage them directly in how we improve the running of our business.

These achievements have been made in a challenging commercial market which has made it difficult for us to achieve the revenue growth to which we aspired. However, we increased our profit (including the Network Subsidy Payment which decreased slightly as planned) by improving our efficiency, taking more cost out of the business. This includes a reduction of losses for Crown branches through the improvements we have made. We have clear plans to increase our revenues in the current year. Our new strategy, *Securing the Future* (published in November 2013), sets out the path to achieving commercial sustainability while remaining at the heart of our communities and developing our digital presence further. We will continue to be a trusted partner, helping our customers meet their needs - traditional and new.

It is very helpful to us that the government has settled our funding through to April 2018 as this gives us the certainty on which to plan; the security of further investment to complete our transformation of the network and the discipline, which we welcome, of reducing our reliance on taxpayer subsidies. The way most people will experience the transformation of the Post Office is by going into one of our modernised branches. We have now transformed over 2,000 of our agency branches and almost a third of the Crown network. Over 1,000 branches are now trading on a Sunday and as a result of our transformation programmes we are now open for an additional 50,000 hours a week.

We are also working with our people and stakeholders in new mutual ways, with the aim of improving engagement, increasing focus on customers and becoming an organisation which truly listens and learns from those with an interest in the business. We have demonstrated our commitment to broad engagement in our future by establishing the Post Office Advisory Council, which had its first meeting in March 2014 chaired by my colleague Tim Franklin who is one of our non-executive directors. The Advisory Council will play an important role in reflecting a cross-section of views, skills and experience from the diverse communities which have a stake in the Post Office in the 21st century.

We have defined our Public Purpose for the first time, which through being commercial means we can continue to help communities thrive and prosper. We will continue to embed this across our business and mark the progress of this in future reports.

I would like to thank the Post Office Chief Executive, Paula Vennells, her team and all the people who work so hard to support the business as we continue along this path to commercial sustainability. I would also like to thank my colleagues on the Board for their work this year in supporting and challenging the Post Office as we undergo this period of change. We were sorry to lose Susannah Storey, our first Shareholder Executive representative, from the Board and look forward to working with Richard Callard who succeeds her.

We have made good progress in our ambitious programme to transform the Post Office. We know we have a long way to go and the path is not linear. The many people who care about the sustainability

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of the Post Office can take comfort from the steps we have taken so far and the increased pace that we have worked. We will build on these drawing on the energy and commitment of our people to secure the future of the Post Office for the benefit of the communities that it serves.

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Chief Executive's review

(This draft is subject to further review with Paula)

The Post Office is changing, and the benefits are becoming more evident.

The 2013-14 financial year saw the number of transformed branches exceed two thousand delivering longer opening hours and brighter retail environments. These branches show our customers, subpostmasters and colleagues the continued commitment of this business to be at the heart of communities, connecting people and providing access to key services into the future.

But the maintenance and development of our physical network is just part of how the Post Office is developing as a business. We have an increased presence online, and we are investing in technology to ensure that we are easy to do business with. We are changing the way we work and we are listening to our people to learn how we can continue to improve.

We have a clear ambition as we change this business – to put the customer first, every time, and we are doing this by driving forward with our modernisation and by becoming a top class retailer – fast, flexible and with a focus on the detail.

Operationally, this has been a tough year for us but I believe that we have met the challenges head on. We have accelerated our change and have continued to put in place the building blocks to upon which our onward journey of transformation can be soundly based.

Financial position

It is pleasing that profit has increased once more, up £13m from last year. Whilst our year on year revenue has dipped by 4.5%, the overall picture demonstrates our commitment to future financial health and the importance of being in a position to keep investing

Our Network Subsidy Payment from the Government reduced by £10 million on the previous year – and we are now set to continue to reduce our reliance on the taxpayer still further in the coming years.

In mails, telecoms and government services we have put in place the fundamentals which will allow us to build and open up new revenue streams in the future. We are fast becoming the challenger brand in the financial services market with a widening product portfolio that now, critically, includes a current account offer.

Funding and modernisation

The Post Office is a unique organisation. It is a commercial business set apart by its public purpose. As such we are committed to maintaining our branch network of at least 11,500 branches and to the unique and universal accessibility it offers. During this past year the Post Office has secured the funding through to 2018 which supports our strategy to the end of the decade.

This transformation of our branch network is an important part of our overall policy of growth and modernisation. This year has seen us pass the milestone of 3,000 contracts for change signed by our subpostmasters and over 2,000 new-style branches completing full refurbishment and re-opening.

The scale and pace of this achievement should not be underestimated. The number of new style branches that we have refurbished and re-opened in the last 18 months is greater than the entire branch network of several of the high street banks. It represents a significant retail investment into Britain's High Streets and local communities.

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And these branches are working for communities. Customer satisfaction is running at over 95% in them and opening hours, which have increased by over % are proving popular. Subpostmasters are benefitting with increased retail sales.

Modernised branches and longer opening hours allow us to support the growth of new, innovative products. With Royal Mail we have announced the launch of the UK's largest Click & Collect network which will provide a greater choice of convenient parcel delivery options for online retailers and their customers. Over xyz small businesses have signed up for our Drop and Go service – whereby they simply bring their packages into the Post Office and we do all the pricing /postage work simply billing the firm on account – increasing efficiency and convenience for all concerned.

Our Crown branches are also being transformed - with over 100 being modernised though the year and their annual losses are reduced by £10 million. We have progressed with franchising xx branches and are on course to franchise a further xx in the coming year. We are moving steadily towards our goal of breakeven in this part of our network.

The modernisation of the Post Office means more than enhancing our physical branch infrastructure. Investment in our mobile website, a Travel Money Card app and the next generation of Post and Go machines are just three examples of how we are creating a modern and dynamic Post Office.

Change can however be difficult and the industrial relations landscape has proved testing, particularly in the first half of the year. However, I am pleased with the way that colleagues have pulled together to ensure that service disruptions were kept to a minimum and the critical focus on customers has been maintained

Learning and communities

We continue to develop new ways of working and engagement with our people and stakeholders. The Post Office has launched business and branch user forums, a branch improvement programme and the Post Office Advisory Council over the previous 12 months. These bodies and schemes will all help us to learn as we develop our approach to work in a way which meets the challenge of mutual ways of working.

We are proud of our commitment to communities across the UK. The strategy agreed with Government ensures this approach will be retained and enhanced – for example through establishing a new Community Investment Fund to support subpostmasters with branches in the 'last shop in the village' to build their businesses.

Our work with Go ON UK highlights our commitment to helping make the UK the most digitally skilled nation in the world through assisting those who need to develop the skills to succeed online. Our Online Centre Locator signposts local training and IT learning opportunities to anyone in any of our branches who states their home postcode.

Concluding remarks

I would like to thank all those who have worked so hard for the Post Office over the past year as we continue to turn around the business. Achieving our aims is not possible without the commitment to customers and local communities of those working in branches up and down the UK. The Post Office Executive team has also played a key role in both developing, and beginning to implement, our strategy.

Alice Perkins and her Board continue to provide invaluable advice and support. We are stronger as an organisation for their focus and determination in helping us to continue our transformation which will secure the future of the Post Office.

In February 2014 the Royal Society of Arts issued a report that outlined the potential of Post Offices in modern Britain. It characterised the Post Office in the following way;

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The Post Office is an organisation like no other. Local Post Offices contribute enormously to the life and soul of their communities, are an essential vehicle for delivering public services, and provide the vital infrastructure that our businesses need to prosper'

Within this Report and Accounts, this view is illustrated in a number of ways and financial results are reported that show the necessary commercial underpinnings in place that support it.

But it is the progress and commitment to securing the future that is the most important result of the last year. The Post Office is a unique organisation with a unique role in national life. We will continue the drive for the change that will ensure it is both vibrant and secure into the future for the communities it serves.

Draft and in confidence**Performance review**

This is to be presented as a bubble page, similar to last year.

Access	Growing business	Awards / other good news	SMEs
11,697 branches	100 mortgage specialists and 220 financial specialists in branch.	Business Finance Awards Best Finance Team (Public Sector & Voluntary) 2014	Number of Drop and Go accounts
2204 branches transformed	Number one travel money provider.	Business Finance Awards Best Annual Report & Accounts (Public Sector & Voluntary) 2014	First Click and Collect customer signed up.
1000 branches open on a Sunday.	Number one mails retailer.	British Travel Awards Best Travel Insurance Provider 2013	
122 Crown branches modernised	Sixth largest telecoms provider.	British Travel Awards Best Foreign Exchange/Travel Money Retailer 2013	
99.7% of population live within 3 miles	21,000 Drop and Go customers	Prepaid Best Marketing Campaign 2013	
60,000 extra opening hours	95% of UK debit card holders can withdraw cash at Post Office	Prepaid Best prepaid consumer campaign 2013	
2,400 ATMs		What Mortgage Best Fixed Rate Mortgage Provider 2013	
Customer satisfaction in our new models is 97%		What Mortgage Best Lender Website 2013	
		Your Money Best Overall Direct Provider for Financial Services 2013	
		Your Money Best Direct Home & Contents Insurance Provider 2013	
		Your Money Best Direct Savings Account Provider 2013	
		Your Money Best Direct Life Insurance Provider 2013	
		Your Mortgage Best Online Mortgage Provider 2013/2014 Customer satisfaction scores.	

Draft and in confidence**Post Office Key Performance Indicators**

	2014	2013	Change
Turnover	£979m	£1,024m	(£45m)
Operating profit before exceptional items	£107m	£94m	£13m
Operating loss before exceptional items and Network Subsidy Payment	(£93m)	(£116m)	£23m
Net cashflow	(£283m)	£151m	(£434m)
Crown branch losses	(£26m)	(£37m)	£11m
Customer satisfaction	87%	87%	-
New main and local format branches	2,058	507	1551
Employee engagement index	57%	55%	2%

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Strategy

In 2012/13 and for the majority of 2013/14 Post Office's strategy model centred on being a commercially successful business while maintaining the key role that Post Office branches play in supporting communities across the UK. This was structured around a range of products in Mails and Retail; Financial Services, Government Services and Telecoms through our branch network, online and on the phone.

[Insert strategy model image from 2013/14 report]

Strategy 2020

In November 2013 we launched our strategy *Securing the Future* which will see the Post Office develop our business strategy through to the end of the decade. The vision we set out was backed by government who awarded a further £640 million of funding to assist us in transforming our business.

As an organisation, the Post Office is unique in its size and reach across the UK as well as the trust that customers place in us. We are determined to continue to serve the UK's changing needs by connecting communities and customers in ever more powerful ways as a commercially sustainable business with a public purpose.

Securing the Future recognises the challenges that the Post Office faces and the changes that must be made in order to ensure that we flourish in the years to come.

Our plan starts with our customers and transforms us from being a passive product channel to a vibrant retailer. *Securing the Future* is guided by four clear principles that will influence the Post Office as we move towards commercial sustainability.

- We will broaden and increase our market presence, by moving from a 'channel' for third parties to a retailer of Post Office branded products.
- We will grow and support our physical network and expand our digital services.
- We will have an organisation and operating model that is cost effective, agile and customer focused
- We will demonstrate mutual ways of working.

We will build on our established position as a retailer of mails, government services, financial services and telecoms products. The Post Office will offer simple, fair, transparent, value for money services with a compelling breadth of products which attracts new customers.

Securing the Future is shaping a commercial Post Office that remains at the heart of our communities, with a purpose that shapes all we do. We will continue to be a trusted partner, helping customers, existing and new, meet a new generation of needs and challenges.

Together we are building a Post Office the nation can continue to be proud of.

Background to the strategy

- The high street has continued to change since 2010. The economic downturn has impacted margins.
- Our traditional markets are the scene of significant pressures as rival firms assert their presence.
- The volume and margins associated with government services have reduced and new business in this area has not materialised as hoped.

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- To stem the decline in traditional services, the Post Office needs to build on our established position as a retailer of financial services and telecoms products as well as introducing new services in growing markets such as collections and returns.
- Our differentiator will be simple, fair transparent and value for money services.
- Our breadth of offer will make our propositions compelling to our customers.
- We will develop targeted product portfolios which will attract new customers. The development of our small business offering will be a key focus in the short term.

Securing the Future will not only set the direction of the Post Office through to 2020, but will see us connecting communities across the UK by serving the essential needs of our customers; individuals and small businesses. The Post Office is determined to remain relevant to society by offering products and services that people want and need via the medium that is most convenient to them.

Post Office Advisory Council

During 2013/14 the Post Office took further steps to embrace mutual ways of working. In March 2014 the Post Office Advisory Council met for its first meeting. The Advisory Council is a unique mix of people and skills from business, charities and unions, which will help shape the future of the Post Office.

The Council's members include E.ON's Head of Digital Pardeep Duggal, Chair of the British Youth Council Mark Kidson, Bill Keown MBE JP, founder of the disability charity the William Keown Trust, and several customers and representatives across the Post Office's branch network.

The Advisory Council will play an important role in reflecting a cross-section of views, skills and experience from the diverse communities which make up 21st century Britain. It will help the Post Office learn from those with an interest in the business, enabling it to innovate and support the transformation of the business and inspire a bright future for the Post Office.

The Advisory Council is made up of 24 members to allow a broad mix of people and interests. Members are appointed for a term of four years, non-renewable, with the first appointments mixed between 2, 3 and 4 years in order to maintain continuity. Meetings will be held three times a year.

The Post Office Advisory Council will ensure we remain at the heart of communities by providing an innovative forum through which ideas can be shared and feedback sought. We are delighted that people with such a wide range of experience and insights have come forward to be part of the Council which will play a key role in helping to shape the future of the business.

Purpose

In 2013/14 we finalised our purpose. We began this journey in October 2012 when we established the Stakeholder Forum which included representatives from the NFSP, BBC, Mutuo and the British Youth Council. The forum embarked on a public engagement campaign that ran throughout the summer of 2013. We asked our customers, colleague's subpostmasters and the public what they thought the purpose of the Post Office was. In April of this year the Board signed off the purpose defined from the research.

We are here to help communities thrive and prosper through offering great products and services that help them live their lives. To deliver our purpose we have to be commercial. The two live side-by-side and these are the principles behind our business which guide us as we lead our teams to deliver our purpose day in day out.

We are delivering our purpose daily. From developing our customer promise to designing amazing products that work across communities, to designing the support that our branches need.

We are clear as to our purpose and direction. In the coming months we will be engaging with our people and embedding it in all that we do.

Draft and in confidence

Business Review

Draft and in confidence

Business in detail

Mails and Retail

Boxout

- Revenue of £390 million
- Over 21,000 Drop & Go priority service customers
- UK's largest collections and returns network launched.

The market for mails continues to be driven by the growth in e-commerce. Consumers increasingly demand better service from carriers in terms of convenience, quality and price. This has led to opportunities in the parcels sector and in 'click and collect' solutions. In the lottery market, sales were impacted by fewer roll-overs than previous years, and a general slow-down of performance impacted by economic conditions.

At the Post Office we have an unrivalled nationwide network, which allows us to offer a range of Royal Mail products and services that cannot be equaled. We also offer a variety of retail products and are one of the largest distributors of National Lottery products with 6,000 outlets offering this service.

During 2013/14, the Post Office has further developed value added services and offerings for our customers in a changing marketplace across lottery, retail, parcels and mails. This included the roll-out of the Drop and Go Service, introduction of new lottery products, parcels discount offers and further improvements to the Post and Go self-vending estate. This was against a background of marketplace changes which included the impact of changing on-line customer shopping habits, increasing cost sensitivities of customers and product price changes.

Working with our strategic partner, Royal Mail, we introduced changes to the exceptions for smaller sized parcels in November 2013 in order to reduce costs for customers and businesses. These changes have been well received and demonstrate how the Post Office is responsive to customer needs, and in particular to our small business and Ebay customers.

The Post Office is developing its wider integrated multichannel presence in order to best meet customer needs whether in-branch or on-line. We now have over 21,000 small businesses signed up for our Drop & Go priority service launched last year for small business customers. Feedback from these customers is that the vast majority are satisfied with this service. This has helped us to retain and grow our customer base and provide a much improved service. We are also developing the capability to provide these customers with tailored offers and enhanced account management facilities on-line.

Our network is unique in its size and reach and we will use this to take advantage of the growth of e-commerce and support customers in their changing lifestyle requirements. In partnership with Royal Mail we announced our Click and Collect initiative in May 2013, which will allow Post Office branches to be used as a convenient parcel delivery option for online retailers and their customers. We are continuing to extend this service to other retailer clients and are confident that this unparalleled service will prove successful.

The Post Office is determined to continue to offer products that fit in with the needs of customers in the 21st century. This includes the provision of facilities for collecting and returning items, improving the customer journeys for sending parcels and mailing solutions, new Lottery products and easier access to mails and parcels services.

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Financial Services

Boxout

- Revenue of £279 million.
- Income from Personal Financial Services has increased by 15.2%
- Launch of current account
- 100 mortgage specialists in branch and 220 financial specialists
- Launch of Payment Services Provider service to SMEs

The UK savings market is still characterised by ultra-low base rates. Customer rates continue to decline, resulting in low demand for savings products. The March 2014 Budget will impact the industry by introducing an increased ISA tax-free savings limit, creation of a new "Pensioner's Bond" and fundamental changes to the pension annuity rules.

The Mortgage market is extremely competitive, with very low rates and new intermediaries expected. Organisations have been focused on meeting the regulatory guidelines of the Mortgage Market Review. The Credit Card market is consolidating, with outstanding balances declining. Regulation continues to impact the industry, with the EU proposing to introduce a cap on Interchange fees for transactions.

Motor insurance regulatory changes and strong competition have driven premium reduction, expected to be extended by the 'My Licence' launch, which will give insurers the ability to check driving records. Home insurance premiums also dropped over the last year, in spite of the severe weather conditions.

Financial services at the Post Office continue to grow as we strive to be a significant challenger to the traditional banks and insurers. We offer products that are simple, fair, transparent, and value for money, supported by the widest access from the largest retail network in Europe.

At the Post Office we provide a well-established range of savings, insurance and lending products in partnership with the Bank of Ireland. We remain the number one provider of travel money and provide a range of other services including over-the-counter payment services, cash machines and access to cash for 95 per cent of UK current account debit card holders.

Financial services are vital to our strategy of growth and modernisation. In the past financial year revenue has declined slightly to £279 million but this masks a transformation in the profile of our financial services business. Traditional products such as bill payment, while important for footfall into our branches, are declining in volume but we are pleased to have won and retained key contracts. At the same time income from Personal Financial Services has increased by 15.2%.

To support our customers, the Post Office is broadening the financial services offer.

In 2013/14 the Post Office launched three current accounts; these are being trialled in 110 branches in the east of England, offering an inclusive approach to banking. We have also offered customers the option of discussing their mortgage needs in branch through the deployment of 100 mortgage specialists across the UK. From April 2014 these specialists will be providing mortgage advice, based on the new Mortgage Market Review regulatory environment. We have also entered the Buy-to-Let market and have announced our intention to join the Government's Help to Buy scheme. In addition to mortgage specialists, the Post Office has a further 220 financial specialists in branches across the UK introducing other financial products and services to customers.

At the Post Office we are increasingly supporting small and medium enterprises (SMEs). This past year has seen us launch our Payment Service Provider platform which allows SMEs to take card and online payments. This illustrates our dedication to supporting the needs of the business community which remain central to our growth aspirations.

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The Post Office is proud to remain the market leader in retail foreign exchange and was voted by the public as Best Foreign Exchange retailer and Best Travel Insurance Provider at the 2013 British Travel Awards, for the seventh and eighth year respectively.

Post Office has complemented its travel range by adding further currencies to our award winning Travel Money Card, which has seen over one million loads since it was launched in May 2011. We have also launched a mobile app that allows customers to manage their Travel Money Card easily while abroad.

Post Office continues to develop competitive products while retaining our focus on the needs of customers. We are fast becoming the challenger brand for financial services in the UK.

The Post Office is committed to growing a wide range of accessible products for our customers, supported by excellent service from a brand they can trust.

Draft and in confidence

Government Services

Boxout

- Revenue of £146 million.
- Seven year contract signed with HMPO.
- Growth in driving licence renewals.

In line with the continued drive to reduce Government expenditure, 'Digital by Default' remains a key priority in 2014/15. The Cabinet Office's Government Digital Service (GDS) is on target to deliver 25 exemplar services by 2015. We believe this will present opportunities to the Post Office: supporting customers who need to establish their identity online or who require face-to-face support and may not have the skills needed to transact online or who require some form of face to face guidance.

The Post Office offers an essential range of services on behalf of government departments. Revenue from government services fell by 11% from £164 million to £146 million over the last year, in line with expectations.

Winning the DVLA framework contract for Front Office Counter Services in 2012 has continued to assist us in winning further government business. This year Her Majesty's Passport Office (HMPO) signed a new seven year contract for the Passport check and send service which is so popular with our customers. Income this year from check and send continued to grow as a result of joint promotional efforts with HMPO and we are working closely with them to develop new services that will support on line applications.

Our Application, Enrolment and Identity (AEI) technology is used to support a variety of transactions including biometric residence permits applications and the ten year renewal of driving licences. Following a joint marketing campaign with the DVLA which included radio adverts, we have seen significant growth in volumes from the renewal of driving licences during 2013/14.

During the course of this year the Post Office and the DWP have been in discussions about the future of the Post Office Card Account as the current contract expires in 2015. An announcement on these discussions should be made in the coming months but all options under consideration conclude that access to pensions and benefits will continue beyond March 2015 across the whole Post Office network.

An exciting development in 2014/15 will be the launch of our Identity Assurance service that supports the Governments digital agenda. We are one of five providers of this service which will enable people to assert their identity online safely and securely when accessing certain government services.

Draft and in confidence

Telecoms

Boxout

- Revenue of £124 million.
- Upgraded physical infrastructure with a transfer to a service managed by Fujitsu.
- Aspirations to enter the mobile market in the next 12 months.

Post Office HomePhone and Broadband offers a competitive residential phone and broadband service to around 450,000 customers, making us the sixth largest fixed line telecoms provider in the UK. Post Office is particularly competitive in the HomePhone only market where we offer market leading prices and recent changes to our broadband pricing has enhanced our competitive positioning. However, the market continues to be dominated by the big four telecoms providers. 2013/14 has been a challenging year for the Post Office telecoms business. Revenue has declined 4% on last year from £129 million to £124 million as a result of a decline in our customer base. However, while this year has been difficult in revenue terms, significant progress has been made in building our infrastructure to enable us to grow our customer base in the future.

September 2013 saw the transition of our services from BT Wholesale to a managed service provided by Fujitsu. This was a large project which has upgraded our physical infrastructure as well as our billing and customer management systems. There were some difficulties during the transition which negatively impacted the experience our customers received and both Post Office and our partners resolved them in a timely manner to minimise the impact on our customers.

By making use of the TalkTalk network, the Post Office can now provide our customers with access to higher speed broadband services. The move to new billing and customer management systems will enable us to deliver innovative solutions to meet the changing needs of our customers in the future. Additionally, it will make us easier to do business with through improved customer sign-up processes, email platform and better self-service options.

The new telecoms infrastructure will allow us to develop more innovative proposition including offering bespoke products for the SME market, an area that is key to the growth agenda of the Post Office.

Whilst we did experience issues during migration, we are now in a position to leverage the power of the new infrastructure and we are confident that this will allow us to grow our business over the coming years.

The mobile market is an area of growth potential for the Post Office and we are planning to enter the market in 2014/15. We believe we can offer compelling propositions in this market and are planning to offer both pre and post-pay mobile services. We maintain the largest network of mobile top-up terminals in the UK and customers can top-up pre-paid mobile phones for the main UK networks in any of our branches or via 1,800 external ATMs. 2013/14 saw 13 million top-up transactions made across the Post Office estate.

Post Office is confident that we can grow our telecoms business over the next 12 months. We are in a position to leverage the new infrastructure and deliver more compelling propositions in the HomePhone and Broadband markets to both SMEs and residential customers, and we are excited about the opportunity to make a real difference for our customers in the mobile market.

Draft and in confidence

Branch Network

Network modernisation

Introduction

The Post Office has the largest branch network of any retailer in Europe. Our unrivalled presence sees our branches within one mile of 99% of the UK population. Many companies talk about being at the heart of the community, but at the Post Office we truly live and breathe communities and they are as central to our strategy today as they have been for the past 370 years.

We are committed to maintaining a network of at least 11,500 branches ensuring our products and services are readily accessible across the UK.

We are investing heavily in our physical branches with new style main and local branches now a feature of high streets across the land. Our branches are increasingly supported by digital and telephone services in line with our ambitions to be a multichannel retailer.

Network Transformation

The Post Office is creating modern, commercially sustainable branches that are improving the customer experience.

A highlight of the 2013/14 financial year has been the pace at which this modernisation programme has continued with around 2,000 branches converted so far with another 1,200 branches awaiting transformation.

Improved customer service is fundamental to the success of main and local models and this is being delivered by our subpostmasters.

Longer hours and improved retail environments are benefitting millions of customers. Over 50,000 extra opening hours have been created each week with an average increase in opening hours of 62% across the main and local estate. On average 9% of customers are also visiting new style branches outside of traditional hours and customer satisfaction is consistently above 95%. In addition more than 1,000 branches are open on a Sunday meeting the demand for accessible services every day of the week.

These new branches are working. Average waiting times are just 1 minute and 33 seconds in local models and 1 minute and 39 seconds in main branches.

Subpostmasters are also benefiting from more efficient ways of working and an increase in revenue both from their Post Office activities and their accompanying retail business. Operator satisfaction with main and local branches is more than 75%.

The transformation of our network has received the endorsement of many Members of Parliament. over 300 MPs have main or local branches in their constituencies while over 300 MPs have officially opened a new branch in the past 18 months.

Community branches

As part of our new strategy, *Securing the Future*, Post Office announced a £20 million fund to support around 3,400 Post Office branches. In addition to providing Post Office services, these branches operate the only retail outlet in a community.

The £20 million Community branch fund represents a significant investment into these subpostmasters' businesses and local communities. These branches will continue as they currently operate to ensure our network reach is maintained and they will be able to access funding to improve their stores and service for Post Office customers.

Case studies

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Sunny Mahill, Villa Road main branch, Birmingham

"My customers enjoy the convenience of longer opening hours so that they can do their banking at the Post Office, rather than having to go all the way to the banks during the day"

Tony Hobbs, Porton local branch, Essex

"The new combi counters and open-plan format means that my staff can serve customers more efficiently. The refurbishment of my branch nearly doubled my retail space too, which has allowed me to expand my retail business".

Ryan Marwaha, Clydebank main branch, Scotland

"Transforming our branch is about future-proofing our business. We have a large demand for financial services in our branch, and I believe financial services will be just as important as mails in the future."

Julie Evans, Arrowe Park local branch, Merseyside

"Network Transformation came at the right time for us - local competition in our area had increased and we knew we had to update our retail business to keep up."

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Crown transformation programme

Work to modernise around 300 Crown branches the Post Office directly manages - normally larger branches in city and town centres - continues at pace.

During 2013/14, losses in the Crown network continued to reduce from £37 million in 2012/13 to £26 million in 2013/14 as a result of our transformation programme which aims to increase revenue, enhance customer experience and control costs.

A total of 122 branches were modernised by the end of the financial year with customers now benefiting from bright modern branches with open plan counters in many cases. All branch transformations will be complete by the end of 2014.

Customers also have the choice to use new and improved self-service at many branches, to post mail, buy stamps and pay for retail items, with staff on hand to help people whenever they need it.

Growing our financial services offer is a key part of the Post Office's strategy and many of our modernised Crown branches now feature private consultation rooms where customers can talk to specialists about our range of financial products and services.

Increasing customer service and reducing our operating costs is a significant part of our plans to achieve break-even by 2015. Introducing new self-service in a large number of branches, and reviewing staffing levels will lead to a reduction equivalent to around 500 full time employees, with some further savings planned for 2014/15. This will be done with excellent customer service in mind, matching future staffing levels to customer needs. Voluntary redundancy has been offered to colleagues interested in leaving the business.

Plans to find retail partners to operate up to 70 of our Crown branches continue and by the end of March 2014, 22 branches have transferred to new stores including WH Smith and independent retailers. Reaction from customers and colleagues to the new branches has been extremely positive.

In a small number of locations, we are taking the opportunity to relocate branches, or consolidate services from two branches into one location. This means we can offer improved facilities for customers and reduce property costs, whilst ensuring the branches remain at the heart of communities.

Industrial action was called by the Communication Workers Union (CWU) on a number of occasions during 2013/14 in a dispute over pay and the future of the Crown network. While the Crown network accounts for less than 3% of the Post Office network, we regret any inconvenience this caused for customers. Throughout the dispute, many colleagues chose not to go on strike and, supported by central staff and managers, the vast majority of Crown branches remained open as normal. The Post Office and CWU agreed to intensive talks in December to find an agreeable way forward and an agreement was reached in April. [insert line after ballot concludes]

Crown case studies

Case study 1

Belfast City Post Office branch

What's changed?

- New modern branch
- Open plan counters
- Three private consultation rooms where customers can have conversations about financial services
- New self-service kiosks, with staff on hand to help, giving customers even more choice about how the send letters and parcels.

Draft and in confidence

Customer feedback

Richard Post on the new self-service kiosks

- “I’ve always avoided self-service in shops and supermarkets but I tried using the machines at Belfast branch and I was really impressed. The first time I used them, a member of staff was on hand to walk me through the process and guided me every step of the way. I regularly post items abroad so this is great for me – it’s easy and it saves a lot of time. Now, if there’s a kiosk free, I’ll use it rather than the counter!”

Case study 2

Merthyr Tydfil Post Office branch

What’s changed?

- New modern branch
- Private consultation room for financial services conversations with customers
- Dedicated travel services counter
- Welcome point where host meets and greets customers

Colleague feedback

- “It’s much more welcoming. How a Post Office looks can really affect a customer’s experience. We really needed a refresh and it has already made us more proactive as a team. We’re delighted with the transformation.”
CSC Tracy Hagerty
- “It’s given us a more positive outlook. It feels like a 21st century design that is as professional as any of the banks we compete with. Our front office has completely changed and the impact was immediate for everyone who works here.”
CSC Leanne John

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A modern IT infrastructure

To meet the evolving needs of our customers the Post Office is investing in new capabilities; digital as well as within the branch network and in the skills to support our technology. This year we have engaged a partner to act as our Service Integrator across our technology landscape. This is a vital part of our modernisation plans is to ensure we have right capabilities, systems and processes in place to allow customers to access services when and where they want.

Technology in Post Office branches

The Post Office is seeking to find new ways to enhance our customers' experience through the use of technology in our branches.

Our branch network currently has over 250 Post & Go machines which allow customers to undertake transactions without the need to go to a counter. During 2014/15 we are rolling-out over 500 of our new generation of self-service kiosks to some of our biggest branches. These enable self-service customers to access a greater range of services, including priority mail services and mobile phone top-ups.

During the next financial year the Post Office plans to create a concept Post Office branch to develop new technology aimed at creating high quality, reliable services. This branch will be important in helping us to generate the systems that will underpin our business in the coming years.

Contactless

The Post Office has led the way in payment technology and we have installed contactless payment terminals across 30,000 counter positions across the branch network. This makes the Post Office the biggest user of contactless acceptance technology in Europe allowing customers to pay for transactions of up to £20 using contactless cards and smart phones with a simple tap of their card or mobile phone at the counter position.

Integrated Multichannel

Over the past year we have made progress with our vision of making the Post Office a truly integrated multichannel business. Our digital capability has improved significantly and it is now possible to make mortgage applications and make use of financial service account management tools online. In addition to these developments we have also launched a Post Office Travel Money Card mobile application which has been well received; and the first of a number of focused 'apps' designed to help our customers navigate our product offerings more easily. The recently launched Post Office mobile website has received over 2.5 million hits, clearly indicating that our customers are keen to interact with the business across a range of channels. We have also invested in a new e-commerce platform that will give us the ability to improve the quality and ease of use of our online products and services.

Draft and in confidence

Customer

Draft and in confidence

Customer excellence

At the Post Office we have a diverse range of customers. With over 17 million customer visits every week and 95% of the UK population visiting a branch each year, the communities we serve remain at the very heart of what we do. In turn the Post Office provides an essential service for the people of the UK.

Our brand has significant strengths, recently being voted one of the 3 most trusted brands in the UK. In order to achieve our commercial income targets it is essential that we maintain and grow our relevance to customers by demonstrating that the Post Office is a place to get things done. As such, detailed qualitative and quantitative research has been undertaken to evaluate different customer propositions which aim to motivate customers to choose Post Office products on more occasions. The outcome of this work will drive the business forward in the coming year and beyond. The key measures of success will be a significant improvement in those that see Post Office as 'easy to do business with' and those that see us as 'a brand on the way up'. The results for 2013/14 were 41% and 23% respectively.

Listening to customers' is vital to improving the service we offer. This year we have added to the wide range of methods to gather the views of our customers:

- Our customer panel of 3,500 people gives us the ability to get the views of customers in a matter of days to quickly provide customer input into our decisions
- In 2013/14 we launched our Voice of the Customer (VOC) programme allowing customers to 'tell us how we did today' in nearly 3,000 branches. This has provided over 130,000 customer responses enabling branches to make immediate customer service changes as well as identifying themes across the whole network. We also receive more than 1,100 'wows' every week where customers take the opportunity to praise outstanding service
- Our website now also gathers equivalent customer feedback from customers and customer feedback on our call centres will be added during 2014
- We completed extensive research with customers, colleagues and other stakeholders to form the Post Office Public purpose
- The Post Office Advisory Council provides regular customer input to the future of the Post Office.

Listening to customers has told us that being easier to do business with is the improvement that is most important to them. For customers this means:

- Improving our waiting experience
- Extending opening hours
- Making it easier to send parcels
- Simpler purchase processes
- Being able to do more on self-service machines.

These have informed our key customer priorities this year, continuing into the coming year.

An integrated multichannel retailer

Over the past year the Post Office has made great strides in moving towards becoming a truly multichannel business. Post Office branches serve a third of small businesses in the UK each week, our website had 39.9 million unique visitors in 2013-14, a year on year growth of 17%, over 2.5 million visits have been made to our mobile website since its launch in December 2013, and almost eight million people contact Post Office via a contact centre.

We are developing functionality across the business that ensures we remain relevant to customers' lives. For example it is now possible to book appointments online to see a mortgage specialist in branch or for SMEs to use our Drop & Go service to conveniently access the postal system. Increasingly Post Office is using self-serve machines in branch to further improve the choice and experience for customers. Branch customer satisfaction rises to 95% for those that have used Drop & Go or Post & Go compared with an overall branch satisfaction of 85%.

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Last year the Post Office made good progress in improving customer experience by reducing wait times, the average time a customer waited before being served fell by 10 seconds to 2 minutes 50 seconds and 82.1% of customers were served within 5 minutes, an improvement of 1.4 percentage points on the previous year. What is more 87% of customers told us the wait time was acceptable. In line with a 3% increase in the number of customers who say they are happy with the effort made by staff to make the service as fast as possible.

Christmas

A focus on customer experience is particularly important in the busy period leading up to Christmas. There were extra colleagues in our busiest branches, longer opening hours, a Christmas help hub on our website and pop-up Post Office (Christmas Stamp Shop) providing customers with the ability to buy personalised stamps in the busy Christmas retail locations.

The result was that 86% of customers found the wait time acceptable in December*, 95% of visitors to the pop-up Post Office had a positive experience** and 81% agreed that the Christmas Stamp Shop made buying stamps a fun and enjoyable experience.

Advertising

The Post Office has increased its investment in marketing during 2013-14 by over 7%, delivering an 8% improvement in return on investment. We ran a number of successful advertising campaigns during the past year intended to raise the profile and revenue of the Post Office.

- A multi-channel travel campaign that highlighted Post Office as the destination for your pre-holiday essentials
- Consistent focus on our financial services offering with a particular focus on our mortgage product
- An unprecedented investment in reinforcing our position as the number 1 mails retailer
- A media campaign on '63 million reasons that we're changing' following the launch of our new strategy.

All these multiple customer focused initiatives combined with the dedication of our subpostmasters and all those working in branches has resulted in a customer satisfaction score of 87% consistent with previous years. This represents strong performance in the context of increased customer expectations and the inevitable disruption to customers caused by industrial action.

* Source Voice of the Customer 11,456 responses in December

** Source - Stamp Shop evaluation - 215 customers

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People

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Our People

Introduction

This is an exciting time for the Post Office. We have set a clear strategy to transform the business by 2020 and we recognise the success of this strategy is predicated on the contribution and engagement of our people.

We are particularly proud of the progress we have made in relation to diversity, investing in capability and engaging with our people as well as the progress made in keeping our people safe at work.

Engaging with our people and subpostmasters

Having engaged teams is important to the Post Office and is essential to the growth of any commercial organisation. To meet the aims in our strategy we need all of our colleagues to deliver on the promises that we make to customers, communities, to our partners and to government. We value the opinions and ideas of our colleagues. Our annual employee engagement survey helps us to gather views, to listen to our people and to take action to make improvements. It is a key lever in supporting the shift that we need to make to more mutual ways of working. This year we have partnered with Hay Group as an independent research agency for our annual survey. We have also introduced an interim 'Pulse' survey, recognising the importance of monitoring engagement levels and gathering the views of our people more regularly.

Loyalty remains high with 74% of employees saying they would like to still be in the business in two years' time. Our people are also proud of Post Office products and services with over three quarters (78%) willing to recommend them to friends and family and 84% saying they understand what customers want from Post Office.

While these figures are encouraging, we recognise that the significant transformation Post Office is going through may have an impact on the way people feel. We will be working hard over the next 12 months to listen to and engage with our people to address the key findings.

This year also saw the introduction of the Branch User Forum. This group is made up of subpostmasters and Crown branch colleagues, giving our people the opportunity to directly feed into the direction of the business. The contribution of the Forum will mean we are in a better position to get things right first time for our customers and our people.

This year we also conducted an engagement survey with subpostmasters. We recognise that we need to have high levels of engagement across the whole organisation for us to deliver our long term strategy and to meet customer needs. This helped us to understand subpostmaster advocacy in relation to the Post Office brand, support for the business strategy and to get a better understanding of engagement across the Post Office, particularly in relation to how we could improve the business in ways which have a clear commercial benefit.

- Subpostmasters see the Post Office as important for the future growth of their wider business (85% positive)
- Subpostmasters advocate Post Office products and services (76% positive)
- Subpostmasters support the move to offering more financial services (72% positive)

We will be rolling out similar feedback surveys with our subpostmasters in 2014/15 to continue to listen to their views, track progress against some of the key metrics and continue to work with our subpostmasters in order to improve our customer offer. Our recent work with the National Federation of subpostmasters in developing our current proposals for the Network Transformation Programme has been a great example of where better engagement has resulted in a better outcome. Through sharing, trusting and recognising that a stakeholder can add real value to the business, together we have helped secure additional government funding and ensured that many more subpostmasters can take advantage of investment in the network.

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We have also initiated a programme of work looking at the training and support we provide to our subpostmasters. The purpose of this is to review every touch point with our subpostmasters and ensure we provide the right tools and information ensuring a positive experience for our customers. We have listened to and taken feedback from our people in our agency branch network and will continue to do so into next year as the programme progresses.

Investing in capability

We are committed to supporting the development of our people right across the organisation and have continued to look at how we do this in new and innovative ways. We recognise that to improve the performance of our business whilst changing the way we do things, we need to build our leadership capability. This year we launched our development programme for senior leaders across the organisation, building commercial acumen and developing a collaborative approach to leading the business.

The Crown Leadership Development Programme has been introduced to support our Crown managers to deliver a strong retail offer and an enhanced customer experience. So far over 300 managers have joined the programme, which will continue through next year. In addition to this we have introduced a number of workshops for line managers to drive and enhance performance in their teams.

In order to support the strategic direction of the business, we have also designed specific development programmes for our Commercial and Financial Services teams. Our people's ability to develop relationships with key clients and ensure we comply with our responsibilities in relation to providing mortgage advice is critical to the success of Post Office.

This year saw the introduction of the Mains Live conferences, where subpostmasters came together at events across the country to talk about how we can grow our business. The sessions have focused on providing additional support to subpostmasters, the development of colleagues in branches and driving customer excellence. The conferences have been well received with plans for further roll out in 2014/15.

In addition, we have refreshed our Post Office behaviours across the business, creating the benchmark for the way we will behave with our customers and each other. Aligning our behaviours with the strategic direction of the business will play a fundamental part in delivering our strategy and demonstrating mutual ways of working.

Following on from the success of the Management Trainee scheme and pilot apprenticeship scheme in the HR Service Centre, in 2014 we will welcome our first graduate intake. Seven graduates will join the business on two schemes; general management and Finance. We look forward to welcoming our new colleagues in the coming months.

Diversity

Diversity plays a critical role in an organisations pursuit of customer excellence. This is why the Post Office has the overall strategic aim to build an inclusive organisation that is representative of, and understands its diverse customer needs.

We aim to be easy to do business with for our diverse customer base and creating an inclusive culture that attracts, develops and retains talent from the widest available pool.

We are proud of the progress we have made in relation to gender equality. Currently, 61.1% of our non-managerial roles are female and last year we saw a 1.4% increase in female representation at first line managerial level. Our Chairman and CEO are women and our Board has equal numbers of males and females. The Executive Committee currently has female representation of 27%.

Last year we signed up as a member to the government's **Think, Act, Report** initiative. Since then we have:

- Established a representative Diversity Forum to ensure business ownership of the diversity agenda.

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- Launched an Unconscious Bias training programme that has been completed by over 70 managers, including our full Executive Committee.
- Launched a 'Women in Leadership Programme' that has profiled female role models and provided networking opportunities for 60 of our female leaders.
- Launched a Female Mentoring scheme that enabled 40 existing senior role models to support and build our female talent pipeline.

Taking positive action in this way has led to an 8.1% increase in black, minority and ethnic appointments and a 12.7% increase in female appointments at senior levels in the organisation. This is a great start but we recognise there is more we can do in this area moving into the next financial year.

Our subpostmasters work at the heart of communities and as such it is important to us as a business that we reflect those communities we serve. 40% of our subpostmaster population are female whereas 29% of entrepreneurs in the UK are female. We are equally proud of our BME representation, with 28.6% of subpostmasters from black, minority and ethnic backgrounds, set against a UK average of 13.1%.

The Post Office has helped to address the challenge of youth unemployment. For the second year running we have continued with the paid work experience scheme over the Christmas period. Offering 43 young people, all under the age of 24, a period of 8 weeks paid work experience in our Crown branches in London. 10 individuals have gone on to gain further employment with the business. The scheme continues to be a success, making Christmas a little easier for our customers and making a real difference to young people's lives.

Safety, health and wellbeing

The wellbeing of our people is of paramount importance to the Post Office in our quest for making healthy and safe working a way of life. Pursuing this aim reflects the high value we place on our people and all those touched by our business activities.

We are continuing on our journey of supporting and encouraging our people and unions to get involved in pursuing a healthy and safe way of living and working by ensuring free health checks are available to all our people. So far, over 3,600 of our people have taken the health checks which equates to 46% of our employees. These checks are a great opportunity to allow our employees to learn more about their body composition, understand how healthy they are and learn more about what they can do to reduce the risk of disease and improve their health and wellbeing. The scheme also provides access to an online wellbeing zone that allows them to track their progress on improving their health and welfare. Next year we will use anonymised data from the health checks to build more bespoke support for our people across the organisation.

This year was the fourth year running that we have seen a reduction in the number of accidents at work. This has decreased by 11% over the last twelve months. We also saw a significant reduction in the seriousness of those accidents which was reflected in a further reduction of accidents that resulted in absence (30%), coupled with a reduction in the length of absences (54%). There is still more to do, however this data does show a significant shift from last year.

Looking ahead

In 2014/15, we will continue to build on the successes of this year and remain focused on driving customer excellence through our biggest asset; our people. Diversity, talent and engagement will continue to be a key focus and play an integral part in securing the future of the Post Office. Developing mutual ways of working, investing in the capability of our people and putting the customer first will ensure we have a commercially sustainable business with a public purpose.

Case Studies

Ismail Loonat - Subpostmaster and Post Office Advisory Council member

Ismail has been a subpostmaster for 20 years. He's been running his Post Office branch in Batley for 10 years and Ismail is heavily involved in the community, using the office for community events including as a classroom for local children at the weekend.

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"I've seen many changes over the years and I always try to adapt and develop a long term strategy for my business. I'm working on my strategy for 2020 at the moment.

"Batley is a really diverse community, and I try to do lots of networking so people know who we are and what they can use the Post Office for. We use the office as a focal point for the community which encourages people to come into the office and helps develop the business.

"When I saw the advert for the Post Office Advisory Council it sounded like the type of thing I already do locally. I have a real passion for the Post Office and the community, so by working with the Advisory Council we have an opportunity to share ideas and develop the whole of the Post Office.

"This is a really exciting chance to build on the experience we have across the whole of the business and use customer insight to generate new ideas."

Bethany Hurst – Apprentice, HR Service Centre

Beth joined the Post Office in October 2012 on an apprenticeship in the HR Service Centre. "I was in college at the time and decided university wasn't for me, so I started looking for an apprenticeship and saw the Post Office advertised. The variety of moving around in the different teams in HR really appealed to me.

"This was my first proper job, so it was a bit scary coming into the Centre, but people were really friendly and genuinely interested in me and made me feel valued. I wasn't just taken on and forgotten about."

Beth has now worked in each product team within the HR Service Centre and has recently picked up a role in the Pay team.

"I'm really happy working in the Pay team and want to stay with the Post Office long term. I'd like to get my payroll qualification next and move into management in the future."

Beth has now been nominated by her external NVQ assessor for the National Apprentice of the year award, which will be announced later this year.

Beverley Meier – Acting Branch Manager, Horsham

Beverley joined the Post Office 14 years ago, working in a small village Post Office branch. After 4 years she moved into the Crown network. Beverley became the acting Branch Manager and started the Crown Leadership Excellence programme last year.

"The programme has been really interesting. I've worked on the counter for a number of years but the programme has really challenged me to think differently, to think like a retailer."

The programme has enabled Beverley to expand her network of support across the business and draw on help and advice from a variety of sources.

"I've learnt some really practical things. For example, I now have a much better understanding of my profit and loss account and how I can personally affect the performance of the business. It's also changed the way I support my team. I think the team have noticed a difference and I feel it has brought the whole office closer together.

"I think the programme is making me a better manager and I want to continue to progress. I also want to use what I've learnt to support the development of others."

Katherine Mearman – Senior Manager, Commercial

Katherine works as part of the Post Office's Marketing team and has previously worked for Orange and American Express. She was part of teams working on global marketing projects. So why move to the Post Office?

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"I have been asked this before and the answer is quite straight forward. Being part of Post Office meant I had the opportunity to take a leading role in developing and growing a brand, it was a real chance to shape the future of the business."

Katherine is part of our Women in Leadership programme and was recently nominated for a Chartered Institute of Marketing 'Women in Marketing' award during 2013/14.

"It was a real honour for me. I was very lucky to be nominated and felt privileged to be part of it. The Women in Leadership programme provides a real springboard for women in the business who want to get on. I'm really encouraged when I see the male/female split at Board and Executive Committee level.

"Post Office has such a huge opportunity ahead of it. Everything that we're involved in brings massive opportunity with it. It really needs people who will grab that opportunity and drive it forward. That will deliver a Post Office of the future."

Gary Shorland - Mortgage Specialist, St Albans

Gary joined Post Office in 2010 as a Financial Specialist. Prior to joining us he had worked for the BBC and HSBC among others. Gary was one of a team of 7 working on the initial Post Office mortgage trial.

"I'd worked in the banking sector previously so when I saw the role in Post Office advertised and started to do some research into the products and services, I was really surprised by the scale of the product offering. There was obviously a lot of potential to grow."

"I'm really encouraged by the way things are going. The branch refurbishment will make us more modern, exciting and professional and will encourage more customers to come in. A key part for customers is the fact that they can come into a branch and speak to you face to face. That's so important when making big financial decisions."

"I'm positive about the future because there is so much potential to grow this area of the business."

Rita Patel – Subpostmaster, Royal Wootton Bassett branch

The Community Enterprise Fund, supported by the Department for Communities, Local Government and the Post Office, was introduced to encourage ideas to support the community, including mentoring for business start-ups, digital access and training.

Rita didn't hesitate to put forward her idea to form WithIT – a drop-in class for residents where they are taught how to use tablet devices, including web browsing, email and taking photos. The group is made up of volunteers from the community and Rita is hoping to involve pupils from the local secondary school to host troubleshooting sessions.

"I thought it'd be a brilliant idea to bring the community together and I know many of my customers have been keen to learn how to use tablets," said Rita.

"The launch took place at the local library and the turnout was fantastic - 39 people registered to attend regular classes and many more have dropped into branch since. I want to create a community hub where they can make friends and learn something new that they can then share.

"The Community Enterprise Fund is a fantastic idea and I can only thank the Post Office."

Among the residents learning how to use a tablet device for the first time was 94-year-old Ena Hatton, who said: "Rita has done a fantastic job, she's so helpful. I'd love a tablet of my own – they're very useful."

WithIT has proved to be a great success and very popular with the local community.

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Supporting Colleagues and Communities

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Supporting Colleagues and Communities

At the Post Office we are at the heart of communities across the UK and this means being aware of our responsibility to be inclusive, accessible and sustainable. That's why we have developed and expanded our Corporate and Social Responsibility Strategy during 2013/14. We will continue to strive to meet demanding goals in the forthcoming year.

Accessibility

The Post Office has long recognised the diverse nature of the communities and the customers we serve. We have an important role to play by providing an accessible, excellent service to everyone. We aim to have one of the most accessible branch networks in the country and to assist this vision we provide our subpostmasters with matched funding to help finance improvements to branches.

To meet these aspirations we have a continuing commitment to diversity and to the delivery of excellent service. We make sure that all of our employees are aware of their obligations under the Equality Act and that they understand the benefits of adopting a positive approach towards meeting the needs of disabled customers.

The Post Office is also aware that not all disabilities are necessarily visible or physical. We train our employees to make adjustments where needed to assist customers in accessing goods and services in our branches.

And for those occasions when things do not go to plan, we have a customer complaint system that it is easy to use for those with disabilities.

Sustainable operations

We are pleased that all the paper we use obtained from sources accredited by the Forest Stewardship Council (FSC), up from 90% last year. We are planning to include the FSC logo on all our point-of-sale leaflets which indicates that the pulp used has come from well-managed forests, controlled sources, or recycled wood or fibres.

Environment and sustainability

The Post Office recognises its environmental responsibilities and is committed to minimising our adverse environmental impact by means of a continuous improvement process.

Our targets for 2013-14:

- 3% reduction in building energy use.
- 3% reduction in CO2 from vehicle fuel.
- 3% reduction in water use.
- 75% of all waste generated to be recycled.

The Post Office exceeded all our targets for 2013/14 and we will set the same challenging goals for next year.

Buildings

A large percentage of Post Office buildings now have low-energy lighting, low-water usage utilities, and all fixtures and fittings are now obtained, wherever possible, from sustainable sources or from materials that can easily be reused or recycled.

Under both Network and Crown Transformation programmes we make sure that the buildings we modernise meet these sustainability standards as well as complying with accessibility legislation.

Vehicles

By autumn 2013 three quarters of our operational fleet of 420 cash in transit vehicles met the current Euro 5 emissions standard, and 50% of the fleet were adapted to accommodate exhaust gas reduction systems and deliver improved performance. We will expect to apply the same standards to all replacement vehicles by March 2016.

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Waste

Most of our buildings are now participating in the Dry Mixed Recycling scheme where everything that can be recycled is now segregated into separate bins or bags. This is a key initiative to reduce the dependence of the Post Office on sending waste to landfill as it is both expensive and environmentally unsustainable.

BBC Children in Need

In 2013/14 the Post Office continued our long-running association with BBC Children in Need. We played a key role, raising over £1 million for the charity and in the process becoming the biggest corporate partner of the charity. Thousands of our branches got involved running a number of activities including the BearFaced campaign where exclusive paw print tattoos were available to purchase across the Post Office branch network.

Computer donations

In 2013/14 Post Office in conjunction with our service provider donated over 200 PCs and a similar number of mobile phone to the Computers4Africa charity, Malaika Kids (www.malaika.kids.co.uk). The computers help the charity support a school for orphaned children in Tanzania giving them the opportunity to learn in a safe environment.

Your Charity

As an employer the Post Office is proud to encourage the support of charitable causes. In 2013/14 we launched Your Charity which enables teams in our Crown branches, central support and cash centres to support local causes throughout the year. We also support colleague fundraising efforts with A Helping Hand. This provides matched funding of up to £200 per application. Your Charity and A Helping Hand are both to be extended to agency branches in 2014/15.

Digital inclusion

As the world we live in becomes increasingly digital, it is more important than ever to support the 11 million people in the UK who lack basic online skills, many of whom are our customers. As a founder member of Go ON UK the Post Office is committed to tackling digital exclusion.

Together with Tinder Foundation and other partners the Post Office launched Get Connected in all of our branches in June 2013. Get Connected is the public face of a live, national database. Every branch can help customers find their five nearest learning centres and libraries for online training and internet access. So far this tool has had over 13,200 searches at over 5,000 Post Office branches.

The Post Office has also continued to be an active partner of Go ON UK and was an integral part of the Go ON North East, a six month campaign to drive up digital skill levels in the north east of England. The campaign launch in October 2013 saw Post Office branches amplify the Get Connected campaign, signposting customers to local help. A number of branches in the region ran free internet taster sessions to reach out to those who need support. Similar campaigns will launch in Northern Ireland and the north west of England during 2014/15.

Community Enterprise Fund

We have always been clear in our aim of supporting community initiatives and in 2013/14 the Post Office joined forces with the Department for Communities and Local Government to launch the Community Enterprise Fund. The £200,000 scheme invited bids from Post Office branches with innovative ideas to support the local community or small businesses in the area. 25 branches received grants of up to £10,000 to implement their ideas which are not for profit but provide a service, activity or support that are easily accessible and open to all.

The successful bids included those that sought to tackle isolation and digital exclusion or providing a space as a hub for the community to utilise. The Cabinet Office also supported the Community Enterprise Fund by awarding grants to three Post Office branches who were working to relieve isolation.

RSA report

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In February 2014 the RSA published 'Making the Connection', a report that looked at the many ways Post Office branches are becoming community enterprise hubs and experimenting with new business models to support their communities and generate income. The report found that a number of subpostmasters, especially those that won the new Community Enterprise Fund, are already trialling new products and services for their customers.

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Supporting charities and appeals

We frequently use our unrivalled branch network as donation points. Post Office has supported a number of initiatives during 2013/14 including the Philippines Typhoon Appeal in November 2013 and Prince's Countryside Trust in their efforts to support to the rural communities that had been devastated by flooding in the south west of England.

Business in the Community

The Post Office has continued its work with Business in the Community during the past year. We have partnered with three of the 27 government-backed Town Teams to help regenerate high streets in Brighton, Stockton-On-Tees and Sydenham and are helping them plan for a thriving future.

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Performance Review

Draft and in confidence**The Post Office**

2013/14 Annual Report and Accounts

Financial Review**Paving the way towards financial sustainability****Summary results**

The Post Office has faced a challenging year with decreases in turnover in each of the core product pillars. Despite this and a reduction of £10 million in the Network Subsidy Payment, operating cost savings have resulted in the operating profit before exceptional items increasing by £13 million to £107 million. The costs of transformational change in the year were significant as the network modernisation accelerated.

Profit and Loss Summary

	2014	2013	Variance	Variance
	£m	£m	£m	%
Turnover	979	1,024	(45)	(4.4)
Network Subsidy Payment	200	210	(10)	(4.8)
Revenue	1,179	1,234	(55)	(4.5)
People costs	(255)	(259)	4	1.5
Other operating costs	(850)	(913)	63	6.9
Total costs	(1,105)	(1,172)	67	5.7
Share of profit from joint ventures and associates	33	32	1	3.1
Operating profit before exceptional items	107	94	13	13.8

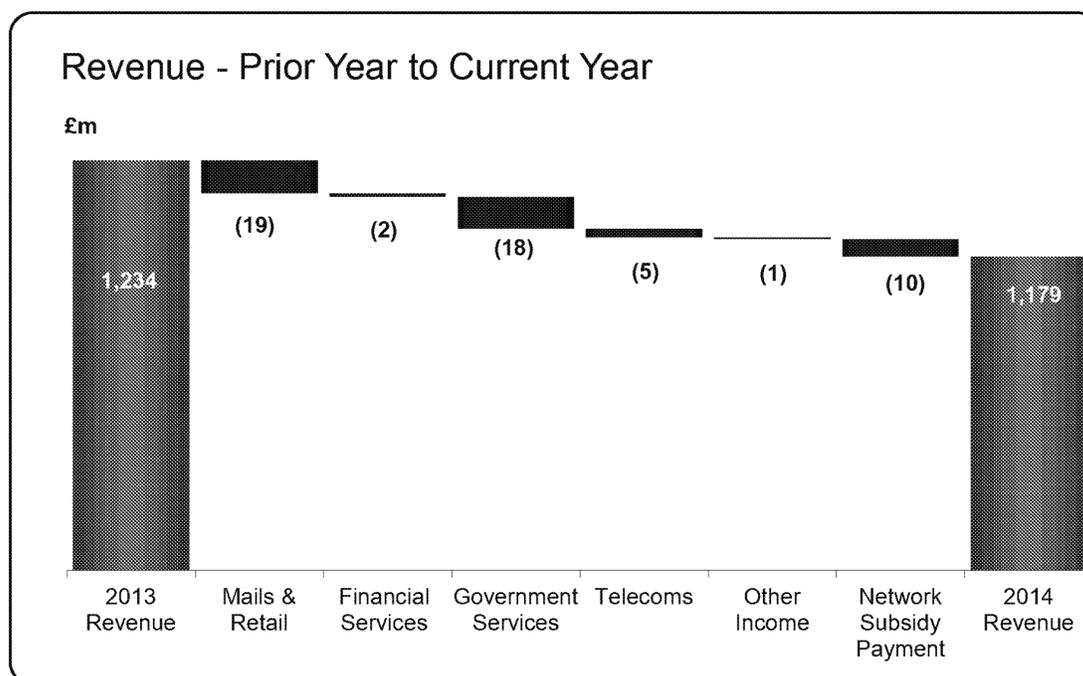
Revenue

The Post Office's revenue decreased by £55 million (4.5%) to £1,179 million including a decrease of £10 million in the Network Subsidy Payment from the government. The Post Office segments income into four pillars; Mails & Retail, Financial Services, Government Services and Telecoms. The pillars and their performance are detailed below:

	2014	2013	Variance	Variance
	£m	£m	£m	%
Mails & Retail	390	409	(19)	(4.6)
Financial Services	279	281	(2)	(0.7)
Government Services	146	164	(18)	(11.0)

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Telecoms	124	129	(5)	(3.9)
Other income	40	41	(1)	(2.4)
Turnover	979	1,024	(45)	(4.4)
Network Subsidy Payment	200	210	(10)	(4.8)
Revenue	1,179	1,234	(55)	(4.5)

**Mails & Retail**

The Mails and Retail pillar includes all the services provided for Royal Mail and Parcelforce. It also includes Lottery and retail services such as sales of collectibles as well as packaging and stationery.

Mails and Retail revenue of £390 million decreased by £19 million (2012- £409 million). Of this, turnover in relation to Royal Mail products decreased by £16 million, driven primarily by a reduction in consumer parcel volumes and lower stamp sales. In addition, retail turnover decreased by £2 million due to the one-off increase in the prior year for collectibles relating to the Diamond Jubilee and the Olympics memorabilia. Revenue from sales of lottery tickets declined marginally by £1m.

Financial Services

The Financial Services pillar includes Post Office branded personal financial services products, ATMs and travel services as well as traditional services such as bill payment and over-the-counter banking transactions.

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Across Financial Services in aggregate, revenue decreased in 2014 by £2 million to £279 million (2013 - £281 million).

Personal Financial Services revenue increased by £15 million (15.2%) driven by strong growth in savings commissions (particularly Growth Bonds, Reward Saver and ISAs), insurance and new mortgage products. Revenue from traditional financial services products including bill payment services, business banking services and Postal Orders declined. This was due to the increasing shift from paper-based to electronically delivered products and the increasing use of alternative payment methods. In addition, the cessation of the Department of Work and Pensions contract for cash cheques (Green Giro) and the continued migration of NS&I products through their own direct channel have resulted in revenue decline.

Government Services

The Government Services pillar covers services provided under contract to government departments. This includes services in relation to the work of the Department for Work and Pensions (DWP), the Driver and Vehicle Licensing Agency (DVLA), Her Majesty's Passport Office (HMPO) and UK Visas and Immigration (UKVI).

Government Services revenue of £146 million decreased by £18 million (2013 - £164 million). Revenue from the Passport Check & Send service increased by £2 million in line with growth in the overall market. However, revenue from the DVLA for car tax and ten year licence renewals decreased by £14 million due to lower volumes and a lower fee per transaction under the new contract effective from 1 April 2013. Revenue from the payment of benefits through the Post Office Card Account was £6 million lower, impacted by customers continuing to migrate to receiving benefits through bank accounts.

Telecoms

The Telecoms pillar includes the Post Office HomePhone and Broadband services as well as e-top up services and phonecards.

Telecoms revenue of £124 million (2013 - £129 million) decreased by £5 million. During the year, the Homephone and Broadband service was transitioned to a new provider and experienced operational issues initially which both the provider and Post Office resolved as quickly as possible. The revenue from HomePhone and Broadband decreased by £4 million primarily due to a reduction in customer numbers driven by reduced sales and marketing activity following the transition to the new supplier. Revenue from e-top ups was £1 million below prior year as more customers moved away from pre-pay and mobile networks reduced their transaction fees. However, the Post Office continues to be a significant provider in the top-up market and its share of the retail market has been maintained at approximately 5%.

Other income

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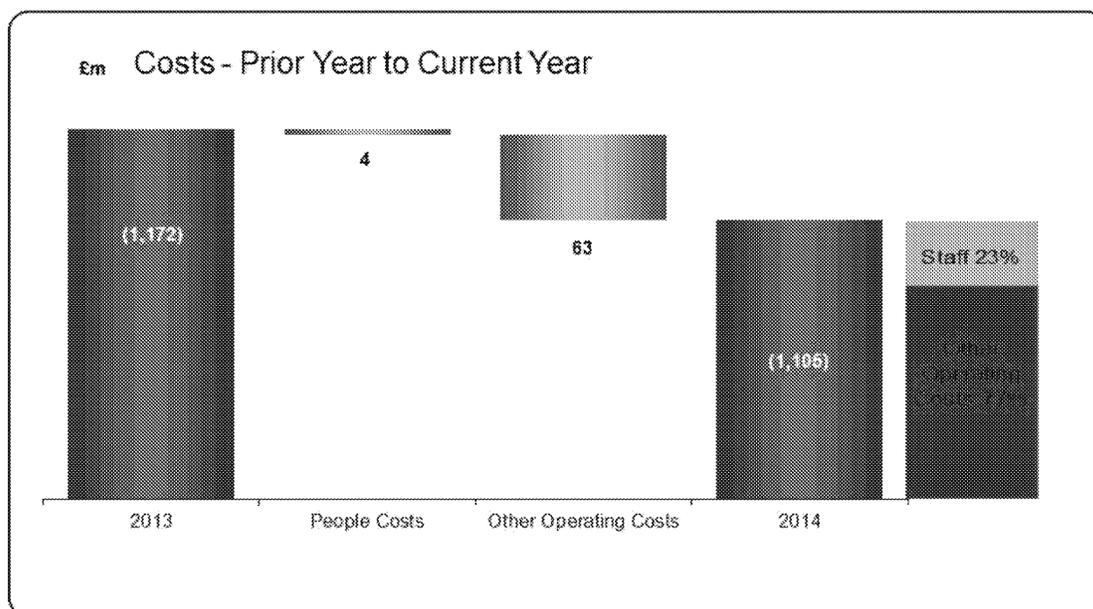
Other income is generated primarily from the Supply Chain business which manages and distributes cash for Post Offices and for third parties. It also offers warehousing services, mainly to Royal Mail. Other income decreased by £1 million to £40 million (2013- £41 million).

Network Subsidy Payment

The Network Subsidy Payment is government grant revenue towards the costs of maintaining the Post Office network. The payment decreased by £10 million in the year to £200 million; this will continue to reduce as set out in the current funding agreement with the government.

Costs

Total costs decreased by £67 million to £1,105 million (2013- £1,172 million).



People costs

People costs of £255 million (2013 - £259 million) decreased by £4 million reflecting efficiency savings, particularly in the Crown network, and lower performance-related bonuses, partly offset by some pay increases and higher pension costs.

Other operating costs

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Other operating costs decreased by £63 million to £850 million (2013 - £913 million), driven largely by lower sales volumes resulting in lower subpostmasters' costs and cost of sales. There was also a decrease in investment in new products and services which had been particularly high during 2012-13.

Joint venture and associate

Share of operating profit from the joint venture (First Rate Exchange Services Holdings Limited) was £33 million, £1m higher than in 2013 when the result also included the associate (Midasgrange Ltd until its sale on 1 September 2012 (2013 - £32 million). First Rate Exchange Services Holdings Limited results improved mainly through delivering efficiencies in operating costs.

Exceptional Items

Exceptional items	2014 £m	2013 £m
Operating exceptional items:		
Restructuring costs including subpostmasters' compensation	(259)	(79)
Impairment of investment, property, plant and equipment	(115)	(66)
Amendment to the terms of RMPP	102	-
Government grant	317	98
Subtotal operating exceptional items	(45)	(47)
Non-operating exceptional items:		
Profit on disposal of property, plant and equipment	3	2
Loss on sale of associate	-	(30)
Net exceptional items	(42)	(75)

Restructuring costs

Restructuring costs include the costs of delivery of major change. Network transformation resulted in costs of £94 million for subpostmasters' compensation (2013: £12 million) and £97 million programme costs (2013: £40 million) with the increases in each reflecting the greater pace of transformation this year. In addition programme costs of £9 million (2013: £nil) were incurred in relation to Crown transformation. Costs of £21 million relate to IT transformation (2013: £10 million) which will create the appropriate IT infrastructure for the future. Redundancy costs of £23 million were incurred during the year and mainly related to the Crown network (2013: £11 million). There were further business transformation payments charged in the year of £5 million (2013 - £4 million). Business transformation payments are payments that are periodically made to staff as an incentive in order to secure agreement for significant changes in working practices in order to improve business efficiency. In addition a gain of £102 million arose on the change to the terms of the Royal Mail Pension Plan (see page XX).

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Government Grant

In addition to the Network Subsidy Payment to support the network, the Post Office also receives government grant funding towards the transformation programme. Government grant funding of £215 million was received in the year. The additional government grant funding is included within operating exceptional items to match the associated costs. £102 million of the 2012-13 grant also remained available for use in the year. The entire balance of £317 million of this government grant funding has been allocated (2013: £98 million) in accordance with the designation letters, dated 2 April 2012 and 27 March 2013, from the Department of Business, Innovation and Skills, to cover £114 million capital expenditure (2013: £66 million), £94 million network transformation related subpostmasters' compensation (2013: £12 million) and £109 million network and IT transformation programme costs (2013: £20 million).

Cash Flow and Net Debt

Post Office Limited operates a Treasury function and manages its own financial assets (including network cash) and financial liabilities (mainly government loans).

The Treasury function derives its authority from the Board and provides regular reports for Board review. It has the authority to undertake financial transactions relating to the management of the underlying business risks, however, it does not engage in speculative transactions and does not operate as a profit centre. The principal financial instruments utilised are deposits and borrowings.

The cash position of the business remains strong with cash and cash equivalents of £688 million (2013: £971 million). There was a net cash outflow during the year of £283 million (2013: inflow £151 million). The outflow was driven by the repayment of the opening loan balance of £291 million. Net debt (excluding cash in the Post Office network) decreased by £174 million year on year as shown in the table below:

	2014	2013
	£m	£m
Net cash inflow from operating activities	69	257
Income tax recovered	11	11
Net cash outflow from investing activities	(65)	(24)
Net cash inflow before financing activities	15	244
Add/(deduct): movement in cash in the network included in net cash inflow	162	(112)
Finance costs paid	(3)	(4)
Net decrease in net debt	174	128
Net debt brought forward at the beginning of the year	(197)	(325)
Total net debt carried forward at the end of the year	(23)	(197)

Post Office Limited's borrowing facility from the government and the associated Framework Agreement imposes constraints on the purposes for which the facility can be used and the availability of external borrowing. Post Office Limited's treasury policy is to minimise the

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amount drawn down on the loan in order to reduce its interest cost. The facility is limited to a maximum of £1.15 billion or the amount of security available (mainly network cash), whichever is the lower. The maximum drawn down under the facility during the year was £261 million on 19 and 20 December 2013 but there was no loan drawn down at 30 March 2014. The facility is available at two days' notice and has an end date of 31 March 2016.

Pensions

Post Office Limited is a participating employer within the Post Office Section of the Royal Mail Pension Plan (RMPP) and is a participating employer within the Royal Mail Defined Contribution Plan (RMDCP). Royal Mail Group Ltd is the principal employer of the Royal Mail Senior Executives' Pension Plan (RMSEPP) and Post Office Limited is a participating employer within RMSEPP. RMPP and RMSEPP are both defined benefit plans.

On 1 April 2012 – after the granting of state aid by the European Commission on 21 March 2012 – almost all of the pension liabilities and pension assets of the Royal Mail Pension Plan (RMPP), built up until 31 March 2012, were transferred to HM Government. On this date, the RMPP was also sectionalised, with Royal Mail Group Ltd and Post Office Limited each responsible for their own sections in future. This pensions transfer left the RMPP fully funded on an actuarial basis in respect of historic liabilities at this date. During 2013/14 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 2013. The key change is 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 resulted in a one-off exceptional gain of £102 million.

The balance sheet pension position moved from an asset of £97 million at March 2013 to an asset of £148 million at March 2014. The improvement in position is primarily due to the change in terms noted above offset by an actuarial loss mainly arising from lower than expected asset values.

Both defined benefit plans closed to new members in March 2008, and RMSEPP closed to future accrual on 31 December 2012. New employees are offered membership of the RMDCP.

Pension cash payments for all plans

The future funding of ongoing pension contributions into RMPP and deficit payments into RMSEPP was agreed with the respective pension trustees during the year and payments were made in accordance with the agreements.

	2014	2013
	£m	£m
Regular pension contributions	(23)	(24)

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Funding of the pension deficit - RMSEPP	(1)	(2)
Payments relating to redundancy	(1)	(2)
Net cash payments	(25)	(28)

The regular future service contributions cash rate for RMPP expressed as a percentage of pensionable pay remained at 17.1% (2013 - 17.1%). The regular rate of employee contributions for the RMPP remains unchanged at 6%.

Events after the reporting period

In accordance with the funding agreement with government announced on 27 October 2010, for which State Aid approval was received on 28 March 2012, Post Office Limited received £330 million of funding on 1 April 2014.

Chris Day

Chief Financial Officer
Post Office Limited
XX June 2014

**Boxout – to go near the beginning of the Financial Review
Key Financial Performance Indicators**

	2014	2013	Variance	Variance
	£m	£m	£m	%
Turnover	979	1,024	(46)	(4.4)
Operating profit before exceptional items	107	94	13	13.8
Operating loss before exceptional items and Network Subsidy Payment	(93)	(116)	23	21.6
Net cashflow	(282)	151	(434)	-

Draft and in confidence**Business risk**

The information below details the key business risks, their impact and how the Post Office manages these risks.

Key risk	Impact	Mitigation
Changes in customer Preferences		
There is decline in the traditional Post Office income streams as customer preferences change. New income streams may fail to grow sufficiently to exceed the losses from traditional products in decline	The Post Office might not be able to reduce its reliance on government subsidy	We have introduced new services in growth areas and continue to refine and develop these product offerings. There is an active programme in place to deliver the growth trajectory. Progress is monitored rigorously and risks to the programme are actively managed.
Business transformation programmes		
We are managing a significant number of change programmes to modernise the Post Office and enable its processes to operate independently of those of Royal Mail. These include the network, Crown and IT transformation programmes. The success of the Post Office strategic plan depends on the successful realisation of benefits from these programmes.	Failure to implement the modernisation programme would leave the Post Office with an unsustainable cost base and a continued reliance on significant government subsidy.	There are detailed plans in place to manage the transformation and ensure it is delivered within budget and on time. The 2013/14 objectives have been met. Delivery is tracked monthly by a Transformation Board made up of Executive Committee members which provides direction and oversight over the programmes' delivery.

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Engagement risk		
<p>The support of our staff and subpostmasters and engagement with them during this significant time of change is key to the successful delivery of our strategy. Withdrawal or lack of support from our staff or subpostmasters in the network could cause delays in the Post Office transformation programmes and limit our ability to meet business objectives.</p>	<p>Lack of support from our staff and subpostmasters would jeopardise our ability to meet our strategic goals of growth, profitability and reduced reliance on government subsidy</p>	<p>We maintain a fluid and comprehensive engagement programme with unions, staff and subpostmasters. These include regular meetings with the National Federation of Subpostmasters (NFSP), the Communication Workers Union (CWU) and Unite; senior management briefings to staff and subpostmasters; and events to engage our people in our vision and strategy. We have a people plan aimed at addressing staff motivation and skill needs. This includes development of new leadership and reward frameworks and increased focus on recruitment and training.</p>
Regulatory & compliance		
<p>There is a risk of non-compliance with the changing regulatory environment. The Post Office operates under an extensive regulatory environment, including areas such as financial and postal services, procurement, competition law and data security.</p>	<p>Failure to comply with regulation could result in fines, adverse outcomes for our customers and significant damage to The Post Office brand.</p>	<p>Our legal and compliance team works closely with the relevant business owners in identifying new requirements and monitoring compliance against existing ones. Regular compliance tests are conducted across the entire branch network covering a broad range of regulatory requirements. The results are closely monitored and corrective action taken where required.</p>

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<p>Business Continuity</p>		
<p>The Post Office has particular operational risks relating to disruption of its services. This includes adverse weather conditions, industrial action, systems breakdown and the failure of a critical supplier</p>	<p>Breakdowns in the network would reduce quality of service, increase costs and damage our reputation.</p>	<p>The Post Office brings together a wide range of business continuity arrangements throughout the company under one central policy and governance framework to ensure that the business is capable of withstanding any significant threat to its on-going operations. This includes contingency planning and training in the event of disruption such as industrial action or IT failure. Key suppliers' ability to continue to meet the Post Office's requirements is closely monitored.</p>

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Corporate Governance

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Directors' Biographies for the Annual Report 2013/14

Alice Perkins CB

Chairman

Joined the Board in July 2011

Chairman of the Nominations Committee and Member of the Remuneration Committee

Skills and experience: Alice has many years of experience at Board and executive management level within a number of industries and the public sector. Alice is an established leader who is committed to coaching and development.

External appointments: Alice is an external member of the Oxford University Council, a business coach at the JCA Group, and a member of the faculty at Meyler Campbell where she teaches senior executives how to coach. Alice was appointed as a Non-Executive Director of the BBC on 1 April 2014.

Former appointments: Alice had a wide-ranging career in the civil service, which included policy and operational roles in health, social security and public spending in the Treasury. Alice was also the Civil Service's Group HR Director in Cabinet Office between 2001 and 2005. Before joining the Post Office, Alice served as Non-Executive Director on the boards of Littlewoods, BAA and TNS, where she also chaired the Remuneration Committee.

Neil McCausland

Senior Independent Director

Joined the Board in September 2011

Chairman of the Remuneration Committee and a Member of the Audit, Risk and Compliance Committee and the Nominations Committee; Member of the Post Office Advisory Council

Skills and experience: Neil has held a portfolio of non-executive roles over the last ten years. He has extensive experience within the retail sector, which makes him well positioned to bring a commercial perspective to the Board and has demonstrable leadership skills through his chairmanship experience on several boards.

External appointments: Neil is currently Chairman of three companies: Snow and Rock, a retail chain selling skiing and outdoor brands, bikes and running gear; Dwell, a multi-channel contemporary furniture retailer; and Skin, a chain of skin treatment clinics specialising in laser hair removal.

Former appointments: Until recently Neil was Chairman of footwear company Kurt Geiger, and a Governor of Nuffield Health, which operates hospitals and health clubs. Neil began his career at Marks & Spencer, before becoming Managing Director of C&A and Chief Executive of NAAFI (an MOD agency).

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Richard Callard

Non-Executive Director

Joined the Board in March 2014

Skills and experience: Richard is the appointed representative for the Department for Business, Innovation and Skills. He currently leads the Post Office and the Green Investment Bank shareholder team at the Shareholder Executive, which enables him to bring fresh insight and a unique perspective to the Board. Richard is a Chartered Accountant with a practice background.

External appointments: Richard joined the Shareholder Executive in 2007, and was appointed Executive Director in March 2013. Whilst at ShEx Richard has primarily worked on the Royal Mail, specialising in the state aid and employee shares aspects of the privatisation process.

Former appointments: Previously, Richard worked in Deloitte's Corporate Finance Government and Infrastructure Team, where he specialised in public private partnerships, advising both the public and private sectors on PFI and other transactions. Richard qualified as a Chartered Accountant with PKF.

Tim Franklin

Non-Executive Director

Joined the Board in September 2012

Member of the Audit, Risk and Compliance Committee and Financial Services Committee; Chairman of the Post Office Advisory Council

Skills and experience: Tim's experience extends across the private and public sectors. He has a strong financial services background at both Board and executive management level, including within a mutual environment. Tim was appointed as the Chairman of the Post Office Advisory Council in October 2013.

External appointments: Tim is a Non-Executive Director of HM Land Registry.

Former appointments: Tim was Chief Operating Officer to the Co-operative Banking Group until the end of 2011, having previously served as Managing Director of the Britannia Building Society. Prior to that, he was Director of Customer Programmes and Loyalty and Managing Director of Savings at Barclays. He was previously on the Boards of Reclaim Fund Limited, Mutual Plus Limited and the Link Cash Machines Network.

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Virginia Holmes

Non-Executive Director

Joined the Board in April 2012

Chairman of the Pensions Committee and the Financial Services Committee

Skills and experience: Virginia brings to the Board extensive knowledge of the financial services industry including both investment management and banking. This knowledge, alongside her experience of chairing board committees, made her the obvious choice to act as Chairman of the newly established Financial Services Committee.

External appointments: Virginia currently serves on the boards and chairs the investment committees of both the Alberta Investment Management Corporation in Canada and the Universities Superannuation Scheme in the UK. She also serves on the boards of Standard Life Investments Ltd and JPMorgan Claverhouse Investment Trust plc.

Former appointments: Virginia's experience includes serving as Chief Executive of AXA Investment Managers UK and more than a decade with the Barclays Bank Group where she ultimately served as Managing Director of Barclays Bank Trust Company.

Alasdair Marnoch

Non-Executive Director

Joined the Board in May 2012

Chairman of the Audit, Risk and Compliance Committee

Skills and experience: Alasdair is a Chartered Accountant and member of the Chartered Institute of Management Accountants with wide experience as Finance Director of a number of FMCG and service businesses. This recent and relevant financial experience enables him to be a knowledgeable and effective Chairman of the Audit, Risk and Compliance Committee.

External appointments: Alasdair was appointed as Chief Financial Officer at CPA Global, the world's leading provider of intellectual property management software and services, in January 2014.

Former appointments: Alasdair's former appointments include serving as CFO of the Equiniti Group, a leading provider of complex administration and processing services to the public and private sectors. He has also held senior financial roles with Iris Software Group, Jarvis plc, Dunlop Slazenger Group (DSG), and Thames Water plc.

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Paula Vennells

Chief Executive

Joined the Board in October 2010

Skills and experience: Paula has worked for the Post Office since 2007 in a number of senior roles, including Managing Director. She became Chief Executive on 1 April 2012. She has extensive commercial experience within the retail sector, having worked for multiple household names throughout her career.

External appointments: Paula is currently a Non-Executive Director and Trustee for Hymns Ancient and Modern Group.

Former appointments: Prior to joining the Post Office, Paula spent five years with Whitbread plc, latterly as Group Commercial Director. She began her career with Unilever and L'Oreal and held directorships in sales and marketing with a number of major retailers including Dixons Stores Group and Argos.

Chris Day

Chief Financial Officer

Joined the Board in September 2011

Member of the Financial Services Committee and Pensions Committee

Skills and experience: Chris joined the Post Office as Chief Financial Officer in August 2011. He has extensive financial experience working within a range of industries, including internationally. Chris has an MBA Finance from City University Business School.

External appointments: None

Former appointments: Chris joined from the BBC where he had been Group Financial Controller since 2005. Prior to that, Chris spent 14 years in FMCG with Grand Metropolitan/Diageo in a succession of Treasury/Corporate Finance roles in the UK, and as Finance Director in the Netherlands and subsequently Germany/Austria. Earlier in his career Chris worked as a financial management consultant at KPMG having started his career with Beecham Group.

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Alwen Lyons

Company Secretary

Appointed as Company Secretary in July 2011

Skills and experience: Alwen Lyons joined the Post Office Limited in 1984 as a graduate entrant and has worked at a senior level in several directorates including network, finance and marketing. She became the Company Secretary after leading the project to separate Post Office Limited from Royal Mail Group.

External appointments: None

Former appointments: Alwen served as a trustee on the Royal Mail Pension Plan Board for 8 years and was Chair of the Audit and Risk Committee for 7 years.

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Corporate Governance Statement

The Post Office is committed to conducting the Group's business ethically and in accordance with high standards of corporate governance.

As the Post Office is not a company with shares listed and traded on a public exchange, it is not formally required to report on its compliance with the UK Corporate Governance Code (the "Code"). Nonetheless, the Board of the Post Office believes this is an appropriate benchmark for reporting on corporate governance.

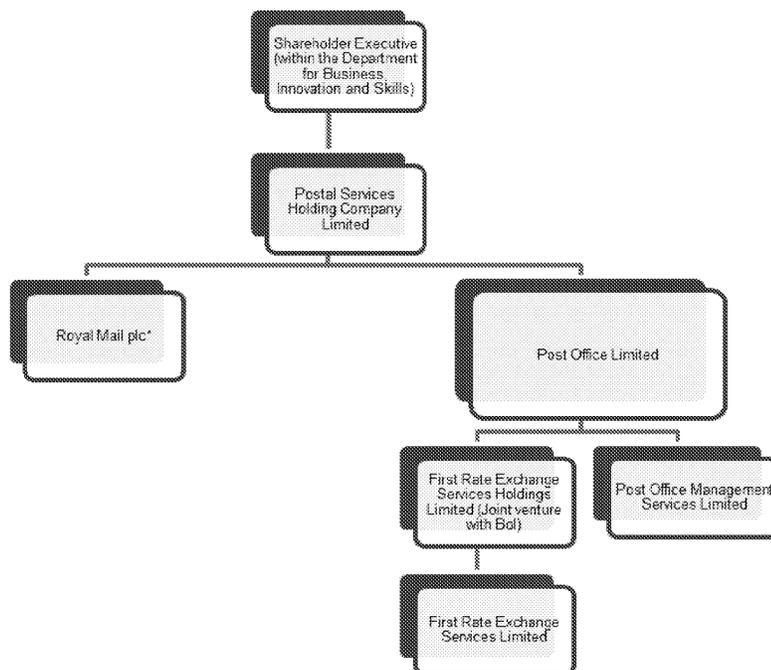
The Post Office's corporate governance structure follows the provisions of the Code in so far as they can apply to a Government-owned entity which has no private or institutional external shareholders.

Legal Ownership Structure

The Post Office is a wholly owned subsidiary of Postal Services Holding Company Limited (formerly named Royal Mail Holdings plc). The Secretary of State for Business, Innovation and Skills ("BIS") holds a special share in Post Office Limited. The Special Shareholder's rights are set out in the Post Office Limited Articles of the Association.

A strong link remains between the Post Office and Royal Mail, underpinned by a strategic agreement to continue to supply Royal Mail products and services through the Post Office.

Neither Postal Services Holding Company Limited nor BIS, through its Shareholder Executive ("ShEx"), have any day to day involvement in the operations of the Post Office or the management of its branch network and staff, although Richard Callard, (Executive Director, Post Office Limited and Green Investment Bank, Shareholder Executive) sits on the Board of Post Office Limited as the shareholder representative.



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*Postal Services Holding Company Limited owns just under 30 per cent of the shares in Royal Mail plc following the initial public offering and the exercise of the over-allotment option

The Board

The Board is comprised of the Chairman, the Chief Executive, the Chief Financial Officer and five Non-Executive Directors.

The Board is responsible for setting the Post Office's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to the shareholder.

Short biographies of all members of the Board appear on page X of this Annual Report.

The Remuneration Committee liaises with ShEx in BIS to obtain Special Shareholder's consent for all Directors' appointments and the terms under which they serve, including Non-Executive Directors' fees and any changes in the total remuneration for each Executive Director.

The Executive Directors' contracts provide for 6 months' notice of termination to be given by the Director and 12 months' notice to be given by the Post Office.

Non-Executive Directors are not employees of the Post Office but provide services under the terms of an individual Letter of Appointment, signed at the commencement of their directorship. Tim Franklin, Virginia Holmes, Alasdair Marnoch and Neil McCausland all met during the year, and continue to meet, the criteria for independence as set out in the Code, and are therefore considered by the Board to be independent.

Non-Executive Directors' Terms of Office

Director	Date of appointment	Term of office	Unexpired term at 30 March 2014	Committee memberships
Alice Perkins	21 July 2011	Rolling 12 month contract	N/A	Nominations (Chair) Remuneration
Richard Callard	26 March 2014	Until removal	N/A	N/A
Tim Franklin	19 September 2012	4 years	2 years 173 days	ARC Financial Services
Virginia Holmes	4 April 2012	3 years	1 years 5 days	Financial Services (Chair) Pensions (Chair) Nominations Remuneration
Alasdair Marnoch	23 May 2012	3 years	1 years 49 days	ARC (Chair)
Neil McCausland	22 September 2011	4 years	1 years 176 days	Remuneration (Chair) ARC Nominations

Board Meetings

The Board meets as least 8 times a year and has a formal Schedule of Matters Reserved to it.

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During the year to 30 March 2014 the Board has focused on the Strategy, Financial Performance, Network and Crown Transformation, and the capability of the business. Over the last six months, the Board's primary focus was on the Strategic Plan and Funding Agreement with the government for the period through to 2020.

To assist in the execution of its corporate governance responsibilities, the Board has Audit Risk & Compliance, Nominations, Pensions and Remuneration Sub-Committees in place. During the year under the review, the Board established a Financial Services Sub-Committee to provide guidance, oversight and authorisation to the development of the Post Office's financial services programmes and activities. Also during the year, the Mutualisation Sub-Committee was subsumed back into the Board.

The Schedule of Matters reserved for the Board and the full Terms of Reference for the Board Sub-Committees can be found on the Post Office website.

The following shows the attendance of the Directors at meetings of the Board and its principal Sub-Committees during the year:

	Main Board	Additional Board meetings	ARC	Financial Services Committee	Nominations Committee	Pensions Committee	Remuneration Committee
Alice Perkins	8/9	7/7	3/6 [†]		6/6		5/5
Richard Callard	1/1*						
Chris Day	8/9	6/7	5/6 [†]	2/2		9/9	
Tim Franklin	9/9	4/7	6/6	2/2			
Virginia Holmes	8/9	4/7		2/2	6/6	9/9	5/5
Alasdair Marnoch	8/9	6/7	6/6				
Neil McCausland	8/9	5/7	6/6		6/6		5/5
Paula Vennells	9/9	6/7	4/5 [†]	2/2 [†]	5/6 [†]		1/5 [†]

*from date of appointment

[†] in attendance, by invitation

Additional Board meetings and ad hoc extra meetings were held by teleconference for specific time-critical issues only.

The Non-Executive Directors also meet at least twice a year without the Executive Directors.

Board Sub-Committees

Audit, Risk and Compliance Committee

The Audit, Risk and Compliance Committee ("ARC") is chaired by Alasdair Marnoch. The other members are Tim Franklin and Neil McCausland; all are independent Non-Executive Directors. The Board considers that the Committee's members have broad commercial knowledge and extensive business leadership experience, and that this constitutes a broad and suitable mix of business and financial experience.

The ARC considers the Post Office's financial reporting, including accounting policies and internal financial controls. It looks at the levels of risk which exist within the Post Office and the steps taken to mitigate those risks.

During the year, the Post Office has been further developing its risk management, internal control and internal audit procedures.

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One of the ARC's primary responsibilities during the period was to review both the half year trading statement and the full year accounts, to assess the validity of assumptions made and the accounting policies used and to consider the ways in which the Post Office should present its financial performance.

A second major responsibility has been to promote the development of a risk management framework suited to the complex nature of the Post Office business. This is under way, supported by an agreed strategy. The development of risk management and control procedures and the establishment of a full internal audit programme remain areas of high priority.

A small internal audit function is now established supported by co-sourcing arrangements with a major firm. The Royal Mail Internal Audit function provided an internal audit service until the summer of 2013. The Post Office Internal Audit function focuses on higher level risk areas providing independent assurance to the ARC, particularly on strategic and major change/IT risks. The Head of Internal Audit now reports to the General Counsel on an administrative basis and the ARC Chair on a functional basis, in line with corporate governance best practice. The Head of Internal Audit attends the ARC and meets with the ARC Chairman with or without management through the year.

The ARC works with both the internal audit team and Ernst & Young, the external auditor.

Remuneration Committee

The Remuneration Committee is a formal committee of the Board and has powers delegated to it under the Articles of Association. Its remit is set out in the terms of reference formally adopted by the Board, which were last reviewed in February 2014. The Remuneration Committee is chaired by Neil McCausland, the Senior Independent Director. The other members are Alice Perkins and Virginia Holmes. They are all independent Non-Executive Directors.

The Committee is responsible for making recommendations to ShEx on the remuneration of the Executive Directors in accordance with the Articles of Association. In doing so, it reviews the remuneration policy and packages of the most senior leadership team, being the roles which report directly to the Chief Executive. It also obtains information on salary levels across the business and within external organisations of comparable size in order to set remuneration levels within an appropriate context.

The Chief Executive may attend meetings, at the invitation of the Chairman, to discuss matters relating to the remuneration of the Chief Financial Officer and members of the Executive Committee but the Committee upholds the principle that no individual may be involved in discussions concerning their own remuneration.

The Committee is able to consult on remuneration matters with the Group People Director, other members of the Human Resources team and with external consultants. In the year under review, advice was primarily obtained from New Bridge Street Consultants on market practice and benchmark development. New Bridge Street Consultants have no other links with the Post Office which could compromise their independence.

No material changes can be made to Directors' base salaries, benefits or incentives without Special Shareholder consent. Further details of the schemes now in place, and a table setting out the remuneration paid to all Directors in the year to 30 March 2014, are provided in the Directors' Remuneration Report on page X.

Nominations Committee

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The Nominations Committee is chaired by Alice Perkins, the Chairman. The other members are Virginia Holmes and Neil McCausland. They are all independent Non-Executive Directors.

The primary role of this Committee is to recommend to the Board any changes in Board membership and to manage the process for recruiting and replacing Directors. This excludes the Non-Executive Director nominated by the Shareholder as their representative. The Committee will keep under review the balance of skills, experience and diversity available within the Board and each of the Board Sub-Committees. The Nominations Committee also oversees the process for Board and Committee performance evaluation.

During the year the Committee has continued to focus on building the overall capability of the organisation through the consideration and approval of Executive appointments, ensuring effective performance and development of the Senior Leadership, and overseeing the diversity agenda.

Pension Committee

The Pensions Committee is chaired by Virginia Holmes. The other member is Chris Day, Chief Financial Officer.

The purpose of the Pension Committee is to make recommendations to the Board in respect of pensions and pre-retirement risk benefits provision within the Post Office and to put into effect appropriate investment strategies for the Post Office section of the Royal Mail Pension Plan (RMPP) on behalf of the Board and in line with the Board's investment beliefs.

The Pensions Committee, with the assistance of AON Hewitt, oversaw the investment of RMPP assets in line with the investment strategy previously agreed with the Trustee of the RMPP. The transition is on-going and is due to be completed in 2014.

2013 saw the implementation of a cap on pensionable pay at RPI (to a maximum of 5%) each year, therefore reducing the salary risk to the RMPP. The project has an effective date of 1 April 2014. This change has allowed the Post Office to manage the costs associated with the RMPP and ensured the security of the RMPP for the foreseeable future.

The Committee also recommended to the Board a proposed change to the Royal Mail Defined Contribution Plan (RMDCP). This proposal would change the structure of the plan by increasing the Post Office's contribution to the RMDCP as laid out in the table below.

The plan members are currently being consulted on the changes. This consultation is due to end on 23 May 2014, with the proposed changes taking effect from 1 June 2014.

A summary of the changes are below:

Current		Proposed	
Employee Rate	Employer Rate	Employee Rate	Employer Rate
3%	5%	REMOVED	REMOVED
4%	6%	4%	7%
5%	7%	5%	8%
-	-	6%	9%

The proposed change was agreed by the Board in March 2014.

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Financial Services Committee

During the year a new Committee was formed to provide guidance on, oversight of and authorisation for the development of the Post Office's financial services. The Committee first met in January and its remit from the Post Office Board includes the activities of First Rate Exchange Services Limited ("FRES"), a 50% joint venture with the Bank of Ireland. The Committee has the delegated authority of the Post Office Board for Financial Services matters.

The Committee is chaired by Virginia Holmes. The other members are Tim Franklin, Non-Executive Director, and Chris Day, Chief Financial Officer.

Performance Evaluation

A board effectiveness review was carried out in July 2013 in the form of an informal assessment by the Chairman and Non-Executive Directors. An appraisal of the personal effectiveness of the Chairman was carried out by Neil McCausland, Senior Independent Director.

The Executive Committee

Below main Board level, the Executive Committee ("ExCo") is the most senior management body and is made up of the Chief Executive and each of her direct reports, supported by some business unit heads who report to members of the Executive Committee. ExCo works within the delegated authorities established by the Board.

The ExCo implements the strategy agreed by the Board and monitors business performance and development at a day-to-day level. It meets formally at least once a month to discuss proposals for new business development, receive financial and other performance reports, and address urgent issues which have arisen within the business requiring senior level resolution. Twice yearly it reviews the results of personal performance assessments undertaken throughout the organisation.

The Chief Executive, Chief Financial Officer and the Company Secretary attend both Board and ExCo meetings which facilitates and strengthens the communication channels between the senior leadership team and the Board and its Committees.

The Terms of reference of the ExCo were reviewed in May 2014 and are available for download from the Post Office website. The ExCo is supported by four Sub-Committees responsible for Transformation, Risk and Compliance, Commercial and Financial issues.

Risk Management

The Post Office has adopted the requirements of the FRC Guide to Corporate Governance and established an approach to the management of risk, tailored to support the Post Office strategy and the ambitious plans for expansion in its chosen markets.

Oversight of risk management is carried out by the ARC on behalf of the Post Office Board. With a reporting line to the ARC, the Risk & Compliance Committee is responsible on behalf of the ExCo for the:

- Review and challenge of risk management
- Approval and endorsement of policies to mitigate risk
- Development of the risk management framework

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This committee is chaired by the General Counsel and reports to the ExCo. The Committee comprises members of the ExCo, including the Chief Executive.

The Business also governs financial and related regulatory risk with its partner, the Bank of Ireland, through established joint regulatory risk committees.

Risk Management Framework

The components of risk management in the risk framework were set out in the 2012/13 Annual Report and Accounts and are available on the Post Office website.

The risk framework is supported by the Risk & Compliance Team, with dedicated professional resource in place to support and advise line management and assist the risk committees in their management of risk.

Progress

The ExCo has identified and refined the top risks in the organisation, focussing on those which affect the 2020 strategy. These risks, with their response plans, are regularly reviewed at the Risk & Compliance Committee and the ARC to assure the robustness of risk assessment and management.

Risk Appetite

The Post Office is developing its risk appetite statement with a view to establishing where additional risk may be taken to generate new opportunities and/or where further treatment of existing risks is required.

Business Continuity

As part of the Post Office approach to risk management, the Post Office brings together a wide range of business continuity arrangements throughout the Group under one central policy and governance framework to ensure that the business is capable of withstanding any significant threat to its on-going operations. The Post Office is committed to ensuring its business has adequate resilience and planning that protects its customers, clients, brand and reputation from business continuity threats, risks and incidents.

Draft and in confidence

Directors' Report

The Directors present the Group Annual Report and Financial Statements for the year ended 30 March 2014.

Expected future developments

Expected future developments are detailed in pages X to X.

Results and dividends

The profit after taxation for the year was £170 million (2013 £49 million). The Directors do not recommend the payment of a dividend (2013 £nil dividend).

Political contributions

No political contributions were made in the year (2013 £nil).

Research and development

There was no research and development expenditure during the year (2013 £nil).

Directors and their interests

The following served as Directors during the year:

R J Callard (appointed 26 March 2014)
C M Day
T A Franklin
V A Holmes
A Marnoch
N W McCausland
A Perkins CB
S J Storey (resigned 26 March 2014)
P A Vennells

No Director has a beneficial interest in the share capital of Post Office Limited. The emoluments of Directors are set out in the Directors' Remuneration Report which appears on pages X to X.

People

Our goal is to ensure that all employees are engaged and involved in the business and are aligned and equipped to meet business objectives. As part of our commitment to drive better service for customers we continue to focus on improving the quality of our leadership, professionalising key roles and achieving greater employee involvement in decision making.

Training and development programmes have been put in place to support our ambition to create a high performance customer-oriented sales culture. This ambition is further supported by a range of bonus schemes which are based on the achievement of business targets.

Underpinning all of this is a need for dignity at work, where everybody feels valued, is treated fairly and equally with everyone playing a full part in helping the Business to achieve its goals. Regular employee opinion surveys are conducted to allow employees an opportunity to express their views and opinions on important issues. This two-way communication encourages all employees to contribute towards making business improvements.

Draft and in confidence

Corporate Responsibility

The Post Office is committed to carrying out its activities in a socially responsible manner in respect of the environment, employees, customers and local communities. Further information can be found in the X on page X.

Disabled employees

The Post Office's policy is to give full consideration to applications for employment from disabled persons. Employees who become disabled whilst employed receive full support through the provision of training and special equipment to facilitate continued employment where practicable. The Business provides training, career development and promotion to disabled employees wherever appropriate.

Post balance sheet events

In accordance with the funding agreement with government announced on 27 October 2010, for which State Aid approval was received on 28 March 2012, Post Office Limited received £330 million of funding on 1 April 2014.

Going Concern

After analysis of the financial resources available and cash flow projections for the Post Office, the Directors have concluded that it is appropriate that the financial statements have been prepared on a going concern basis. Further details are provided in accordance with the fundamental accounting concept in note X to the financial statements.

Audit information

The Directors confirm that, so far as they are aware, there is no relevant audit information of which the auditor is unaware and that each Director has taken all reasonable steps to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information.

Auditor

The auditor, Ernst & Young LLP, is deemed to be reappointed under section 487(2) of the Companies Act 2006.

By Order of the Board

Alwen Lyons
Secretary
Post Office Limited (company number 2154540)
148 Old Street, London EC1V 9HQ

XX XXXX 2014

Draft and in confidence

**[Directors remuneration report to come after the remuneration committee on
13 May]**

Post Office Limited

Registered Number 2154540

Post Office Limited
Financial Statements
2013-2014

Note: Disclosures highlighted are to be confirmed.

Post Office Limited

Statement of directors' responsibilities [Wording TBC with EY]

The Directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the Group and of the Company and the financial performance and cash flows of the Group and of the Company for that period. Under that law the Directors have elected to prepare the Group consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and have elected to prepare the Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law.) In preparing those financial statements, the Directors are required to:

- Select suitable accounting policies and apply them consistently;
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance;
- State that applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records, which disclose, with reasonable accuracy at any time, the financial position of the Group and of the Company to enable them to ensure that the Group consolidated financial statements comply with the Companies Act 2006 and Article 4 of the IAS Regulation and the Company financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors confirm that to the best of their knowledge:

- The Group consolidated financial statements, prepared in accordance with IFRS as adopted by the EU and in accordance with the provisions of the Companies Act 2006 give a true and fair view of the assets, liabilities, financial position and profit of the Group;
- The Company financial statements prepared in accordance with United Kingdom Generally Accepted Accounting Practice, give a true and fair view of the assets, liabilities, financial position and profit of the Company; and
- The management report contained in this report includes a fair view of the development and performance of the business and the position of the Group as a whole and of the Company, together with a description of the principal risks and uncertainties they face.

Post Office Limited

Independent auditor's report to the members of Post Office Limited [Wording TBC with EY]

We have audited the consolidated financial statements of Post Office Limited for the 52-week period ended 30 March 2014 which comprise the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated statement of cash flows, the Consolidated balance sheet, the Consolidated statement of changes in equity and the related notes 1 to 24. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's 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 company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page X, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the group financial statements:

- give a true and fair view of the state of the group's affairs as at 30 March 2014 and of its profit for the 52-week period then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the group financial statements are prepared is consistent with the group financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the parent company financial statements of Post Office Limited for the 52 week period ended 30 March 2014.

Angus Grant (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London
[Date]

Post Office Limited

Consolidated income statement
for the 52 weeks ended 30 March 2014 and the 53 weeks ended 31 March 2013

	Notes	2014 £m	2013 £m
Continuing operations			
Turnover		979	1,024
Network Subsidy Payment		200	210
Revenue		1,179	1,234
People costs excluding restructuring costs	3	(255)	(259)
Other operating costs		(850)	(913)
Share of post tax profit from joint ventures and associates	11	33	32
Operating profit before exceptional items	4	107	94
Operating exceptional items	5	45	(47)
- government grant		317	98
- Royal Mail Pension Plan amendment		102	-
- restructuring costs		(259)	(79)
- other		(115)	(66)
Operating profit		152	47
Profit on disposal of property, plant and equipment		3	2
Loss on sale of associate	11	-	(30)
Profit before financing and taxation		155	19
Finance costs	7	(3)	(4)
Finance income	7	1	1
Net financing income relating to pensions	18	5	2
Profit before taxation		158	18
Taxation credit	8	12	31
Profit for the financial year from continuing operations		170	49

Post Office Limited

Consolidated statement of comprehensive income
for the 52 weeks ended 30 March 2014 and the 53 weeks ended 31 March 2013

	Notes	2014 £m	2013 £m
Profit for the financial year from continuing operations		170	49
Other comprehensive income:			
Remeasurements on defined benefit surplus	18	(52)	14
Income tax effect	8	(2)	(21)
Total comprehensive income for the year		116	42

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

Post Office Limited

Consolidated statement of cash flows
for the 52 weeks ended 30 March 2014 and the 53 weeks ended 31 March 2013

	Notes	2014 £m	2013 £m
Cash flows from operating activities			
Operating profit before exceptional items		107	94
Adjustment for:			
Depreciation and amortisation	4	-	-
Share of profit from joint ventures and associates	11	(33)	(32)
Pension operating costs		27	25
Working capital movements:		(20)	63
Decrease/(increase) in trade and other receivables		45	(138)
(Decrease)/increase in trade and other payables		(67)	199
Decrease/(increase) in inventories		2	(2)
Increase in non-exceptional provisions		-	4
Pension operating costs paid		(24)	(26)
Cash receipts in respect of operating exceptional items:		12	133
Government grant		215	200
Restructuring costs		(170)	(52)
Other		(33)	(15)
Net cash inflow from operating activities		69	257
Income tax recovered		11	11
Cash flows from investing activities			
Investment in associate		-	(11)
Dividends received from joint ventures and associates	11	32	40
Finance income received		1	1
Proceeds from sale of property, plant and equipment		3	2
Proceeds from disposal of associate		-	2
Purchase of non-current assets		(101)	(58)
Net cash outflow from investing activities		(65)	(24)
Net cash inflow before financing activities		15	244
Cash flows from financing activities			
Finance costs paid		(3)	(3)
Payments to finance lease creditors		(4)	(3)
Repayment of borrowings from BIS		(291)	(86)
Net cash outflow from financing activities		(298)	(92)
Net (decrease)/increase in cash and cash equivalents		(283)	152
Effect of exchange rates on cash and cash equivalents		-	(1)
Cash and cash equivalents at the beginning of the year	13	971	820
Cash and cash equivalents at the end of the year	13	688	971

Post Office Limited

Consolidated balance sheet
at 30 March 2014 and 31 March 2013

	Notes	2014 £m	2013 £m
Non-current assets			
Intangible assets	9	-	-
Property, plant and equipment	10	10	11
Investments in joint ventures and associates	11	61	60
Retirement benefit surplus	18	148	97
Trade and other receivables	12	15	10
Total non-current assets		234	178
Current assets			
Inventories		6	8
Trade and other receivables	12	302	352
Cash and cash equivalents	13	738	971
Financial assets – derivatives	17	-	1
Total current assets		1,046	1,332
Total assets		1,280	1,510
Current liabilities			
Trade and other payables	14	(767)	(874)
Financial liabilities – interest bearing loans and borrowings	15	-	(291)
– obligations under finance leases	21	(3)	(3)
Provisions	16	(70)	(19)
Total current liabilities		(840)	(1,187)
Non-current liabilities			
Financial liabilities – obligations under finance leases	21	-	(4)
Other payables	14	(28)	(24)
Provisions	16	(8)	(7)
Total non-current liabilities		(36)	(35)
Net assets		404	288
Equity			
Share capital	19	-	-
Share premium		465	465
Retained earnings		(63)	(179)
Other Reserves		2	2
Total equity		404	288

The financial statements on pages XX to XX were approved by the Board of Directors on XXX 2014 and signed on its behalf by:

P A Vennells
Chief Executive

C M Day
Chief Financial Officer

Post Office Limited

Consolidated statement of changes in equity for the 52 weeks ended 30 March 2014 and the 53 weeks ended 31 March 2013

	Notes	Share premium £m	Retained earnings £m	Other reserves £m	Total equity £m
At 1 April 2013		465	(179)	2	288
Profit for the year		-	170	-	170
Remeasurements on defined benefit surplus	18	-	(52)	-	(52)
Income tax effect	8	-	(2)	-	(2)
At 30 March 2014		465	(63)	2	404

Other reserves of £2 million relate to First Rate Exchange Services Holdings Limited, the joint venture entity.

	Notes	Share premium £m	Retained earnings £m	Other reserves £m	Total equity £m
At 26 March 2012		465	(552)	47	(40)
Profit for the year		-	49	-	49
Remeasurements on defined benefit surplus	18	-	14	-	14
Transfer of pension deficit to government	18	-	286	-	286
Sale of interest in associate		-	45	(45)	-
Income tax effect	8	-	(21)	-	(21)
At 31 March 2013		465	(179)	2	288

Post Office Limited

Notes to the financial statements

1. Accounting Policies

Financial year

The financial year ends on the last Sunday in March and for this reason these financial statements are made up to the 52 weeks ended 30 March 2014 (2013 – 53 weeks ended 31 March 2013).

Basis of preparation

The financial statements on pages XX to XX have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. Unless otherwise stated in the accounting policies below, the financial statements have been prepared under the historic cost accounting convention.

The Company is incorporated and domiciled in the United Kingdom. The Group consolidated financial statements are presented in Sterling and all values are rounded to the nearest £m except where otherwise indicated.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiary undertaking. Subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies. All intra-group balances, transactions, unrealised gains and losses resulting from intra-group transactions are eliminated in full.

Changes in accounting policy and disclosures

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 19R is not material in the opinion of the Directors. IAS 19R 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 19R 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.

Accounting standards issued but not yet applied

The following new and revised accounting standards are relevant to the Group and are in issue but were not effective (and in some instances have not yet been adopted by the EU) at the balance sheet date:

- IFRS 9 Financial Instruments
- IAS 32 Offsetting Financial Assets and Liabilities

The Directors do not expect that the adoption of the standards listed above will have a material impact on the financial statements of the Group in future periods.

Fundamental 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 financial statements have been prepared on a going concern basis.

The Group has net assets at 30 March 2014 and has operated at a profit before exceptional items during 2013-14 for the sixth year running. A funding agreement with Government was announced on 27 October 2010 which provided for:

- Funding of £410 million for 2012-13
- Funding of £415 million for 2013-14
- Funding of £330 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 31 March 2016

State Aid approval for the funding for 2012-13 to 2014-15 was received on 28 March 2012 and it was also recognised that the working capital facility was no longer deemed State Aid. £410 million was received on 2 April 2012 and £415 million was received on 2 April 2013.

Post Office Limited

An additional funding agreement with Government was announced on 27 November 2013 which provided for:

- Funding of £280 million for 2015-16
- Funding of £220 million for 2016-17
- Funding of £140 million for 2017-18
- Extension of the existing working capital facility with the Department for Business, Innovation & Skills (BIS) amended with a limit of £950 million from 31 March 2015 up to 31 March 2018

State Aid approval for the funding for 2015-16 to 2017-18 has not yet been received.

This investment takes 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 dependant on direct subsidy. This programme will not involve branch closures.

The Directors are satisfied with the continued progress made towards modernisation during 2013-14 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.

Critical accounting estimates and judgements in applying accounting policies

The Group makes certain estimates and assumptions regarding the future. Estimates and assumptions are continually evaluated based on historical experience and other factors. In the future, actual experience may differ from these estimates and assumptions. In addition the Group has to make judgements in applying its accounting policies which affect the amounts recognised in the accounts. The most significant areas where judgements and estimates are made are discussed below:

Pension assumptions

The costs, assets and liabilities of the pensions operated by the Group are determined using methods relying on actuarial estimates and assumptions. These pension figures are particularly sensitive to changes in assumptions for discount rates, mortality and inflation rates. The Group exercises its judgement in determining the assumptions to be adopted, after discussion with its Actuary. Details of the key assumptions are set out in note 18.

Pension liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term. Judgement has been applied in determining that for these purposes a high quality corporate bond constitutes AA rated or equivalent status bonds.

The prior year pension deficit transfer to HM Government on 1 April 2012 was taken directly through equity, as in management's judgement this transaction was undertaken with HM Government in its capacity as the owner of Royal Mail Holdings plc, the Company's former parent company, rather than in its capacity as government.

Provisions

The Group has recognised provisions where a present legal or constructive obligation exists as a result of a past event, where it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. Provisions are detailed in note 16. Due to the nature of provisions the future amount settled may be different from the amount that has been provided.

Impairment of non-current assets

The Group assesses whether there are any indicators of impairment for all non-currents assets at each reporting date. Due to ongoing operational losses (excluding the 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.

Revenue

Turnover from Government, financial, mails and telephony services comprises the value of services provided. Turnover from all other products comprises the commission received excluding VAT, from the Group's principal activities in providing access to a wide range of financial and retail services through its network of post office branches across the UK and other channels. Turnover relating to line rental for telephony services is recognised evenly over the period to which the charges relate and revenue from calls is recognised at the time the call is made. Turnover from all other transactions is recognised when the transaction is completed. All turnover is derived wholly from within the United Kingdom.

The Network Subsidy Payment is Government grant revenue recognised to match the related costs of making available the network of public Post Offices that the Secretary of State for Business, Innovation and Skills considers appropriate.

Net revenue

Net revenue is calculated using revenue less the directly attributable costs of delivering the service or product.

Post Office Limited

Operating exceptional items

Operating exceptional items 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 in the year, in comparison to prior years.

Intangible assets

Intangible assets acquired separately or generated internally are initially recognised at cost and are reviewed for impairment. An impairment loss is recognised in the income statement for the amount by which the carrying value of the asset exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Amortisation of intangible assets with finite lives is charged annually to the income statement on a straight-line basis as follows.

Software	1 to 6 years
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Where intangible assets are impaired to their recoverable amount on acquisition the above range of asset lives is not applied.

Property, plant and equipment

Property, plant and equipment is recognised at cost, including attributable costs in bringing the asset into working condition for its intended use.

Depreciation of tangible fixed assets is provided on a straight-line basis by reference to cost and to the remaining useful economic lives of assets and their estimated residual values. The lives assigned to major categories of tangible fixed assets are:

	Range of asset lives
Land and buildings:	
Freehold land	Not depreciated
Freehold buildings	Up to 50 years
Leasehold buildings	The shorter of the period of the lease, 50 years or the estimated remaining useful life
Plant and Machinery	3 – 15 years
Motor vehicles and trailers	2 – 12 years
Fixtures and equipment	2 – 15 years

Where property, plant and equipment is impaired to its recoverable amount on acquisition the above ranges of asset lives are not applied. This is currently the case for plant and machinery, motor vehicles and trailers and fixtures and equipment.

Impairment reviews

Unless otherwise disclosed in these accounting policies, assets are reviewed for impairment if events or changes in circumstances indicate that the carrying value may be impaired. The Group assesses at each reporting date whether such indications exist. Where appropriate, an impairment loss is recognised in the income statement for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Leases

Finance leases, where substantially all the risks and rewards incidental to ownership of the leased item have passed to the Group are capitalised at the inception of the lease with a corresponding liability recognised for the fair value of the leased item or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Leases where substantially all the risks and rewards of ownership of the asset are retained by the lessor, are classified as operating leases and rentals are charged to the income statement over the lease term. The aggregate benefit of incentives are recognised as a reduction of rental expenses over the lease term on a straight-line basis.

Investments in joint ventures and associates

Investments in joint ventures and associates within the Group's financial statements are accounted for under the equity method of accounting. Under this method the investment is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of the net assets of the joint venture/associates less any impairment in value. The income statement reflects the Group's share of post tax profits from the joint venture/associates. The financial statements of the joint venture are prepared for the same reporting period as the Group. [Further wording in relation to the nature of the relationship with the joint venture TBC].

Inventories

Inventories include printing and stationery, retail and lottery products, is carried at the lower of cost and net realisable value after adjusting for obsolete or slow-moving stock.

Taxation

The charge for current income tax is based on the results for the year as adjusted for items which are not taxed or are disallowed. It is calculated using tax rates in legislation that has been enacted or substantively enacted by the balance sheet date.

Deferred income tax assets and liabilities are recognised for all taxable and deductible temporary differences and unused tax assets and losses except:

Post Office Limited

- initial recognition of goodwill
- the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit and loss.
- taxable temporary differences associated with investments in subsidiaries, associates and interest in joint ventures, where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future and
- deferred tax assets are recognised only to the extent that it is probable that taxable profit will be available against which they can be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the tax asset is realised or the liability is settled, based on tax rates that have been substantively enacted at the balance sheet date. Deferred tax balances are not discounted.

Current and deferred tax is recognised in the income statements, except to the extent that it relates to items recognised in other comprehensive income or directly to equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively. Further details on deferred tax can be found in note 8 to the financial statements.

Pensions and other post-retirement benefits

People working for the Company were employed by Royal Mail Group Limited and seconded to the Company until 31 March 2012. On 1 April 2012 they were transferred to be directly employed by the Company. Membership of occupational pension schemes is open to most permanent UK employees of the Company. All members of defined benefit schemes are contracted out of the earnings-related part of the State pension scheme.

The pension assets of the defined benefit schemes are measured at fair value. Liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term. The resulting defined benefit asset or liability is presented separately on the face of the balance sheet. Full actuarial funding valuations are carried out at intervals not normally exceeding three years as determined by the Trustees and, actuarial valuations are carried out at each balance sheet date and form the basis of the surplus or deficit disclosed.

For defined benefit schemes, the amounts charged to operating profit, as part of staff costs, are the current service costs and any gains and losses arising from settlements, curtailments and past service costs. The net difference between the interest costs and the expected return on plan assets is recognised as net pensions interest in the income statement. Actuarial gains and losses are recognised immediately in the statement of comprehensive income. Any deferred tax movement associated with the actuarial gains and losses is also recognised in the statement of comprehensive income.

For defined contribution schemes, the Group's contributions are charged to operating profit, as part of staff costs, in the period to which the contributions relate.

Foreign currencies

The functional and presentational currency of the Group is sterling (£).

Transactions in foreign currencies are recorded at the spot exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional rate of exchange ruling at the balance sheet date. Currently hedge accounting is not applied to any monetary assets and liabilities. All differences are therefore taken to the income statement.

Trade receivables

Trade receivables are recognised and carried at original invoice amount less an allowance for any non-collectable amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

Borrowing costs

Borrowing costs in relation to the working capital loan facility are recognised as an expense when incurred unless they are directly attributable to the construction or development of a qualifying asset, in which case they are capitalised using the weighted average cost of borrowing for the period of construction/development.

Government grants

Government grants are shown separately in the income statement to match the expenditure to which they relate.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probably that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at an appropriate pre-tax rate.

Financial instruments

The classification of financial instruments included on the balance sheet is set out below:

Financial assets

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Financial assets are classified into the following categories: at fair value through the income statement, loans and receivables, and available for sale as appropriate based on the purpose for which they were required. Financial liabilities are classified as either fair value through the income statement or as financial liabilities measured at amortised cost.

Financial liabilities – interest-bearing loans and borrowings

All loans and borrowings are classified as financial liabilities measured at amortised cost.

Financial liabilities – obligations under finance leases

All obligations under finance lease and hire purchase contracts are classified as financial liabilities measured at amortised cost.

Derivative financial instruments

The Group uses derivative financial instruments to manage its exposure to fluctuations in foreign exchange rates. Such derivative financial instruments are stated at fair value. Hedge accounting has not been claimed for foreign exchange derivative instruments.

Fair value measurement of financial instruments

The fair value of quoted investments is determined by reference to bid prices at the close of business on the balance sheet date.

Where there is no active market, fair value is determined using valuation techniques. These include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; and discounted cash flow analysis and pricing models. Specifically, in the absence of quoted market prices, derivatives are valued by using quoted forward prices for the underlying currency and discounted using quoted interest rates. Hence derivative assets and liabilities are within Level 2 of the fair value hierarchy as defined within IFRS 7.

For the purposes of disclosing the fair value of investments held at amortised cost in the balance sheet, in the absence of quoted market prices, fair values are calculated by discounting the future cash flows of the financial instrument using quoted equivalent interest rates as at close of business on the balance sheet date.

Derecognition of financial instruments

A financial asset or liability is derecognised when the contract that gives rise to it is settled, sold, cancelled or expires.

Cash and cash equivalents

Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits (cash equivalents) with an original maturity date of three months or less. In addition the Group uses Money Market funds as a readily available source of cash, and these funds are also categorised as cash equivalents.

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of bank overdrafts. Cash equivalents are classified as loans and receivables financial instruments.

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2. Segmental reporting

In accordance with IFRS 8 'Operating segments,' an operating segment is defined as a business activity whose operating results are reviewed by the chief operating decision maker ('CODM') and for which discrete information is available. The Group's CODM is the Executive Committee as defined in the Corporate Governance section on page XX.

The CODM has determined the operating segments based in the information reviewed by them for the purposes of allocating resources and assessing performance. Operating segments have not been aggregated in order to present reportable segments. All segmental activities are located wholly within the United Kingdom.

The CODM assesses the performance of the operating segments based on net revenue. This is calculated using segmental revenue less the directly attributable costs of delivering the service or product. The net revenue measure excludes the effect of indirect costs and the effects of non-recurring expenditure such as redundancy costs and asset impairment. Interest income and expenditure is not allocated to segments as this type of activity is driven by the central treasury function.

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. The information reviewed by the CODM does not include assets or liabilities split by segment. A description of the activities of the business segments is included from page XX of the Operational review.

Revenue from a major customer represents approximately 30% of the Group's total revenue in 2014. This revenue was reported within the Mails & Retail segment.

	2014		
	Revenue £m	Directly Attributable Costs £m	Net Revenue £m
Mails & Retail	390	(4)	386
Financial Services	279	(1)	278
Government Services	146	(30)	116
Telecoms	124	(78)	46
Other	40	-	40
Sub total	979	(113)	866
Network Subsidy Payment	200	-	200
Total	1,179	(113)	1,066

	2013		
	Revenue £m	Directly Attributable Costs £m	Net Revenue £m
Mails & Retail	409	(5)	404
Financial Services	281	(1)	280
Government Services	164	(30)	134
Telecoms	129	(85)	44
Other	41	-	41
Sub- total	1,024	(121)	903
Network Subsidy Payment	210	-	210
Total	1,234	(121)	1,113

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

	2014 £m	2013 £m
Underlying segment net revenue	1,066	1,113
Indirect costs	(992)	(1,051)
Share of post tax profit from joint ventures and associates	33	32
Operating profit before exceptional items	107	94
Operating exceptional items	45	(47)
Operating profit	152	47
Profit on disposal of property, plant and equipment	3	2
Loss on sale of associate	-	(30)
Profit before financing and taxation	155	19
Finance costs	(3)	(4)
Finance income	1	1
Net pensions interest	5	2
Profit before taxation	158	18

3. Staff costs and numbers

Employment and related costs were as follows:

	2014 £m	2013 £m
People costs excluding restructuring costs:		
Wages and salaries	208	215
Social security costs	20	19
Pension costs (note 18)	27	25
Total	255	259

	Period end employees		Average employees	
	2014	2013	2014	2013
Total employees	7,787	7,886	7,950	7,842

Total employee numbers can be categorised as follows:

	2014	2013
Administration	1,691	1,345
Crown Offices	3,946	4,511
Supply Chain	1,553	1,585
Network and Crown transformation programmes	597	445
Total	7,787	7,886

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4. Operating profit from continuing operations before exceptional items

Operating profit from continuing operations before exceptional items is stated after charging:

	2014 £m	2013 £m
Subpostmasters' fees	448	478
Bureau de Change foreign currency exchange losses/(gains)	2	(1)
Depreciation	-	-
Operating lease charges – Land and buildings	19	20
- Vehicles and equipment	42	62
Fees payable to the group's auditors for audit and other services:	£000	£000
- parent company and group audit	329	309
-audit related assurance services	40	22
-other non-audit services	106	103

5. Operating exceptional items

	2014 £m	2013 £m
Government grant	317	98
Royal Mail Pension Plan amendment	102	-
Restructuring:		
Business transformation	(5)	(4)
Network transformation including subpostmasters compensation	(191)	(52)
Crown transformation	(9)	-
Restructuring – severance	(23)	(11)
- other	(31)	(12)
Other:		
Impairment of intangible assets (note 9)	(42)	(25)
Impairment of property, plant and equipment (note 10)	(73)	(41)
Total operating exceptional items	45	(47)

For further information in relation to the Royal Mail Pension Plan amendment refer to note 18. Restructuring costs are those incurred in order to implement the major transformation programmes primarily the Crown and Network programmes which are discussed further in the Financial Review on page XX. 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.

6. Directors' emoluments

The Directors received the following emoluments:

	2014 £000	2013 £000
Emoluments, excluding pension contributions and LTIP*	TBC	1,129
Contributions to pension schemes	-	1
Amounts receivable under Long-Term Incentive Plans	TBC	218

*Figures include any cash supplements received in lieu of pension.

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	2014	2013
Directors accruing pension entitlements during the period under:		
	Number	Number
Defined benefit schemes	-	0
Defined contribution schemes	-	-

The highest paid Director received the following emoluments:

	2014 £000	2013 £000
Emoluments and LTIP, excluding pension contributions but including cash supplements received in lieu of pensions	TBC	698
Company contributions to pension schemes	-	1

7. Net finance costs

	2014 £m	2013 £m
Interest receivable	1	1
Interest charge, unwinding discount on provisions	(1)	(1)
Interest payable on loans	(2)	(3)
Total	(2)	(3)

8. Taxation**(a) Taxation gains recognised in the year**

	2014 £m	2013 £m
Corporation tax credit for year	(9)	(10)
Tax under provided in previous years	(1)	-
Current tax	(10)	(10)
Deferred tax credit relating to the origin and reversal of temporary differences	(5)	(21)
Effect of change in tax rate	3	-
Income tax credit reported in the consolidated income statement	(12)	(31)

Deferred income tax of £2 million (2013 £21 million) has been charged to equity relating to actuarial movements in the retirement benefit surplus. This offsets the deferred tax credit of £2 million (2013 £21 million) that has been reported in the consolidated income statement.

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(b) Factors affecting current tax credit on profit on ordinary activities

The tax assessed for the year differs from the standard rate of corporation tax in the UK of 23% (2013 24%). The differences are explained below:

	2014 £m	2013 £m
Profit on ordinary activities before tax	158	18
Profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 23% (2013 24%)	36	4
Net decrease in tax charge resulting from recognition of deferred tax assets	(41)	(35)
Expenditure disallowable for tax	1	1
Adjustment in respect of prior period	(1)	-
Losses from disposals ineligible for relief	-	7
Effect of group relief surrenders to other companies	1	-
Associates/joint venture profit after tax included in Group pre-tax profit	(8)	(8)
Total current tax (see above)	(12)	(31)

(c) Deferred tax

Deferred tax assets relate to the following:

	Balance sheet		Income statement	
	2014 £m	2013 £m	2014 £m	2013 £m
Pensions temporary differences	(21)	(21)	-	-
Losses available for offset against future taxable income	21	21	2	21
Total deferred tax asset	-	-		
Income statement			2	21

(d) Factors that may affect future tax charges

The Group has unrecognised deferred tax assets of £144 million (2013 £190 million), comprising £94 million (2013 £133 million) relating mainly to fixed asset timing differences, £5 million (2013 £0 million) relating to timing differences on provisions and £45 million (2013 £57 million) relating to tax losses that are available to offset against future taxable profits. The Group has rolled over capital gains of £3 million (2013 £3 million); no tax liability would be expected to crystallise should the assets into which the gains have been rolled be sold at their residual value, as it is anticipated that a capital loss would arise.

Finance Act 2013 reduced the main rate of corporation tax to 21% with effect from 1 April 2014 and to 20% with effect from 1 April 2015. Following these changes the deferred tax balances were reduced from 23% to 20%. The impact of this change on deferred tax balances is included in these financial statements.

(e) Tax effect of exceptional items

There is a tax credit on exceptional items of £nil (2013 £nil). This is calculated on a "with and without" basis assuming that losses are surrendered to joint ventures.

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9. Intangible assets

Cost	2014	2013
	£m	£m
At 1 April 2013, 26 March 2012	208	183
Additions	42	25
Disposals	(7)	-
At 30 March 2014, 31 March 2013	243	208
Amortisation and impairment		
At 1 April 2013, 26 March 2012	208	183
Disposals	(7)	-
Impairment (see note 5)	42	25
At 30 March 2014, 31 March 2013	243	208
Net book value		
At 30 March 2014, 31 March 2013	-	-

The above intangible assets relate to software.

10. Property, plant and equipment

	Land and Buildings				Plant and machinery	Fixtures and equipment	Total
	Freehold	Long leasehold	Short leasehold	Motor vehicles			
	£m	£m	£m	£m	£m	£m	£m
Cost							
At 1 April 2013	87	18	114	42	1	719	981
Reclassification	(5)	-	3	-	-	2	-
Additions	20	-	4	7	-	41	72
Disposals	(2)	(1)	(8)	(5)	-	(23)	(39)
At 30 March 2014	100	17	113	44	1	739	1,014
Depreciation							
At 1 April 2013	77	17	114	42	1	719	970
Impairment (see note 5)	16	-	7	7	-	43	73
Disposals	(2)	(1)	(8)	(5)	-	(23)	(39)
At 30 March 2014	91	16	113	44	1	739	1,004
Net book value							
At 30 March 2014	9	1	-	-	-	-	10
At 31 March 2013	10	1	-	-	-	-	11

Depreciation rates are disclosed within accounting policies (note 1). No depreciation is provided on freehold land, which represents £3 million (2013 £3 million) of the total cost of properties.

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11. Investments in joint ventures and associates

The following entities have been included in the consolidated financial statements using the equity method:

Joint ventures

During 2013-14 and 2012-13, the Group's only joint venture investment was a 50% interest (1,000 £1 ordinary A shares) in First Rate Exchange Services Holdings Limited, whose principal activity is the provision of Bureau de Change. First Rate Exchange Services Holdings Limited is a company registered in the United Kingdom.

Associates

During 2012-13, the Group's only associate investment was a 49.99% interest (4,999 £0.01 ordinary A shares) in Midasgrange Limited, whose principal activity is the provision of personal financial products. This investment was disposed of during the year ended 31 March 2013.

	Joint venture £m	Total £m
Share of net assets		
Total net investment at 1 April 2013	60	60
Share of post tax pre dividend profit	33	33
Dividend	(32)	(32)
Total net investment at 30 March 2014	61	61

	Joint venture £m	Associate £m	Total £m
Share of net assets			
Total net investment at 26 March 2012	67	22	89
Share of post tax pre dividend profit/ (loss)	33	(1)	32
Investment in associate	-	11	11
Disposal	-	(32)	(32)
Dividend	(40)	-	(40)
Total net investment at 31 March 2013	60	-	60

	2014	2013
	Joint venture £m	Joint venture £m
Share of assets and liabilities:		
Current assets	175	184
Non-current assets	5	3
Share of gross assets	180	187
Current liabilities	(119)	(127)
Share of net assets	61	60
Share of revenue and profit:		
Revenue	77	75
Profit after tax	33	33

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12. Trade and other receivables

	2014 £m	2013 £m
Current:		
Trade receivables	54	32
Prepayments and accrued income	82	71
Client receivables	158	240
Other receivables	8	9
Total	302	352
Non-current:		
Prepayments and accrued income	15	10

The Group receives and disburses cash on behalf of Government agencies and other clients to customers through its branch network. Amounts owed from/to government agencies and other clients are disclosed separately as client receivables (as above) and client payables (see note 14).

As at 30 March 2014 trade and other receivables of £17 million (2013 £16 million) were impaired and fully provided for. During the year £2 million (2013 £2 million) of the provision has been utilised and an additional £3 million (2013 £4 million) has been provided for. Trade and other receivables of £18 million (2013 £8 million) were past due but not impaired. The aging analysis of the past due amounts are as follows:

	2014 £m	2013 £m
Provided for or not yet overdue	36	24
Past due not more than one month	10	7
Past due more than one month and not more than two months	2	1
Past due more than two months	6	-
Total	54	32

The fair value of trade and other receivables is not materially different from the carrying value.

13. Cash and cash equivalents

	2014 £m	2013 £m
Cash in the Post Office Limited network	708	870
Short-term bank deposits	30	15
Money market fund investments	-	86
Total cash and cash equivalents	738	971

Cash and cash equivalents comprise amounts held physically in cash, cash deposits available on demand or for three months or less. For the purposes of the consolidated statement of cash flows, cash and cash equivalents consists of £738 million defined above, net of a bank overdraft of £50 million which is disclosed in note 14.

Where interest is earned it is at a floating or short term fixed rate. The fair value of cash and cash equivalents is not materially different from the carrying value.

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14. Trade and other payables

	2014 £m	2013 £m
Current:		
Bank overdraft	50	-
Trade payables	54	49
Accruals and deferred income	133	110
Advance customer payments	37	50
Social security	14	10
Client payables	438	528
Capital payables	31	18
Business transformation	10	7
Government Grant deferred income	-	102
Total	767	874
Non-current:		
Other payables	28	24

Of the £215 million (2013 £200 million) Government Grant received £215 million (2013 £98 million) has been allocated against income statement expenditure in accordance with the terms and conditions of the Grant. The remaining £nil (2013 £102 million) has been deferred into the balance sheet as disclosed above. The fair value of trade and other payables is not materially different from the carrying value.

15. Financial liabilities – interest bearing loans and borrowings

	2014 £m	2013 £m
Department of Business, Innovation & Skills loans drawn down	-	291

The loans under the facility are short dated on a programme of liquidity management and mature on average 1 day after the year end (2013 1 day). The fair value of borrowings is not materially different from the carrying value. On maturity it is expected that further loans will be drawn down under this facility, which expires in 2016. The undrawn committed facility, in respect of which all conditions precedent had been met at the balance sheet date is £1,150 million (2013 £859 million). The average interest rate on the drawn down loans is 1.0% (2013 1.0%).

The facility is currently restricted to funding the cash and near cash items held within the Post Office Limited network.

The facility (including drawn down loans) is secured by a floating charge over all assets of Post Office Limited and a negative pledge over cash and near cash items. The negative pledge is an agreement not to grant security over the assets or to set up a vehicle that has the same effect.

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16. Provisions

	Crown Conversions Project £m	Network Transformation £m	Other £m	Total £m
At 1 April 2013	7	10	9	26
Charged in operating exceptional items	(2)	93	27	118
Charged in operating costs	-	-	6	6
Utilisation	(3)	(52)	(17)	(72)
At 30 March 2014	2	51	25	78
Disclosed as:				
Current	2	48	20	70
Non - current	-	3	5	8
	2	51	25	78

The Crown Conversions project relates to past franchising of Crown offices and onerous property lease provisions are expected to be utilised within 4 years.

The Network Transformation provision relates to the major transformation programme which is discussed further in the Financial Review on page XX.

Other provisions of £25 million (2013 £9 million) include property contracts, onerous lease obligations and personal injury claims.

17. Financial assets and liabilities

The Group's financial assets and liabilities are shown in the table below:

	2014			2013		
	Current	Non current	Total	Current	Non current	Total
	£m	£m	£m	£m	£m	£m
Cash and cash equivalents	738	-	738	971	-	971
Derivative assets	-	-	-	1	-	1
Bank overdraft	(50)	-	(50)	-	-	-
BIS loan	-	-	-	(291)	-	(291)
Finance leases obligations	(3)	-	(3)	(3)	(4)	(7)
Total financial assets/ (liabilities)	685	-	685	678	(4)	674

The Group's principal financial assets and liabilities comprise cash, money market liquidity investments, loans and finance leases. The Group has various other financial instruments such as trade receivables and trade payables, which arise directly from operations are disclosed further in notes 12 and 14.

The Group enters into derivative transactions, which create derivative assets and liabilities, principally forward currency contracts. The purpose is to manage the currency risks arising from the Group's operations.

The main risks arising from the Group's financial assets and liabilities are interest rate risk, liquidity risk, foreign currency risk and credit risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below:

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Interest rate risk

The Group's exposure to market risk for changes in interest rates relates to the Group's debt obligations and interest bearing financial assets. The BIS loans to Post Office Limited of £nil (2013 £291 million) are at short-dated fixed interest rates – average maturity 1 day (2013 average 1 day). On maturity it is expected that further loans will be drawn down under this facility which expires in 2016. The total interest bearing financial liabilities of the Group of £20 million (2013 assets of £92 million) are at short-dated fixed or variable interest rates.

The table below sets out the carrying amount by maturity of the Group's financial instruments that are exposed to interest rate risk.

Financial year ended 31 March 2014

	Average Effective interest rate	Within one year £m	1-2 years £m	2-5 years £m	More than 5 years £m	Total £m
Fixed rate						
Short-term bank deposits /(overdrafts)	0.5	(20)	-	-	-	(20)
BIS loan	1.0	-	-	-	-	-
Obligations under finance leases	TBC	(3)	-	-	-	(3)
Total		(23)	-	-	-	(23)
Floating rate						
Money market fund investments	0.4	-	-	-	-	-
Non-interest bearing						
Cash in Post Office network	-	708	-	-	-	708
Net total financial assets		685	-	-	-	685

Financial year ended 31 March 2013

	Average Effective interest rate	Within one year £m	1-2 years £m	2-5 years £m	More than 5 years £m	Total £m
Fixed rate						
Short-term bank deposits	0.5	6	-	-	-	6
BIS loan	1.0	(291)	-	-	-	(291)
Obligations under finance leases	10.0	(3)	(4)	-	-	(7)
Total		(288)	(4)	-	-	(292)
Floating rate						
Money market fund investments	0.5	86	-	-	-	86
Non-interest bearing						
Cash in Post Office network	-	870	-	-	-	870
Derivative assets	-	1	-	-	-	1
Total		871	-	-	-	871
Net total financial assets/(liabilities)		669	(4)	-	-	665

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Foreign currency risk

The Group is exposed to foreign currency risk resulting from balances held to operate Bureau de Change services. The Group's foreign currency risk management objective is to minimise the impact on the Income Statement of fluctuations in the exchange rates. The Group aims to hedge 90% of significant forecast future currency balances (principally but not restricted to US dollar and Euro) to match the anticipated holding period of the currency. The Group hedges its foreign currency risk principally through external forward foreign currency contracts with a number of providers including First Rate Exchange Services Holdings Limited.

Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. Financial credit risk arises from cash balances (including bank deposits and cash and cash equivalents) held by the Group and business credit risk arises from exposures to customers. Business risk includes commissions receivable and client related settlements for amounts paid out of the Post Office network on their behalf.

The Group aims to minimise its financial credit risk through the application of risk management policies approved by the Board. Counterparties are limited to major banks and financial institutions. The policy restricts the exposure to any one counterparty by setting appropriate credit limits.

Business credit risk is monitored centrally. The individual relationships and the contracts attached to them are managed by dedicated teams and procedures are place to monitor any concentrations of credit risk. The level of bad debt incurred for the Group is less than 2% (2013 less than 1%) of turnover.

Capital management

The Group's objectives when managing capital (defined as the net of borrowings and amounts due under finance leases and cash and cash equivalents excluding cash in the Post Office Network) are to safeguard its ability to continue as a going concern and to maintain an optimal capital structure in order to support the business and maximise stakeholder value. In managing the Groups capital levels the Board and the Executive Committee regularly monitor the level of debt in the Group, the working capital requirements and the forecast cash flows. The Board and Executive Committee plan accordingly following this review process in order to meet the Group's capital management objectives.

Liquidity risk

The Group's primary objective is to ensure that the Group has sufficient funds available to meet its financial obligations as they fall due. This is achieved by aligning short-term investments and borrowing facilities with forecast cash flows. Typical short-term investments include short term bank deposits with approved counterparties. Borrowing facilities are regularly reviewed to ensure continuity of funding. The unused facility for the Group of £1,150 million (2013 £859 million) expires in 2016.

Sensitivity

As a result of the mix of fixed and variable rate financial instruments and the currency hedge programmes in place, the group has no material exposure to risk from interest rate or exchange rate prices.

The tables below set out the gross (undiscounted) contractual cash flows of the Group's financial liabilities. For loans and finance leases, these cash flows represent the undiscounted total amounts payable including interest.

	2014		
	BIS Loan	Finance Lease	Total
Amounts falling due in:	£m	£m	£m
One year or less	-	(3)	(3)
More than 1 year but not more than 2 years	-	-	-
More than 2 years but not more than 5 years	-	-	-
More than 5 years	-	-	-
Total	-	(3)	(3)

	2013		
	BIS Loan	Finance Lease	Total
Amounts falling due in:	£m	£m	£m
One year or less	291	4	295
More than 1 year but not more than 2 years	-	4	4
More than 2 years but not more than 5 years	-	-	-
More than 5 years	-	-	-
Total	291	8	299

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18. Pensions

The disclosures in this note relating to the year ended 30 March 2014 and the comparatives for the year ended 31 March 2013 reflect the Post Office Limited sectionalised RMPP scheme which is independently operated by the Group and the approximate 7% share of the RMSEPP scheme. Royal Mail Group Limited is the principal employer in Royal Mail Senior Executive Pension Plan (RMSEPP) and Post Office Limited became a participating employer with effect from 1 April 2012.

During the year 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 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.

IAS 19R 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 19R retrospectively is not material to the Group, and therefore no restatement has been required.

The disclosures in this note show how the value of the assets and liabilities have been calculated at the balance sheet date.

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

Defined Contribution

The charge in the income statement for the defined contribution schemes and the Group contributions to these schemes was £2 million (2013 £1 million) during the year. A new defined contribution plan (RMDCP) was launched in April 2009. New recruits joining from 31 March 2008 are able to begin paying contributions to the new plan after they have worked for the Group for a year.

Defined Benefit

Both RMPP and RMSEPP are funded by the payment of contributions to separate trustee administered funds. The latest full actuarial funding valuation of RMPP was carried out as at 1 April 2012 using the projected unit method. For RMPP, this valuation was concluded at £135 million surplus. The latest full actuarial funding valuation of RMSEPP was carried out as at 31 March 2012 using the projected unit method. For 100% of the RMSEPP plan, the valuation was concluded at £70 million surplus. RMPP includes sections A, B and C each with different terms and conditions:

- Section A is for members (or beneficiaries of members) who joined before 1 December 1971;
- Section B is for members (or beneficiaries of members) who joined after 1 December 1971 and before 1 April 1987 or to members of Section A who chose to receive Section B benefits;
- Section C is for members (or beneficiaries of members) who joined after 1 April 1987 and before 1 April 2008.

A series of changes to RMPP and RMSEPP began to take effect on 1 April 2008.

The changes encompassed:

- the Plans closed to new members from 31 March 2008;
- all pensions and benefits earned before 1 April 2008 are still linked to final salary at the time of retirement;
- from 1 April 2008, defined benefits building up for employee members of the Plan are earned on a career salary basis;
- employees can continue to take their pension on reaching 60 but the normal retirement age increased to 65 for benefits earned from 1 April 2010;
- from 1 April 2010 it is possible to draw pension earned before the change to normal retirement age at 55, and continue working while still contributing to the Pension Plan until the maximum level of benefits has been reached; and
- RMSEPP was closed to future accruals on 31 December 2012.

Payment of £21 million (2013 £23 million) was made by the Group during the year in respect of regular 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% (2013 17.1%), effective from April 2010. This rate is not expected to change materially during 2014-15. For RMSEPP, these contributions have remained at 35.9% (2013 35.9%) until its closure.

The Group pays 7% of the total deficit payment required to fund the deficit in RMSEPP and a payment of £1 million (2013 £2 million) was made by the Group during the year. No RMPP deficit payments were made during 2012-13 or 2013-14. For RMSEPP, deficit recovery payments will be £1 million per annum, from 1 April 2010 to 31 January 2024.

A current liability of £nil (2013 £nil) has been recognised for payments to the pension schemes relating to redundancy. During the year, payments of £1 million (2013 £2 million) relating to redundancy were made.

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The weighted average duration of the RMPP fund is 28 years, and for the RMSEPP fund is 20 years. Over the next financial reporting period to 29 March 2015 it is expected that employer contributions to the plans will be £21 million and £1 million for RMPP and RMSEPP respectively.

The following disclosures relate to the gains/losses and surplus/deficit in the scheme recognised for RMPP and RMSEPP defined benefit plans in the financial statements of the Group:

a) Major long-term assumptions

The size of the RMPP pension surplus, which is large in the context of the Group and its finances, is materially sensitive to the assumptions adopted. Small changes in these assumptions could have a significant impact on the surplus and overall income statement charge. The major long-term assumptions in relation to both RMPP and RMSEPP were:

	At 30 March 2014	At 31 March 2013
	% pa	% pa
Rate of increase in salaries	3.2	4.3
Rate of pension increases – RMPP sections A/B	2.3	2.3
Rate of pension increases – RMPP section C	3.2	3.2
Rate of pensions increases – RMSEPP members transferred from Section A or B of RMPP	2.4	3.3
Rate of pension increases – RMSEPP all other members	3.3	3.2
Rate of increase for deferred pensions – RMSEPP members transferred from Section A or B of RMPP	2.4	3.3
Rate of increase for deferred pensions	2.3	2.3
Discount rate	4.5	4.8
Inflation assumption (RPI) – RMPP	3.3	3.3
Inflation assumption (CPI) – RMPP	2.3	2.3
Inflation assumption (RPI) – RMSEPP	3.4	3.3
Inflation assumption (CPI) – RMSEPP	2.4	2.3

In June 2010, the Government announced that it was intending to change the inflation measure used to determine statutory minimum indexation in deferment and in payment from RPI to CPI from April 2011. Where relevant, the inflation assumption has changed from RPI to CPI.

The ultimate cost of the RMPP plan to the Group will depend upon future events rather than the assumptions made. The assumptions made may not be borne out in practice and as such the cost of the plan may be higher (or lower) than disclosed.

In common with other defined benefit schemes, the main risk in relation to the arrangements is the value of the assets does not keep pace with the increase in the value of the liabilities. This can arise for many reasons, but the most significant risks are as follows:

Investment risk: If the assets of the arrangements fall short of expectations, this will lead to a decrease in the funded status.

Asset volatility: The arrangements hold return seeking assets (including equities and property) which are expected to outperform corporate bonds in the long term but give exposure to volatility and risk in the short term. RMPP does, however, invest in liability driven investment (LDI) assets which mitigates the impact of interest rate and inflation volatility on the funded status.

Inflation risk: Higher inflation rates than expected will act to increase the plan liabilities as benefits will increase to a higher level than assumed. The arrangements have a maximum pension increase (generally 5% per annum) written into the rules which limits the increase for many benefits, so limiting the impact of high inflation. This includes pensionable pay in RMPP, which was amended with effect from 1 April 2014. In addition, the arrangement holds assets that increase in value as price inflation expectations rise, so mitigating the impact of rising inflation expectations. These assets include LDI assets in respect of RMPP.

Changes in bond yields: A decrease in corporate bond yields will increase the plan liabilities, although this will be partially offset by an increase in the value of the bond holdings and, to some extent, the LDI assets.

Pensioner longevity: If members live longer than expected, the liabilities would increase because pensions would be paid for a longer time.

Liabilities accrued in the Royal Mail Pension Plan to 31 March 2012 were transferred to the Royal Mail Statutory Pension Scheme. These liabilities are no longer an obligation of the Group and consequent the transfer resulted in a significant removal of pension risk from the Group.

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The following table shows the potential impact on the RMPP assets and pension surplus of changes in key assumptions:

	2014 £m	2013 £m
Changes in RPI and CPI inflation of +0.1% pa	(3)	(4)
Changes in discount rate of +0.1%pa	3	4
Changes in real salary growth of +0.1% pa	(1)	(6)
Changes in CPI assumptions of +0.1% pa	(1)	(1)
An additional 1 year life expectancy	(3)	(4)

The sensitivity analysis has been prepared using projected benefit cashflows as at the latest full actuarial valuation of the plan. The same method was applied as at the previous reporting date. The accuracy of this method is limited by the extent to which the profiles of the plan cashflows have changed since those valuations although any change is not expected to be material in the context of the above sensitivity analysis.

Mortality

The mortality assumptions for the RMPP sectionalised scheme are based on the latest self administered pension scheme (SAPS) mortality tables with appropriate scaling factors (106% for male pensioners and 101% for female pensioners). For future improvements the assumptions allow for 'medium cohort' projections with a 1.25% floor. These are detailed below:

Average expected life expectancy from age 60:	2014	2013
For a current 60 year old male RMPP member	26 years	26 years
For a current 60 year old female RMPP member	29 years	29 years
For a current 40 year old male RMPP member	29 years	29 years
For a current 40 year old female RMPP member	32 years	32 years

b) Plans' assets and expected rates of return

The assets in the plans for the Group were:

Sectionalised RMPP	Market value 2014	Market value 2013
	£m	£m
UK equities	1	2
Overseas equities	18	27
Government bonds	-	2
Corporate bonds	156	203
Property	5	-
Other assets	80	9
Fair value of RMPP assets	260	243
Present value of RMPP liabilities	(90)	(144)
Surplus in plan before asset ceiling adjustment	170	99
Less effect of asset ceiling	(23)	(3)
Surplus in plan after asset ceiling adjustment	147	96

Share of RMSEPP	Market value 2014	Market value 2013
	£m	£m
UK equities	1	4
Overseas equities	9	6
Government bonds	-	-
Corporate bonds	13	12
Property	2	1
Other assets	1	2
Fair value of share in plan assets for RMSEPP	26	25
Present value of share in plan liabilities for RMSEPP	(24)	(24)
Surplus in plan for the share of RMSEPP before asset ceiling adjustment	2	1
Less effect of asset ceiling	(1)	-
Surplus in plan for share of RMSEPP after asset ceiling adjustment	1	1

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A retirement benefit surplus of £148 million is disclosed on the balance sheet, representing the surplus in plans of £170 million and £2 million for RMPP and RMSEPP respectively, and net of tax of £24 million at a rate of 35% on the element of the surplus which is recoverable through a refund from the plans.

There is no element of the above present value of liabilities that arises from plans that are wholly unfunded.

The major categories of plan assets as a percentage of total plan assets are as follows:

Securities with quoted price in an active market:	2014	2013
	%	%
UK equities	-	1
Overseas equities	7	11
Government bonds	-	1
Corporate bonds	60	83
Property	2	-
Other assets	31	4
Total quoted securities	100	100

c) Movement in plans' assets and liabilities

Changes in the fair value of the plans' assets are analysed as follows:

Assets	Sectionalised RMPP 2014 £m	Sectionalised RMPP 2013 £m
Assets in sectionalised RMPP at beginning of period	243	2,108
Transfer of pension assets to government	-	(1,953)
Contributions paid	22	25
Employee contributions paid	8	8
Finance income	12	11
Actuarial (losses)/gains	(24)	46
Benefits paid to members	(1)	(2)
Assets in sectionalised RMPP at end of period	260	243

Assets	Share of RMSEPP 2014 £m	Share of RMSEPP 2013 £m
Share of assets in RMSEPP at beginning of period	25	21
Contributions paid	1	2
Movement in contributions accrued	-	-
Employee contributions paid	-	-
Finance income	1	1
Actuarial gains	-	1
Benefits paid to members	(1)	-
Share of assets in RMSEPP at end of period	26	25

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

Liabilities	Sectionalised RMPP 2014 £m	Sectionalised RMPP 2013 £m
Liabilities in sectionalised RMPP at beginning of period	(144)	(2,313)
Royal Mail Pension Plan amendment	102	-
Transfer of pension liabilities to government	-	2,239
Current service cost	(25)	(24)
Curtailment costs*	(1)	(2)
Finance cost	(7)	(9)
Employee contributions	(8)	(8)
Actuarial loss	(8)	(29)
Benefits paid	1	2
Liabilities in sectionalised RMPP at end of period	(90)	(144)

Liabilities	Share of RMSEPP 2014 £m	Share of RMSEPP 2013 £m
Share of liabilities in RMSEPP plans at beginning of period	(24)	(22)
Current service cost	-	-
Curtailment costs*	-	-
Finance cost	(1)	(1)
Employee contributions	-	-
Actuarial gain/(loss)	-	(1)
Benefits paid	1	-
Share of liabilities in RMSEPP at end of period	(24)	(24)

*The curtailment costs in the income statement are recognised on a consistent basis with the associated compensation costs. Estimates of both are included, for example, in any redundancy provisions raised. The curtailment costs above represent the costs associated with those people paid compensation in respect of redundancy during the accounting period. Such payments may occur in an accounting period subsequent to the recognition of costs in the income statement.

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d) Recognised charges

An analysis of the separate components of the amounts recognised in the performance statements of the Group is as follows:

	2014 sectionalised RMPP £m	2013 sectionalised RMPP £m
Analysis of amounts recognised in the income statement		
Analysis of amounts charged to operating profit before exceptional items:		
Current service cost	25	24
Total charge to operating profit before exceptional items		
Analysis of amounts charged to operating exceptional items:		
Royal Mail Pension Plan amendment	(102)	-
Loss due to curtailments	1	2
Total (credit)/charge to operating profit		
	(76)	26
Analysis of amounts charged/(credited) to net pensions interest:		
Interest on plan liabilities	7	9
Interest income on plan assets	(12)	(11)
Net pensions credit to financing		
	(5)	(2)
Net (credit)/charge to the income statement before deduction for tax		
	(81)	24
Analysis of amounts recognised in the statement of changes in equity		
Transfer of pension liabilities to government	-	2,239
Transfer of pension assets to government	-	(1,953)
Gain on transfer to government	-	286
Total gains recognised in the statement of changes in equity		
	-	286
Analysis of amounts recognised in the statement of comprehensive income		
Actual return on plan assets	(12)	57
Less: expected interest income on plan assets	(12)	(11)
Less: taxation on surplus recoverable through plan refunds	(20)	(3)
Actuarial (losses)/gains on assets (all experience adjustments)	(44)	43
Experience adjustments on liabilities	-	(20)
Effects of changes in actuarial assumptions on liabilities	(8)	(9)
Actuarial losses on liabilities	(8)	(29)
Total actuarial (losses)/gains recognised in the statement of comprehensive income		
	(52)	14

19. Called up share capital

	2014 £	2013 £
Authorised		
Ordinary shares of £1 each	51,000	51,000
Total	51,000	51,000
Allotted and issued		
Ordinary shares of £1 each	50,003	50,003
Total	50,003	50,003

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20. Commitments

Capital commitments contracted for but not provided in the financial statements amount to £68 million (2013 £48 million).

The Group is committed to the following minimum lease payments under non-cancellable operating leases:

	Land and buildings		IT equipment	
	2014 £m	2013 £m	2014 £m	2013 £m
Within one year	20	16	-	15
Between one and five years	45	42	-	-
Beyond five years	31	38	-	-
Total	96	96	-	15

21. Finance lease liabilities

	2014		2013	
	Minimum payments £m	Present value of minimum lease payments £m	Minimum payments £m	Present value of minimum lease payments £m
Within one year	3	3	4	3
Between one and five years	-	-	4	4
Total minimum lease payments	3	3	8	7
Less amounts representing finance charges	-	-	(1)	-
Present value of minimum lease payments	3	3	7	7
Of which:				
Current	3	3	3	3
Non-current	-	-	4	4

The aggregate finance charges allocated for the period in respect of finance leases was £470,680 (2013 £738,859). The fair value of finance lease liabilities is not materially different from the carrying value.

The Group has finance lease contracts for equipment. The leases have no terms for renewal, purchase options or escalation clauses and there are no restrictions concerning dividends, borrowings or additional leases. The leases have an average term of six years.

22. Related party disclosures

Joint venture

The following company is a joint venture of the Group:

Company	Country of incorporation	% Holding	Principal activities
First Rate Exchange Services Holdings Limited	United Kingdom	50	Bureau de Change

Associates

The following company was an associate of Post Office Limited during the prior year: The Group's interest was disposed of in September 2012.

Company	Country of incorporation	% Holding	Principal activities
Midasgrange Limited	United Kingdom	50	Financial services

All shareholdings are equity shares.

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Related party transactions

During the year the Group entered into transactions with the following related parties. The transactions were in the ordinary course of business. The transactions entered into and the balances outstanding at the financial year end were as follows:

	Sales/recharges to related party		Purchases/recharges from related party		Amounts owed from related party including outstanding loans		Amounts owed to related party including outstanding loans	
	2014 £m	2013 £m	2014 £m	2013 £m	2014 £m	2013 £m	2014 £m	2013 £m
Royal Mail Plc	356	371	40	37	29	-	48	4
Midasgrange Limited	-	35	-	1	-	-	-	-
First Rate Exchange Services Holdings Limited	27	27	125	125	5	7	6	11

The sales to and purchases from related parties are made at normal market prices. Balances outstanding at the year end are unsecured, interest free and settlement is made by cash. Royal Mail Plc is an associate of Postal Services Holding Company Limited. Midasgrange Limited was an associate of the Group until September 2012 and First Rate Exchange Services Holdings Limited is a joint venture of the Group.

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 (note 15);
- the Group has received a Government Grant of £215 million, £215 million of which was recognised through the income statement (note 5); and
- the Group has received the Network Subsidy Payment from Government (note 1).

Key management comprises Executive and Non-Executive Directors of the Post Office Limited Board and the members of the Executive Committee at 30 March 2014. The aggregate remuneration of the key management personnel of the Post Office Group is set out below:

	2014 £000	2013 £000
Short-term employee benefits	TBC	3,568
Post-employment benefits	TBC	119
Other long-term benefits	TBC	651
Termination benefits	TBC	-
Total	TBC	4,338

23. Post balance sheet events

In accordance with the funding agreement with government announced on 27 October 2010, for which State Aid approval was received on 28 March 2012, Post Office Limited received £330 million of funding on 1 April 2014.

24. Immediate and ultimate parent company

At 30 March 2014, the Directors regarded Postal Services Holding Company Limited as the immediate and ultimate parent company. The largest group to consolidate the results of the company is Postal Services Holding Company Limited, a company registered in the United Kingdom. Postal Services Holding Company Limited financial statements can be obtained from Companies House.

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Post Office Limited
Parent Company Financial Statements
2013-2014

Post Office Limited

Company statement of comprehensive income
At 30 March 2014

	Notes	2014 £m	2013 £m
Profit for the financial year		169	74
Other comprehensive income:			
Remeasurements on defined benefit surplus	13	(52)	14
Income tax effect		(2)	(21)
Total comprehensive income for the year		115	67

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

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Company balance sheet
at 30 March 2014

	Notes	2014 £m	2013 £m	2012 £m
Intangible assets	2	-	-	-
Tangible assets	3	10	11	11
Investment in subsidiaries	4	-	-	-
Investments in joint ventures and associates	5	1	1	5
Retirement benefit surplus	13	148	97	-
Total non-current assets		159	109	16
Current assets		6	8	6
Stocks		302	352	226
Debtors - receivable within one year	6	15	10	-
Debtors - receivable in more than one year	6	30	101	62
Financial assets - investments	7	-	1	-
Financial assets - derivatives		708	870	758
Cash at bank and in hand	8			
		1,061	1,342	1,052
Current liabilities		(770)	(877)	(587)
Creditors - amounts falling due within one year	9	-	(291)	(377)
Financial liabilities - interest bearing loans and borrowings	10			
Net current assets		291	174	88
Total assets less current liabilities		450	283	104
Creditors - amounts falling due after more than one year	11	(28)	(28)	(8)
Provisions for liabilities	12	(78)	(26)	(14)
Retirement benefit obligation	13	-	-	(206)
Net assets/(liabilities)		344	229	(124)
Capital and reserves		-	-	-
Called up share capital	14	465	465	465
Share premium		(121)	(236)	(589)
Profit and loss account				
Shareholder's surplus/(deficit)		344	229	(124)

The financial statements on pages XX to XX were approved by the Board of Directors on XXX 2014 and signed on its behalf by:

P A Vennells
Chief Executive

C M Day
Chief Financial Officer

Post Office Limited

Company statement of changes in equity
at 30 March 2014

	Notes	Share premium £m	Retained earnings £m	Total equity £m
At 1 April 2013		465	(236)	229
Profit for the year		-	169	169
Remeasurements on defined benefit surplus	13	-	(52)	(52)
Income tax effect		-	(2)	(2)
At 30 March 2014		465	(121)	344

	Notes	Share premium £m	Retained earnings £m	Total equity £m
At 26 March 2012		465	(589)	(124)
Profit for the year		-	74	74
Remeasurements on defined benefit surplus	13	-	14	14
Transfer of pension deficit to government			286	286
Income tax effect		-	(21)	(21)
At 31 March 2013		465	(236)	229

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Notes to the financial statements

1. Accounting Policies

The accounting policies which follow set out those which apply in preparing the financial statements for the year ended 30 March 2014.

Financial year

The financial year ends on the last Sunday in March and accordingly, these financial statements are made up to the 52 weeks ended 30 March 2014 (2013 53 weeks ended 31 March 2013).

Authorisation of financial statements and statement of compliance with FRS 101

The parent company financial statements of Post Office Limited (the 'Company') for the year ended 30 March 2014 were authorised for issue by the Board of Directors on XX May 2014 and the balance sheet was signed on the board's behalf by P A Vennells and C M Day. Post Office Limited is a limited company incorporated and domiciled in England and Wales.

These financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101). These financial statements are prepared under the historical cost convention.

As permitted by Section 408 of the Companies Act 2006 Post Office Limited has not presented its own profit and loss account. The result dealt with in the accounts of the company amounted to £169 million profit (2013 £74 million profit).

The results of Post Office Limited are included in the consolidated financial statements of Post Office Group which are available from XXXX.

Basis of preparation

The Company has transitioned to FRS 101 from previously extant UK Generally Accepted Accounting Practice for all periods presented. The Company has adopted FRS 101 early which is permitted under the Standard. Transition tables showing all material adjustments are disclosed in note 20. The Company has taken advantage of the following disclosure exemptions under FRS 101:

- (a) the requirements of IFRS 7 Financial Instruments: Disclosures
- (b) the requirements of paragraphs 91-99 of IFRS 13 Fair Value Measurement
- (c) the requirement in paragraph 38 of IAS 1 'Presentation of Financial Statements' to present comparative information in respect of:
 - i. paragraph 73(e) of IAS 16 Property, Plant and Equipment
 - ii. paragraph 118(e) of IAS 38 Intangible Assets
- (d) the requirements of paragraphs 10(d), 10(f), 39(c) and 134-136 of IAS 1 'Presentation of Financial Statements'
- (e) the requirements of IAS 7 Statement of Cash Flows
- (f) the requirements of paragraphs 30 and 31 of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'
- (g) the requirements of paragraph 17 of IAS 24 'Related Party Disclosures'
- (h) the requirements of IAS 24 'Related Party Disclosures' to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member.

In making an assessment of the Company's ability to continue as a going concern, the Directors have considered the going concern assessments made in relation to the Group (see note 1 on page XX) and are of the view that it is appropriate that these financial statements have been prepared on a going concern basis.

Critical accounting estimates and judgements in applying accounting policies

The Company makes certain estimates and assumptions regarding the future. Estimates and assumptions are continually evaluated based on historical experience and other factors. In the future, actual experience may differ from these estimates and assumptions. In addition the Company has to make judgements in applying its accounting policies which affect the amounts recognised in the accounts. The most significant areas where judgements and estimates are made are discussed below:

Pension assumptions

The costs, assets and liabilities of the pensions operated by the Company are determined using methods relying on actuarial estimates and assumptions. These pension figures are particularly sensitive to changes in assumptions for discount rates, mortality and inflation rates. The Group exercises its judgement in determining the assumptions to be adopted, after discussion with its Actuary. Details of the key assumptions are set out in note 13 of the Company financial statements.

Pension liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term. Judgement has been applied in determining that for these purposes a high quality corporate bond constitutes AA rated or equivalent status bonds.

The prior year pension deficit transfer to HM Government on 1 April 2012 was taken directly through equity, as in management's judgement this transaction was undertaken with HM Government in its capacity as the owner of Royal Mail Holdings plc, the Company's former parent company, rather than in its capacity as government.

Provisions

The Company has recognised provisions where a present legal or constructive obligation exists as a result of a past event, where it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate of the amount can be made. Provisions are detailed in note 12. Due to the nature of provisions the future amount settled may be different from the amount that has been provided.

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Impairment of non-current assets

The Company assesses whether there are any indicators of impairment for all non-currents assets at each reporting date. Due to ongoing operational losses (excluding the 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.

Intangible fixed assets

Intangible assets acquired separately or generated internally are initially recognised at cost and are reviewed for impairment. An impairment loss is recognised in the profit and loss account for the amount by which the carrying value of the asset exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Amortisation of intangible assets with finite lives is charged annually to the profit and loss account on a straight-line basis as follows.

Software	1 to 6 years
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Where intangible fixed assets are impaired to their recoverable amount on acquisition the above range of asset lives is not applied.

Tangible fixed assets

Tangible fixed assets are recognised at cost, including attributable costs in bringing the asset into working condition for its intended use.

Depreciation of tangible fixed assets is provided on a straight-line basis by reference to net book value and to the remaining useful economic lives of assets and their estimated residual values. The lives assigned to major categories of tangible fixed assets are:

	Range of asset lives
Land and buildings:	
Freehold land	Not depreciated
Freehold buildings	Up to 50 years
Leasehold buildings	The shorter of the period of the lease, 50 years or the estimated remaining useful life
Plant and Machinery	3 – 15 years
Motor vehicles and trailers	2 – 12 years
Fixtures and equipment	2 – 15 years

Where tangible fixed assets are impaired to their recoverable amounts on acquisition the above ranges of asset lives are not applied. This is currently the case for plant and machinery, motor vehicles and trailers and fixtures and equipment.

Impairment reviews

Unless otherwise disclosed in these accounting policies, fixed assets are reviewed for impairment if events or changes in circumstances indicate that the carrying value may be impaired. The Company assesses at each reporting date whether such indications exist. Where appropriate, an impairment loss is recognised in the profit and loss account for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Leases

Finance leases, where substantially all the risks and rewards incidental to ownership of the leased item have passed to the Company are capitalised at the inception of the lease with a corresponding liability recognised for the fair value of the leased item or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Leases where substantially all the risks and rewards of ownership of the asset are retained by the lessor, are classified as operating leases and rentals are charged to the profit and loss account over the lease term. The aggregate benefit of incentives are recognised as a reduction of rental expenses over the lease term on a straight-line basis.

Investments in joint ventures and associates

Investments in joint ventures and associates within the Company's financial statements are stated at cost less any accumulated impairment losses.

Investments in subsidiaries

Investments in subsidiaries within the Company's financial statements are stated at cost less any accumulated impairment losses. The carrying value relates solely to the Company's investment in Post Office Management Services Limited, a 100% subsidiary of the Company and is less than £1m.

Stocks

Stocks, which include printing and stationery, retail and lottery products, are carried at the lower of cost and net realisable value after adjusting for obsolete or slow-moving stock.

Deferred tax

Deferred tax is generally provided in full on timing differences at the balance sheet date, at rates expected to apply when the tax liability (or asset) crystallises based on substantively enacted tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements.

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Deferred tax is not recognised in the following instances:

- on gains on disposal of fixed assets where, on the basis of available evidence, it is more likely than not that the taxable gain will be rolled over into replacement assets and charged to tax only when there is a commitment to dispose of those replacement assets;
- on unremitted earnings of subsidiaries and associates where there is no commitment to remit those earnings; and
- deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax assets and liabilities are not discounted. Deferred tax is charged or credited directly to reserves if it relates to items that are credited or charged directly to reserves. Otherwise it is recognised in the profit and loss account.

Pensions and other post-retirement benefits

People working for the Company were employed by Royal Mail Group Limited and seconded to the Company until 31 March 2012. On 1 April 2012 they were transferred to be directly employed by the Company. Membership of occupational pension schemes is open to most permanent UK employees of the Company. All members of defined benefit schemes are contracted out of the earnings-related part of the State pension scheme.

The pension plans' assets of the defined benefit schemes are measured at fair value. Liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term. The resulting defined benefit asset or liability is presented separately on the face of the balance sheet, net of any associated deferred tax balance. Full actuarial valuations are carried out at intervals not normally exceeding three years as determined by the Trustees and, with appropriate updates and accounting adjustments at each balance sheet date, form the basis of the deficit disclosed.

For defined benefit schemes, the amounts charged to operating profit, as part of staff costs, are the current service costs and any gains and losses arising from settlements, curtailments and past service costs.

The net difference between the interest costs and the expected return on plan assets is recognised as net pensions interest in the profit and loss account. Actuarial gains and losses are recognised immediately in the statement of comprehensive income. Any deferred tax movement associated with the actuarial gains and losses is also recognised in the statement of comprehensive income.

For defined contribution schemes, the Company's contributions are charged to operating profit, as part of staff costs, in the period to which the contributions relate.

Foreign currencies

The functional and presentational currency of the Company is sterling (£).

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction (or at the contracted rate if the transaction is covered by a forward foreign currency contract). Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date (or the appropriate forward contract rate). All differences are taken to the profit and loss account.

Debtors

Debtors are recognised and carried at original invoice amount less an allowance for any non-collectable amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

Financial assets – investments (current assets)

Financial assets – investments in the balance sheet comprise short-term deposits and money market funds. All financial assets – investments are classified as loans and receivables and are measured at amortised cost using the effective interest rate method. Gains and losses are recognised in the profit and loss account when the investments are derecognised or impaired, as well as through the amortisation process.

Financial liabilities – interest-bearing loans and borrowings

All loans and borrowings are classified as financial liabilities measured at amortised cost. Borrowing costs are recognised as an expense when incurred.

Financial liabilities – obligations under finance lease and hire purchase contracts

All obligations under finance lease and hire purchase contracts are classified as financial liabilities measured at amortised cost.

Borrowing costs

Borrowing costs are recognised as an expense when incurred unless they are directly attributable to the construction or development of a qualifying asset, in which case they are capitalised using the weighted average cost of borrowing for the period of construction/development.

Fair value measurement of financial instruments

The fair value of quoted investments is determined by reference to bid prices at the close of business on the balance sheet date. Where there is no active market, fair value is determined using valuation techniques. These include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; and discounted cash flow analysis and pricing models.

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For the purposes of disclosing the fair value of investments held at amortised cost in the balance sheet, in the absence of quoted market prices, fair values are calculated by discounting the future cash flows of the financial instrument using quoted equivalent interest rates as at close of business on the balance sheet date.

Derecognition of financial instruments

A financial asset or liability is derecognised when the contract that gives rise to it is settled, sold, cancelled or expires.

Government grants

Government grants of a revenue nature are recognised to match costs in relation to the performance of certain specified activities.

Auditor's remuneration

The remuneration paid to auditors is disclosed in the Group financial statements (note 4).

Director's emoluments

The emoluments paid to Directors are disclosed in the Group financial statements (note 6).

2. Intangible assets

	2014
Cost	£m
At 1 April 2013	208
Additions	42
Disposals	(7)
At 30 March 2014	243
Amortisation and impairment	
At 1 April 2013	208
Disposals	(7)
Impairment	42
At 30 March 2014	243
Net book value	
At 30 March 2014	-
At 1 April 2013	-

The above intangible assets relate to software.

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3. Tangible fixed assets

	Land and Buildings				Plant and machinery £m	Fixtures and equipment £m	Total £m
	Freehold £m	Long leasehold £m	Short leasehold £m	Motor vehicles £m			
Cost							
At 1 April 2013	87	18	114	42	1	719	981
Reclassification	(5)	-	3	-	-	2	-
Additions	20	-	4	7	-	41	72
Disposals - external	(2)	(1)	(8)	(5)	-	(23)	(39)
At 30 March 2014	100	17	113	44	1	739	1,014
Depreciation							
At 1 April 2013	77	17	114	42	1	719	970
Depreciation	-	-	-	-	-	-	-
Impairment (see note 5)	16	-	7	7	-	43	73
Disposals - external	(2)	(1)	(8)	(5)	-	(23)	(39)
At 30 March 2014	91	16	113	44	1	739	1,004
Net book value							
At 30 March 2014	9	1	-	-	-	-	10
At 1 April 2013	10	1	-	-	-	-	11

Depreciation rates are disclosed within accounting policies (note 1). No depreciation is provided on freehold land, which represents £3 million (2013 £3 million) of the total cost of properties.

4. Investment in subsidiaries

The carrying value of £100 relates solely to the Company's investment in Post Office Management Services Limited, a 100% subsidiary of the Company.

5. Investments in joint ventures

	2014 £m	2013 £m
Investment in joint ventures	1	1

Joint ventures

During 2013-14 and 2012-13, the Company's only joint venture investment was a 50% interest (1,000 £1 ordinary A shares) in First Rate Exchange Services Holdings Limited with a carrying value of £0.6 million (2013 £0.6 million), whose principal activity is the provision of Bureau de Change. First Rate Exchange Services Holdings Limited is a company registered in the United Kingdom.

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6. Debtors

	2014	2013
	£m	£m
Receivable within one year:		
Trade debtors	54	32
Prepayments and accrued income	82	71
Client debtors	158	240
Other receivables	8	9
Total	302	352
Receivable after more than one year:		
Prepayments and accrued income	15	10

7. Current financial assets - investments

	2014	2013
	£m	£m
Money market funds	-	86
Short-term deposits - bank	30	15
Total	30	101

8. Cash at bank and in hand

	2014	2013
	£m	£m
Cash in the Post Office Limited network	708	870

9. Creditors - amounts falling due within one year

	2014	2013
	£m	£m
Bank overdraft	50	-
Trade creditors and accruals	187	159
Advance customer payments	37	50
Social security	14	10
Client creditors	438	528
Obligations under finance leases	3	3
Capital creditors	31	18
Business transformation payments	10	7
Government Grant	-	102
Total	770	877

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10. Financial liabilities – interest bearing loans and borrowings

Analysis of loans and committed facilities:

	2014 £m	2013 £m
Department of Business, Innovation & Skills loans drawn down	-	291
Total facility	1,150	1,150

The loans under the facility are short dated on a programme of liquidity management and mature on average 1 day after the year end (2013 1 day). On maturity it is expected that further loans will be drawn down under this facility, which expires in 2016. The undrawn committed facility, in respect of which all conditions precedent had been met at the balance sheet date is £1,150 million (2013 £859 million.) The average interest rate on the drawn down loans is 1.0% (2013 1.0%).

The facility is currently restricted to funding the cash and near cash items held within the Post Office Limited network.

The facility (including drawn down loans) is secured by a floating charge over all assets of Post Office Limited and a negative pledge over cash and near cash items. The negative pledge is an agreement not to grant security over the assets or to set up a vehicle that has the same effect.

11. Creditors – amounts falling due after more than one year

	2014 £m	2013 £m
Obligations under finance leases	-	4
Other payables	28	24
Total	28	28

12. Provisions for liabilities

	Crown Conversions Project £m	Network Transformation £m	Other £m	Total £m
At 1 April 2013	7	10	9	26
Charged in operating exceptional items	(2)	93	27	118
Charged in operating costs	-	-	6	6
Utilisation	(3)	(52)	(17)	(72)
At 30 March 2014	2	51	25	78

The Crown Conversions project relates to past franchising of Crown offices and onerous property lease provisions are expected to be utilised within four years.

The Network Transformation provision relates to the major transformation programme which is discussed further in the Financial Review on page XX.

Other provisions of £25 million (2013 £9 million) include property contracts, onerous lease obligations and personal injury claims.

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13. Pensions

The disclosures in this note relating to the year ended 30 March 2014 and the comparatives for the year ended 31 March 2013 reflect the Post Office Limited sectionalised RMPP scheme which is independently operated by the Company and the approximate 7% share of the RMSEPP scheme. Royal Mail Group Limited is the principal employer in Royal Mail Senior Executive Pension Plan (RMSEPP) and Post Office Limited became a participating employer with effect from 1 April 2012.

During the year 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 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 disclosures in this note show how the value of the assets and liabilities have been calculated at the balance sheet date.

The Company 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

Defined Contribution

The charge in the profit and loss account for the defined contribution schemes and the Company contributions to these schemes was £2 million (2013 £1 million) during the year. A new defined contribution plan (RMDCP) was launched in April 2009. New recruits joining from 31 March 2008 are able to begin paying contributions to the new plan after they have worked for the Company for a year.

Defined Benefit

Both RMPP and RMSEPP are funded by the payment of contributions to separate trustee administered funds. The latest full actuarial funding valuation of RMPP was carried out as at 1 April 2012 using the projected unit method. For RMPP, this valuation was concluded at £135 million surplus. The latest full actuarial funding valuation of RMSEPP was carried out as at 31 March 2012 using the projected unit method. For 100% of the RMSEPP plan, the valuation was concluded at £70 million surplus. RMPP includes sections A, B and C each with different terms and conditions:

- Section A is for members (or beneficiaries of members) who joined before 1 December 1971;
- Section B is for members (or beneficiaries of members) who joined after 1 December 1971 and before 1 April 1987 or to members of Section A who chose to receive Section B benefits;
- Section C is for members (or beneficiaries of members) who joined after 1 April 1987 and before 1 April 2008.

A series of changes to RMPP and RMSEPP began to take effect on 1 April 2008.

The changes encompassed:

- the Plans closed to new members from 31 March 2008;
- all pensions and benefits earned before 1 April 2008 are still linked to final salary at the time of retirement;
- from 1 April 2008, defined benefits building up for employee members of the Plan are earned on a career salary basis;
- employees can continue to take their pension on reaching 60 but the normal retirement age increased to 65 for benefits earned from 1 April 2010;
- from 1 April 2010 it is possible to draw pension earned before the change to normal retirement age at 55, and continue working while still contributing to the Pension Plan until the maximum level of benefits has been reached; and
- RMSEPP was closed to future accruals on 31 December 2012.

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Payment of £21 million (2013 £23 million) was made by the Company during the year in respect of regular 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% (2013 17.1%), effective from April 2010. This rate is not expected to change materially during 2014-15. For RMSEPP, these contributions have remained at 35.9% (2013 35.9%) until its closure.

The Company pays 7% of the total deficit payment required to fund the deficit in RMSEPP and a payment of £1 million (2013 £2 million) was made by the Company during the year. No RMPP deficit payments were made during 2012-13 or 2013-14. For RMSEPP, deficit recovery payments will be £1 million per annum, from 1 April 2010 to 31 January 2024.

A current liability of £nil (2013 £nil) has been recognised for payments to the pension schemes relating to redundancy. During the year, payments of £1 million (2013 £2 million) relating to redundancy were made.

The weighted average duration of the RMPP fund is 28 years, and for the RMSEPP fund is 20 years. Over the next financial reporting period to 29 March 2015 it is expected that employer contributions to the plans will be £21 million and £1 million for RMPP and RMSEPP respectively.

The following disclosures relate to the gains/losses and surplus/deficit in the scheme recognised for RMPP and RMSEPP defined benefit plans in the financial statements of the Company:

a) Major long-term assumptions

The size of the RMPP pension surplus, which is large in the context of the Company and its finances, is materially sensitive to the assumptions adopted. Small changes in these assumptions could have a significant impact on the surplus and overall profit and loss charge. The major long-term assumptions in relation to both RMPP and RMSEPP were:

	At 30 March 2014	At 31 March 2013
	% pa	% pa
Rate of increase in salaries	3.2	4.3
Rate of pension increases – RMPP sections A/B	2.3	2.3
Rate of pension increases – RMPP section C	3.2	3.2
Rate of pensions increases – RMSEPP members transferred from Section A or B of RMPP	2.4	3.3
Rate of pension increases – RMSEPP all other members	3.3	3.2
Rate of increase for deferred pensions – RMSEPP members transferred from Section A or B of RMPP	2.4	3.3
Rate of increase for deferred pensions	2.3	2.3
Discount rate	4.5	4.8
Inflation assumption (RPI) – RMPP	3.3	3.3
Inflation assumption (CPI) – RMPP	2.3	2.3
Inflation assumption (RPI) – RMSEPP	3.4	3.3
Inflation assumption (CPI) – RMSEPP	2.4	2.3

In June 2010, the Government announced that it was intending to change the inflation measure used to determine statutory minimum indexation in deferment and in payment from RPI to CPI from April 2011. Where relevant, the inflation assumption has changed from RPI to CPI.

The ultimate cost of the RMPP plan to the Group will depend upon future events rather than the assumptions made. The assumptions made may not be borne out in practice and as such the cost of the plan may be higher (or lower) than disclosed.

In common with other defined benefit schemes, the main risk in relation to the arrangements is the value of the assets does not keep pace with the increase in the value of the liabilities. This can arise for many reasons, but the most significant risks are as follows:

Investment risk: If the assets of the arrangements fall short of expectations, this will lead to a decrease in the funded status.

Asset volatility: The arrangements hold return seeking assets (including equities and property) which are expected to outperform corporate bonds in the long term but give exposure to volatility and risk in the short term. RMPP does, however, invest in liability driven investment (LDI) assets which mitigates the impact of interest rate and inflation volatility on the funded status.

Inflation risk: Higher inflation rates than expected will act to increase the plan liabilities as benefits will increase to a higher level than assumed. The arrangements have a maximum pension increase (generally 5% per annum) written into the rules which limits the increase for many benefits, so limiting the impact of high inflation. This includes pensionable pay in RMPP, which was amended with effect from 1 April 2014. In addition, the arrangement holds assets that increase in value as price inflation expectations rise, so mitigating the impact of rising inflation expectations. These assets include LDI assets in respect of RMPP.

Changes in bond yields: A decrease in corporate bond yields will increase the plan liabilities, although this will be partially offset by an increase in the value of the bond holdings and, to some extent, the LDI assets.

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Pensioner longevity: If members live longer than expected, the liabilities would increase because pensions would be paid for a longer time.

Liabilities accrued in the Royal Mail Pension Plan to 31 March 2012 were transferred to the Royal Mail Statutory Pension Scheme. These liabilities are no longer an obligation of the Group and consequent the transfer resulted in a significant removal of pension risk from the Group.

The following table shows the potential impact on the RMPP assets and pension surplus of changes in key assumptions:

	2014 £m	2013 £m
Changes in RPI and CPI inflation of +0.1% pa	(3)	(4)
Changes in discount rate of +0.1%pa	3	4
Changes in real salary growth of +0.1% pa	(1)	(6)
Changes in CPI assumptions of +0.1% pa	(1)	(1)
An additional 1 year life expectancy	(3)	(4)

The sensitivity analysis has been prepared using projected benefit cashflows as at the latest full actuarial valuation of the plan. The same method was applied as at the previous reporting date. The accuracy of this method is limited by the extent to which the profiles of the plan cashflows have changed since those valuations although any change is not expected to be material in the context of the above sensitivity analysis.

Mortality

The mortality assumptions for the RMPP sectionalised scheme are based on the latest self administered pension scheme (SAPS) mortality tables with appropriate scaling factors (106% for male pensioners and 101% for female pensioners). For future improvements the assumptions allow for 'medium cohort' projections with a 1.25% floor. These are detailed below:

Average expected life expectancy from age 60:	2014	2013
For a current 60 year old male RMPP member	26 years	26 years
For a current 60 year old female RMPP member	29 years	29 years
For a current 40 year old male RMPP member	29 years	29 years
For a current 40 year old female RMPP member	32 years	32 years

b) Plans' assets and expected rates of return

The assets in the plans for the Company were:

Sectionalised RMPP	Market value 2014 £m	Market value 2013 £m
UK equities	1	2
Overseas equities	18	27
Government bonds	-	2
Corporate bonds	156	203
Property	5	-
Other assets	80	9
Fair value of RMPP assets	260	243
Present value of RMPP liabilities	(90)	(144)
Surplus in plan before asset ceiling adjustment	170	99
Less effect of asset ceiling	(23)	(3)
Surplus in plan after asset ceiling adjustm	147	96

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Share of RMSEPP	Market value 2014 £m	Market value 2013 £m
UK equities	1	4
Overseas equities	9	6
Government bonds	-	-
Corporate bonds	13	12
Property	2	1
Other assets	1	2
Fair value of share in plan assets for RMSEPP	26	25
Present value of share in plan liabilities for RMSEPP	(24)	(24)
Surplus in plan for the share of RMSEPP before asset ceiling adjustment	2	1
Less effect of asset ceiling	(1)	-
Surplus in plan for share of RMSEPP after asset ceiling adjustment	1	1

A retirement benefit surplus of £148 million is disclosed on the balance sheet, representing the surplus in plans of £170 million and £2 million for RMPP and RMSEPP respectively, and net of tax of £24 million at a rate of 35% on the element of the surplus which is recoverable through a refund from the plans.

There is no element of the above present value of liabilities that arises from plans that are wholly unfunded.

The major categories of plan assets as a percentage of total plan assets are as follows:

Securities with quoted price in an active market:	2014 %	2013 %
UK equities	-	1
Overseas equities	7	11
Government bonds	-	1
Corporate bonds	60	83
Property	2	-
Other assets	31	4
Total quoted securities	100	100

c) Movement in plans' assets and liabilities

Changes in the fair value of the plans' assets are analysed as follows:

Assets	Sectionalised RMPP 2014 £m	Sectionalised RMPP 2013 £m
Assets in sectionalised RMPP at beginning of period	243	2,108
Transfer of pension assets to government	-	(1,953)
Contributions paid	22	25
Employee contributions paid	8	8
Finance income	12	11
Actuarial (loss)/gain	(24)	46
Benefits paid to members	(1)	(2)
Assets in sectionalised RMPP at end of period	260	243

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Assets	Share of RMSEPP 2014 £m	Share of RMSEPP 2013 £m
Share of assets in RMSEPP at beginning of period	25	21
Contributions paid	1	2
Movement in contributions accrued	-	-
Employee contributions paid	-	-
Finance income	1	1
Actuarial gains	-	1
Benefits paid to members	(1)	-
Share of assets in RMSEPP at end of period	26	25

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

Liabilities	Sectionalised RMPP 2014 £m	Sectionalised RMPP 2013 £m
Liabilities in sectionalised RMPP at beginning of period	(144)	(2,313)
Royal Mail Pension Plan amendment	102	-
Transfer of pension liabilities to government	-	2,239
Current service cost	(25)	(24)
Curtailment costs*	(1)	(2)
Finance cost	(7)	(9)
Employee contributions	(8)	(8)
Actuarial loss	(8)	(29)
Benefits paid	1	2
Liabilities in sectionalised RMPP at end of period	(90)	(144)

Liabilities	Share of RMSEPP 2014 £m	Share of RMSEPP 2013 £m
Share of liabilities in RMSEPP plans at beginning of period	(24)	(22)
Current service cost	-	-
Curtailment costs*	-	-
Finance cost	(1)	(1)
Employee contributions	-	-
Actuarial loss	-	(1)
Benefits paid	1	-
Share of liabilities in RMSEPP at end of period	(24)	(24)

*The curtailment costs in the profit and loss account are recognised on a consistent basis with the associated compensation costs. Estimates of both are included, for example, in any redundancy provisions raised. The curtailment costs above represent the costs associated with those people paid compensation in respect of redundancy during the accounting period. Such payments may occur in an accounting period subsequent to the recognition of costs in the profit and loss account.

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d) Recognised charges

An analysis of the separate components of the amounts recognised in the performance statements of the Company is as follows:

	2014 sectionalised RMPP £m	2013 sectionalised RMPP £m
Analysis of amounts recognised in the profit and loss account		
Analysis of amounts charged to operating profit before exceptional items:		
Current service cost	25	24
Total charge to operating profit before exceptional items		
Analysis of amounts charged to operating exceptional items:		
Royal Mail Pension Plan amendment	(102)	-
Loss due to curtailments	1	2
Total (credit)/charge to operating profit		
	(76)	26
Analysis of amounts charged/(credited) to net pensions interest:		
Interest on plan liabilities	7	9
Interest income on plan assets	(12)	(11)
Net pensions credit to financing		
	(5)	(2)
Net (credit)/charge to the profit and loss account before deduction for tax		
	(81)	24
Analysis of amounts recognised in the statement of changes in equity		
Transfer of pension liabilities to government	-	2,239
Transfer of pension assets to government	-	(1,953)
Gain on transfer to government	-	286
Total gains recognised in the statement of changes in equity		
	-	286
Analysis of amounts recognised in the statement of comprehensive income		
Actual return on plan assets	(12)	57
Less: expected interest income on plan assets	(12)	(11)
Less: taxation on surplus recoverable through plan refunds	(20)	(3)
Actuarial (losses)/gains on assets (all experience adjustments)	(44)	43
Experience adjustments on liabilities	-	(20)
Effects of changes in actuarial assumptions on liabilities	(8)	(9)
Actuarial losses on liabilities	(8)	(29)
Total actuarial (losses)/gains recognised in the statement of comprehensive income		
	(52)	14

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14. Called up share capital

	2014 £	2013 £
Authorised		
Ordinary shares of £1 each	51,000	51,000
Total	51,000	51,000
Allotted and issued		
Ordinary shares of £1 each	50,003	50,003
Total	50,003	50,003

15. Commitments

Capital commitments contracted for but not provided in the financial statements amount to £68 million (2013 £48 million).

Details of the Company commitments under non-cancellable operating leases are disclosed in the Group financial statements (note 20).

16. Finance lease liabilities

Details of the Company's finance lease liabilities are disclosed in the Group financial statements (note 21).

17. Related party disclosures

Details of transactions with related parties are disclosed in the Group financial statements (note 22).

18. Post balance sheet events

In accordance with the funding agreement with government announced on 27 October 2010, for which State Aid approval was received on 28 March 2012, Post Office Limited received £330 million of funding on 1 April 2014.

19. Immediate and ultimate parent company

At 30 March 2014, the Directors regarded Postal Services Holding Company Limited as the immediate and ultimate parent company. The largest group to consolidate the results of the Company is Postal Services Holding Company Limited, a company registered in the United Kingdom. Postal Services Holding Company Limited financial statements can be obtained from Companies House.

20. Transition to FRS 101

For all periods up to and including the year ended 31 March 2013, the Company prepared its financial statements in accordance with the previously extant United Kingdom generally accepted accounting practice (UK GAAP). These financial statements, for the year ended 30 March 2014 are the first the Company has prepared in accordance with FRS 101.

Accordingly, the Company has prepared individual financial statements which comply with FRS 101 applicable for periods beginning on or after 26 March 2012 and the significant accounting policies meeting those requirements are described in the relevant notes.

In preparing these financial statements, the Company has started from an opening balance sheet as at 26 March 2012, the Company's date of transition to FRS 101, and made those changes in accounting policies and other restatements required for the first-time adoption of FRS 101. As such, this note explains the principal adjustments made by the Company in restating its previously published UK GAAP financial statements for the year ended 31 March 2013. No restatements are required in relation to the Company balance sheet for the year ended 25 March 2012.

On transition to FRS 101, the Company has applied the requirements of paragraphs 6-33 of IFRS 1 'First time adoption of International Financial Reporting Standards'.

IFRS 1 allows first-time adopters certain exemptions from the general requirements to apply IFRSs as effective for March 2014 year ends retrospectively. The Company has taken advantage of the following exemptions:

Cumulative actuarial gains and losses on pensions and other post employment benefits are recognised in full in equity on the date of transition to IFRS. This is the same treatment as under UK GAAP.

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	Notes	UK GAAP £m	FRS 101 Re- measurements/ Re- classifications £m	IFRS Total £m
Reconciliation of equity as at 31 March 2013				
Intangible assets		-	-	-
Tangible assets		11	-	11
Investment in subsidiaries		-	-	-
Investments in joint ventures and associates		1	-	1
Retirement benefit surplus	1	100	(3)	97
Debtors – receivable after more than one year	2	10	(10)	-
Total non-current assets		122	(13)	109
Current assets				
Stocks		8	-	8
Debtors – receivable within one year		352	-	352
Debtors – receivable after more than one year		-	10	10
Financial assets – investments		92	-	92
Financial assets – derivatives		1	-	1
Cash at bank and in hand		879	-	879
		1,332	10	1,342
Current liabilities				
Creditors – amounts falling due within one year		(877)	-	(877)
Financial liabilities – interest bearing loans and borrowings		(291)	-	(291)
Net current assets		164	10	174
Total assets less current liabilities				
		286	(3)	283
Creditors – amounts falling due after more than one year		(28)	-	(28)
Provisions for liabilities		(26)	-	(26)
Net assets		232	(3)	229
Capital and reserves				
Called up share capital		-	-	-
Share premium		465	-	465
Profit and loss account		(233)	(3)	(236)
Shareholder's surplus		232	(3)	229

- Under IFRS the retirement benefit surplus as at 31 March 2013 was assessed under IFRIC 14 which requires the maximum asset to be recognised using appropriate recovery methods. An element of the defined benefit surplus on the balance sheet was recoverable through a reduction in future pension contributions which created a separate deferred tax liability. The remainder was recoverable through a refund from the pension scheme which was subject to a tax deduction at 35% which was shown net against the pension surplus. Under UK GAAP no retirement benefit surplus is recognised based on refunds, and the surplus as at 31 March 2013 was recoverable fully through a reduction in future pension contributions and therefore created a larger deferred tax liability.

The impact of transition to FRS 101 has been to decrease the retirement benefit surplus as at 31 March 2013 by £3 million in order to recognise the tax deduction on the element of the surplus recoverable through a refund from the pension scheme. This also had the effect of reducing the actuarial gain recognised through reserves from £17 million under UK GAAP, to £14 million under FRS 101.

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The effect of the transition on reported profit of the Company for the year ended 31 March 2013 is as follows:

	£m
Profit for the year ended 31 March 2013 under UK GAAP	76
Deferred tax asset	(2)
Profit for the year ended 31 March 2013 under IFRS	74

The corresponding movement in the deferred tax liability is taken through the Company statement of comprehensive income, and therefore has no overall effect on equity.

2. The use of FRS 101 requires preparation of a balance sheet in accordance with *'The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008'* which requires presentation of debtors falling due after more than one year within current assets.

Post Office Limited

Corporate information

Registered Office

Post Office Limited
148 Old Street
LONDON
EC1V 9HQ

Auditor

Ernst & Young LLP
1 More London Place
LONDON
SE1 2AF

Solicitor

Linklaters LLP
One Silk Street
LONDON
EC2Y 8HQ

Actuary

Towers Watson Limited
Watson House
London Road
REIGATE
Surrey
RH2 9PQ

Consumer Body

Consumer Focus
4th Floor
Artillery House
Artillery Row
London
SW1P 1RT

Annex 4



Post Office Limited
Audit, Risk and Compliance Board Sub-Committee
Briefing Book
Full Year ended 30 March 2014

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1. Glossary

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

Abbreviation	Meaning
AEI	Application Enrolment Identity
ATM	Automated teller machine
BACS	Bankers' Automated Clearing Services
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
GRNI	Good Received Not Invoiced
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
RM	Royal Mail
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
FBU	Fair, Balanced and Understandable

2. Introduction

This Briefing Book has been prepared to explain the Post Office Limited results for the full year ended 30 March 2014. It is a summary of the key data, trends and analyses to be read in conjunction with the Annual Report & Financial Statements, which readers may find useful to further their own understanding of the results for full year 2013-14.

Most of the analysis is based on 2013-14 outturn compared to the 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 Consolidated Income Statement

Post Office Limited consolidated income statement for the 52 weeks ended 30 March 2014 and 53 weeks ended 31 March 2013

		30 March 2014 £m	31 March 2013 £m
	Notes		
Continuing operations			
Turnover		979	1,024
Network Subsidy Payment	8.1	200	210
Revenue		1,179	1,234
People costs excluding restructuring costs	7.2	(255)	(259)
Other operating costs	7.3	(850)	(913)
Share of post tax profit from joint ventures and associates		33	32
Operating profit before exceptional items	5	107	94
Operating exceptional items	10.1	45	(47)
- government grant		317	98
- Royal Mail Pension Plan amendment		102	-
- restructuring costs		(259)	(79)
- other		(115)	(66)
Operating profit		152	47
Profit on disposal of property, plant and equipment	10.1	3	2
Loss on sale of associate		-	(30)
Profit before financing and taxation		155	47
Finance costs	11.1	(3)	(4)
Finance income		1	1
Net financing income relating to pensions		5	2
Profit before taxation		158	18
Taxation credit	18.1	12	31
Profit for the financial year from continuing operations		170	49

4.2 Post Office Limited Consolidated Cashflow Statement

Post Office Limited consolidated cashflow statement for the 52 weeks ended 30 March 2014 and 53 weeks ended 31 March 2013

	2014	2013
	£m	£m
Cash flows from operating activities		
Operating profit before exceptional items	107	94
Adjustment for:		
Depreciation and amortisation	-	-
Share of profit from joint ventures and associates	(33)	(32)
Pension operating costs	27	25
Working capital movements:	(20)	63
Decrease/(increase) in trade and other receivables	45	(138)
(Decrease)/increase in trade and other payables	(67)	199
Decrease/(increase) in inventories	2	(2)
Increase in non-exceptional provisions	-	4
Pension operating costs paid	(24)	(26)
Cash receipts in respect of operating exceptional items:	12	133
Government grant	215	200
Restructuring costs	(170)	(52)
Other	(33)	(15)
Net cash inflow from operating activities	69	257
Income tax recovered	11	11
Cash flows from investing activities		
Investment in associate	-	(11)
Dividends received from joint ventures and associates	32	40
Finance income received	1	1
Proceeds from sale of property, plant and equipment	3	2
Proceeds from disposal of associate	-	2
Purchase of non-current assets	(101)	(58)
Net cash outflow from investing activities	(65)	(24)
Net cash inflow before financing activities	15	244
Cash flows from financing activities		
Finance costs paid	(3)	(3)
Payments to finance lease creditors	(4)	(3)
Repayment of borrowings from BIS	(291)	(86)
Net cash outflow from financing activities	(298)	(92)
Net (decrease)/increase in cash and cash equivalents	(283)	152
Effect of exchange rates on cash and cash equivalents	-	(1)
Cash and cash equivalents at the beginning of the year	971	820
Cash and cash equivalents at the end of the year	688	971

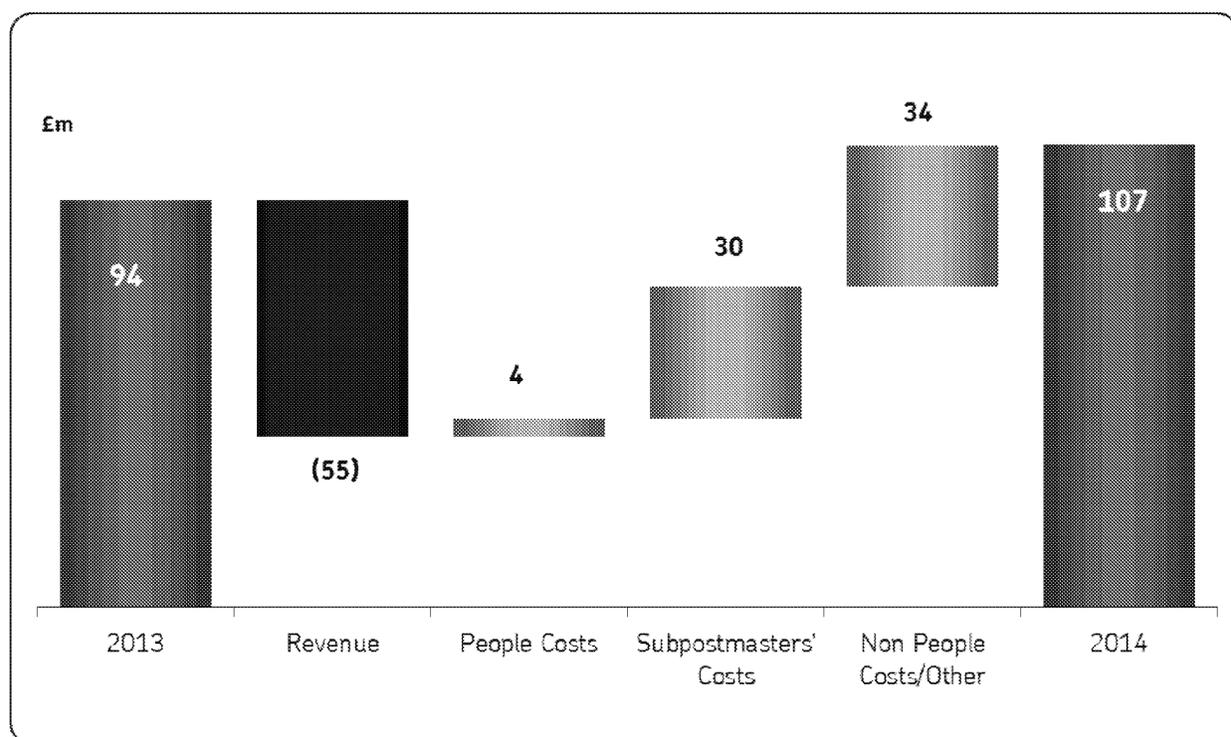
4.3 Post Office Limited Consolidated Balance Sheet

Post Office Limited consolidated balance sheet at: 30 March 2014 and 31 March 2013

	Notes	2014 £m	2013 £m
Non-current assets			
Intangible assets		-	-
Property, plant and equipment	13.1	10	11
Investments in joint ventures and associates	14.1	61	60
Retirement benefit surplus	9	148	97
Trade and other receivables		15	10
Total non-current assets		234	178
Current assets			
Inventories	15.1	6	8
Trade and other receivables	15.2	302	352
Cash and cash equivalents		738	971
Financial assets – derivatives		-	1
Total current assets		1,046	1,332
Total assets		1,280	1,510
Current liabilities			
Trade and other payables	15.3	(767)	(874)
Financial liabilities – interest bearing loans and borrowings	11.2	-	(291)
- obligations under finance leases	11.2	(3)	(3)
Provisions	16	(70)	(19)
Total current liabilities		(841)	(1,187)
Non-current liabilities			
Financial liabilities – obligations under finance leases	11.2	-	(4)
Other payables		(28)	(24)
Provisions	16	(8)	(7)
Total non-current liabilities		(36)	(35)
Net assets		404	288
Equity			
Share capital		-	-
Share premium		465	465
Retained earnings		(63)	(179)
Other Reserves		2	2
Total equity		404	288

5. Operating Profit

5.1 Operating profit bridge analysis



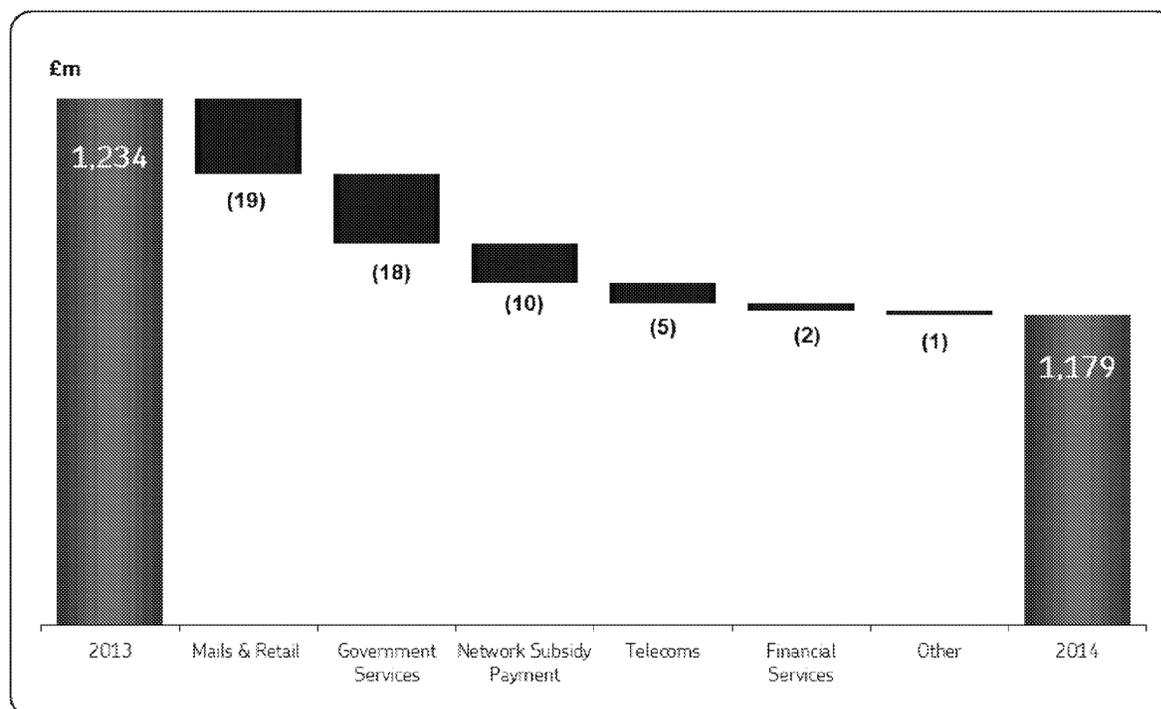
5.2 Explanations for key movements are as follows:

- 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

	30 March 2014 £m	31-March 2013 £m	Variance £m
Turnover	979	1,024	(45)
Network Subsidy Payment	200	210	(10)
Revenue	1,179	1,234	(55)

6.1 Revenue bridge analysis



The decrease in year on year total revenue of £55m (4.5%) to £1,179m (2012 £1,234m) is driven by a decrease of £45m in turnover and the £10m decrease in the Network Subsidy Payment.

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

6.1.1 Mails

The £16.1m (4.5%) decrease in Mails revenue is driven by volume reductions following the Royal Mail parcel price changes implemented in May 2013 together with the unusually high prior year figure reflecting the impact of the buy forward of stamps prior to the May 2012 price increase and the 53rd trading week in 2012-13.

- Approximately £19.1m was driven by volume decreases, (mainly stamps, labels and parcels) and a further £1.2m by the reduced fixed fee, partially offset by a £4.3m favourable impact driven primarily by Dangerous Goods income.

6.1.2 Retail & Lottery

Retail and Lottery revenues have decreased by £3.0m:

- Lottery is £1.2m lower than last year, driven by lower Euromillions volumes and fewer rollovers, partially offset by the UK Lottery price increase in Oct 2013.
- Retail is down by £1.8m due to lower sales as the prior year included higher Collectibles revenue for the Olympic and Paralympic games, as well as the Diamond Jubilee.

Mails & Retail Income is analysed in the table below:

	2013-14	2012-13	Variance	Volume	Price
	£m	£m	£m	£m	£m
Special Delivery	51.4	53.2	(1.8)	(1.7)	(0.1)
Parcelforce 24/48	11.2	8.3	2.9	8.1	(5.2)
Labels	92.4	100.2	(7.8)	(11.8)	4.0
Stamps	30.6	35.2	(4.6)	(4.8)	0.2
Royal Mail Parcels	0.0	6.2	(6.2)	(6.2)	-
International Priority & Standard	34.1	34.9	(0.8)	(2.3)	1.5
Other Parcel Force	8.2	8.1	0.1		0.1
Other Royal Mail	41.2	37.8	3.4	(0.4)	3.8
Total Variable Income	269.1	283.9	(14.8)	(19.1)	4.3
Fixed Fee	73.2	74.4	(1.2)	-	(1.2)
Total Mails	342.2	358.3	(16.1)	(19.1)	3.1
Lottery	38.9	40.2	(1.2)	(1.2)	-
Retail	8.8	10.5	(1.8)	(1.8)	-
Total Mails & Retail	389.9	409.0	(19.1)	(22.2)	3.1

6.1.3 Government Services

The £17.7m (10.8%) decrease in Government Services revenue is principally due to:

- £11.9m lower DVLA revenues from lower new contractual rates and lower volumes.
- £6.3m adverse from falling numbers of live POCA accounts due to natural attrition and migration of customers to bank accounts.
- £3.1m lower AEI impacted by the reduced rates from the new DVLA contract and the UKBA product being new in the prior year and so income was set at an assured level.

This is offset by;

- £1.6m increase in check & send revenues driven by higher volumes.
- £1.2m recovery of ID Assurance development costs incurred in the year

6.1.4 Telecoms

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

Telecoms Services revenue of £124.2m (2012: £129.5m) has decreased by £5.3m. Income from the Post Office Homephone and Broadband product decreased by £3.5m, primarily due to lower customer numbers and reduced average revenues per customer.

During the year the service provider was changed from BT to Fujitsu. There were initial operational issues and the marketing campaign was delayed resulting in a fall in customer numbers from 475,576 to 447,677.

Income from mobile top-ups and phone cards was £1.6m 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 circa 5%.

6.1.5 Financial Services

Financial Services income has decreased by £1.2m year on year. This continues the trend of declining traditional products, largely offset by the continued increases in new products. Overall PFS (defined as Post Office savings, insurance, travel, mortgages and transaction services) is up by £15.2m (15.2%) year on year. By product the main Financial Services variances are:

- £6.6m 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,
- £8.4m net decrease in Banking revenue from:
 - a £6.7m decrease in business banking revenues due to rate reduction from renegotiated contract, and
 - a £3.9m fall from DWP exceptions (cash cheques and green giros). This work has now ceased, offset by
 - an increase of £2.2m in personal banking due to increased volumes and new clients.
- £2.5m decrease from Payment Services due to:
 - a £2.4m decrease in Postal Order income as the product is in decline, and
 - a £1.6m 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, offset by
 - a £0.6m increase from Post office pay out due to new contracts and clients, and
 - a net increase of £0.3m across other products.

The above decline was offset by;

- £9.4m increase in savings products commissions mainly Growth Bonds £4.4m, Reward Saver £2.8m, and ISA £3.0m. These increases follow the completion of the 'Eagle' deal in September 2012,
- £2.2m increase in Mortgages as this a new product,
- £3.0m increase in Insurance revenues driven by the new BOI/ Junction contract and better rates, and
- £1.2m increase in ATM revenue, driven by the rollout of new machines and increased volumes as machines reach maturity.

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 full year ending 30 March 2014 compared to the full year ending 31 March 2013

		2013-14	2012-13	Variance	Variance
		£m	£m	£m	%
Expenditure - (pre- exceptional)	Notes				
Wages & Salaries		174	182	8	4%
Overtime		10	9	(1)	(7%)
Productivity/Bonus		16	15	(1)	(5%)
Employers NI		20	19	(1)	(7%)
Pensions		27	25	(2)	(8%)
Projects (temp people resource)		1	2	1	27%
Temporary Resource		7	7	0	3%
PEOPLE COSTS	7.2.1	255	259	4	2%
Subpostmasters' costs	7.3.1	448	478	30	6%
Collection, Delivery & Conveyance Charges	7.3.2	0	1	1	67%
Compensation	7.3.3	5	1	(4)	(644%)
Property Facilities	7.3.4	59	62	4	6%
Property Maintenance	7.3.5	7	8	1	12%
Vehicles	7.3.6	8	9	1	5%
Computers & Telephones	7.3.7	75	79	4	5%
Consultancy, Marketing & Legal Fees	7.3.8	33	27	(6)	(22%)
Staff & Agent Related Costs & Consumables	7.3.9	4	2	(2)	(146%)
Finance	7.3.10	11	16	5	29%
Cost of Sales	7.3.11	113	121	8	7%
Other Operating Costs	7.3.12	63	57	(6)	(10%)
Depreciation		0	0	0	(1%)
Projects (excluding temp people resource)	7.3.14	25	52	27	52%
Total Other Operating Costs	7.3	850	913	63	7%
TOTAL EXPENDITURE (Pre Exceptionals)		1,105	1,172	67	6%

7.2 People Costs (2014 £255m vs 2013 £259m)

7.2.1 People costs (2014 £255m vs 2013 £259m)

People costs have decreased by £4.3m (1.7%) to £254.7m, representing 23.1% (2013 22.1%) of the cost base.

The number of people employed also decreased, by 99 to 7,787 at 30 March 2014 (2013 7,886), primarily due to redundancies arising from the Crown Transformation Programme.

The people cost movement comprises:

- Wages and Salaries have decreased by £8.1m (4.4%), of which 3.4m relates to the 53rd week, Crown staff reductions and the remainder is due to industrial action savings.
- Pension costs have increased by £2.2m (8.9%), driven primarily by the increase in the IAS19 pension service cost rate from 18.2% to 20.6%.
- Productivity costs have increased by £0.9m (5.9%), and are predominantly due to a £2.1m increase in the LTIP accrual as none was booked in 2012-13 following an over provision in 2011-12, additional bonus costs relating to 2012-13 of £1.8m due to high performance in the final quarter, partially offset by a £2.8m lower performance related bonus accrual for 2013-14.
- Overtime has increased by £0.6m (6.5%).
- Temporary resource costs have decreased by £0.3m (2.7%), 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 year.

The People numbers were as follows:

	Period end employees		Average employees	
	30 March 2014	31 March 2013	2013-14	2012-13
Total employees	7,787	7,886	7,950	7,861

7.2.3 Average Cost Per Employee

The average number of employees for year ending 30 March 2014 was 7,950 (2013 7,861). The average annual cost per employee (excluding exceptional costs and exceptional heads) based on these averages has increased by £114 (0.3%) to £34,114 (2013 £34,000),

7.3 Other Operating Costs (2014 £850m vs 2013 £913m)

7.3.1 Subpostmasters costs (2014 £448m vs 2013 £478m). Total subpostmasters costs decreased by £30.6m (6.3%);

- £16.2m due to lower sales, including the impact of the 53rd week and lower Mails volumes following the price changes in 2013 and the prior year buy forward pre May 2012 price increase,
- £7.5m lower fixed pay from unfreezing the Core Tier Payment and roll out of Locals,
- £3.2m relating to the accrual in 2012-13 for a lump sum to compensate for the lower rate/ transaction for DVLA,
- £2.5m improved VAT recovery,
- partially offset by a £1.0m increase for payments for mails segregation.

The average annual cost per subpostmaster branch (excluding VAT and NI) is £41,532 (2013 £43,727). This is a 5.0% decrease on the prior year.

	2013-14	2012-13
Agency Branches (incl. Mains and Locals)	10,257	10,347
Outreach	1,091	1,060
Crown	350	373
Total Branches	11,698	11,780

7.3.2 Collection, Delivery & Conveyance costs have decreased by £1.1m due to ATM replenishment costs, which were paid to an external company, now being fulfilled by internal Supply Chain staff.

7.3.3 Compensation costs have increased by £4.0m, mainly due to an accrual for the Mail segregation contract penalties of £3.0m.

7.3.4 Property Facilities costs have decreased by £3.5m, due to a decrease of £1.7m in the provision for the extension of business rates to ATM's, £1.1m reduction in general rates, £1.6m decrease in property business as usual costs offset by £0.9m increase in electricity and security charges.

7.3.5 Property Maintenance costs has decreased by £1.0m, due to the Network or Crown Transformation Programme (Romec maintenance costs) reducing the requirement for routine maintenance.

7.3.6 Vehicles have decreased by £0.5m due to improved vehicle maintenance rates following separation and resultant change of supplier.

- 7.3.7 Computers and Telephones costs have decreased by £3.8m mainly due to a £3.9m discount relating to Horizon Fujitsu Costs. In addition there was a £1.8m decrease in CSC and Prism charges which was offset by a net increase of £1.9m for software licences, BT charges and computer maintenance.
- 7.3.8 Consultancy, Marketing & Legal Fees have increased by £5.9m year on year. £4.4m relates to increased marketing costs, in the prior year rebranding was within project one- off costs, £1.1m increase in internet production, £0.7m relates to increased consultancy costs for the Programme Office Operating model and mutualisation and £0.4m increased legal costs relating primarily to separation. The remainder relates to decrease in database management and creative agency fees.
- 7.3.9 Staff & Agent Related costs & Consumables have increased by £2.5m due to T&S costs of £0.3m (partly due to strike cover) £1.0m recruitment due to reclassification from other staff related costs, £0.7m medical charges due to changes post separation from the ATOS contract and £0.9m training costs for the Senior Leadership Team, IT teams and Crown Staff partially offset by savings in printing & stationary and excess fares.
- 7.3.10 Finance costs have decreased by £4.5m, mainly driven by £7.3m higher VAT rebates, offset by an increase in bank charges/ insurance premium (previously RM, now in house since September 2012) of £1.8m and the ceasing of the Bureau rebate of £2.2m (ceased October 2012).
- 7.3.11 Cost of Sales has decreased by £8.2m (6.7%), mainly driven by 53rd week impact and new supplier contract. The main reasons are detailed below:

Cost of Sales

	30 March 2014	31 March 2013	Variance	Variance	Comments
	£m	£m	£m	%	
Telecoms	78	85	7	7%	Reduction of £6.2m due to 53 rd week impact and new supplier contract (Fujitsu)
Government Services	30	30	0	2%	
Mails & Retail	4	5	1	22%	Decreased Sales due to collectable products for Jubilee and the Olympics
Financial Services	1	1	0	13%	
Total	113	121	8	7%	

- 7.3.12 Other Operating costs have increased by £5.6m mainly driven by £6.0m higher telephony supplier costs during migration and £1.5m increase in Official Mail costs, offset by a net decrease of £1.9m from other costs.

7.3.13 Expenditure with Royal Mail is now reported within the appropriate cost categories but has remained flat overall as shown below:

	2013-14	2012-13	Variance
Expenditure with Royal Mail	£m	£m	£m
Official Mail (Other Operating Costs)	18	16	(2)
Call Centres (Other Operating Costs)	5	5	0
Facilities Management (Accommodation –Property Facilities)	16	15	(1)
Vehicle Services (Vehicles)	6	6	0
Romec (Accommodation –Property Facilities/ Maintenance)	10	10	0
Property (Accommodation –Property Facilities)	31	32	1
Overhead Allocations (Other Operating Costs)	15	15	0
Other (Other Operating Costs)	0	1	1
Total	101	100	(1)

7.3.14 Project expenditure has decreased by £27m to £26m and is detailed below:

2013-14 Project Expenditure	£m
Customer Engagement (Brand Campaign)	7
Financial Services (Portfolio)	2
FOoG (DVLA Enhancements & Home Office Development)	2
Telecoms (Fixed Line Tender, Contract negotiations and Migration & Mobile)	4
Mails (Collections & Returns, Small, Medium Business Proposition)	1
Finance (Business Operating Model)	1
HR & Compliance (Recruitment, Training & Data Protection & Freedom of Information)	2
IT Delivery (Salesforce Licences & RMG Small App Migration (UEX Phase 2)	2
Property (Crown Network)	1
Supply Chain (North West Cash Centre & Swindon Barcode Scanners & Printer)	1
Security (Fraud Software Analysis)	1
Digital (Digital & Multi-Channel)	1
Network	1
Network Transformation (property)	1
Total Projects (excluding temp people resource & IB)	25
Projects (temporary resource)	1
Grand Total	26

8. Quality of Earnings

		2013-14	2012-13	Growth	
Post Office Limited (consolidated)		£m	£m	£m	%
Reported profit before other exceptional items		107	94	13	14%
Network Subsidy Payment	8.1	(200)	(210)	10	5%
Project one off costs	8.2	26	53	(27)	51%
Reported profit before project one off costs, exceptional items and NSP		(67)	(63)	(4)	(5%)
Bonus outturn higher in 2012-13 than accrued	8.3	2	(2)		
VAT/NI recovered re prior year agents' fees	8.4		(1)		
VAT recovery re earlier years	8.4	(9)	7		
LTIP over-accrued in 2011-12	8.5		(2)		
Total adjustments		(7)	2		
Total		(74)	(61)	(13)	(21%)

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.

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 accelerated but have decreased in 2013-14. These costs were excluded from the quality of earnings calculation in 2012-13 due to the particularly high level in that year and have been excluded again for comparison. The level of spend is expected to remain more consistent in future years so this adjustment is likely to cease to be required.

8.3 2012-13 bonus outturn

The bonus outturn was £1.8m higher than accrued due to higher performance in the final quarter and higher than anticipated individual performance scores.

8.4 VAT recovery re earlier years

There were additional VAT recoveries relating to earlier years when the final recovery rates were confirmed with HMRC.

8.5 LTIP over-accrued in 2011-12

Following a change in the scheme rules, LTIP was overaccrued at the end of 2011-12 and resulted in no charge being required in 2012-13 as the accrual balance was corrected.

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

Royal Mail Pensions Trustees Limited manages the main defined benefit scheme Royal Mail Pension Plan (RMPP) which has circa 5,600 Post Office active members.

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 year to 30 March 2014 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. 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 RMPP Post Office Section	March 2014	March 2013
Inflation (RPI)	3.3	3.3
Inflation (CPI)	2.3	2.3
Discount rate (i.e. bond rate)	4.5	4.8
Rate of increase in Pensionable salaries	3.2	4.3
Rate of pension increases – RMPP A/B	2.3	2.3
Rate of pension increases – RMPP C	3.2	3.2
Rate of increases in deferred pensions	3.2	3.2

Demographic assumptions, for example mortality, remain aligned with the assumptions used for the actuarial valuation and unchanged from those made in March 2013.

The RMSEPP inflation risk premium adjustment assumption is 0.1 basis points lower reflecting the shorter duration of the liabilities and resulting in a RPI assumption of 3.4% and a CPI assumption of 2.4%. The rate of pension increases is at CPI for those who transferred in from RMPP section A/B and at RPI for all other members. The rate of increase in deferred pensions is at CPI.

9.3 Movements in the defined benefit surplus

The movement in the RMPP defined benefit surplus during the year to 30 March 2014 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.

	Year ended 30 March 2014 £m	Year ended 31 March 2013 £m
Opening sectionalised RMPP net retirement benefit surplus/(deficit)	99	(205)
Royal Mail Pension Plan amendment	102	-
Transfer of pension deficit to government	-	286
Current service cost	(25)	(24)
Curtailment costs	(1)	(2)
Net financing credit	5	2
Employers contributions	22	25
Actuarial (losses)/gains	(32)	17
Closing RMPP net retirement benefit surplus	170	99
RMSEPP surplus	2	1
Total net retirement benefit surplus	172	100
Effect of asset ceiling	(24)	(3)
Closing net retirement benefit surplus	148	97

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%). Payments of £21m were made in respect of RMPP future service contributions at a rate of 17.1% (2012 - 17.1%) and £1m was paid in respect of redundancies.

The net financing credit of £5m, 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 £32m during the year arose primarily due to a decrease in the value of assets as a result of changes in market conditions for corporate bonds.

A £1m deficit contribution was paid in relation to RMSEPP and the RMSEPP surplus has increased from £1m to £2m at 30 March 2014.

The charge in the income statement and cash contributions for the defined contribution scheme were £2m in the year to 30 March 2014.

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. Royal Mail took legal advice both before and after sectionalisation. This confirmed that Post Office Limited and Royal Mail Plc have absolute rights to the assets left over in their individual sections after benefits have been secured if the RMPP terminates. There is no trigger for termination in the Trust Deed but that does not mean that the RMPP cannot terminate. It would be wound up by the courts, or the Regulator, or when the last beneficiary dies. Towers Watson has calculated that Post Office Limited would be able to recover £104m of the £170m surplus in RMPP through lower contributions and the remaining £60m 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, (made up of a £170m surplus for RMPP and £2m surplus for RMSEPP), has been reduced by £24m to £148m. 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 year to 30 March 2014.

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 years ended 30 March 2014 and 31 March 2013.

10.2	2013-14 £m	2012-13 £m
Exceptional items		
Operating Exceptionals:		
Royal Mail Pension Plan amendment	102	-
Government Grants	317	98
Restructuring costs including Subpostmasters compensation	(259)	(79)
Impairments	(115)	(66)
Total operating exceptionals	45	(47)
Non operating exceptionals:		
Profit on disposal of property	3	2
Loss on sales of associate	-	(30)
Net Exceptional gain/ (loss)	48	(75)

Government Grants – In April 2013 the Post Office received grants totalling £215m from the Government, (April 2012 £200m) to fund capital projects and transformation. There were £102m of 2012-13 grants carried forward into 2013-14 as unutilised – these have all been utilised in the current year along with the £215m grants in respect of 2013-14, a total of £317m.

The larger amounts utilised in 2013-14 are: £88m against Subpostmasters' compensation, £94m against capital spend, £85m Network Transformational exceptionals and £30m IT transformational costs.

- 10.3 Restructuring costs – include the costs (£219m) of delivery of a major change in the network. Network and Crown Transformation introduces new style agency offices and seeks to improve fundamentally the profitability of the Crown network. The overall figure includes £106m Network Transformation and Crown Transformation programme costs, £94m Subpostmasters' compensation and £19m Crown redundancy costs. The IT Transformation programme (£21m) will create the IT infrastructure appropriate for an independent group with ambitious growth plans. Other costs included are business separation of £7m, redundancy of £4m, business transformation payments chiefly for Crown staff of £5m and other items of £3m.

Network Transformation	£m
Programme Costs	25
Subpostmasters' Retail Survey	19
Investments (e.g. enabling works)	35
Property project resource	9
Management Consultancy	4
Other (Legal, Comms, consultation, IT projects)	5
Total Network Transformation	97
Crown Transformation	9
Total	106

11. Interest, Cash, Debt, Funding and Hedging

11.1 Net finance costs March 2014 £2m vs March 2013 £3m

	30 March 2014	31 March 2013
	£m	£m
Finance costs & investment income		
Interest received on investments – UK	1	1
Total finance income	1	1
Interest charged on Government borrowings	-	(1)
Interest payable on finance leases	(1)	(1)
Unwinding of discounts	-	(1)
Other finance costs	(2)	(1)
Total finance costs	(3)	(4)
Net finance cost	(2)	(3)

Interest payable on the BIS Loan continued to remain low due to low draw down throughout the year.

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

		30 March 2014	31 March 2013
	Section	£m	£m
Net cash/debt analysis			
Cash in the Post Office Limited network	11.3	708	870
Other cash at bank (overdraft)/deposits		(50)	9
Cash equivalent investments		30	92
Total cash and cash equivalents		688	971
Loans, repayable on demand or less than 1 year	11.4	-	(291)
Obligations under finance leases (current)	11.5	(3)	(3)
Total current financial liabilities		(3)	(294)
Obligations under finance leases (non-current)	11.5	-	(4)
Total		685	673

11.3 Cash within the Post Office Limited network (March 2014 £708m vs March 2013 £870m)

The reduction in Post Office network cash from March 2013 levels is due to the 2012-13 year-end coinciding with Easter bank holidays necessitating increased branch and cash centre holdings, while Easter was after year end 2013-14.

11.4 Loans and borrowings (March 2014 £nil vs March 2013 £291m)

Daily borrowing requirements in 2013-14 are significantly lower than the year end loan position on account of advanced government funding of the £215m transformational funding all of which has been allocated but has not all been spent.

11.5 Obligations under finance leases (current & non-current) (March 2014 £3m vs March 2013 £7m)

The obligations under finance leases have decreased by £4m in the year attributable to lease repayments in 2013-14. Lease types are shown in section 13.2.

11.6 Loan facilities

At year end the Post Office had no external borrowing except for a £50m overdraft facility due to the timing of the payroll run.

12. Going concern

Post Office Limited has net cash and cash equivalents of £738m (section 11.2), a bank overdraft of £50m and a borrowing facility of £1,150m of which none (section 11.4) was drawn down at 30 March 2014.

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 though 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 (received 1 April 2014)
- 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).

On 27 November 2013, a funding agreement was announced providing:

- Funding of £280m for 2015-16
- Funding of £220m for 2016-17
- Funding of £140m for 2017-18
- Extension of the existing working capital facility with BIS up to 31 March 2018 but at a reduced level of up to £950m.

State Aid approval for the funding for 2015-16 to 2017-18 is currently being sought and is anticipated to be given during the 2014-15 financial year.

The going concern analysis is based on the 2020 strategic plan that was the basis for the Government funding agreed.

12.2 Assessment for the Post Office

The Post Office 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, with the exception of 2012-13 and 2013-14, still operated with a cash outflow and expects further cash outflows in the coming years. The 2011-15 plan reversed the trend of an increasing Network Subsidy Payment (NSP) and the 2020 Strategy continues on the path to a sustainable Post Office supported by a much lower subsidy.

The 2014-15 budget and the 2020 Strategy plan financials have been shown in Table 1, and show 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. The funding beyond March 2015 is still subject to State Aid clearance so downsides have been applied to reflect a situation where the funding for NSP and transformation post March 2015 is not available. In addition, downside scenarios have been overlaid reflecting the possibility 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. The working capital facility was deemed not to be State Aid in 2012 so does not require further clearance and is now available (at the reduced level of £950m) through to March 2018.

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 2017. Royal Mail Plc 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 Plc is a going concern or that an alternative mails provider would work similarly with Post Office Limited providing a similar level of income. Post Office Ltd and Royal Mail entered into a ten year agreement (Master Distribution Agreement) in 2012 for the provision of mails products through post offices.

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 March 2014					
£m (cumulative apart from free cash flow)	2012-13	2013-14	2014-15	2015-16	2016-17
Opening Funds	(336)	(204)	(24)	(191)	(505)
Borrowing facilities	1,150	1,150	1,150	950	950
Restriction due to level of network cash	(98)	(286)	(300)	(100)	(100)
Borrowing from other sources - finance leases, bank overdraft etc	14	4			
Latest plan free cashflow before assumed non NSP grant injection	(68)	(35)	(337)	(464)	(77)
Non NSP grant injection per October 2010 plan/ April 2013 plan	200	215	170	150	140
Closing Funds Headroom	862	844	659	345	408
Downside impact of no NSP beyond March 2015				(130)	(210)
Downside impact of no further grant injection beyond March 2015				(150)	(290)
Adjusted Headroom pre risk	862	844	659	65	(92)

Table 2: Risks, with management actions					
£m (cumulative)	2012-13	2013-14	2014-15	2015-16	2016-17
Headroom pre risk (as above)	862	844	659	65	(92)
Risks					
Financial Services growth slower than plan			(8)	(18)	(60)
Mails revenue decline halted but not reversed (net of agents' cost saving)			(10)	(20)	(30)
Network Transformation benefits are not fully delivered			(6)	(9)	(12)
Crown Transformation benefits are not fully delivered			(10)	(25)	(40)
Pension contribution rates increase			(4)	(8)	(12)
Increase in cost as a consequence of stopping transformation post March 2015				(42)	(126)
Headroom post risks pre management actions	862	844	621	(57)	(372)
Management actions				390	597
Stop transformation post March 2015				188	319
Reduce capex to replacement only (£30m pa) post March 2015				202	278
Headroom post risk and management actions	862	844	621	333	225

Notes:

2012-13 and 2013-14 show the year end outturn, 2014-15 is the approved budget and later years are from the 2020 Strategy.

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 as set out in Table 2.

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.

The action identified to manage the lack of future funding and downside risk within the headroom would be to cease the transformational spend and reduce capex to replacement only at £30m pa. This adds further downside but results in positive headroom to March 2017 even without the funding post March 2015. There are further actions that could be taken but are not required. These include the sale of property.

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 March 2014 was £10m (March 2013 £11m). Movements during the year were as follows:

Movement in NBV	Land and buildings £m	Vehicles, plant and fixtures £m	Intangible fixed assets £m	Total £m
NBV at 31 March 2013	11	-	-	11
Reclassification	(2)	2	-	-
Add capital expenditure	24	48	42	114
Less disposals	-	-	-	-
Less depreciation	-	-	-	-
Less impairment	(23)	(50)	(42)	(115)
NBV at 30 March 2014	10	-	-	10

Reclassifications consisted of alarms and security equipment which had been initially brought to account as property spend and subsequently classified as fixtures.

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 2006-07 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 30 March 2014:

Capital expenditure analysis	Land & buildings £m	Vehicles, plant & fixtures £m	Intangibles £m	Total £m
Technology Roadmap	-	-	14	14
Crown, Network Transformation	20	36	-	56
Separation (from RMG) project	-	-	3	3
IT Delivery	-	-	5	5
Finance Roadmap	-	-	10	10
FOoG Front Office of Govt	-	-	2	2
Vehicles	-	8	-	8
Property	4	-	-	4
Other (items <£1m)	-	5	8	13
Total	24	49	42	115

14. Goodwill, investments and intangibles

14.1 Investments in joint ventures and associates

	30 March 2014 £m	31 March 2013 £m
Investment in joint ventures	61	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 during the year is Post Office Limited's share of 2013-14 post tax profit £33m and a dividend receipt from FRES of £32m.

15. Working capital

15.1 Inventories (March 2014 £6m vs March 2013 £8m)

	30 March 2014	31 March 2013
	£m	£m
Scratchcards	4	5
Retail	2	3
Total	6	8

15.1.1 Inventory written off

The provision for stock write downs and discrepancies remains at £0.5m (March 2013 £0.5m). Shrinkage and obsolete stock written off for the year was £0.3m (March 2013 £0.3m).

15.2 Trade receivables

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

Receivables		30 March 2014	31 March 2013
	Section	£m	£m
Trade receivables	15.2.1	54	32
Client receivables	15.2.2	158	240
Prepayments and accrued income	15.2.3	82	71
Other receivables (taxation)		8	9
Total		302	352

15.2.1 Trade receivables: Current (due within one year)

Trade receivables		30 March 2014	31 March 2013
		£m	£m
Sales ledger		30	18
Doubtful debt provision		(2)	(1)
Homephone debtors		12	14
Homephone provision		(6)	(6)
Subpostmasters debt		13	14
Subpostmasters debtors provision		(8)	(9)
Property debtors		3	-
Bank of Ireland, FRES cost recovery		12	2
Total		54	32

The increase in sales ledger is largely explained by higher year end balances in respect of utility and bill payment partners, also a new debtor with Royal Mail.

Telecoms debtors are similar to opening. Despite some difficulties in establishing a reliable billing pattern – following POL switching provider from BT to Fujitsu – the debtor position is now stable. The telecoms revenue is based on estimated volumes and is not fully supported by Fujitsu data at this stage. As a result the debtor is also not fully supported. A provision has been included for £1.7m of the unsupported balance reflecting a prudent estimate of recoverability.

Receivable balances in relation to former subpostmasters of £8m have been provided for in full in line with previous years. 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 Bank of Ireland cost recovery debtor relates to marketing and promotional spend incurred on their behalf and which should be pre-funded. Agreement of both parties to the costs incurred will enable POL to raise invoices and reduce this debtor.

Cessation of RM managing the accounting for POL's property estate, effective at year end, has resulted in several property balances being newly visible (previously held within RMG). These balances are the prepayment funding with BNP Paribas for April's outgoings, and property rents, rates and services prepaid.

A profile of the trade receivables is as follows:

Trade receivables	30 March 2014	31 March 2013
	£m	£m
Royal Mail	3	-
Bank of Ireland	11	11
FRES	1	-
Partner banks	2	-
Bank of Ireland (ATM commission)	3	2
Bill payment partners	3	1
Subpostmasters	-	1
Telecoms under-billing (Fujitsu)	3	-
Others	4	3
Total	30	18

Ageing of trade receivables:

Debtors over 60 days overdue: March 2014 £0.5m (March 2013: £0.4m).

The Post Office does not have a general risk in relation to bad debts due to the agency and business partner nature of our client base. This is fully provided for.

15.2.2 Client receivables

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

Client receivables	30 March 2014	31 March 2013
	£m	£m
ATM (Bank of Ireland)	96	123
Card Account (JP Morgan)	30	76
Partner banks	22	29
Others	10	12
Total	158	240

The reason for the significant difference in Client levels year on year 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 March 2014 £82m (March 2013 £71m)

Accrued income represents the majority of this amount (March 2014: £65m, March 2013: £34m), Royal Mail is a new accrual at March at value £26m (previously a net of all Royal Mail balances was shown), otherwise year on year the product components and values are similar. The larger accruals at March 2014 are: Bank of Ireland commissions £9m, DWP card account income for March £6m, and telecoms income £6m.

A new prepayment at March 2014 is £4m relating to property costs, as responsibility for property transferred to the Post Office from Royal Mail at year end. The prepayment of telephony take-on costs with Fujitsu is £6m at March 2014 (March 2013: £2m)

A prepayment existing at March 2013 – nil at March 2014 – was a £28m advance payment to Fujitsu in respect of the 2013-14 operational costs, which has not been repeated.

15.3 Payables: **amounts due within one year**

A summary of payables categories is:

		30 March 2014	31 March 2013
	Section	£m	£m
Trade payables	15.3.1	54	49
Accruals and deferred income	15.3.1	133	110
Client payables	15.3.2	438	528
Advance customer payments		37	50
Capital payables		31	18
Social security		14	10
Business transformation		10	7
Government grant deferred income	10.2		102
Bank Overdraft		50	-
Total		767	874

15.3.1 Trade payables and accruals

Trade payables and accruals	30 March 2013	31 March 2013
	£m	£m
Trade payables	54	49
Accruals, GRNI	98	55
Subpostmaster, employee pay balances	14	24
Productivity, bonus schemes	14	16
Deferred income (Gamma)	4	7
Others	3	8
Total	187	159

Manual accruals and GRNIs represent the material trade liabilities at any point. High levels of project activity commensurate with the Transformational programmes currently underway are driving this liability, being Crown, Network, Separation and Finance Roadmap programmes.

Within trade payables at March 2014 is the largest supplier balance, Royal Mail, at £12m which had no prior year equivalent (as previously noted Royal Mail balances were netted off). March 2013 had included a one-off entry for Clydesdale Bank of £7m. The remaining trade payables balances relate to the purchase ledger.

Included in subpostmaster pay balances at March 2013 is a £3m one-off accrual for DVLA payments and £7m product pay due on account of March being a five week period. (March 2014 equivalents: £nil)

15.3.2 Client payables

	30 March 2014	31 March 2013
	£m	£m
Santander	135	183
NS&I	19	28
DVLA	56	107
Utility companies	18	24
Bank of Ireland	5	8
BACS	45	59
Royal Mail	36	-
Others	124	119
Total	438	528

March 2013 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.

Royal Mail is a new balance during 2013-14.

15.3.3 Client advances

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

Client advances	30 March 2014	31 March 2013
	£m	£m
Client advances, deferred income	11	23
Postal order liability	15	17
Homephone line rental advance payments	11	10
Total	37	50

15.4 Payables: amounts due after one year

Payables due after one year	30 March 2014	31 March 2013
	£m	£m
Amounts due under finance leases	-	4
Bank of Ireland deferred income (Gamma)	28	24
Total	28	28

Bank of Ireland deferred income concludes in financial year 2022-23 and is recognised in line with an agreed amortisation schedule. In addition to the above sum, there is £4m in March 2014 trade payables and a further £5m remains to be received in 2014-15 and £2m in 2015-16.

16. Provisions

Provisions March 2014 £78m vs March 2013 £26m)

	Crown Conversions Project £m	Network Transformation £m	Other £m	Total £m
At 31 March 2013	7	10	9	26
Charged/ (released) in operating exceptional items	(2)	93	27	118
Charged in operating costs		-	6	6
Utilisation	(3)	(52)	(17)	(72)
At 30 March 2014	2	51	25	78
				70
				8

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 March 2014. The programme is further advanced than a year ago hence the liability is increased.

Crown conversions relates to the contract with WH Smith for the original tranche of Crown outlets franchised (2008-9). 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 £2m. This provision concludes in 2014-15.

Included within Other provisions is the current tranche of onerous lease provisions in relation to Crown office franchises and a £19m exceptional charge was taken in the year. At March 2014 there remains £13m in this Crown provision balance.

Other provisions at March 2014 include onerous property lease obligations £6m, personal injury claims £2m, Bank of Ireland sales capability investment (Eagle provision) £2m 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 Following discussions with James Arbuthnot MP and JFSA, in July 2012 independent investigator Second Sight Support Services Ltd (Second Sight) was appointed to carry out a review into these allegations.

17.3 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.

17.4 Following Second Sight's July 2013 Report, on 27 August 2013 Post Office Limited launched a Mediation Scheme aimed at finally resolving individual complaints made about Horizon.

17.5 The Scheme has received 150 applications. These are being progressed through the Scheme under the direction of a Working Group chaired by retired Court of Appeal Judge Sir Anthony Hooper, and comprising representatives from POL, Second Sight, and JFSA. Further, a sub-committee of the Post Office Limited Board was formed in April 2014 to oversee Post Office Limited's management of the applications and options generally.

17.6 Post Office Limited has also reviewed its approach to the criminal prosecutions it brings against SPMs which use Horizon data, and generally. To ensure POL complies with the continuing evidential, public interest, and disclosure standards required for prosecutions, Post Office Limited has also undertaken a review of past criminal prosecutions which used Horizon data. Post Office Limited has instructed former First Senior Treasury Counsel Brian Altman QC to assist it in these regards.

17.7 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, arising out of the matters raised in Second Sight's July 2013 Report.

18. Taxation

18.1 Income statement

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

	2014	2013
	£m	£m
Corporation tax credit for year	(9)	(10)
Tax under provided in previous years	(1)	-
Current tax	(10)	(10)
Deferred tax credit relating to the origin and reversal of temporary differences	(5)	(21)
Effect of change in tax rate	3	-
Income tax credit reported in the consolidated income statement	(12)	(31)

18.2 Factors affecting tax credits

A deferred tax credit of £21m was recognised in 2013 in relation to the retirement benefit surplus as a proportion of this surplus was considered to be recoverable through future contributions. An equal and opposite entry was recognised through equity. In the year to 2014 the movement in the proportion of the surplus recoverable through future contributions was largely offset by the effects of the change in tax rate, giving a net deferred tax credit of £2m.

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.

19. 'Fair, Balanced and Understandable' (FBU) requirement

19.1 Requirement

Under provision C1.1 of the UK Corporate Governance Code, boards of premium listed companies are required to make the following statement in the annual report:

'The board confirms that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the performance, strategy and business model of the company.'

This is considered to be a matter of Board judgement and the statement should be interpreted in accordance with the standard meaning of the words in the English dictionary. Although the Post Office is not required to make this statement it could choose to do so. In order to provide assurance that this statement could be made the following assessment considers each of the components against the content of the Annual Report.

19.2 Indicators and assessment of FBU

Indicator	Demonstrated in the Post Office Annual Report by:
<i>Fair – Definition: not exhibiting any bias, reasonable or impartial, done according to the rules</i>	
Are all important elements included in the 'story'?	<p>Key elements of the performance story were identified as:</p> <ul style="list-style-type: none"> Solid profit performance Revenue decline not what we hoped for Cost management resulted in improved profit Challenging year More investment for the future has been made A year of laying foundations for the future <p>Underpinned by:</p> <ul style="list-style-type: none"> A good pace on network conversions Improved customer satisfaction from new branches Progress on the purpose and mutual ways of working with the set up of POAC <p>These themes run through the front half consistently with different emphasis as appropriate in the overview, operational review and performance review.</p>

<p>Have sensitive material areas been omitted?</p>	<p>Notable sensitive areas:</p> <p>Declining revenue performance - noted in chairman's and CEO's report as well as pillar overviews and financial review</p> <p>Industrial relations problems throughout the year - expected to be noted in CEO's report (tbc)</p> <p>Operational issues with the new telecoms service provider - noted in pillar overview and financial review</p>
<p><i>Balanced – Definition: even-handed, taking account of all sides on their merits without prejudice or favouritism</i></p>	
<p>Is there a good level of consistency between the front and back sections of the annual report?</p>	<p>All financial references align and profit quoted is consistently profit before exceptional items which runs through from the CEO's report to the financial review and the face of the income statement.</p> <p>The revenue performance is highlighted first in the chairman's report, then CEOs, through the pillar summaries, the financial review and in the financial statements including note 2 (segmental reporting).</p> <p>Operating cash flow is noted as strong in the chairman's statement aligning with the repayment of the loan in the year in the cash flow statement and a much reduced net debt position in the financial review.</p> <p>The chairman's and CEO's reports both highlight the level of investment in modernisation. The branch network section of the operational review refers to the investment in new models and IT transformation for which expenditure is drawn out in the exceptional items section of the financial review, on the face of the income statement and in note 5 (exceptional items).</p>
<p>Do you get the same message from reading the two sections independently?</p>	<p>Evidence of alignment noted above.</p>

<p>Are the key judgements referred to in the narrative reporting and the significant issues reported in the Audit Committee Report consistent with the disclosures of key estimation uncertainties and critical judgements set out in the financial statements?</p>	<p>The critical accounting estimates and judgements in the financial statements relate to pension assumptions, provisions (largely relating to obligations relating to transformation activity) and the continued impairment of non-current assets. The narrative reporting covers the transformation activity that has resulted in the provisions but the other two points above are technical accounting points that are not required to be discussed in the narrative. The Audit Committee report refers to approach rather than specific judgements.</p>
<p>How do these compare with the risk that the external auditor is planning to include in their report?</p>	<p>As the PO is not listed the EY opinion will not include risks. If they were to prepare a listed –style audit opinion the risks likely to be included would be:</p> <ul style="list-style-type: none"> • Revenue recognition – a complex variety of contractual arrangements resulting in a risk of over or under recognition of revenue. As PO applied strong financial control this is not considered a business risk or judgement. • Classification of exceptional items – due to the scale of change there is a risk that normal operating expenses are classified as exceptional. Financial controls over postings to exceptional items mean that this is not considered a business risk. However, the scale of the change is highlighted as a business risk. <p>Possible lower level risks that may be mentioned include pension risk (highlighted as a financial estimate but not a business risk), counterparty risk (covered by the Business continuity business risk), fraud and burglary (not considered a material business risk due to security and controls) and litigation (covered by the Regulatory and Compliance business risk).</p>
<p><i>Understandable – Definition: having a meaning or nature that can be understood, able to be accepted as normal, reasonable or forgivable</i></p>	
<p>Is there a clear and cohesive framework for the annual report?</p>	<p>The format follows the successful approach used in 2012-13 which won a Business Finance Award in early 2014.</p>

Are the important messages highlighted and appropriately 'themed' through the report?	The Annual Report has a 'theme' of 'Heart of the community' which runs through the story of the annual performance but the key performance messages (above) are consistently drawn out in the relevant sections.
Is the information set out in the annual report easy to find and do sections link well together to tell the whole story?	The format follows the approach established in 2012-13 and follows established practice for plc reporters. The story flows from the Chairman's and CEO's reports into detail on the operational aspects of the business and the performance review. This leads into the financial statements in a natural progression.
Is the report written in accessible language?	The document will be fully proof read for clarity of message and ease of reading.
Are the messages clearly drawn out?	The messages (above) run through the front half and are consistent with the financial results in the financial statements.
Is there excessive use of specialist terms and is there a glossary if required?	Terminology has been kept as simple as possible and explained where necessary.

19.3 Performance, strategy and business model

The following questions have been considered in review of the Post Office performance, strategy and business model.

Question	Demonstrated in the Post Office Annual Report by:
<i>Performance</i>	
Is it clear how outcomes are measured using KPIs?	A new KPIs section has been added at the front of the report highlighting both financial and non financial KPIs. In addition the financial KPIs are repeated at the start of the financial review and other key metrics appear in 'the Post Office in numbers' (branch numbers, customer visits, accessibility).
Is there a good mix of financial and non financial KPIs?	See above – KPIs cover financial results, customer satisfaction, progress with strategic actions and employee engagement.

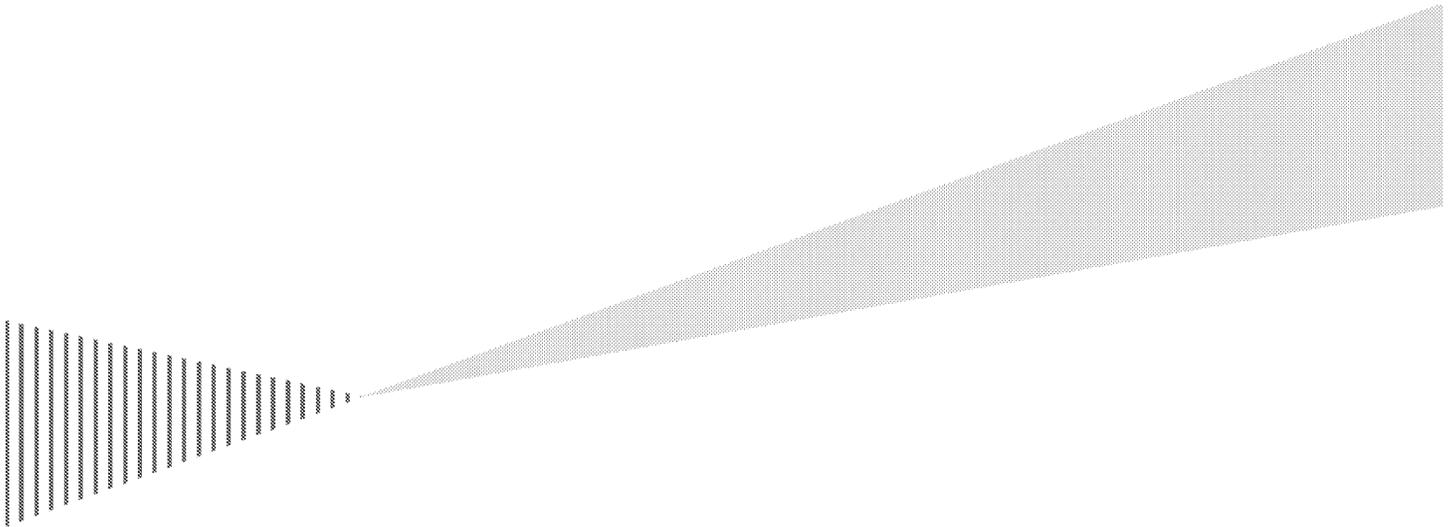
Is it clear that the KPIs measure the achievement of the strategy not just short term performance?	The KPIs demonstrate the strategic commitments to our shareholder and are indicators of the performance required for the long term delivery of the strategy - financial performance, network transformation, Crown losses, customer satisfaction and employee engagement.
Are movements in KPIs open and explained?	Where appropriate the prior year statistic is shown. Changes are explained where significant, particularly in financial KPIs.
Can the reader understand why those measures are KPIs and how they are derived?	The KPIs are not complex and are explained where required.
Are key performance risks explained?	The business risks section highlights risk to the strategy and actions to mitigate them.
<i>Strategy</i>	
Is the company's purpose clearly articulated?	The purpose will be shown, probably inside the front cover.
Does the strategy discuss how the business intends to achieve its objectives in the context of the market outlook?	The steps to achieving the strategy of moving from passive product channel to vibrant retailer are set out in the strategy section.
Are the value drivers explained clearly?	This is set out in the strategy section.
Is there enough information to assess strategic risks?	The risks can be assessed from reading the strategy section supported by the business risks section.
<i>Business model</i>	
Are key elements of the business model clearly explained?	The operational review explains the core product pillars and the underpinning branch network operation supported by IT.
Are business model risks and disruptions adequately drawn out?	This is set out in the business risks section.
Do the business risks disclosed in the narrative sit well with the risks or sensitivities set out within the financial statements?	The business risks are not the same as the sensitivities in the financial statements but are not inconsistent. The main sensitivity is the pension asset and its sensitivity to changes in market conditions but, as it is in surplus and future risk has been mitigated by the recent 'Project Robin' changes to terms, it is not a significant business risk. The sensitivity of provision estimates is consistent with the scale of change which results in the business transformation risk highlighted in the business risk section.

Post Office Limited

Report to the Audit and Risk Committee

FY 2013/14 Audit Results Report

15 May 2014



Building a better
working world



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



Private and confidential

15 May 2014

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

Dear Members of the Audit and Risk Committee

Audit results report

We are pleased to attach our audit results board report for the forthcoming meeting of the Audit Committee. This report summarises our preliminary audit conclusion in relation to Post Office Limited's financial position and results of operations for 52 week period ended 30 March 2014 ("the period").

The audit is designed to express an opinion on the Group and Company financial statements for the period ended 30 March 2014 and address current statutory and regulatory requirements. This report contains our findings related to the areas of audit emphasis, our views on Post Office's accounting policies and judgments and material internal control findings.

This report also contains our final summary of audit differences, communications regarding our independence, a summary of communications we are required to make to you and a draft management representation letter.

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

We welcome the opportunity to discuss the contents of this report with you at the Audit Committee meeting scheduled on 15 May 2014.

Yours faithfully

Angus Grant

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

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The contents of this report are subject to the terms and conditions of our appointment as set out in our engagement letter of 28 November 2013.

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.

Section 1

Overview

Overview

1. Audit scope and status update

- ▶ No significant changes in audit scope, materiality or change to our significant risk assessment to that presented in our 2013/14 Audit Planning Report.
- ▶ Our audit procedures are substantially complete, with the exception of those items listed in Appendix A.
- ▶ We have received full co-operation from both management and the teams with whom we work and, subject to a few routine outstanding matters, as noted at the end of this section, we have received all information necessary to enable us to complete our audit.
- ▶ In the following pages, we provide you with a summary of our audit scope and status, our areas of focus around significant audit and accounting issues, findings from our controls testing, our required independence communications and a draft management representation letter for your review.
- ▶ There are no unadjusted misstatements in the current year.

2. Summary of key areas of audit emphasis

Refer to section two "Areas of Audit Emphasis" for a detailed discussion of significant accounting and audit issues

We have concluded on the following accounting and audit issues following discussions with management at the planning and year-end audit stages:

Significant risks identified in our Audit Planning report

Revenue	<p>The Company continues to sell a large variety of products/services across a number of revenue streams totalling £1,179m (including £200m Network Subsidy Payment).</p> <p>Homephone Management dispute the information provided by new provider Fujitsu, and have adjusted recognised revenue to reflect their detailed data analysis. Homephone revenue reflects management's best estimate.</p> <p>Stamp solution The stamp solution agreed between RM and POL has resulted in no impact to revenue recognition during the year.</p>
Exceptionals	<ul style="list-style-type: none"> ▶ Total Government grant utilised during the year £317m, included bought forward deferred grant not utilised from the PY of £102m and cash received of £215m in the current year. ▶ Network transformation including subpostmasters compensation of £191m <ul style="list-style-type: none"> ▶ £97m relating to Network transformation costs ▶ £94m relating to Agent compensation ▶ Redundancy expense of £23m ▶ IT transformation costs of £21m ▶ Intangible and tangible asset impairment of £115m ▶ £102m gain relating to pension curtailment (see below)

Overview (cont'd)

Other Areas of Audit Emphasis	
Pensions	<p>IAS 19 Revised became effective 1 January 2013 which management deemed to not be retrospectively material for the primary statements but was applied in March 13/14.</p> <p>The current year IAS19 valuation shows the RMPP scheme to be in a net asset surplus position of £148m (PY £96m). (Net of Asset ceiling reduction)</p> <p>A pension curtailment benefit was recognised as a one off exceptional gain in the year of £102m. As a result of a change in the definition of pensionable pay, which now will broadly increase in line with RPI (capped at 5%) in future, regardless of actual pay growth. EY actuaries have reviewed Tower Watsons assumptions and deemed them to be appropriate and we audited the asset valuations driving the asset position.</p>
Counter party risk	<p>Based on the procedures performed, we conclude that the counterparty credit risk is monitored and managed and that all counterparty receivables have been recovered post year end or are deemed highly likely to be recoverable under normal trading arrangements.</p> <p>POLs biggest counter party exposure is £96m BOI and £30m with JP Morgan</p>
Risk of fraud/burglary arising from the logistics process and cash centre network	<p>We visited a cash centre and a branch to attend cash counts by internal audit, and observed controls around cash management.</p> <p>We held a meeting with the head of security to gain insight into Post Office's assessment of risks and events of fraud.</p> <p>We have also carried out substantive testing of cash and bank balances which included bank reconciliation and cut-off testing at year end over cash balances.</p>
Corporate tax accounting:	<p>We reviewed the net total tax credit of £12m for the current year, and assess management's calculation to be reasonable.</p> <p>Consistent with prior years, no deferred tax assets have been recognised in respect of losses and other temporary differences, due to uncertainty around the availability of future taxable profits.</p> <p>During FY13/14, POL received £415m in grants from HM Government. It also had deferred revenue liability of £102m brought forward from unused grants in the prior year. We agree that management's taxation with regards to this is appropriate in current year.</p>
VAT	<p>Our VAT specialists reviewed the POL VAT records, including the October-December VAT submission and the reconciled the draft (unsubmitted) VAT figures to the year end VAT ledger balance.</p> <p>VAT implications associated with the separation of Post Office from RM was also reviewed, in particular, the VAT accrual accounting for the recharges between Post Office and RM, and the proposed "stamp solution".</p> <p>HMRC are evaluating whether Bill Payment Services are VAT exempt; the preliminary view is that this is highly unlikely, so no provision is required.</p> <p>For the FY 13/14 VAT returns, POL is applying a provisional recovery rate of 40% which has been applied to calculate residual input VAT recovery. Whilst POL has submitted a proposal for a new partial exemption method to HMRC, which would give it a rate of 57% for FY13/14, management have not accounted for the additional VAT that would be receivable at year end based on the presumption that HMRC could still challenge the proposed method. We agree that management's conclusion is reasonable.</p>
Project Sparrow	<p>POL have entered into a mediation process with Subpostmasters who claim they have suffered systemic problems with HNGX</p> <p>Management have obtained written legal advice from Linklaters that confirms that it is not probable that POL have a constructive obligation in relation to these claims given that there is no evidence to support systemic problems with HNGX.</p> <p>Management therefore have recorded no financial liability with respect to these claims which we agree is management's best estimate.</p>

Overview (cont'd)

3. Control themes and observations

Refer to section three "Control themes and observations"

The key internal control findings arising from our audit work are:

- ▶ Key controls tested around revenue and payroll were deemed to be operating effectively.
- ▶ For this year, we are able to rely on the ISAE 3402 report from Fujitsu in relation to the IT general controls (ITGC) operated by them. The report did not identify deviations from the controls operated by Fujitsu therefore, in conjunction with the results of our independent testing of POL operated controls, we placed reliance on both the HNGX and POLSAP applications.
- ▶ We identified logical access-related issues for POLSAP, SAP ESFS, and SAP HR which have required us to modify our audit approach by testing and placing more reliance on alternative IT process controls. These additional procedures were performed to mitigate the impact on the overall controls based reliance approach.
- ▶ In light of the continued separation of POL from Royal Mail (RM), with Post Office taking on more activities which RM had previously carried out on their behalf, the finance team was resilient and well prepared for the year end. We noted no adverse impact on the quality of information produced.

Detailed control observations and recommendations are currently being discussed with management and will be reported in our forthcoming management letter.

4. Our opinions and confirmations

- ▶ We anticipate issuing an unqualified audit opinion on the Post Office Group and Company financial statements for the period ended 30 March 2014.
- ▶ We confirm that our fees for non-audit services during 2013/14 have been reviewed in order to make sure that they do not compromise our independence as your external auditor.
- ▶ We confirm our independence as your external auditor in this report in Appendix B.

Section 2

Areas of audit emphasis



Areas of audit emphasis

We summarise below our conclusions on significant risks (as defined by auditing standards) and other key areas of subjectivity involved in determining the accounting treatments used in preparing the 2013/14 financial statements, including our assessment of management's judgements and estimates.

2.1 Significant risk - Revenue recognition across diverse range of revenue streams

The Company continues to sell a large variety of products/services across a number of revenue streams. Total revenues for Post Office (excluding the network subsidy payment, which is also included in total revenue and is discussed in Section 2.7) decreased during FY2014, by 4.5% to £979m (FY2013: £1,024m). The decline is caused by the stamps buy forward, ahead of last year's price increase and lower parcel volumes this year.

As noted in our planning report, most of Post Office's revenues are not overly complex in their calculation. The main risk associated with the diverse range of streams is in the correct contractual terms being applied. We performed controls testing on revenue as part of our interim procedures, where a sample of revenue lines was tested to ascertain whether the controls over revenue recognition were effective throughout the period. No exceptions were noted in our testing. Further, we were able to obtain comfort over the contractual rates and volumes used in the revenue calculations and that an adjustment for actual income is made where estimates are used.

We also performed detailed analytical reviews of each major revenue stream, considering and evaluating the movements in the key revenue lines across the business. We did not note any unusual results or variances. We also considered the accounting treatment for significant new products or revenue streams where applicable, noting no exceptions with management's application of its revenue recognition policy.

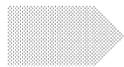
In addition to the above, we performed cut-off testing procedures to give further comfort that revenue has been recorded in the correct period. We also carried out substantive testing of accrued and deferred income that included investigating any estimates made and comparing this to the actual amounts received subsequent to year-end for any material differences, and noted no issues as part of our year end review.

Homephone Considerations

During September 2013 Post Office changed the provider of its Telecoms products from BT to Fujitsu. Fujitsu has experienced a number of billing issues during the year which have not been resolved. Whilst Fujitsu has provided Post Office with billing (revenue) data, Post Office disputes its accuracy and demonstrated it is significantly lower than expectations. To correctly account for revenue, Post Office modelled revenue based on customer information and data retained by the Post Office commercial team. We concur with management's view that this represents their best estimate and that the income is highly probable.

Stamps Solution Revenue Considerations

Historically, RM has sold stamps through the Post Office channel, paying Post Office commission on monthly sales. Management has accounted for these sales in the past on the basis that Royal Mail Group is the Principal and Post Office is the Agent in the relationship, meaning that Post Office only show the commission they have earned through the sale of postage stamps as part of their revenue recognised.



Areas of audit emphasis (cont'd)

2.1 Significant risk - Revenue recognition across diverse range of revenue streams (continued)

Stamps Solution Revenue Considerations (continued)

Following RM's IPO during the current year, Post Office left RM's VAT group, meaning that VAT would be required to be charged on transactions between both parties. Due to the VAT exemption applying to many postal services, RM would be unable to recover a proportion of the VAT incurred on commission charged by Post Office. To ensure that RM did not suffer this irrecoverable VAT, under the "stamps solution" documented in the Mails Distribution Agreement, following the IPO, Post Office agreed to obtain title from RM for those postage stamps it sells - a moment before it sells them - and earn a margin on the sale. This margin is not subject to VAT.

Management considered whether the introduction of the stamps solution would impact Post Office's classification as an agent in the relationship. Management concluded that under the stamps solution, the risks and rewards of stock ownership clearly remain with RM up to the point of sale to Post Office, which is immediately prior to Post Office's sale to the customer, meaning Post Office bear no such stock ownership risk. Management concluded that Post Office would remain an agent in the relationship for accounting purposes and the stamps solution would not change the way in which revenue will be recognised in both Post Office and RM. We note that management's treatment is reasonable and in line with IAS18 *Revenue Recognition*.

Based on the procedures performed, including involvement from our VAT specialists, we conclude that revenue, accrued income and deferred income balances at year end are appropriately stated.



Areas of audit emphasis (cont'd)

2.2 Significant risk - Classification of exceptional items relating to Network Transformation & utilisation of government grant, and risk of management override

Post Office has been executing a Network Transformation programme on all of its existing branches in order to modernise them as part of the overall strategy to make the Post Office more competitive for the future. This is a one-off programme which is expected to continue until FY2017/18. Management have concluded that the costs of Network Transformation are exceptional in nature given that a branch modernisation programme of this scale has not been carried out before, and is not a 'business as usual' activity at Post Office. As such, management believe this requires separate presentation on the face of the income statement to allow a better understanding of financial performance in the year. Management's treatment is consistent with the approach followed in the prior year.

We have revisited the appropriateness of classifying such costs as exceptional, and note this is reasonable. We have made inquiries of management to understand how these costs are distinguished from normal operating costs, and the nature of the costs classified as exceptional costs. We have also reviewed supporting documents to verify that the costs link to Network Transformation programme or any other one-off projects and meet with the requirement under IAS 1 to be presented as exceptional costs in the financial statements. We noted no issues in our testing and concluded that exceptionals have been classified appropriately.

As anticipated in our planning report, Post Office's Network and Crown Transformation programme during the current period led to a significant increase in exceptional costs which was partially offset by full utilisation of the 2013/14 £215m government grant from the Department of Business, Innovation & Skills ("BIS"), in addition to the full utilisation of the deferred grant as at March 13 of £012m. Management's disclosure of the exceptional costs on their financial statements is set out below. We consider each of these classifications below:

£m	FY2013-14	FY2012-13
Transformation and restructuring costs	(259)	(79)
Intangible and tangible assets (see section 2.6 for further consideration)	(115)	(66)
Government Grants (see Section 2.7 for further consideration)	317	98
RM pension plan amendment (see section 2.4 for further consideration)	102	-
Total exceptional income / (expense)	45	(47)



Areas of audit emphasis (cont'd)

2.2 Significant risk - Classification of exceptional items relating to Network Transformation & utilisation of government grant, and risk of management override (continued)

Transformation and restructuring costs

Restructuring and business transformation exceptional items largely related to the costs of carrying out the Network Transformation programme.

The breakdown of restructuring and business transformation costs is given below and a summary of our considerations on the classification of each of these costs follows.

£m	FY2013-14
Network & Crown Transformation costs	(97)
Agents Compensation	(94)
Network transformation including subpostmaster compensation	(191)
Crown Transformation	(9)
Redundancy	(23)
IT Transformation Costs	(21)
Business Transformation costs	(5)
Separation	(7)
Other	(3)
Total Transformation & Restructuring Costs	(259)

Network & Crown Transformation costs (FY2013-14: £106m)

The Network Transformation (£97m) and Crown Transformation (£9m) costs are attributable to the modernisation of Post Office's existing branches as part of their transformation programme. In keeping with the one-off nature of the programme to modernise Post Office's network, management have classified these costs as exceptional. We have revisited the appropriateness of classifying such costs as exceptional and reviewed supporting documents to verify that these costs link to Network & Transformation one-off project costs. We have noted no exceptions from our testing.

Agents Compensation Costs (FY2013-14: £94m)

In the current year agents (Subpostmasters) have been incentivised and compensated for ensuring their branches take part in the Network Transformation programme. Agents have been offered four different compensation schemes totalling £94m. For agent compensation costs we reviewed the respective signed conditional resignation notices given to agents and concur with management that these costs are correctly classified as exceptional. We vouched a sample of termination payments to conditional resignation notice submitted and noted no issues.



Areas of audit emphasis (cont'd)

2.2 Significant risk - Classification of exceptional items relating to Network Transformation & utilisation of government grant, and risk of management override (continued)

Redundancy Costs (FY2013-14: £23m)

Management provided for redundancy costs of £23m during the current year. Management note these are specific redundancy costs largely related to the Crown Transformation programme and the closure of the Manchester cash centre and as such were treated as exceptional items.

IT Transformation costs (FY2013-14: £21m)

The current IT transformation was one of Post Office's key programmes to deliver the commitments made in 2010 in the Government Funding and Strategic Plan. Consistent with prior year, management treats this specific transformation project as an exceptional cost given the project results in a fundamental change to the entire Post Office IT model, and acts as a key enabler to the Network Transformation project as a whole. Management noted that the changes in the Network Transformation project would not be achievable without the IT transformation project - thus following that both, which are non-recurring costs once these projects are completed at the same time in 2017/18, should be regarded as exceptional. We noted that management continues to be consistent with the prior year in the IT Transformation costs it treats as exceptional.

Business Transformation Costs (FY2013-14: £5m)

Owing to the strong connection between business transformation costs and the Network Transformation project, management treats business transformation costs as exceptional, which is consistent with the practice in the prior year (£4m). Post Office reached an agreement on 25 April 2014 with the CWU, who now support Post Office's proposal for Crown pay and working practice reform. We would expect the full cost accrued of £13m to be paid to members before or shortly after the signing of the financial statements.

Separation Costs (FY2013-14: £7m)

Separation costs comprise of costs incurred to achieve separation from Royal Mail. Separation involves creating new internal capabilities and implementing new commercial relationships. These costs are part of a defined programme and are designed to bring about significant changes to the business. Totals expenditure is expected to be in the region of £25m, with £7m included in this year's income statement.

Other (FY2013-14: £3m)

Other exceptional costs mainly consist of consultancy costs relating to Project Sparrow which relate to identifying improvements that should be made to Horizon IT interface system, as part of the Network Transformation programme. These costs are incurred for the first time in 2013/14. We concur with management's treatment of these costs as exceptional is reasonable however note that management should continue to assess future cost on a specific basis and formulate a policy to determine when they become business as usual costs.



Areas of audit emphasis (cont'd)

2.3 Counterparty Credit Risk

Post Office continues to undertake a review of all counterparties to assess the level of exposure and relative risks. In particular, given the concentration of risk associated with the Bank of Ireland ('BOI'), Post Office has performed a more detailed assessment to determine if steps should be taken to mitigate any risk exposure perceived to be excessive. As part of their assessment, the appropriate detailed contingency plans have been put in place, in particular focusing on Instant Saver and general banking areas.

Given the concentration of risk associated with the Bank of Ireland, Post Office performs a more detailed assessment. This plan was prepared in October 2010 at the height of the banking crisis and management continues to believe it to be relevant in the current year. Management noted that the first stages of the contingency plan were deployed successfully when the Irish banking crisis was widely reported in the media in previous years. This plan takes into account all similar types of banking and how they would cope with customer related issues (e.g. all deposits taken in one day) and/or counterparty related issues such as liquidation of a third party.

Since FY2008/09, counterparty risk, particularly relating to the Bank of Ireland, was regarded as a significant risk for the audit. However, as noted in our Audit Planning Report, Post Office now appears to have sufficient procedures in place over the counterparty risk, and the likelihood of the risk appears to have decreased, we have reclassified this as an inherent risk.

Counterparty	Exposure at 30/03/14 (£m)	Nature of business with POL to cause exposure
Bank of Ireland	96	ATM Debtor
JP Morgan	30	Processing benefit settlements

Significant counterparty receivables for POL as at 30 March 2014

We tested the recoverability of the material counterparty receivables due to Post Office, which included vouching the most significant counterparty debtors to bank receipts received post year end.

We have also held meetings with the Head of Corporate Finance to discuss how Post Office manage and mitigate counterparty risk. We noted that Post Office mitigates trading counterparty credit risk by imposing the recommended credit terms and credit limits as advised by a credit agency (Experian) and monitors amounts overdue from key counterparties via circulating weekly reports to the Corporate Finance department. We noted that the Co-op bank has been under scrutiny in the financial press recently however our procedures have identified that although Post Office has a commercial relationship with the Co-Op, as at 30 March 2014, it has limited financial exposure.

Based on the procedures performed, we conclude that the counterparty credit risk is monitored and managed and that all counterparty receivables have been recovered or deemed recoverable post year end.



Areas of audit emphasis (cont'd)

2.4 Pension Valuation and Accounting

The Group is subject to the requirements of IAS 19 (Revised) effective 1 January 2013. The main impact for Post Office is the expected returns on plan assets of defined benefit plans, which are no longer recognised in the income statement. For 30 March 2014, as per IAS 19R, finance interest on net defined benefit surplus is now recognised in the income statement as a pension finance income.

The impact of transition to IAS 19R retrospectively has been deemed not material to the Group, and therefore no restatement has been required for the prior year.

During the year 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 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 which was discussed in detail in our Half Year Results Report.

Post Office Limited has recognised a pension asset of £148m, representing the surplus in plans of £170m and £2m for RMPP and RMSEPP respectively, net of withholding tax of £23 m and £1m recorded in accordance with IAS 19 *Employee Benefits* and IFRIC 14 *The Limit on a Defined Benefit Asset*.

RMPP Scheme

Post Office Limited has an asset for its RMPP scheme of £260 million (March 2013: £243 million), offset by a present value liability of £90m (PY £144m). This results in a net surplus of £170m (PY £99m) that is further reduced by the impact of the asset ceiling charge of £23m (PY £3m) resulting in a net surplus of £147m (PY £96m) recognised on the balance sheet.

Pension Assumptions

We have reviewed the key financial assumptions underpinning the measurement of the defined benefit obligation, with input from EY pension specialists where appropriate. We have also discussed and reviewed the methodology used in preparing the assumptions with Post Office's actuaries. In our opinion, Post Office has used reasonable assumptions in valuing their pension obligation in accordance with the measurement criteria set out in IAS 19R.

A summary of the main assumptions used to calculate the defined benefit obligation were as follows:

Financial assumptions	RMPP		
	March 2014	March 2013	Change
Discount rate	4.5	4.8	-0.30
Inflation rate (RPI)	3.3	3.3	-
Inflation rate (CPI)	2.3	2.3	-
Rate of salary increases	3.2	4.3	-0.9



Areas of audit emphasis (cont'd)

2.4 Pension Valuation and Accounting (continued)

The critical assumptions and our view on Management's choice of assumptions are set out below:

Discount rates

AA corporate bond yields slightly declined in 2013-14 resulting in a decrease in discount rates for the RMPP scheme from 4.8% to 4.5%. We acknowledge that there is no single correct approach to deriving the discount rate, due to no deep market in corporate bonds that match the liability profile (28 years). Although this is highly subjective the methodology used by Towers Watson is appropriate and takes into account the duration of the scheme's liabilities and market conditions as at 30 March 2014.

Inflation rates

Consistent with the prior year approach, Post Office continues to use a combination of RPI (3.3%) and CPI (2.3%) as its basis for measuring the inflation rate. There is subjectivity in the CPI assumption given limited market data with derivation based on the reduction of the RPI rate by 1.00%. Based on our experience we note that the differentials as adopted by Post Office are mid-point of what we consider to be an acceptable range.

Net interest cost

IAS 19 (R) has replaced the expected return on assets with the net interest cost, which is the discount rate applied to the net balance sheet asset at the beginning of the accounting period. This calculation is not deemed to have a material impact on the prior year return on asset cost included in the income statement and therefore no restatement has been proposed by management.

Demographic assumptions

We have reviewed the demographic assumptions related to salary increases and mortality. These are in line with the Post Office's latest experience and are consistent with those agreed between the Trustees and Post Office. We note that the mortality assumptions are consistent with prior year, and are based on an investigation of scheme experience that was performed for the full actuarial valuations as at 31 March 2012.

The basis applied for the current year IAS 19(R) valuation is considered appropriate for the current year. We do however note that mortality assumptions should be reviewed on a regular basis so that they take account of new research and scheme experience, where observable.

Asset ceiling restriction

Adjustments required to restrict assets to their recoverable amounts (the 'Effect of the APS asset ceiling') are recorded through other comprehensive income (£23m), with the exception of financing cost on the asset ceiling which is immaterial for the year.

RMSEPP Scheme

The RMSEPP scheme is not material to the Group. We reviewed the basis applied for the current year valuation and there were no issues to note. We note that Post Office recognised a pension surplus of £2m (2013: deficit of £1m) relating to the RMSEPP scheme based on a 7% allocation from Royal Mail Group.



Areas of audit emphasis (cont'd)

2.5 Risk of Fraud/Burglary arising from the logistics process

Post Office holds large quantities of cash within its retail centres, cash centres and in transit (£708m as at 30 March 2014), which is potentially subject to misappropriation or threat of burglary attempts by organised crime. As noted in our planning report, management has strong controls to prevent and detect any risk of fraud and attempted burglary, and we note that they continue to reassess whether they need to increase their security measures.

We visited both a cash centre and a Post Office branch to observe cash counts performed by internal audit, and observe security controls around cash management. We noted that management continue to have strong security controls in place to deter risk of fraud and burglary. Additionally, we held a meeting with the head of security at cash centres to gain insight into their assessment of risks and events of fraud in the logistics process and branch networks, and note no issues to report.

As part of our audit procedures, we have also performed detailed substantive tests on cash and bank reconciliations at year end, as well as testing cash cut-off. We noted no issues from our testing.

2.6 Fixed and Intangible Asset Impairment

Post Office continue to adopt a policy of fully impairing all fixed asset additions made during the year in which they are purchased, except for freehold land & buildings and building shells. Management's justification for adopting this policy is mainly due to the fact that Post Office has historically been, and continues to be, a loss making entity excluding the Network Subsidy Payment and Government grant it receives.

As an additional factor in the decision to impair, Post Office has been working on a major programme of network change costing £500m between the current year and FY2014-15, which is included within the current State Aid funding package. Investment of this scale will lead to significant cash outflows for the immediate years. The degree of transformational change and the impact on cash flows would impact the future profits of the Company and accordingly management believes that Post Office will continue to be a loss making entity in near to medium term.

We continue to agree that Post Office's accounting policy for impairment and disclosure of the charge as an exceptional item is reasonable, and in line with IAS 36, *Impairment of Assets*.

Looking forward

We have discussed with management the impact to the business with respect to the financial statements and forecasting as it becomes more likely that Post Office will be cash generative without reliance on the government grant. We recommend Management should continue to review its impairment policy in relation to these assets.



Areas of audit emphasis (cont'd)

2.7 Government Grants

On 28 March 2012, Post Office received confirmation that its application for State Aid funding for 2012/13 to 2014/15 had been approved, which included an extension to its existing working capital facility of £1.15bn up to March 2016. An additional funding agreement was announced on 27 November 2013 which amended the limit to £950m running from 2015 to 2018. In addition, Post Office received approval to obtain the following funding from the Department of Business, Innovation & Skills ('BIS') by way of grants: FY2013/14 - £415m, FY2014/15 - £330m, FY2015/16 - £280m, FY2016/17 - £220m, FY2017/18 - £140m however beyond 2014/15 these amounts have not been approved for State Aid.

Of the amounts above, £200m (2013/14) and £160m (2014/15), £80m (2016/17), and £70m (2017/18) were agreed to be made by way of a Network Subsidy Payment, which has been regularly paid by the government to Post Office over the last few years, enabling the company to keep branches open that would otherwise not be viable. We note that the network subsidy payments do not prescribe how these funds should be utilised. Management elected to use the 'Income Approach' relating to this grant since FY2006/07 when it was first received with the amounts recognised as part of revenue in the year in which they are received. We note this is in line with IAS20 *Accounting for Government Grants and Disclosure of Government Assistance*, the agreement with the government and consistent with prior years.

At the year end, of the £317m of the funds have been utilised; being the £102m deferred government grant (funds unspent last year end) and £215m government grant provided for the current year. Post Office spent £94m on capital expenditure, £88m on agent's compensation (contained within Restructuring costs) and £135m on other expenses relating to the Network Transformation (contained within Restructuring costs). There is no deferred government grant creditor at the year end. We reviewed documentation from BIS which indicated that the costs included were an allowable offset against the funds provided.

Based on our procedures performed, we conclude that the government grant has been appropriately recognised in the income statement in accordance with the contract from BIS.

Finally, as above, in light of Post Office's receipt of State Aid funding up to 2014/15, extension of its working capital facility until 31 March 2018 and review of management's forecasts underlying its going concern assessment, we concur with management's assessment that Post Office can continue as a going concern.



Areas of audit emphasis (cont'd)

2.8 Project Sparrow

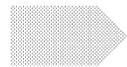
There have been a number of legal claims made against Post Office in relation to Horizon from Subpostmasters, who claim they have suffered losses due to systemic problems within the HNGX system. From our discussion with the Group's legal counsel, we note the claims vary in magnitude and rationale.

Post Office have entered into a mediation process to assess the complaints, and therefore previously have not acted (as per the agreement with mediators) to limit or manage the expectation of the claimants.

Subsequent to this position, Post Office have sought legal advice from Linklaters to ascertain whether Post Office has a legal or constructive obligation in relation to these claims.

Management have reviewed written legal advice from Linklaters' which we have reviewed. The legal position per Linklaters indicates that Post Office have no financial liability for any consequential losses suffered by the subpostmasters subject to there being no evidence to support systematic failing of Horizon, of which there is none.

As such, no provision has been recognised nor any contingent liability disclosed at this time. We agree with management's approach to not recognise any liability for the purposes of the FY2013/14 financial statements to be reasonable. We will continue to monitor any developments in this matter through FY2014/15.



Areas of audit emphasis (cont'd)

2.9 Corporate Tax Considerations

The Group's tax charge for the period is as follows:

£m	FY2013-14	FY2012-13
Profit before tax	£158m	£18m
Tax credit - income statement	£(12)m	£(31)m
Tax charge - items taken directly to equity	£2m	£21m
Net total tax credit recognised in year	£(10)m	£(10)m

The total tax credit for the year of £10m arises from the surrender of tax losses to joint ventures associates (the majority to First Rate Exchange Services Limited) for payment at the statutory rate of 23%.

The tax credit for the year of £10m is in line with the prior year, however profit before tax has increased significantly. The main reconciling items arise from the change in the pension terms of £102m, which is a non-taxable credit to the income statement in the current year. Additionally, grant income of £94m was credited to the profit and loss account, with the underlying expenditure relating to the purchase of capital assets, this is treated as non taxable in the period.

Deferred tax assets and liabilities

At 30 March 2014, the Group has a net deferred tax balance of £nil on the balance sheet (2013: £nil). A deferred tax liability of £2m in respect of the movement in the pension surplus has been recorded through OCI. This is offset by the recognition of an equal deferred tax asset in respect of tax losses carried forward at 30 March 2014 which has been recorded in the income statement.

The deferred tax liability referred to above relates to the pension surplus of £172m (before withholding tax) recognised for accounting purposes. We understand that it is management's expectation that £104m of the pension surplus will be recovered solely through a reduction in future pension contributions over the life of the scheme. The reduction in future pension contributions will increase the future current tax liabilities of Post Office and therefore, a taxable temporary difference arises in respect of which a deferred tax liability should be recognised.

It is management's intention that the remaining element of the surplus of £68m will be recovered through refunds from the scheme. Accordingly, the surplus has been shown on the face of the balance sheet net of a 35% withholding tax of £24m. We agree this treatment is appropriate and in line with EY's interpretation of IFRIC 14.

Consistent with prior years, no deferred tax assets have been recognised in respect of losses and other temporary differences for the year ended 30 March 2014 (other than to match the deferred tax liability arising on the pension surplus), due to uncertainty around the availability of future taxable profits.



Areas of audit emphasis (cont'd)

2.9 Corporate Tax Considerations (cont'd)

Other tax matters

1) Postal Services Act 2011

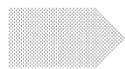
On 1 April 2012, almost all of the UK Group's pension liabilities and assets were transferred to Her Majesty's Government. The Postal Services Act 2011 ('the Act') provides that the transfer of the net pension deficit out of the UK Group should not have any UK tax consequences in itself. However, under the Act, certain trading losses of Post Office were extinguished with effect from 1 April 2013.

As these losses have not historically been recognised as a deferred tax asset, there was no impact on Post Office's balance sheet from this loss extinguishment. Under the terms of the Act, losses extinguished as at 1 April 2013 were £178m. Losses of approximately £328m have been carried forward and are available for use in future periods.

2) Government Grants

During the year, Post Office received £415m in grants from HM Government. It also had a deferred revenue liability of £102m brought forward from an unused grant in the prior year. Of this total amount of £517m;

- a) £200m has been treated as taxable in 2013/14 (and is covered by current year losses and capital allowances claims).
- b) £94m has been allocated to capital expenditure. This is made up of a £40m allocation in the current period and a £54m allocation brought forward from the prior period. The spend relates to assets which qualify for capital allowances for tax purposes. Whilst this amount has been treated as non-taxable in the current year (as agreed with HMRC on the basis it relates to capital expenditure), no capital allowances will be claimed on these assets going forward.
- c) £88m relates to agents compensation, made up of a £40m allocation in the current period and a £48m allocation brought forward from the prior period. This was treated as taxable income, and the related expenditure as tax deductible.
- d) The remaining £135m is unallocated and was spent on the general costs of carrying out the Network Transformation. This was treated as taxable income, and the related expenditure as tax deductible.



Areas of audit emphasis (cont'd)

2.10 VAT Considerations

As part of the VAT audit, we have reviewed the calculation of the figures for the VAT return (with only the return for the period ended 29 December 2014 being available for review at the time of the audit). We also reviewed the new proposed partial exemption method which was required as a result of Post Office leaving the RM VAT group (although this has not yet been formally agreed with HMRC).

For the FY 13/14 VAT returns, Post Office is applying a provisional recovery rate of 40% which has been applied to calculate residual input VAT recovery. Whilst Post Office has submitted a proposal for a new partial exemption method to HMRC, which would give it a rate of 57% for FY13/14, management have not accounted for the additional VAT that would be receivable at year end based on the presumption that HMRC could still challenge the proposed method. We agree that management's conclusion is reasonable.

Overall, our findings were that the proposals which had been put to HMRC appeared to be reasonable and the calculation of the VAT figures appeared to have been carried out correctly in accordance with those proposals.

Our review of the figures and the underlying processes for calculating VAT did not reveal any material issues. No VAT provisions were held by Post Office (although there was an accrual for £1.5m to be paid to RM as a result of the differences between the VAT recovery rates in RM and POL, but this arose from an agreement under the MDA and is not strictly VAT).

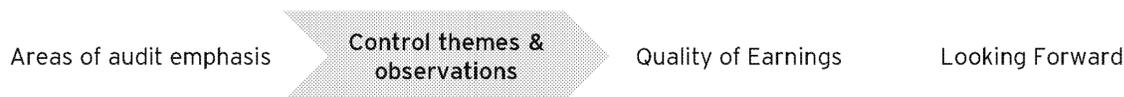
The only other potential issue was a query from HMRC in relation to the VAT liability of Bill Payment Services offered by Post Office. However, we believe that the position taken by Post Office in relation to these services is reasonable.

Section 3

Control themes & observations

Control themes & observations

Gaining assurance through the control environment



As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you any significant deficiencies in internal control.

We can confirm that on the basis of our audit work performed, we did not identify any significant deficiencies in internal controls other than the control deficiencies reported below. However, we anticipate providing a detailed letter incorporating certain recommendations for process improvements noted by us in the performance of our procedures at the conclusion of this year's audit cycle.

The following pages will detail our considerations.

Observations on the IT Environment

POL makes use of two groups of systems that are in scope for the audit. These are POL-supported systems (HNGX and POLSAP) and RM-supported systems (ESFS and HRSAP).

POL-supported systems

Background

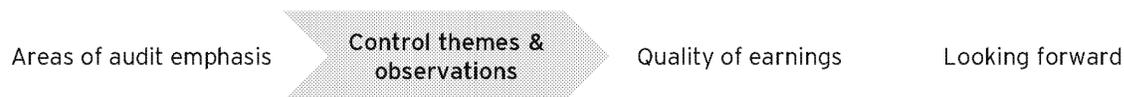
HNGX and POLSAP are supported by Fujitsu, a third party service provider. Our audit approach is to rely on the ISAE 3402 report commissioned by Fujitsu on the controls it operates, and independently test POL-operated controls.

Result of the IT audit

- ▶ In respect of Fujitsu-operated controls, no significant findings were noted in the ISAE 3402 report, and we have therefore been able to rely upon it as part of our audit approach.
- ▶ Our testing of the Post Office-operated controls confirmed that the control observations raised last year have been remediated and/or the risk formally accepted by management.
- ▶ However, this year we noted that the periodic review of users' access rights was not performed for some Cash Centre POLSAP users, and the evidence was not retained for the limited review that has been performed. We undertook additional procedures to identify mitigating evidence by testing the changes to the users' access rights and performing testing of leavers. We recommend management should ensure that the access for all POLSAP users is periodically reviewed and evidence retained.
- ▶ As a result of the lack of periodic review of users' access rights, we performed alternative procedures to test controls over leavers. We noted one POLSAP account belonging to a leaver that was not removed in a timely manner, and had been used after the leaving date. Whilst management is in the process of investigating why this occurred, our investigation showed that the user had not posted financially significant transactions relevant to the audit, thus mitigating the risk to the financial statements. Management should revoke the leaver's access immediately and complete their investigation to identify the root cause.

Control themes & observations (cont'd)

Gaining assurance through the control environment (cont'd)



Observations on the IT Environment (cont'd)

RM-supported systems

Background

A key consideration for the IT audit this year has been Post office's separation from the RM IT environment. There are two key systems managed by RM (where the support services have been outsourced to CSC, a third party service provider) that support Post Office's financially significant processes. These systems are SAP ESFS, supporting the processing of branch, fixed assets, purchasing and general ledger transactions, and HRSAP, which supports the payroll for Post Office employees. SAP ESFS is a common platform used by both RM and Post Office whereas HRSAP is used by Post Office only.

Result of the IT audit

- ▶ Our testing of the RM-operated controls confirmed that the control observations raised last year have been remediated and/or the risk formally accepted by management.
- ▶ For ESFS and HRSAP, the IT audit team identified a total of 11 active user accounts belonging to POL and RM leavers, four of were used after the leaving date, though management consider that three of these actually relate to ongoing employees; Post Office management is in the process of investigating why this occurred. Our follow-up work showed that these users have not posted financially significant transactions relevant to the audit, thus mitigating the risk to the financial statements. We understand that management has initiated work with RM and CSC to revoke the leavers access and complete their investigation to identify the root cause.

We understand Post Office plans to implement a separate SAP system by October 2014 which will replace SAP ESFS. A plan is also in place to separate HRSAP from RM's IT environment by September 2014. As Post Office progresses its plans on the IT separation, it should consider the impact of the control weakness and how this will be addressed in a separated Post Office IT environment.

Control themes & observations (cont'd)

Gaining assurance through the control environment (cont'd)

Areas of audit emphasis

Control themes & observations

Quality of earnings

Looking forward

Non-IT control environment observations

We continue to utilise a controls based approach in respect of the identified significant processes of revenue, purchasing, cash settlements and payroll. Our controls testing approach focuses on the controls implemented across the entire Post Office business, including the London head office, Bolton (payroll), Chesterfield (shared services), branches, cash centres and test controls in London, Bolton and Chesterfield annually.

Financial statement close process

- ▶ Following the separation of Royal Mail and Post Office, we continued to see progress in the reorganisation of financial reporting responsibilities between London head office and the shared service centre in Chesterfield. Despite the changes in the location where financial reporting functions were performed, we note management continues to employ a robust system of internal controls around its financial reporting and financial statement close process, and overall, there continues to be appropriate rigour over the P11 hard close and P12 year-end process. We noted no significant deficiencies, and were able to rely on controls for the purposes of our audit. However, we did note areas within the financial reporting reconciliation process which could be improved to make both the financial statement close process and audit process more efficient.

Payroll process

- ▶ Whilst Post Office's payroll system is supported by the HRSAP system which is shared with RM, the Post Office payroll process is independent of the payroll process and systems that support Royal Mail Group Plc. It covers approximately 16,000 employees and agents, which primarily include front line workers and agents working at Post Offices around the country.
- ▶ As highlighted in our IT observations on the previous page, logical access-related issues in the RM-provided HRSAP system meant that we had to modify our audit approach, by testing and placing more reliance on the manual business process controls and carry out top-up procedures. Aside from this, our work on the manual business process controls for payroll was completed with no significant findings identified, and we were ultimately able to rely on controls in this area.

Transactional, branch and cash centre process and controls

- ▶ For the revenue, purchasing and cash settlements processes, we note that the controls framework remains consistent with the prior year with no significant findings from our testing. We have completed our walkthroughs and the results of our testing indicate that we will continue to be able to rely on controls.
- ▶ Additionally, our controls testing in respect of branches and cash centres was completed with no findings to communicate to you.

Section 4

Quality of earnings

Quality of earnings

We reviewed Management's Quality of Earnings paper, which highlights the net impact of certain items affecting normalised profits, and we consider it to be a fair summary. The following table summarises the more significant/ judgemental items which featured in our discussion of the results above:

This table shows underlying operating profit performance adjusted for one off items and items relating to an earlier year. Each item in the table is explained further below:

£m		2014	2013	Movement	
Reported profit before other exceptional items		107	94	13	14%
Network Subsidy Payment	(i)	(200)	(210)	10	-5%
Project one off cost	(ii)	26	53	(27)	-51%
Reported profit before Exceptionals and project one of cost		(67)	(63)	(4)	6%
Bonus outturn higher in 2012-13 than accrued	(iii)	2	(2)		
VAT/NI recovered re prior year agents' fees	(iv)		(1)		
VAT recovery re earlier years	(iv)	(9)	7		
LTIP over-accrued in 2011-12	(v)		(2)		
Total adjustments		(7)	2		
Total		(74)	(61)	(13)	21%

Each item in the table is explained further below:

(i) 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.

(ii) 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 accelerated but have decreased in 2013-14. These costs were excluded from the quality of earnings calculation in 2012-13 due to the particularly high level in that year and have been excluded again for comparison. The level of spend is expected to remain more consistent in future years so this adjustment is likely to cease to be required.

(iii) 2012-13 bonus outturn

The bonus outturn was £2m higher than accrued due to higher performance in the final quarter and higher than anticipated individual performance scores.

(iv) VAT recovery re earlier years

There were additional VAT recoveries relating to earlier years when the final recovery rates were confirmed with HMRC.

(v) LTIP over-accrued in 2011-12

Following a change in the scheme rules, LTIP was over accrued at the end of 2011-12 and resulted in no charge being required in 2012-13 as the accrual balance was corrected.

Section 5

Looking Forward

Looking Forward

Considerations for the coming year

Areas of audit emphasis

Control themes
and observations

Quality of earnings

Looking forward

We highlighted in our communications to you last year on our thoughts on how the 'look and feel' of the audit would change as a result of the separation of Royal Mail Group and Post Office. The flotation of Royal Mail Group marked a major milestone in Post Office's separation process, bringing many more milestones and challenges; the new Post Office-CFS accounting system roll-out in 2014/15 and the completion of network transformation programme to name a few. We continue to see separation and network transformation dominating the agenda in the upcoming years.

The following factors are expected to have the following accounting and IT implications, which is not meant to be exhaustive but is provided to indicate how the audit will continue to evolve as Post Office continues to shape its new corporate identity and drive its organisation forward.

Impact on substantive and non-IT related testing

- ▶ Consideration of accounting, data and systems implications and likely impacts of new IFRS revenue recognition accounting standard, which is expected to be released in mid-2014;
- ▶ Development of accounting facilities for accounts payable and fixed assets function, for which some elements are still done by RM;
- ▶ Continue to monitor the risk of new financial services revenue line offerings and any audit regulatory related implications (such as FSA regulations);
- ▶ The new ERP system should be reviewed to ensure supplier invoices and supplies by POL are correctly treated from a VAT perspective;
- ▶ Management should continue to monitor classification of exceptional costs, especially those arising from Network Transformation to ensure such costs are not "business as usual" and do not recur following the completion of the Network Transformation programme when it is scheduled to complete in FY2017/18.

Impact of IT transformation

- ▶ Due to size and nature of the IT transformation programme, management should ensure that robust governance framework has been built into the model to address the inherent risks of the new IT model.
- ▶ We understand certain IT services started to transition to Atos from April 2014. Considering Atos is a third party and they will play a key role in integrating the different IT services provided to POL, management should look into how assurance is obtained for controls operated by Atos. We discussed with management the provision of an ISAE 3402 report for services relevant to POL.
- ▶ We also understand that management is looking to award a number of IT service contracts to third parties between 2014 to 2015. We will continue to work with management to understand the exact nature of these services, the timing of the transition and discuss the implication on the audit.

Impact of Core Financial System (CFS) implementation and HRSAP separation

- ▶ POL is looking to replace SAP ESFS with a separate SAP system, called CFS by October 2014. We are in discussion with management to help ensure we get sufficient assurances throughout the key stages of the implementation to enable us to place reliance on the new system once it goes live.
- ▶ A plan is also in place to physically and commercially separate HRSAP from RM's IT environment by September 2014. Our understanding of the current plan is that it will be a 'lift and drop' approach and we do not anticipate this to have a significant impact on our audit approach.

Section 6

Summary of Audit Differences

Summary of audit differences

Audit Adjustments for FY13/14 ARA

In the normal course of any audit, we identify misstatements between amounts we believe should be recorded in the financial statements and amounts actually recorded.

These differences are classified as 'known' or 'judgemental'. Known differences represent items that can be accurately quantified and relate to a definite set of facts or circumstances. Judgemental differences generally involve estimation and relate to facts or circumstances that are uncertain or open to interpretation.

We have not noted any misstatements which have not been corrected by management.

There are no amounts that we identified that are individually or in aggregate material to the presentation and disclosures of the consolidated financial statements for the year ended 30 March 2014.

Appendices

Appendix A - Audit Status Update

Appendix B - Independence report

Appendix C - Draft letter of representation

Appendix D - Required communications with the Audit and Risk Committee

Appendix A

Audit Status Update

Our audit work in respect of the opinion on Post Office's consolidated financial statements is substantially complete. The following items relating to the completion of our audit procedures were outstanding at the date of drafting this report.

Item	Actions to resolve	Responsibility
Letter of representation	To be signed/ dated contemporaneous with our audit opinion on the Group and Company financial statements, which is anticipated to be in June 2014.	Management Audit Committee
Subsequent events procedures	To be completed through the date of our audit opinion on the Group and Company financial statements (matters to be updated include: management enquiries, review of latest management accounts, unrecorded liabilities testing and board minute review to date of signing).	Management EY
Confirmations	Awaiting receipt of all bank, derivative and pension asset confirmations, anticipated to be received by 21 May 2014.	Management
Annual report and accounts	<ul style="list-style-type: none"> Review of 'front end' statements including audit of aspects of the Directors' Remuneration Report, Chairman's and CEO's statements and completion of EY technical review thereon; Review of directors' emoluments disclosures once final bonus outturns confirmed; Post balance sheet events review; Finalisation of EY review comments on disclosure notes; and Financial statements to be approved by management and audit report to be signed by EY. 	Management EY
Tax	The review is in process and no adjustments have been noted to date.	Management EY
Interoffice reporting deliverables	<ul style="list-style-type: none"> Final signed deliverables from PwC FRES team 	Management EY

Appendix B

Independence update

We confirm there are no changes in our assessment of independence since our confirmation in our planning board report. We complied with the APB Ethical Standards and in our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.

We consider that our independence in this context is a matter that should be reviewed by both you and ourselves. It is therefore important that you and your Audit Committee consider the facts of which you are aware and come to a view. If you wish to discuss any matters concerning our independence, we will be pleased to do so at the forthcoming meeting of the Audit Committee on 15 May 2014.

Relationships, services and related safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including the principal threats, if any. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective.

Description of relationship or service and related independence threat	Period provided/duration	Safeguards adopted and reasons considered to be effective
Service 1: Fujitsu ISAE 3402 report - ISAE3402 report for the Fujitsu services supporting the POL account. This report will provide an assessment of the Fujitsu controls supporting POL business critical systems. We have placed reliance on the ISAE3402 as part of the 2013-14 financial statement audit.	April 2013 to February 2014	<ul style="list-style-type: none"> ▶ Not a prohibited service ▶ A separate team from the POL IT team has been engaged for the review of the ISAE3402 report, and standard ring fencing applied between two teams. ▶ Went through review exercise to ensure in line with Ernst & Young independence rules
Service 2: ISAE 3000 report on POL Note Circulation Scheme related services to the Bank of England for the FY2013-14 period and to be performed in May 2014.	Performed on continued annual basis	<ul style="list-style-type: none"> ▶ Not a prohibited service ▶ These are standard agreed-upon-procedures, where management instructs us on exactly the procedures to be performed and we conclude by issuing a factual findings report only.
Service 3: Agreed-upon procedures performed which relate to testing of covenants relating to the loan from the Department of Business, Innovation and Skills (BIS). This is a standard Agreed-Up On Procedures service which has been performed for the past six years and is in the process of being performed in May 2014.	Performed on continued annual basis	<ul style="list-style-type: none"> ▶ Not a prohibited service ▶ These are standard agreed-upon-procedures, where management instructs us on exactly the procedures to be performed and we conclude by issuing a factual findings report only.
Service 4: Agreed-upon procedures performed to ensure that the amount which is collected by Post Office Limited on behalf of the DVLA for road tax is subsequently paid over to the DVLA. This is a standard agreed-upon procedures service which has been performed for the past seven years, and is in the process of being performed in May 2014.	Performed on continued annual basis	<ul style="list-style-type: none"> ▶ Not a prohibited service ▶ These are standard agreed-upon-procedures, where management instructs us on exactly the procedures to be performed and we conclude by issuing a factual findings report only.

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified and we therefore confirm that Ernst & Young is independent and the objectivity and independence of the audit engagement partner and the audit engagement team have not been compromised.

Appendix B

Independence update (cont'd)

Fees update

As part of our reporting on our independence, we set out below a summary of fees for the year ended 30 March 2014.

£000s	2014
- Post Office Limited audit fee*	329
-first time IAS34 consolidated accounts (Half Year Review)	39
Total audit fees	368
- Note Circulation Scheme ISAE 3000 Report*	78
- BIS Agreed Upon Procedures Report**/**	12
- DVLA Agreed Upon Procedures Report**/**	13
Total non-audit services	103
Total	471

*Excludes out of pocket expenses incurred

Confirmations

Ernst & Young LLP (E&Y) has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained.

Details of the key policies and processes in place within E&Y for maintaining objectivity and independence can be found in our annual Ernst & Young LLP Transparency Report which the Firm is required to publish by law. The most recent version of this Report is for the year ended 30 June 2012 and can be found here: <http://www.ey.com/UK/en/About-us/About-EY---Transparency-Report>.

We are not aware of any inconsistencies between the company's policy for the supply of non audit services and APB Ethical Standards. We are not aware of any apparent breach of that policy.

We confirm that in our professional judgment, the firm is independent.

We confirm that the engagement team and others within the firm, the firm and network firms have complied with relevant ethical requirements regarding independence.

Appendix C

Management representation letter for statutory reporting

xx May 2014
Ernst & Young
1 More London Place
London SE1 2AF

Dear Sirs,

This representation letter is provided in connection with your audit of the consolidated and parent company financial statements of Post Office Limited ("the Group and Company") for the 52 weeks ended 30 March 2014 ("the period"). We recognise that obtaining representations from us concerning the information contained in this letter is a significant procedure in enabling you to form an opinion as to whether the consolidated and parent company financial statements give a true and fair view of the financial position of the Group and Company financial position of Post Office Limited as of 30 March 2014 and of its results of operations and its cash flows for the period then ended in accordance with IFRS and FRS101 respectively.

We understand that the purpose of your audit of our consolidated and parent company financial statements is to express an opinion thereon and that your audit was conducted in accordance with International Standards on Auditing (UK and Ireland), which involves an examination of the accounting system, internal control and related data to the extent you considered necessary in the circumstances, and is not designed to identify - nor necessarily be expected to disclose - all fraud, shortages, errors and other irregularities, should any exist.

Accordingly, we make the following representations, which are true to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

A. Financial Statements and Financial Records

We have fulfilled our responsibilities, as set out in the terms of the audit engagement letter dated 28 November 2014, for the preparation of the consolidated financial statements in accordance with IFRS and the standalone company financial statements in accordance with FRS101.

We acknowledge, as members of management of the Group and Company, our responsibility for the fair presentation of the financial statements. We believe the financial statements referred to above give a true and fair view of (or 'present fairly, in all material respects') the financial position, results of operations and cash flows of the Group and Company in accordance with IFRS and FRS101 respectively, and are free of material misstatements, including omissions. We have approved the consolidated and parent company financial statements.

The significant accounting policies adopted in the preparation of the financial statements are appropriately described in the financial statements.

As members of management of the Group and Company, we believe that the Group and Company have a system of internal controls adequate to enable the preparation of accurate Group financial statements in accordance with IFRS and the Company financial statements in accordance with FRS101 that are free from material misstatement, whether due to fraud or error.

We believe that the effects of any unadjusted audit 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 Group and Company financial statements taken as a whole. We have not corrected these differences identified by and brought to the attention from the auditor because we do not believe that they are material to the reader's understanding of the Group and Company financial statements.

Appendix C

Management representation letter for statutory reporting (continued)

B. Fraud

We acknowledge that we are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.

We have disclosed to you the results of our assessment of the risk that the Group and Company financial statements may be materially misstated as a result of fraud.

We have disclosed to you all significant facts relating to any frauds, suspected frauds or allegations of fraud known to us that may have affected the Group and Company (regardless of the source or form and including, without limitation, allegations by “whistle-blowers”), whether involving management or employees who have significant roles in internal control. Similarly, we have disclosed to you our knowledge of frauds or suspected frauds affecting the entity involving others where the fraud could have a material effect on the Group and Company financial statements. We have also disclosed to you all information in relation to any allegations of fraud or suspected fraud communicated by employees, former employees, analysts, regulators or others, that could affect the Group and Company financial statements.

C. Compliance with Laws and Regulations

We have disclosed to you all known actual or suspected noncompliance with laws and regulations whose effects should be considered when preparing the Group and Company financial statements.

D. Information Provided and Completeness of Information and Transactions

We have provided you with:

- Access to all information of which we are aware that is relevant to the preparation of the Group and Company financial statements such as records, documentation and other matters as agreed in terms of the audit engagement;
- Additional information that you have requested from us for the purpose of the audit; and
- Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

All material transactions have been recorded in the accounting records and are reflected in the Group and Company financial statements.

We have made available to you all minutes of the meetings of shareholders, directors and committees of directors (or summaries of actions of recent meetings for which minutes have not yet been prepared) held through to the most recent meeting on 15 May 2014.

We confirm the completeness of information provided regarding the identification of related parties. We have disclosed to you the identity of the Group’s related parties and all related party relationships and transactions of which we are aware, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements, guarantees, non-monetary transactions and transactions for no consideration for the period ended, as well as related balances due to or from such parties at the year end. These transactions have been appropriately accounted for and disclosed in the consolidated financial statements.

We have disclosed to you, and the Group and Company has complied with, all aspects of contractual agreements that could have a material effect on the Group and Company financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

E. Liabilities and Contingencies

All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the Group and Company financial statements.

We have informed you of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.

Appendix C

Management representation letter for statutory reporting (continued)

We have recorded and/or disclosed, as appropriate, all liabilities related to litigation and claims, both actual and contingent, and have disclosed in the Group and Company financial statements all guarantees that we have given to third parties.

F. Subsequent Events

Other than those disclosed, there have been no events subsequent to period end which require adjustment of or disclosure in the Group and Company financial statements or notes thereto.

G. Accounting Estimates

We believe that the significant assumptions we used in making accounting estimates, including those measured at fair value, are reasonable.

Accounting estimates recognized or disclosed in the Group and Company financial statements:

- We believe the measurement processes, including related assumptions and models, we used in determining accounting estimates is appropriate and the application of these processes is consistent.
- The disclosures relating to accounting estimates are complete and appropriate in accordance with the applicable financial reporting framework.
- The assumptions we used in making accounting estimates appropriately reflects our intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.
- No subsequent event requires an adjustment to the accounting estimates and disclosures included in the Group and Company financial statements.

H. Going Concern

Note 1 to the Group and Company financial statements discloses all of the matters of which we are aware that are relevant to the Company's ability to continue as a going concern, including significant conditions and events, our plans for future action, and the feasibility of those plans.

I. Contingent Liabilities

We are unaware of any violations or possible violations of laws or regulations the effects of which should be considered for disclosure in the Group and Company financial statements or as the basis of recording a contingent loss (other than those disclosed or accrued in the Group and Company financial statements).

We are unaware of any known or probable instances of non-compliance with the requirements of regulatory or governmental authorities, including their financial reporting requirements, and there have been no communications from regulatory agencies or government representatives concerning investigations or allegations of non-compliance.

Yours Faithfully,

Chief Executive Officer

Chief Financial Officer

Appendix D

Required communications with the Audit and Risk Committee

There are certain communications that we must provide to the Audit and Risk Committees. We have detailed these here together with a reference of where and when they were covered:

	Communicate when event occurs	Communicate on a timely basis, at least annually	Planned/actual timing of communication to the Audit and Risk Committee
Communications required on all audits			
Overview of planned scope and timing of the audit		✓	Refer to our 2013-14 Audit Planning Report dated 6 March 2014.
Major issues discussed with management in connection with initial or recurring retention	✓		Refer to our 2013-14 Audit Planning Report dated 6 March 2014.
Other information in documents containing audited financial statements		✓	Discussed within this report.
Significant audit adjustments		✓	Discussed within this report.
Unrecorded misstatements considered by management to be immaterial		✓	Discussed within this report.
Expected modifications to the audit report		✓	Not applicable, we do not anticipate any modifications to our audit report.
Our judgements/views about qualitative aspects of the Company's accounting practices and financial reporting		✓	Discussed within this report.
Disagreements with management	✓		Discussed within this report.
Consultations with other accountants	✓		Not applicable, no such instance noted during our audit.
Serious difficulties encountered in dealing with management when performing the audit	✓		Not applicable, no such instance noted during our audit.
The adoption of, or a change in, an accounting policy	✓	✓	We note that POL in its consolidated accounts has adopted for the first time, IAS 19 (Revised 2011) Employee Benefits, and that in the Company accounts it has transitioned to FRS 101 from previously extant UK Generally Accepted Accounting Practice for all periods presented. This has been discussed in this report as well as during the Planning Audit Committee meeting on 6 March 2014.

Appendix D

Required communications with the Audit and Risk Committee (cont'd)

	Communicate when event occurs	Communicate on a timely basis, at least annually	Planned/actual timing of communication to the Audit and Risk Committee
Communications required on all audits (cont'd)			
Methods of accounting for significant unusual transactions and for controversial or emerging areas	✓	✓	Discussed within this report.
Events or conditions that cause us to conclude that there is substantial doubt about the entity's ability to continue as a going concern	✓	✓	Not applicable - no such events and conditions to communicate to the committee.
Sensitive accounting estimates		✓	Discussed within this report.
Consideration of laws and regulations		✓	Discussed within this report.
Fraud and illegal acts involving senior management and fraud and illegal acts that cause a material misstatement of the financial statements	✓		No such instances of fraud to communicate.
Significant matters arising during the audit in connection with the entity's related parties		✓	Not applicable - no such matters to communicate to the committee.
Management's refusal for us to request external confirmations or our inability to obtain relevant and reliable audit evidence from other procedures		✓	No such instances to communicate.
Representations that the auditor is requesting from management		✓	We have attached draft management letters of representation in our appendix as part of this report.
Significant deficiencies and material weaknesses in internal control over financial reporting		✓	This will be included, as necessary, within our Controls, Themes and Observations Report which will be shared with you after the conclusion of our audit.
Group audits			
▶ An overview of the type of work to be performed on the financial information of the components		✓	Discussed within this report.
▶ An overview of the nature of the Group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components			
▶ Instances where the Group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work			
Any limitations on the Group audit, for example, where the Group engagement team's access to information may have been restricted			
Fraud or suspected fraud involving Group management, component management, employees who have significant roles in Group-wide controls or others where the fraud resulted in a material misstatement of the Group financial statements.	✓	✓	No such instances of fraud to communicate.

Appendix D

Required communications with the Audit and Risk Committee (cont'd)

	Communicate when event occurs	Communicate on a timely basis, at least annually	Reference
Audit and Risk Committee pre-approval of services, including specific pre-approval of internal control-related services and non-prohibited tax services		✓	Discussed within this report.
Critical accounting policies and practices. ISA 260 (UK and Ireland) requires the auditor to communicate the auditor's views on the qualitative aspects of the Company's accounting practices and financial reporting		✓	Discussed within this report.
All material alternative accounting treatments discussed with management		✓	Discussed within this report.
Fees		✓	Discussed in our planning report dated 6 March 2014 and in this report.
Other material written communications with management		✓	Discussed within this report.
Communication of independence matters		✓	Discussed within this report.
Other findings or issues regarding the oversight of the financial reporting process		✓	Discussed within this report.

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AUDIT RISK AND COMPLIANCE COMMITTEE

Data Centre Procurement

1. Purpose

The purpose of this paper is to respond to the committee request for an update on the risk management evaluation of the Data Centre Tower Procurement.

2. Background and Approach

One of the main components of the Post Office IT Transformation Programme was the Data Centre tower providing hosting services. The procurement process started in March 2012 but the procurement was cancelled in February 2014.

Risk & Compliance have carried out a review to determine the risk management in place and whether it was appropriate for a procurement of this level and complexity. The review was based on interviews with members of the management team and review of programme documentation.

3. Recommendations

The Audit Risk & Compliance Committee is asked to

- Review the conclusions and recommendations of the report.

Chris Aujard
15th May 2014



RISK & COMPLIANCE
REVIEW OF DATA CENTRE TOWER PROCUREMENT
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Programme	IT Transformation Programme	To	Lesley Sewell – Chief Information Officer Chris Aujard – General Counsel Chris Day – Chief Financial Officer
Date	9 May 2014	From	Dave Mason, Adnan Killedar

EXECUTIVE SUMMARY

Post Office Limited has started a major IT Transformation Programme. One of the main components of the programme was the Data Centre tower providing hosting services. The procurement process started in March 2012 but the procurement was cancelled in February 2014.

Risk & Compliance have carried out a review to determine the risk management in place and its appropriateness for a procurement of this level and complexity. During our review we met with key contacts and reviewed documentation. We were asked to focus this review on the following seven questions and the details of our findings are included in section 3 below.

1. How and why did Post Office follow the procurement process before cancelling the bid at the last stage? Was it good sense to continue the procurement process with only 1 bidder/supplier?
2. Have there been other instances where government contracts have been given to single bidders. If so, what was the experience and are there any examples?
3. Why was the Fujitsu response so different from that required?
4. What market intelligence did Post Office gather about Fujitsu as part of the procurement process?
5. Whether Post Office used the services of the central government to help us understand the full dynamics of the alleged, high profile, failings by Fujitsu in its previous dealings with government agencies.
6. A large number of contractors worked on the DC tower procurement. What was the mechanism to manage risk, how did Post Office maintain commercial focus and how was knowledge retained within the team?
7. What processes are in place to ensure commercial sustainability of contracts for Post Office?

We have also made the following five recommendations:

1. Post Office should avoid continuing procurement process for large tenders where it finds itself in a single bidder situation. Where, due to circumstances, the Post Office has to proceed with the procurement process with a single bidder, a full risk



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assessment should be carried out and presented to the appropriate committee for approval. In tandem and in line with current good practice, market assessments and benchmarking should be carried out at appropriate stages in the procurement process and in parallel to discussions with the sole bidder.

2. Post Office should enhance the programme risk assessment and management process to ensure that risks are captured in a timely manner and that the assessment of emerging risks is comprehensive.
3. Post Office should ensure that the resourcing model for future programmes includes the sharing and retention of programme and business knowledge. A better mix of permanent and temporary staff, with more permanent staff involved in the process would ensure that knowledge and expertise from these programmes are maintained within the organisation. Where it is necessary to have a high number of temporary staff, Post Office should consider varying contracting mechanism to include longer notice periods for key temporary staff.
4. The procurement was carried out in compliance of all regulatory and legal requirements and all relevant documentation requirements were met. The IT Transformation Programme Board met regularly and meeting minutes and papers were maintained. Lack of documentation covering dialogue and some internal discussions has made it difficult to evidence what was discussed during the dialogue process. The IT Transformation Programme Board in its meeting of 7 May 2014 has agreed to change the approach to the dialogue process, for all remaining tower procurements. A draft Invitation to Submit Final Tender (ISFT) will be provided to the bidders and updated during the dialogue process, ahead of the final tender being formally issued to bidders.

For future projects, Programme Boards should ensure that an adequate level of documentation is maintained of internal discussions and meetings of the working groups involved. The documentation should include minutes of meetings, action plans and agreements / discussions on scope. The level of documentation should also reflect the balance of permanent / temporary Post Office staff involved in the process. It is recommended that Post Office considers that the approach of providing a draft ISFT to all bidders is adopted across all procurements.

5. For future projects, Post Office should consider that reference site visits are carried out earlier in the procurement process at the ISFT stage where suppliers have been shortlisted but before selection of a preferred supplier.

The procurement was carried out under the OJEU process. Six bidders submitted their interest at the PQQ stage after which five bidders were shortlisted and were invited to submit their proposed solution. At this stage, four of the five shortlisted bidders withdrew from the process. Post Office discussed the reasons for withdrawal which were mainly due to the requirement for co-location; however, there is no documented assessment as to reasons of withdrawal by so many bidders.

The procurement process was carried out in line with legal requirements and Post Office policy and procedures. The process included inputs at various stages from key stakeholders and external advisors. Fujitsu's final tender was evaluated through a proxy bid process using



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Gartner. This was done to ensure that services being procured will achieve value for money and will be commercially sustainable and support the long term strategy of Post Office.

The final tender submitted by Fujitsu was not in line with the requirements of Post Office and did not meet the strategic objectives of Post Office. Fujitsu are the incumbent suppliers for Horizon which will be replaced as part of the Front Office Tower. The Data Centre tower proposal by Fujitsu could have tied Post Office in more closely with Fujitsu thus limiting the choice of a supplier to replace Horizon. As a result, the tender was cancelled in February 2014.



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1. BACKGROUND

Post Office is undergoing a major change led by the Strategy 2020, focussing on growth to become a sustainable business. Post Office has recently separated from Royal Mail and this has resulted in additional challenges as Post Office was using a number of services provided by Royal Mail which include IT infrastructure.

Post Office has documented an IT strategy to support the overall strategy of the business which is being implemented. As part of the strategy implementation, Post Office has decided to outsource hosting, support and maintenance of major IT systems and infrastructure. A tower model approach was agreed which included the following:

- Data centre (DC) tower
- Application and Infrastructure (AI) tower
- Network tower
- End User Computing (EUC) tower

A Service Integrator / Service Desk (SISD) will manage these towers and the SISD will also be outsourced. The DC tower included three main services:

- Co-location hosting
- Private cloud hosting
- Virtual cloud hosting

The procurement followed the Official Journal of European Union (OJEU) process and after pre-qualification, only a single bidder submitted their proposal for proposed solution. Extensive dialogue was held with the supplier to ensure they understood the requirements of Post Office and after eight months of dialogue, the sole bidder was invited to submit a final tender. The tender submitted did not meet Post Office requirements and was also not considered Value for Money (VfM) and after various discussions, Post Office and the supplier could not reach an agreement on the scope and pricing and hence the tender was cancelled in February 2014.

2. SCOPE

This review was carried out to understand the process followed and to provide insight to the following seven areas:

1. How and why did Post Office follow the procurement process before cancelling the bid at the last stage? Was it good sense to continue the procurement process with only 1 bidder/supplier?
2. Have there been other instances where government contracts have been given to single bidders. If so, what was the experience and are there any examples?
3. Why was the Fujitsu response so different from what Post Office required?
4. What market intelligence did Post Office gather about Fujitsu as part of the procurement process?



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5. Whether Post Office used the services of the central government to help us understand the full dynamics of the alleged, high profile, failings by Fujitsu in its previous dealings with government agencies.
6. A large number of contractors worked on the DC tower procurement. What was the mechanism to manage, risk and how did Post Office maintain commercial focus and how was knowledge retained within the Post Office team?
7. What processes are in place to ensure commercial sustainability of contracts for Post Office?

3. DETAILED FINDINGS

The review was carried out based on discussions with key stakeholders and review of documentation. Appendix A contains a list of stakeholders contacted during this review.

This section contains the findings based on the seven questions covered in the scope above.

- **How and why did Post Office follow the procurement process before cancelling the bid at the last stage? Was it appropriate to continue the procurement process with only one bidder/supplier?**

The procurement for DC tower services was undertaken in line with legal requirements and followed the OJEU process. Six bidders showed interest in providing services and five suppliers were shortlisted after Pre-Qualification Questionnaire (PQQ). These suppliers were issued an Invitation to Submit Proposed Solutions (ISPS). At this stage only one bidder submitted the ISPS by the deadline of March 2013 and the other bidders withdrew from the process. The reasons for withdrawal of other bidders were discussed in the IT Transformation Programme Board but no documentation of the discussion is available. Post Office wanted to have flexibility in the services it received under the contract which would in turn have provided wider options at the time of procurement of future services and contracts. As a result, the requirement for co-location was included in the DC tower.

After legal advice and internal discussions, including discussions at the IT Transformation Programme Board, it was decided to proceed with the sole bidder for the following reasons:

- Fujitsu (the sole bidder) was the incumbent.
- The ISPS was within the overall budget and well scoped.
- Post Office had never encountered a single bidder situation for procurement of this size and complexity. Legal advice was sought which was that Post Office could terminate the process or continue it as the law did not prohibit either. VfM would need to be ensured and Post Office was confident that the Gartner and ISG benchmarking would ensure VfM.



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- Post Office had plans to have the final tender submissions benchmarked against the market and had appointed Gartner to act as a proxy bidder and ISG to provide market price benchmarks for the rate card. No other measures to assess the proposal were considered after it became clear that there would only be a single bidder as the reviews by Gartner and ISG would provide sufficient challenge to the ISFT.
 - Fujitsu also support Horizon, and some of the risks associated with Horizon including an extension of its support contract may have been mitigated if Fujitsu were awarded this contract.
 - The dialogue process resulted in Post Office issuing an ISFT to Fujitsu. The response to the ISFT was very different, very brief and much higher in cost as compared to the ISPS. While this was of concern, in the first few dialogue meetings, Fujitsu had indicated that it wanted to improve the solution, bring the scope in line with Post Office requirements (already included in earlier invitations to bid) and therefore, proceeding with the dialogue process could result in award of contract.
-
- **Have there been other instances where government contracts have been given to single bidders. If so, what was the experience and are there any examples?**

The withdrawal of four bidders resulted in Post Office being left with a single bidder. Post Office had not encountered such a situation before for a complex procurement nor was it aware of a similar situation where any other government contracts had been awarded to single bidders. Post Office did have single bidder situations for the mobile (Project Wave) and Money Card projects, but these were simpler projects.

Post Office's solicitors (CMS-McKenna) were contacted for legal advice on this matter. The advice received was that the UK and EU procurement laws did not prohibit continuation of the dialogue process and award of contract to single bidder. CMS did advise that Post Office will have to demonstrate VfM which Post Office was confident of doing through the benchmarking exercise to be carried out by Gartner and ISG. CMS did some high level research on award of contracts in a sole bidder situation. Their research indicated that such instances are rare and largely restricted to small contracts / procurements or procurements for specialist equipment where suppliers may be very limited.

- **Why was the Fujitsu response so different from what Post Office required?**

All shortlisted suppliers were invited to submit ISPS which laid out details of the solution that they will provide based on the scope and requirements listed by Post Office. Only Fujitsu responded to the ISPS as all other suppliers withdrew from the process. Fujitsu were informed that they were the sole bidders and invited to submit ISFT after a detailed dialogue process. Post Office's requirements were discussed during the dialogue process which preceded the ISFT.



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Fujitsu's final tender submission was:

- Very brief and at a high level. Post Office had specifically asked for details in the response, which for reasons unknown, were not provided. A number of details were still outstanding at the time when Post Office decided to terminate the procurement. In fact, the ISPS had more details and was very close to Post Offices requirements compared to the ISFT.
 - Fujitsu's final tender was a bespoke solution for Post Office. Post Office had asked for a commodity product, something like a "switch-on", "switch-off" solution. A bespoke solution did not meet Post Offices strategic objectives as it could potentially make switching providers very difficult and costly at a later stage.
 - Initially, Post Office required Horizon to be hosted and brought into the DC tower. Horizon was being hosted by Fujitsu in their Belfast data centre. This requirement was later de-scoped and the hosting agreement extended till March 2017. This was done as the costs to move the data centre were going to be very high (estimated at around £4.4million) and Horizon was going to be migrated / re-developed in the coming 3 years. Fujitsu's final tender and dialogue discussions seemed to still include aspects of Horizon hosting and migration (one of the reasons for a bespoke solution). This was despite various discussions during the dialogue process to remove this. These aspects of the proposal were only known in December 2013 when the final tender was submitted.
 - The divergence in Fujitsu's understanding of scope contributed to the pricing of the service which was very high compared to the benchmarks. The scope was discussed extensively during the dialogue process and had been well documented in earlier tender documents as well as the ISFT which contained the details of the dialogue process and the exact requirements of Post Office. However, Fujitsu's response to the ISFT was very different to the requirements of Post Office.
- **What market intelligence did Post Office gather about Fujitsu as part of the procurement process?**

Post Office did not conduct any specific market research or intelligence gathering exercise. One of the main reasons was that Post Office has an 18 year relationship with Fujitsu which includes data centre and hosting services. Post Office was therefore confident of the capabilities and history of service delivery of Fujitsu (in a single bidder scenario).

The procurement process included a visit to the data centres which would provide services to Post Office. The visit was scheduled once a preferred supplier had been selected and was, therefore, not part of the evaluation criteria. Procurement regulations require that the evaluation criteria are laid out in the tender documents and any change must ensure that all bidders who participated must not be disadvantaged by the change. References can be obtained and checked, however no independent references can be obtained and market intelligence cannot be used for evaluation.



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- **Whether Post Office used the services of the central government to help us understand the full dynamics of the alleged, high profile, failings by Fujitsu in its previous dealings with government agencies.**

While there were instances when Fujitsu had not delivered some central government projects satisfactorily, details of these projects were not considered during the selection / procurement process. The main reasons were:

- There was no documentation / evidence available stating that Fujitsu had been black listed for contracts for government agencies. CMS were requested to find out if Fujitsu had been black listed by government departments, however, they could find no evidence of this.
 - There was also, at that time, no regulations by which companies / suppliers could be black listed by the government. Such regulations were introduced in late 2013.
 - The services required by Post Office were very different to those for which Fujitsu had received negative publicity. These projects did not include data centre / hosting services.
- **A large number of contractors worked on the DC tower procurement. How or what was the mechanism to manage risk, how did Post Office maintain commercial focus and how was knowledge retained within the Post Office team?**

Post Office was going through the separation process during which staff and services were being separated from Royal Mail. Before separation, Post Office was reliant on Royal Mail for procurement and IT services. As a result of the separation, there was a skills gap for procurement and IT services which was filled by inducting a number of specialists on contract in temporary / interim roles.

There were and still are a large number of contractors involved in the various tower procurement processes. During our review we discovered that only two Post Office staff members have been involved with the process of DC tower procurement from its inception. The majority of staff representing Post Office during the procurement were temporary / contract staff (both technical and procurement specialists) who have since left. There is very limited level of documentation covering the dialogue process and there was no feedback mechanism (from Fujitsu to Post Office) to determine the level of understanding of Fujitsu of Post Office's requirements.

There was a risk that temporary staff on contracts may leave during the process, which did materialise to varying degrees and enhanced documentation would have helped in managing this risk better.



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- **What processes are in place to ensure commercial sustainability of contracts for Post Office?**

Post Office set up a number of measures to ensure commercial sustainability of the contract. The main reason for cancelling the tender was because it did not meet the strategic objectives of Post Office and would have resulted in an unsustainable, expensive and inflexible contract which would not have met Post Office's strategic objectives.

During the dialogue process, Post Office tried on various occasions to convey their dissatisfaction and reservations but the final tender was not modified sufficiently by Fujitsu to ensure it became commercially sustainable.

From inception, the procurement process included benchmarking exercises by Gartner and ISG to determine the operational costs, as well as rate cards for additional, out of scope, fixed cost work. Gartner also acted as a proxy bidder and submitted a bid based on the same documentation and information as that provided to Fujitsu. The benchmarking exercise confirmed Post Office's apprehensions over the pricing of the final tender. Post Office envisaged having the pricing in the upper quartile (lower 25% of cost estimates), however only one out of seven and one out of twelve costs respectively for the operational costs and rate card were within these quartiles.

Post Office had also included options for extension of the contract so as to ensure flexibility. Procurement and contract management expertise was on the project team at appropriate stages. Solicitors were consulted and were asked to review the Master Services Agreement as well as the detailed schedules to ensure VfM and sustainability.

The final tender submitted by Fujitsu was not in line with the requirements of Post Office as listed in the ISFT and did not meet the strategic objectives of Post Office. Post Office is going to replace Horizon (the point of sale system at the branches) with a new system by March 2017. Fujitsu are the incumbent suppliers for Horizon, which will be replaced as part of the Front Office Tower. The solution proposed by Fujitsu in the ISFT could have given Fujitsu an advantage at the time of replacement of Horizon.

4. OBSERVATIONS AND RECOMMENDATIONS

- 4.1 The DC tower procurement was a complex and critical aspect of Post Offices IT strategy and infrastructure. Post Office being a recipient of public / tax payers' money must ensure that its procurement demonstrates VfM. Achieving VfM is very difficult in a single bidder situation, especially for large and complex projects.

Post Office should not continue the procurement process for future projects of this complexity and size where it ends up in a single bidder situation as it is difficult to achieve VfM. Where, due to circumstances, the Post Office has to proceed with the procurement process with a single bidder, a full risk assessment should be carried out and presented to the appropriate committee for approval. In tandem and in line with



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good practice, market assessments and benchmarking should be carried out at appropriate stages in the procurement process and in parallel to discussions with the sole bidder.

- 4.2 Post Office became aware of the withdrawal of four of the five shortlisted suppliers in March 2013. However, the risks discussed at the IT Transformation Board did not recognise or assess the risk of cancelling the contract.

Future project / programme boards should assess risks more frequently and comprehensively to ensure that high impact risks are assessed as early as possible.

- 4.3 At the time of procurement for the DC tower, Post Office was undergoing major changes due to separation from Royal Mail and the IT transformation programme. This resulted in a high level of demand for resources, including those in IT&C. The programmes underway were unique as Post Office had never before undertaken programmes of this size and complexity. As a result, a large number of contract / temporary staff had to be inducted into the programme teams (including IT Transformation) to ensure an adequate level of expertise and experience. Consequently, a large number of contract staff were involved in the process, the majority of whom are no longer with Post Office.

While it is appreciated that this was due to the prevailing situation we recommend that in future, arrangements should be in place to ensure that an adequate level of documentation and supervision by permanent Post Office staff is maintained to ensure continuity and retention of knowledge within Post Office. Where it is necessary to have a high number of temporary staff, Post Office should consider varying contracting mechanism to include longer notice periods for key temporary staff.

- 4.4 The procurement was carried out in compliance of all regulatory and legal requirements and all relevant documentation requirements were met. The IT Transformation Programme Board met regularly and meeting minutes and papers were maintained. Lack of documentation covering dialogue and some internal discussions has made it difficult to evidence what was discussed during the dialogue process. The IT Transformation Programme Board in its meeting of 7 May 2014 has agreed to change the approach to the dialogue process, for all remaining tower procurements. A draft Invitation to Submit Final Tender (ISFT) will be provided to the bidders and updated during the dialogue process, ahead of the final tender being formally issued to bidders.

For future projects, Programme Boards should ensure that an adequate level of documentation is maintained of internal discussions and meetings of the working groups involved. The documentation should include minutes of meetings, action plans and agreements / discussions on scope. The level of documentation should also reflect the balance of permanent / temporary Post Office staff involved in the process. It is recommended that Post Office considers that the approach of providing a draft ISFT to all bidders is adopted across all procurements.



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- 4.5 Post Office followed the OJEU process for the DC tower procurement. The Post Office plan included a visit to sites, however this was to be done only when the preferred supplier had been selected. Whilst it is not a requirement to carry out site visits at any time during the process, such visits could provide insights into the service / product being provided by the supplier and should be given weight at the time of evaluation.

For future projects, Post Office should consider that reference site visits are carried out earlier in the procurement process, at a stage where suppliers have been shortlisted but before selection of a preferred supplier.

5. CONCLUSIONS

Post Office carried out the DC tower procurement in compliance with all legal requirements and internal procedures. Governance was provided by a programme board which met regularly. Support for the procurement was provided by the procurement team, legal team, Post Office's solicitors and by staff nominated by key stakeholders. Post Office realised that this was a critical project and invested a lot of time, effort and money by carrying out extensive dialogue with the sole bidder to ensure that the bidder understood Post Office's requirements and that the final tender included the appropriate scope.

Post Office also commissioned two independent reviews by Gartner and ISG to assess VfM and to benchmark the final tender submission by the sole bidder against the benchmark to ensure that Post Office achieved VfM for the DC tower procurement. Post Office continued the dialogue process, despite there being a significant difference between the scope and costs in the proposal and the benchmarks provided by Gartner and ISG, in order that Fujitsu could have a clearer understanding of the requirements and scope their solution to meet Post Office's requirements. The DC tower procurement was cancelled when it became clear that the gap could not be narrowed and the procurement would not achieve VfM.

We have made recommendations based on our review which should be considered and implemented for future projects / programmes to further enhance and improve the process within Post Office.



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REVIEW OF DATA CENTRE TOWER PROCUREMENT
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Appendix - A

KEY CONTACTS

The following contacts were identified as key contacts for this review.

S. No.	Name	Role	Meeting Date
1	Lesley Sewell	CIO	8 April 2014
2	Jo Turner	Project Manager from November 2013	10 March 2014
3	Paul Bleasby	Programme Manager	25 March 2014 and 11 April 2014
4	Richard Boyce	Procurement lead involved in "dialogue"	28 March 2014 and 11 April 2014
5	Jo Bates	Legal team	13 March 2014
6	CMS	Solicitors	19 March 2014
7	Liz Tuddenham	Procurement	17 March 2014
8	Chris Taylor	Evaluator	11 March 2014
9	Neil Wilkinson	Head of Separation Programme	3 April 2014
10	Carol Ayres	Dialogue with Fujitsu	20 March 2014

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POST OFFICE LTD BOARD

Noting Paper

Lessons Learned – Second Sight Investigation into Horizon

1. Issue

1.1 This paper addresses the lessons learned from the handling of the commissioning of the Second Sight investigation into Horizon and subsequent events.

2. Background

2.1 Following the publication of the interim Second Sight report into Horizon and associated issues the Board commissioned a short review to capture the key lessons learned from the experience, starting from the point at which James Arbuthnot MP first raised concerns with the Chair of the Post Office, to help increase the maturity and resilience of the business and its ability to handle similar challenges more effectively in the future.

3. Approach

3.1 Rather than attempt an in depth analysis of all the documentation relating to this subject, this review is based on individual interviews with all key Post Office personnel involved at the time this issue first arose (some of whom had left the Post Office) and is therefore based, in a large part, on people's understanding and perceptions. No attempt has been made to identify written evidence or corroboration of any information or opinion I have been given.

3.2 In undertaking the review, and presenting my 'findings' I have drawn on:

- the information gleaned from my interviews with key Post Office personnel;
- other relevant experience within Post Office; and
- my previous experience of 'independent' reviews and inquiries within Government.

3.3 Having discussed the approach previously with both the Chair and the Chief Executive of Post Office Ltd, I have positioned my findings as a 'best practice' approach which can be developed into a more detailed blueprint for handling similar challenges in the future.

4. Conclusions

4.1 There will be occasions where it is necessary for Post Office Ltd to respond quickly and publicly to an issue, as it was felt necessary to do in response to

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concerns raised about Horizon. **Appendix 1** sets out, in draft, the key high level issues and learning points presented as a generic best practice guide for managing crises and other high-profile non-BAU activity.

4.2 The aim of the approach is not to fetter Post Office's ability to respond to new or unexpected high profile issues, or make it slow to do so, but acknowledges that the type of issue that is likely to give rise to some sort of 'independent' review is exactly the type of issue over which particular care should be taken to ensure the response is the right one for the business and is dealt with in a way that gives internal and external confidence in the outcomes.

5. Recommendation

5.1 The Board is asked to note the draft lessons learned paper and provide any comments direct to me (by 10 May). I will take any comments into account before finalising the best practice guide. This will then be presented to the ExCo to inform the development of the detailed blueprint for handling similar challenges in the future.

5.2 To note the intention to follow the best practice principles set out in the paper when implementing any decisions on the future of the Mediation Scheme.

Belinda Crowe
24 April 2014

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Appendix 1

DRAFT

Best Practice based on Lessons Learned from the investigation into Horizon

1. Enterprise wide response

- 1.1 There are a number of different circumstances where an enterprise-wide response is called for and what follows should apply to dealing with any crisis, high risk or high-profile issue, including the establishment of an 'independent' review, and, particularly, in the face of public attention.
- 1.2 It will normally be clear where accountability for managing the work rests. However, to enable the accountable person to effectively discharge their responsibilities in circumstances such as those referred to in this paper, an enterprise wide response is required which acknowledges that the issue is usually:
 - high profile and above and beyond normal BAU activity;
 - likely to be stressful (and relentless) for those involved due to the scrutiny of ExCo/Board/media/Ministers/MPs; and
 - likely to require financial and staff resource outside of BAU.
- 1.3 To ensure this non-BAU activity is given the support, attention and resource appropriate to its importance and risk profile by the ExCo and the Board Post Office should have arrangements in place which:
 - provide an 'off the shelf' (and generally acknowledged and understood) protocol, covering for example, governance arrangements, which reflects the complexity, importance and risk profile of the work;
 - enable pan-enterprise identification of BAU or project activity which could be delayed or stopped to counter the cost of the new project;
 - enable the identification and rapid mobilisation of an appropriately sized and skilled team to manage the work as a priority (see 1.4 below); and
 - require and allow ExCo to manage the work as a business wide project to ensure that the project team does not encounter cross directorate barriers and that the appropriate support is available from all areas.
- 1.4 Post Office should consider whether it has the in-house capacity and capability to effectively manage this type of issue and, if not, whether the permanent recruitment of such a resource would provide better value for money than 'buying in' suitably skilled staff when required. If the latter, the costs will probably be high (for the duration of the project) and arrangements need to be in place to access the external resource quickly and easily.

2. Clarity of message and its ownership

- 2.1 Post Office should aim to deliver and own the relevant message/narrative and keep control of it. The more high profile the issue and complexity of the stakeholder landscape, the more important this is.
- 2.2 Whilst it can be helpful for stakeholders to endorse or publicise a statement or announcement, Post Office should retain control of the content and timing of announcements, including the appropriate time to update interested parties.

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3. Engaging external services/suppliers

3.1 There will be occasions where it is necessary to engage external suppliers/contractors at short notice without going through the Post Office normal procurement processes. A rapid, bespoke engagement outside of normal processes should not mean lack of rigour and the following points should be considered when engaging suppliers/contractors in such circumstances:

- the more sensitive/high profile the work, the greater need for a rigorous engagement process;
- the absence of the robustness of a full procurement process, increases the need for other additional due diligence. This should include an interview panel, confirmation of qualifications and direct oral references from other clients to confirm capability and quality of outcomes;
- the agreement of a letter of engagement before work starts. Post Office has a comprehensive set of 'standard' terms for suppliers on call off contracts which cover all the basics and which should be adapted as required without watering down the essence of a solid framework for managing contractors; and
- a workplan should be agreed at the outset with proper, albeit light touch, control arrangements in place for varying that.

4. Managing external suppliers

4.1 The delivery of services or outputs from external suppliers should always be subject to the proper management and propriety arrangements. This is also true in the case of an 'independent' review, short of fettering the independence of the conclusions. Effective and visible management of delivery against cost, timescales etc. is a matter of propriety and Post Office has a responsibility to properly manage and account for public funding; it should therefore be clear at the outset about how it will do that and rebut suggestions that doing so is in any way fettering the independence of outputs.

5. Stakeholder engagement

5.1 **At the outset:** There may be a need to obtain stakeholder agreement or buy in to a proposed form of action or elements of it. Before committing to engage with external stakeholders, clear parameters should be set and articulated to give clarity about what external stakeholders can influence and what they cannot, and the extent of that influence.

5.2 **Ongoing:** Ongoing stakeholder involvement may be appropriate but here too the rules of engagement should be clearly communicated and should not extend to direct contact or directing activities unless within a framework agreed in advance by Post Office.

6. Public commitments

6.1 Before any non BAU public commitments are made announced or agreed to publicly (i.e. outside of the Post Office) internal agreement should be sought and obtained through proper governance mechanisms to:

- scope and Terms of Reference including outcomes and outputs; and
- understand the legal, financial and PR implications and risk.

POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE**Internal Audit
Proposed Plan for 2014/2015****1. Purpose**

A detailed plan with supporting schedules was provided to the committee at the March 6th meeting. The meeting requested a simplified and revised plan with an updated view on resourcing.

Since that meeting the revised budget and three additional heads for 2014/15 have been approved, subject to the ARC approving the plan of work. The approval of the outline work plan is required by the HR processes because roles need to be templated and supported by work plans in order for recruitment to commence.

The purpose of this paper is to:

- 1.1 Summarise the internal audit plan for 2014/15
- 1.2 The committee is requested to review the plan based on current resources, discuss any items that are on the additional list or suggest items not listed for consideration.
- 1.3 The committee is requested to formally approve the plan and support the resource request.

2. Risk Based planning

- 2.1 As outlined in the Internal Audit paper for the March 2013 ARC, internal audit planning commenced in November and ran through to early February.

Planning followed internal auditing international standards and considered:

- The emerging risk management framework,
- Top identified risks and risk maps in development by Directorate.
- Current control frameworks allied to them
- Feedback from senior management,
- Items identified by POL IA itself and items raised by ARC members.

- 2.2 In taking a risk based approach, it is necessary to consider a range of risk types that most organisations will face as well as those identified by management. A number of these may be among management's top risks and particular attention is given to those. However it is important to consider the wider range of risks when constructing the plan.
- 2.3 As with most organisations, a plan for the year is indicative based on current known risks and priorities. Internal Audit receives requests from management during the year for advisory support or audit assistance. These may amend the plan or replace certain items. As in previous years the ARC will review the upcoming quarterly plan.

3. Revised Plan and Priorities

- 3.1 The original plan which is rolling in nature has been reviewed.
- 3.2 The rolling plan commenced in April 2014 and carried over items from the 2013/14 plan while the 2014/15 plan was being revised. These include:
- Benefits Realisation (underway from late April), Business Continuity Planning (commence late April)
 - Completion of Atos on boarding work.
 - Continuation of programme assurance work on the new Finance Systems due to over the summer.
 - Completion of investigation of credit card selling issues requested by the CEO.
- 3.3 The plan will be flexed during the year to accommodate new risks or issues. This may mean some items will have to be moved in the plan or replaced. If these are major changes then the ARC members will be consulted before final agreement with the business.
- 3.4 As outlined in the original plan paper presented in March 2014, the approach has considered business risks including those identified by the ExCo but not withstanding other top risk areas that impact the business.

4. Top Priorities

- The COSO¹ framework which is a recommended global method for risk and control, identifies four main risk types – Strategic, Financial, Operational and Regulatory. Whilst there are other risk types (e.g. Technology, major change, customer, fraud etc) these can usually be grouped within the four risk categories.
 - The proposed areas for independent assurance are listed below followed by a table that summarises the linkage to risk using the framework and the ExCo top risks.
Items 1 – 15 should be covered by the current size and skills mix of the incumbent team with co-source PwC support where appropriate. Items 16 onwards are considered important but will need the recruitment.
1. Benefits Realisation (underway)
 2. Continuity Management (underway)
 3. Crown Transformation Programme
 4. Network Transformation Programme
 5. Atos SISD, transition and post transition (underway and future work based on PwC outcomes)
 6. IT Towers

¹ Committee of Sponsoring Organisations. A global body that has set out frameworks for control and risk management. The latest framework was issued in 2013.

7. IT Governance of new IT organisation.
8. New Finance System – final testing/go live, PIR.
9. Contract Management
10. Financial Misselling risks
11. Health and Safety
12. Bribery and AML risk management
13. Stock and shrinkage management,
14. Third party cash collection services
15. Fraud Management - Risk and process review.

The items below this line will require the additional audit managers to be recruited.

16. Independent Assurance on Business Transformation Programme.
 17. Overall approach to outsourcing
 18. Data Protection
 19. Common Digital Platform
 20. Social Media and external communication risk
 21. Overall approach to procurement
 22. Governance of Information Security in new IT organisation.
 23. Cyber-Security
 24. Implementation of Business Improvement actions around branch network.
 25. Post Implementation Review of new Finance System
 26. Cash Centres – operation and controls
 27. Sales incentive schemes
- 4.1 Some of these will be point in time reviews, others ongoing through their development (IT work, NTP, CTP for example).
- 4.2 The committee is advised that due to the current skill mix and experience in the incumbent team it is not a simple matter of, for example swapping the assurance work on the Business Transformation Programme with stock management work.
- The team has one individual with significant project assurance experience with others focused on IT and business operational expertise. To cover the increasing needs of assurance over the programmes in the business requires recruiting experienced internal auditors with that expertise combined with some generalist knowledge to support general business audits such as outsourcing or procurement.

Keys risks and priority audit work. Items 1-15

Type	Top ExCo Risks - linkage	IA 3 rd line assurance
<p>Strategic. Top Risks to the planned direction, positioning and financial stability of Post Office.</p> <p>Company-wide change programmes, transformations and transitions pull on the ability of the company's resources, capability to effect, and raise dependency on third parties. Interdependencies result in complexity and delays can have domino effects on other organisational goals.</p> <p>Dependency of effective systems to deliver services and products, information security and disclosure risks, very high degree of technical and structural change. Increasing reliance on third parties during transformation and into BAU. Increasing cyber security threat landscape. increasing use of cloud based computing</p>	<p>Failure to deliver top line growth in line with strategic plans.</p> <p>Non delivery of the Network Transformation Programme.</p> <p>Risk to the successful delivery and operation following IT Transformation.</p>	<ul style="list-style-type: none"> • Benefits Realisation Process • Review of Risk Management Framework • CTP • NTP • ATOS on boarding • Towers and Post SISD implementation (Dependent on findings of PwC risk advisory work – likely to be full time for one IT audit manager) • Overall IT Governance of new organisation.
<p>Financial</p> <p>Risks arising from financial control failure, working capital and treasury, management of costs, maintaining adequate funding operationally and strategically.</p>	<p>Operating model fails to deliver requisite cost savings.</p>	<ul style="list-style-type: none"> • New Core Finance System • Contract Management

Type	Top ExCo Risks - linkage	IA 3 rd line assurance
<p>Regulatory</p> <p>Ensuring compliance with government requirements, the law and recognised standards.</p> <p>Ensuring staff are safe, accidents are avoided etc (Corporate Manslaughter risk for Board directors)</p>	<p>Risk of regulatory action or reputational damage from FS misselling</p>	<ul style="list-style-type: none"> • FS misselling risk • Bribery Risk • AML risk • Health and Safety
<p>Operational</p> <p>Distribution of large quantities of cash, value and operational stock presents risks through the network.</p> <p>Management and control of cash, customer, delivery and reputational risk in the 3rd party cash collection/delivery business, security and bonding risks (Bank of England bonding scheme), criticality of the supply chain/vehicle network to supporting agency, multiple and crown locations.</p> <p>Changing organisational structure, systems, processes, business models create ongoing continuity risks.</p>	<p>Strike action with supply chain could damage ability to distribute cash to network.</p>	<ul style="list-style-type: none"> • Stock & Shrinkage • Third party Cash Collections business • Continuity – business readiness for incident/crises management • Fraud risk assessment (Head office and central functions as well as branch)

5. Resourcing

- 5.1 Current resource will also be required to deal with ad-hoc requests from management during the year.
- 5.2 The IT Audit Manager commences maternity from June. An interim IT Auditor has been engaged to start early May and conduct a handover.
- 5.3 The risk and compliance team will, upon reasonable notice, provide short term ad-hoc support to IA audits particularly in the areas of information gathering or volume work. Staff will not be seconded to IA.
- 5.4 The Co-source arrangement with PwC provides for a capped annual budget of £100k. This provides for expertise not within the team or additional advisory support for audits run by IA. For example it has been utilised to perform the IT Risk Advisory work requested by the ARC.
- 5.5 This £100k budget has been partly used for the IT Risk Advisory work completing this May and support for additional audits in the IT area may be needed due to:
 - New assurance work that may arise out of the current project.
 - Other support identified for audits known or arising.
 - Support the interim IT audit manager if necessary.
- 5.6 The budget will be managed. Should there be a need above the cap, this will be discussed with the General Counsel and CFO before approval by the ARC.
- 5.7 We have reviewed the needs for the above audits/reviews and discussed with our co-sourced IA Partner at PwC. The above plan has little room for contingency or additional requests for advisory and other work.
- 5.8 Additional Resource:
 - Earlier discussions in 2013 and reviews identified that the initial 3 person team was not sufficient and a 2-3 man resource target (2 generalist and 1 IT) was identified.
 - The approval of the work plan will be required to enable the HR team to complete sign off processes and commence recruitment.
 - As the audit year has already commenced it is anticipated that the earliest additional heads will be in situ will be during Q3 if recruitment commences during late Q1.
 - This means that some of the items listed 16 onwards will roll into 2015/16.

6. Actions

6.1 The Committee is requested to:

- Review the candidate audits.
- Direct as necessary.
- Approve the plan including the elements needing the additional resource.

Malcolm Zack
Head of Internal Audit
15th May 2014

Appendices:

Summary Gantt Chart of plan

Summary of scope by audit (with current resource)

Summary of additional audit candidates (using additional resource)

	Lead	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Atos SISD, transition and post transition*	EN/EB												
IT Towers*	EN/EB												
IT Governance	EN/EB												
Complete Supply Chain Compliance team review (2013/14 audit)	GH												
Business Continuity – Readiness Assessment	GH												
Health and Safety	GH												
Stock and shrinkage management,	GH												
Third party cash collection services	GH												
Bribery and AML risk management	GH/SS												
Fraud Management - Risk and process review.	GH/SS												
Complete current investigation	SS												
Benefits Realisation*	SS												
Contract Management*	SS												
Financial Mis-selling risks*	SS/ANO												
New Finance System – final testing/go live	SS/EN/EB												
Crown Transformation Programme	SS/GH												
Network Transformation Programme	ANO?												
Review of Embedded Risk Management Framework.	SS/GH/EN												
Advisory work requests as received from business	ALL												
Branch support - Xmas working	ALL												
	*	Agreed with PwC co-source team for additional support - either direct resource or advisory/benchmarking/information											
		Tentative date allocation only											
	EN	Elena Nistor - IT Audit Manager (on Maternity from June to Dec 2014)											
	EB	Edwin Bowden - Interim IT audit Manager - maternity cover											
	GH	Garry Hooton - Network and Supply Chain Audit Manager											
	SS	Safia Saeed - Project and Programmes Audit Manager (& Generalist)											
	ANO	Additional allocation may be needed											

Audit/Review/Project Assurance	Outline of work
Atos SISD, transition and post transition*	Already agreed with ARC in Nov 2013 as key activity in 2014 for IT auditor, terms of reference already agreed and work underway. Will continue into 2014/15. Build on PwC Risk Advisory work due May 2014. This is likely to result in a series of focused pieces of work around the assurance model advised.
IT Towers*	As above.
IT Governance	Review of IT model once Atos embedded to assess governance over in-house/outsource relationship.
Complete Supply Chain Compliance team review (2013/14 audit)	Carried forward from work commenced March 2014.
Business Continuity – Readiness Assessment	Framework has been under development by management for about a year. This review will assess status and the degree of business readiness and capability to respond to a major incident. This should include all areas. IT Disaster Recovery may need to be assessed within the Atos work.
Health and Safety	Review of the second line defence team's approach to managing risk, key controls, reporting, escalation etc. Whilst not considered a top risk by the business, health and safety issues can affect reputation quickly. Work to include visits to operational sites (Head offices, cash depots and selected branches)
Stock and shrinkage management,	Key operational area not reviewed by IA for many years. Working capital is tied up in stock. In POL's move towards retail focused organisation, a thorough assessment of stock management competency is considered essential.
Third party cash collection services	Considerable business collecting cash from retailers and other high street parties. Risk not only to financial loss but also to reputation. Selected tests and observational visits to customers. Observation of cash controls, completion and security.
Bribery and AML risk management	Bribery. Review of policy and training and other controls in light of the MoJ's guidance on "adequate procedures" AML - Linked to Financial Services risks, testing and approach to AML risks both in head office and in branches. May need direct working with FSA team in Network Operations or possible secondment of staff from there to cover scope/scale
Fraud Management - Risk and process review.	Fraud is a management responsibility and the Board must satisfy itself that it has complete and robust measures in place to prevent, detect and deal with fraud, theft and irregularities. Fraud could happen not only in the network, or in depots but also in head office functions. Procurement, expenses and bribery risks are of particular feature in many organisations. Estimated reported fraud in UK in 2012 exceeded £40bn, about half in public sector.
Benefits Realisation*	Key management processes for building, monitoring and realising benefits from programmes. Test the degree of the embedding of it to date, measures used, application of its controls by the business and post implementation reviews.

Audit/Review/Project Assurance	Outline of work
Contract Management	Contracts are key vehicles for managing supplier performance and client relationships. As the business moves to a more outsourced model, this competency increases in its significance and risk to performance.
Financial Misselling risks	New area for POL IA. Risk discussed at ARC recently. Potentially a large review. Financial Services Risk Management Framework - its design and application, whole approach to managing conduct within branches and in head office. Liaison of POL with key partners such as Bol/Mystery shoppers"
New Finance System – final testing/go live	(Already underway - ongoing project audit commenced April 2013 - – full audit plan to summer 2014 in place - Some reliance being placed by E&Y. Majority of IA work to be in Q1 with some Q2 work post implementation
Crown Transformation Programme	Programme Governance and planning, risk and issue management, lessons learnt from previous franchising programmes, reporting of financials, engagement with other parts of the business, benefits review and implications if objectives not achieved.
Network Transformation Programme	Similar to CTP but with wider focus on the agency side and overall branch programme.
Review of Embedded Risk Management Framework.	The application and implementation of the company's risk management framework should be independently reviewed so as to provide assurance to the audit committee. The business is approaching the stage where internal audit (MZ) can begin to step away from assisting /directing the risk management framework which has been the case in 2013.

Outline of items that will need 2 Generalists/Project Assurance staff plus 1 IT auditor to fully cover.

Audit/Review/Project Assurance	Outline of work
Independent Assurance on Business Transformation Programme	Governance, Risk and Issue management, identification of future assurance needs from the 3 lines of defence model. Likely to be a large piece of work requiring coordination with 1 st and 2 nd lines of defence and possibly third party support.
Overall approach to outsourcing	Consistency of approach, management of risk, key policies and controls, management information and performance monitoring.
Data Protection	Consistency of framework, application in branches, head offices and specific databases.
Common Digital Platform	Technically complex infrastructure operating within the cloud environment. Growing area of IT infrastructure with various unique risks Assess the cloud environment of the Common digital platform
Social Media and external communication risk	Management approach, communication methods, dealing with twitter and Facebook feeds, LinkedIn presence. Review of tools and techniques used, possible benchmarking,

Audit/Review/Project Assurance	Outline of work
	reputation management if communication goes wrong.
Overall approach to procurement	Consistency of policy and process within the range of services procured by the business. Use of frameworks, exceptions, management of risk.
Governance of Information Security in new IT organisation.	Whilst this is understood to have improved since 2012, it remains a key area of concern and significance for ensuring our data remains confidential, available and has integrity. Of increasing importance as business functionality and capability is sourced/managed by third parties.
Cyber Security	Increasingly visible business topic as digital business and world develops. Linked to above technical security topics.
Implementation of Business Improvement actions around branch network.	Actions arising from the Business Improvement programme need to stick and deliver the changes envisaged. This may be a mix of ongoing involvement as improvements are rolled out and specific tests. Scope and timing will be dependent on the improvement programme specifics
PIR of new Finance System	Post Implementation review of new CFS system – including testing of Segregation of Duties and testing of selected processes/controls.
Sales incentive schemes	Specific focus on the sales incentive schemes designed and employed by POL including compliance or risk of deviation in light of the £28m fine imposed by the FCA on Lloyds in December 2013

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

The purpose of this paper is to:

- 1.1 Update the Committee on the POL IA audit activity during March and April since the previous meeting in February 2014 including key outcomes
- 1.2 The committee is requested to note and provide directions as necessary.

2. Table of recently completed audits, reviews and advisory work and underway

	Completed	In Progress	Starting
<u>Audits/Reviews</u>	Design of Segregation of Duties in new Finance System (CFS) Credit Card sales process review	Supply Chain Compliance team – assessment of 2 nd line assurance provided	Business Continuity - Readiness assessment Benefits Realisation – assessment of bedding in of process
<u>Project/Programme Assurance</u>	SISD Programme Assurance Highlight report #2 Programme Assurance CFS	SISD ongoing on boarding of ATOS – (New IT organisation and governance)	Next stage of New Finance system. (CFS) (UAT, ongoing assessment of risk management) SISD – new IT organisation
<u>Advisory</u>	Transport for London – external audit rights work. (Closing memo) Review/feedback of Data Centre procurement report.	Risk Advisory and assurance advice project with PwC	Requests will be assessed if received.
<u>Other</u>	Design of new protocol for dealing with invocation and management of third party audit rights requests. Regular follow up on Recommendations status, IT, Treasury etc Annual Appraisals etc	Finalisation of IA goals plans and individual team objectives for 2014/15 Establishment of IT Audit governance forum.	Coordination with Finance and E&Y on external audit work on CFS.

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3. Key Highlights and Outcomes

Area	Highlights and Outcomes
SoD – SAP Authorisation Matrix	<ul style="list-style-type: none"> • This reviewed the proposed design of segregation of duties in the new CFS system. It required a technical review of the SAP Authorisation matrix which determines the proposed access rights of each role. • The overall aim was to gain assurance over the proposed design of access and identify segregation of duties risk for the senior management team to consider and address prior to implementation • It was conducted with the assistance of technical expertise from PwC and considered SoD risks in <ul style="list-style-type: none"> • Authorisation • Custody • Transaction Recording • Checking/Reconciliation • Master File Maintenance. • The report was discussed with the project team and the Project Board for the project. A full action plan was devised by the project team in response to the remaining identified risks and potential conflicts of interest. <p>At time of writing the completed management response is underway.</p> <p><u>Outcomes</u> No design or actual implementation will be perfect either due to error, business circumstances or simply numbers of staff and therefore some segregation of duties risk (SOD) may remain, however we concluded that design was satisfactory.</p> <p>There were 13 identified areas for management to address. Eight were amended during the review directly by the project team. Of the remaining five there remained some risk in Accounts Payable, Purchasing, Asset Management and Treasury.</p> <p>Where project team had decided to accept the risk or explained a business need, IA highlighted these for review by the senior Finance team and the FRP programme manager who have determined additional controls and measures or designed compensating controls.</p> <p>A table of the identified issues is included in the appendix. Following a post audit review, Finance management have identified additional controls where appropriate on the amber items.¹</p> <p>A review of the actual implemented authorisations will be needed after go live.²</p>

¹ A draft response paper has been supplied to IA at time of writing but is not included in the appendix.

² This may be conducted by the external auditors as part of their 2014/15 external audit.

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Area	Highlights and Outcomes
SISD programme assurance	<p>On-going involvement in the transition of the SISD provider (Atos) continued.</p> <p>The highlight report to IT management and the programme board was issued in March 2014 including the CIO and CFO and focused mainly on:</p> <ul style="list-style-type: none"> • Risk Management, governance, decision making processes and key documentation in the programme. <p>The following issues were highlighted</p> <ul style="list-style-type: none"> • Classification and communication/escalation of those risks which are considered high impact • Raising, tracking, managing and escalation of risks by different stakeholders (• Integration of the POL and Atos risk registers. <p>During our ongoing review, attendance at meetings and discussions with management, IA noted and also reported the following made by some members of management and staff:</p> <ul style="list-style-type: none"> • A stated lack of awareness of the new governance programme and how it operates. • No visibility and knowledge of different work streams status. • Decision making processes for the 1st April transition was unclear and there was a risk that the decision owners may not be fully informed on what they need to decide upon and the criteria to use. <p>It was acknowledged that these were mainly comments raised by staff during our attendance and at meetings but due to the timing of the transition, were highlighted in the report.</p> <p>It was also noted that an outstanding issue from our December Highlight report on the logging of quality issues was still to be addressed. This focused around clarity of deliverables, target dates and review/approval.</p> <p>Actions agreed:</p> <ul style="list-style-type: none"> • The risk identification, escalation, mitigation and tracking process will be reviewed to ensure there is transparency on risks raised and on their mitigation status. • The Quality Log, which gives an overview of all documentation delivered by Atos and the PO internal approvals, will be in place before the 21st March <p><u>Note to ARC Members:</u> - The Atos Service Desk went live with its initial services on April 1st 2014</p>
CFS	<p>The primary CFS assurance work was the SoD work highlighted above. IA attended the Programme board and followed up on previous highlight report actions and liaised with the Finance Governance Manager who is designing the overall controls environment.</p>

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Area	Highlights and Outcomes
Transport for London – external Audit rights and lessons learnt.	<p>No major issues to highlight.</p> <p>The IA activity report for the March ARC highlighted the results from the external review relating to oyster card forms that had not reached their destination for processing. There were no major issues but a few process improvements were noted.</p> <p>Internal Audit who were involved throughout the process formally closed the matter through Nick Kennett and Chris Aujard in April following confirmation that the business had acted upon the recommendations agreed between TfL and POL.</p> <p><u>However – Lessons Learnt</u></p> <p>The episode had identified a lack of proper and effective process in responding to, invoking and managing a response from such a third party who is invoking their audit rights. I.e. a major client.</p> <p>This resulted in some confusion over responsibilities, coordination and ownership. There was some tendency for the 1st line to wish to “hand this over” to Risk or Internal Audit as it was an “audit” but in reality it is vital that the management area under review (1st line) who has the client relationship take a coordinating lead, because it is their relationship and their area under review.</p> <p>Nonetheless, it was recognised that parts of the business may find dealing with such requests to be challenging and it is necessary to support the 1st line with effective direction, guidance and coaching, typically from 2nd and 3rd line support functions (including legal, branch FSAs and information security for example, besides risk and internal audit).</p> <p><u>Outcome</u></p> <p>A protocol and process for responding to, managing through and closing such requests was drafted by the Head of IA with input from Head of Risk and Head of Information Security Assurance.</p> <p>The paper was included in the May ExCo meeting for noting.</p>

3.2 The review of the credit card sales and related processes is complete but undergoing reporting and clearance with Legal Counsel at time of writing.

3.3 IT Risk Advisory work – PwC

- The ARC requested that the business commission a third party to advise POL on the risks that the IT Transition (SISD and Towers) presented and the risks in the operating model once implemented. This was to help ensure that the business had a full understanding of the risk landscape that it would have to manage.
- PwC were engaged to conduct the assignment. The terms of reference were drawn up jointly between Internal Audit and IT and also requested that the work include guidance on where POL should obtain assurance both during and after the transition.

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It was made clear upon PwC that this was to be advisory in nature and not an audit. The Terms of reference were also reviewed by Legal Counsel and the CFO.

- At time of the writing (April 30th) the work has been completed and the draft report has been initially reviewed by Internal Audit. It is now passing through POL management for internal review. POL will consult internally and formulate its response with PwC prior to a full discussion with the ARC.

4. Actions

4.1 The Committee is requested to:

- Note the outcomes of the recent audits and reviews and direct as necessary.
- Note the current and upcoming work and direct as necessary.

Malcolm Zack
Head of Internal Audit
15th May 2014

Appendix:
Table of Segregation of Duties findings.

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Ref	Business Area Reviewed	Potential Conflict in design	Risk	Agreed action or Management position	Owner/Date
1	Accounts Payable	<p>AP Manager Role –authorise vs transact.</p> <p>The AP Manager role currently has the ability to unblock invoices and perform the payment run activities.</p> <p>This means that invoices that were blocked for a business reason could be unblocked and then paid when it was not authorised to do so.</p>	<p>There is a risk of potential fraud or unauthorised invoice payment, if blocked invoices are unblocked and payments are run without the adequate approval process.</p>	<p><u>Business need:</u></p> <p>Where an invoice is blocked as a result of LIV verification (price or quantity difference) the PO will have to be changed before the release of the invoice can occur. This will be a scheduled job and the manager role has been given the ability to manually run this if it is required.</p> <p><u>Mitigating controls:</u></p> <p>The AP Manager role cannot perform a full payment run process because the AP Clerk role has to instigate the payment run by entering the parameters and creating the proposal.</p> <p>The AP Clerk can change the account document (i.e. put in a manual payment block on an invoice) and the AP Manager can manually unblock the invoice so the segregation is defined.</p> <p>In summary the supplier payment and blocking process has been segregated between the AP Manager and AP Clerk to provide the controls required.</p>	<p>Chris Allen – Project Business Process Lead (Business Analyst)</p>
2	Purchasing	<p>FSC Buyer Role /Category Manager role/ PO Receipt Role</p>	<p>Unless there is an additional approval step</p>	<p>The Category Manager role has been removed from the FSC Buyer role within the matrix</p>	<p>Chris Allen – Project Business Process Lead</p>

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Ref	Business Area Reviewed	Potential Conflict in design	Risk	Agreed action or Management position	Owner/Date
		<p>The "FSC Buyer" role has 'create PO Authorisation' and Category Manager role and the role "PO Goods Receiver"</p> <p>The Category Manager role has PO Release capability.</p> <p>The PO goods receiver role has the ability to receipt goods.</p>	<p>or control there is a risk of the FSC Buyer role having the ability to create a PO and approve it. If the Goods receipt role is also maintained then the buyer role has ability to receipt goods/services as well.</p> <p>A risk of fraud or irregularity remains.</p>	<p><u>Business Need:</u></p> <p>For operational reasons (to be explained) the PO Receiver role will remain with the FSC Buyer.</p> <p>Management has accepted the risk due to compensating controls - the buyer cannot create a PO without an approved requisition and they are not able to create requisitions themselves.</p>	<p>(Business Analyst)</p> 
3	Purchasing	<p>PO approval vs Goods Receipt roles</p> <p>The "Category Manager" role has Purchase Order ("PO") Approval capability. Therefore, this role should not be given together with the "Goods Receipt" role.</p>	<p>There is a risk that purchase orders might be approved and goods received by the same user, avoiding in this way the 3 way matching principle which ensures the comparison of the quantity, price per unit, terms, etc.</p>	<p>Management has agreed with the point raised and the documentation/matrix has been updated to reflect this.</p>	<p>Done</p> 
4	Purchasing	<p>PO Maintenance ability vs Goods Receipt</p> <p>The "Central Administration (FSC)" role has PO Maintain capability and should not be given in conjunction with role</p>	<p>There is a risk of potential fraud by changing any existing PO and also receive goods against it, therefore avoiding the 3 way matching principle (quantity ordered, price</p>	<p>Management has agreed with the point raised and the documentation/matrix has been updated to reflect this.</p>	<p>Done</p> 

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Ref	Business Area Reviewed	Potential Conflict in design	Risk	Agreed action or Management position	Owner/Date
		"PO Goods Receipt".	unit, quantity received).		
5	Asset management	<p>Asset Transactions vs Data Maintenance.</p> <p>The "Asset Transactions (FSC)" role has capability to change or reverse an asset document and/or make a sale of an asset resulting in revenue being earned.</p> <p>This role should not be given in conjunction with the role "Asset Master Data Maintenance (FSC)".</p>	Having both functions means there is a risk of misstating the revenue or a risk of fraud by misstating the revenue.	<p><u>Risk Acceptance</u></p> <p>The risk has been accepted because the capital accountant currently needs this functionality to conduct their role.</p> <p><u>Recommendation:</u> - Management to consider monitoring changes to asset master data and review of asset disposals.</p>	Hayley Jones – Project Business Change Champion for Finance
6	Treasury	<p>Bank Master Data vs Bank Statement Processing and Reconciliation</p> <p>The roles "Bank Master Data Maintenance (FSC)", "Bank Statement Processing (Treasury)" and "Bank Statement Reconciliation" should not be given together.</p> <p>IA note: Normally, processing activities should be segregated from reconciling activities to prevent against an individual being able</p>	There is a risk of increased fraud by changing bank details and processing the statement without any additional third party check.	<p>Management has agreed that the "Bank Master Data" role should not be given in conjunction with the other two roles and the authorisation matrix has been updated to reflect this.</p> <p><u>Risk Acceptance</u></p> <p>However, management has stated a preference not to separate the 'Bank statement processing' and the 'Bank statement reconciliation'</p> <p>The users need to be able to upload a bank statement and then reconcile non-auto matched entries.</p> <p><u>Recommendation.</u> Consider an oversight control or approval mechanism (third party check) to address</p>	Chris Lake - Project Business Change Champion for Treasury

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Ref	Business Area Reviewed	Potential Conflict in design	Risk	Agreed action or Management position	Owner/Date
		to modify a bank statement and then hide the activity through the reconciliation (for example).		residual risk.	
7	Sales	<p>Sales Order Processing vs Maintain Price/Condition or Order</p> <p>Within the role "SD Sales Order Processor", there is also the ability to "Maintain (Create/Change) Price or Condition" and "Maintain Sales order".</p> <p>These authorisation transactions are in potential conflict.</p>	There is a risk of potential fraud as the same user can change the pricing and then create a sale order at a lower price, resulting in financial loss for POL.	<p>Risk Acceptance</p> <p>The business believes this is an acceptable risk and they need the team to have the flexibility to immediately change pricing tables if the need arises. The pricing brought through into a sales order can be overtyped as these fields are not locked to support manual invoicing.</p>	<p>Phil Elliot - Project Business Process Lead</p> 
8	Master data	<p>PTP Master Data Maintenance vs creating and releasing contract</p> <p>PTP Master Data Maintenance Role has "create and release contract" access (MK31K, MK32K, MK35K, MEAN).</p> <p>These two activities should be segregated from each other and from this role where the role purpose is to maintain vendors.</p>	There is a risk of creating and releasing a contract within the Master Data DB.	<p>Management confirmed removing the conflicting access (ME35K) from the role as they do not use it.</p> <p>Authorisation matrix has been updated.</p>	<p>Done</p> 
9	Master data	GL Master Data Maintenance in	There is a risk of financial	Management has agreed with the point raised and	Done

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Ref	Business Area Reviewed	Potential Conflict in design	Risk	Agreed action or Management position	Owner/Date
		<p>selected AP, Treasury and accounting transactional roles.</p> <p>The role for "GL Master Data Maintenance" has been found not to be segregated from the following roles:</p> <p>"AP Clerk" or "AP Manager (FSC)" or "Bank Statement Upload (Treasury)" and "Central & Departmental Finance Accountant (FSC)" which all have the ability to post accounting document in GL.</p>	<p>misstatement due to the user's ability to both create any GL accounts in a Chart of Accounts and extend an existing G/L Account to a company code as well as make any posting to the incorrect G/L Account.</p>	<p>the documentation/matrix has been updated to segregate the highlighted roles.</p>	
10	Master data	<p>Co Master Data Maintenance</p> <p>The roles "Co Master Data Maintenance", "CO Processing (FSC)" or "FI/CO Periodic Processing" are in conflict of duties.</p>	<p>There is a risk that the Master Data maintenance role will allow users to create, change, delete, lock CO related to Master Data, which can lead to financial fraud risk in combination with CO processing capability.</p>	<p>Management has agreed with the point raised and the documentation/matrix has been updated to reflect this.</p>	<p>Done</p> 
11	Accounts Receivable	<p>AR Master Data maintenance vs selected transactional roles</p> <p>The role AR Master Data Maintenance has been found not to be segregated from the roles "AP Clerk", "AP Manager (FSC)", "Bank Statement Upload (Treasury)" and "Central & Departmental Finance</p>	<p>There is a risk of financial fraud by anyone who has access to post accounting entries as well as having the master data maintenance.</p>	<p>Management has agreed with the point raised and the documentation/matrix has been updated to reflect this.</p>	<p>Done</p> 

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Ref	Business Area Reviewed	Potential Conflict in design	Risk	Agreed action or Management position	Owner/Date
		Accountant (FSC)", which have the ability to post accounting entries in the GL.			
12	Accounts Receivable	AR Master Data maintenance vs Sales Order Processor Role The role "AR Master Data Maintenance" has been found not to be segregated from "SD Sales Order Processor" role.	There is a risk of financial fraud by changing the AR master data record without any authorisation and processing the sales order using incorrect account details.	Management has agreed with the point raised and the documentation/matrix has been updated to reflect this.	Done 
13	Accounts Receivable	AR Master Data Maintenance role vs SD Invoice Processor The "AR Master Data Maintenance" role has been found not to be segregated from "SD Invoice Processor". The 2 roles should be segregated because "Invoice processor" role has ability to Create Credit Note for Migrated Invoices.	There is a risk of potential fraud by creating invalid credit notes for unauthorised accounts added to the AR master data.	Management has agreed with the point raised and the documentation/matrix has been updated to reflect this.	Done 

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POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE

Internal Audit – Status of Agreed Actions

1. Purpose

The purpose of this paper is to:

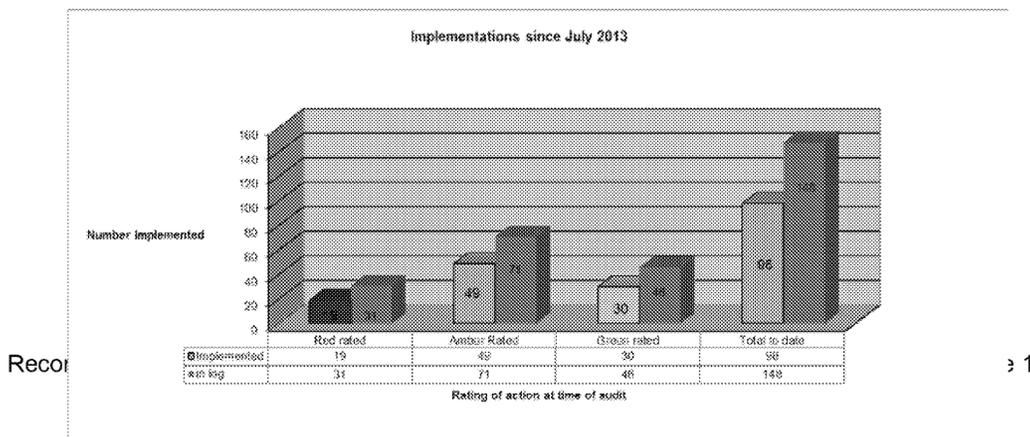
- 1.1 Update the committee on the status of agreed actions arising from formal audit and advisory activity
- 1.2 The committee is requested to note and provide directions as necessary.

2. Process and Summary

- 2.1 As outlined in previous 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 set by management. These are retained in the log even though it may be agreed between management and internal audit to subsequently re-set the 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 In summary:
 - Overall Implementation rate has increased from 54% to 66% (70% and above deemed acceptable levels)
 - Amber and Green rated risks improved in implementation with particular action in Treasury and the new Finance System
 - Some sticking in some areas from original target dates, mainly IT.
 - A separate paper has been submitted by IT. This is included in ARC papers for noting. IA notes that a new IT governance and controls role commenced in March 2014. It is intended that this will help the IT team keep focus on agreed actions.

3. Overall position as at 30th April 2014

- Including items brought forward from the transition from Royal Mail at June 30th 2013, the current log holds **148** agreed actions, of which **98** have been implemented since then. This is POL's first year under the revised internal audit tracking approach.



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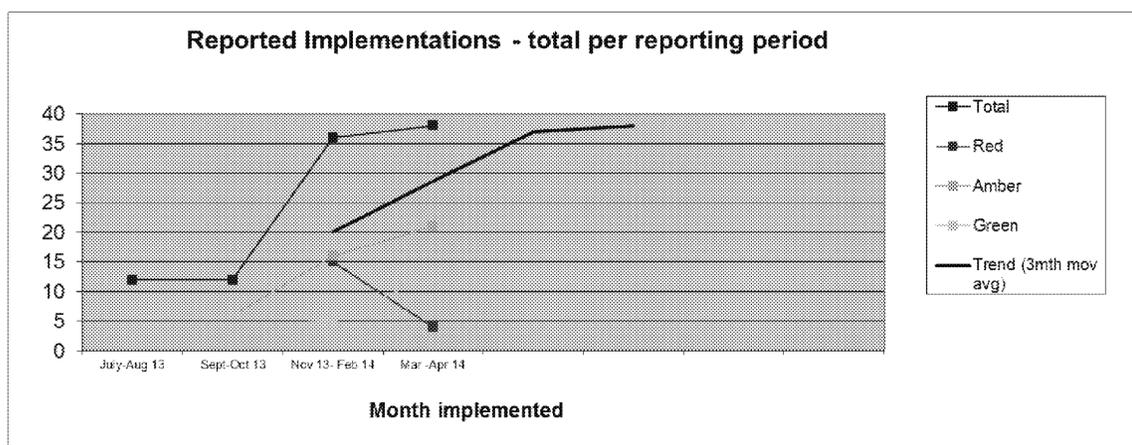
The same data in % terms is below. The total implementation rate at any time is influenced by the items being implemented by management and the items arising from new audits and reviews. Whilst there is no "best practice" target, previous experience suggests that an overall rate at any time should be around 70%. POL's current overall implementation rate is 66% up from 54% reported as at mid February

Implementations achieved (from June 2013)

	Implemented	Total in log	%
Red rated	19	31	61%
Amber Rated	49	71	69%
Green rated	30	46	65%
Total to date	98	148	66%

3.1 Through the period Mid February through to April 2014:

- 51 Actions were brought forward from 20th February 2014,
- 38 agreed actions were added to the log through a mix of audit and advisory work that took place in that period.
- 37 actions were implemented by management or agreed as closed which brings the total to 98 since the transition in June 2013. Green (low risk) and Amber (medium risk) items increased their rates, whereas red items were slower.



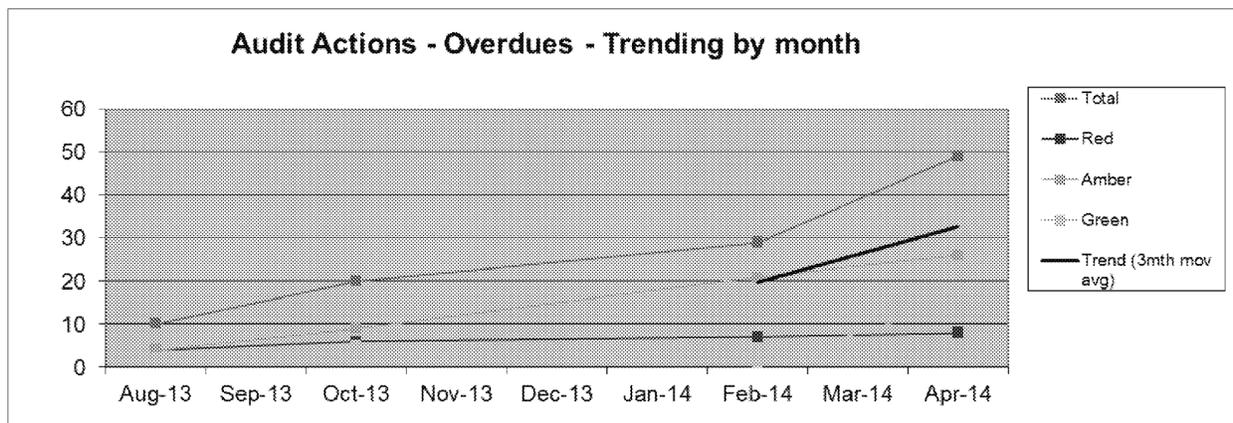
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Overall Summary as at 30th April 2014				
	Total	Red	Amber	Green
Total actions outstanding bfwd as at 20th February 2014	51	13	22	16
Implemented by Mgt - to April 2014	(38)	(4)	(21)	(13)
Actions added (audits and advisory)	37	3	21	13
Superceeded/amended	(2)		(2)	
Carried Forward as at April 30th	48	12	20	16

3.2 Analysis of items carried forward as at 30th april 2014.

- Of the 48 items carried forward, 29 are overdue from original target dates but are in progress and a further 9 are yet to gain traction. These 9 are mainly in IT and are outlined in a further section below. 10 items are not yet due having original target dates after April 30th.

Analysis of Carried forward				
Overdue - yet to start	9	6	3	
Overdue - Work in progress	29	3	12	14
Not yet due	10	3	5	2
	48	12	20	16



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The 37 actions **implemented** in the period are summarised below.

Area	Actions implemented	Risks addressed/Benefits
Treasury Audit (15)	Treasury Finance Committee reporting, meetings and review of Treasury & Financial Services committee.	Governance, reporting and information.
	Changes to panels Written records of passwords destroyed POL SAP access rights reviewed and review of Sun Gard access rights and password changing rules. Email accounts for consultants not to be external emails.	Confidentiality, integrity of data, reduce risk or error, irregularity or fraud.
	Documentation of Counterparty decisions	Governance and reporting
	Revised spreadsheets and move to a Treasury Management system.	Efficiency, reduced risk of error.
SISD /Transition Execution Programme Assurance (IT) (7)	Risk Mitigation plans Risk tracking, escalation and reporting. Sharing of risks with Atos.	Governance, openness of risks and issues, clarity over structure.
	Documentation for deliverables from Atos Roles for new IT transition	
CFS (new finance system) (13) Other (3)	Overview of Segregation of duties issues. (See IA Activity report)	Fraud, error, irregularities.
	Process notes and training for absence management in HR, Separation programme documentation	

4.2 Significantly overdue items

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As reported in the March ARC, a number of items that were outstanding were within IT.

- The CIO has originally determined dates for actions arising from the software licencing audit, LAN Identity and Access management and the ATOS transition by end of Q3 2013/14. These dates were passed and the CIO gave permission to extend these to 28 Feb 2014. (As reported in March ARC)
- The CIO was actioned by the committee to provide a response to the May ARC meeting.
- A number of these are still outstanding as 30th April although the CIO had taken specific action to discuss these with the senior team. Action is ongoing as some target dates proved to be ambitious or impacted by changing events. A revised plan and target dates are being formulated by the IT team.
- A paper has been written by the recently appointed IT Governance & Controls manager who is part of the new IT organisation. The supporting paper "CIO Audit Actions – Noting paper" is referred to at this point.
- IA was notified on May 7th just prior to this paper's submission that that 5 items are now considered closed by IT. However as this is still subject to review with Internal Audit, IA and IT agreed they will be considered and reported as implementations in the next set of IA statistics.
- Internal Audit will continue to monitor progress and will provide regular updates to the ARC members

Other significant overdue items

- The action to revise and reshape the branch auditing function as recommended in Q2 2013/4 remains on hold until the business determines final actions over branch improvement and other priorities. (This was rated as red as the conclusion from the audit was that only low levels of assurance over the branch control environment could be obtained from the current Field Support Advisor approach – mainly cash and valued stock)
- There are also a number of items remaining from advisory work on HR SAP following attendance at workshops at HR's request in Q3 2013. All are considered of low risk with primarily a process improvement focus.
- The regular issuance of the Treasury Financial Services report as per the Treasury Framework is overdue but in progress. The Corporate Finance Director is keeping this item open until presented at the ARC.(Due at May meeting).

5 ARC members action

- The committee is requested to note the status and to provide direction as necessary

Malcolm Zack
15th May 2014

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POST OFFICE LTD AUDIT, RISK AND COMPLIANCE COMMITTEE

CIO Audit Actions Noting Paper

1. Purpose

The purpose of this paper is to:

- 1.1 Provide an update on Audit Actions within the CIO's Directorship.

2. Background

- 2.1 Two separate internal audits were conducted in the period 2013/2014 which made a number of observations relating to Software Licence Management (SLM) and Local Area Network (LAN) - Identity Access Management (IAM).
- 2.2 Internal Audit (IA) held a review meeting in October 2013 with the CIO, Head of IT Services & Head of Information Security and Assurance Group to review and agree the observations.
- 2.3 Upon initial review of the observations, agreed actions and timescales were agreed and communicated with internal audit.

3. Activities/Current Situation

In summary:

SLM:-Total of 8 actions, 2 completed to date, proposed closure of a further 4, 2 remain open with revised dates to be confirmed by 23rd May.

LAN-IAM: - Total of 18 actions, 7 completed to date, proposed closure of 1, 10 remain open where the revised dates will be subject to the tower procurements.

- 3.1 With the introduction of an IT Governance & Control Lead in March 2014 a complete review and assessment of the Audit Actions were carried out.
- 3.2 Nine actions have been completed to date, with a further 5 subject to IA sign off. Some timescales and actions original set in October 2013 in order to address the audit findings were over ambitious in light of activities relating to the transition to the Service Integrator (Atos). Some we cannot complete until the procurements have concluded, these need to be realigned once the procurements are complete, this totals 12 actions.
- 3.3 Progress has been made, and some actions are indeed complete subject to internal audit review and sign off, scheduled for May.

4. Recommendations

ARC is asked to note that:

- 4.1 The IT Governance and Control Lead is working with the responsible owners to set realistic and achievable dates for those remaining, ensuring appropriate rigour is put in place, and will be agreed with Internal Audit.
- 4.2 A bi-monthly governance meeting with IT, Audit & Risk is in the process of being established which will track IT Risks and Audit actions.

Lesley Sewell
6 May 2014

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Post Office Ltd

Update on various risk matters including Bank of Ireland (UK) plc capital & liquidity

Nicholas Kennett, Director, Financial Services

26.03.2014

Post Office Ltd Board
Financial Services Committee – 2nd April 2014
Item 5.1



1. Purpose

- 1.1. The purpose of this paper is to update the Committee for noting on:
 - 1.1.1. Bank of Ireland (UK) plc's ("Bol") capital and liquidity position against its regulatory and Eagle contract requirements;
 - 1.1.2. Mortgage Market Review update;
 - 1.1.3. FCA "deep dive" on mortgages in Post Office
 - 1.1.4. PRA visit to Post Office branch
 - 1.1.5. Video Mystery Shopping
 - 1.1.6. FCA market study on general insurance "add ons"

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 27th March, 3rd June, 23rd August, 26th November 2013 and most recently on 7th March 2014 that, on each occasion:
 - 2.2.1. Bol's Core Tier 1 Capital Ratio exceeded the amount required in the FSJVA and has increased during 2013;
 - 2.2.2. Bol was holding a surplus over its regulatory liquidity requirements;
 - 2.2.3. 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:
 - 2.4.1. Moody's - B1 with stable outlook (30th January 2014) down from Ba1 to bring it into line with BoIG, following a change in the BoIG baseline credit assessment;
 - 2.4.2. S&P - BB+ stable outlook (July 2013) - revised up from negative.
- 2.5. BoIG's financial position continues to improve. The Preliminary Statement for the year ended 31st December was published on 3rd March 2014. The key points were:
 - 2.5.1. Financial results substantially improved - almost €1 billion improvement in underlying performance.
 - 2.5.2. Safely managed Eligible Liabilities Guarantee (ELG) Scheme expiry.
 - 2.5.3. Reimbursement of Irish Government investments in 2009 Preference Stock and 2011 Contingent Capital.
 - 2.5.4. Net interest margin of greater than 2% achieved, despite the low interest rate environment.
 - 2.5.5. Asset quality improved; defaulted loans reduced by €1.2 billion since June 2013.
 - 2.5.6. Regulatory Balance Sheet Assessment / Asset Quality Review addressed.
 - 2.5.7. Raised over €3 billion during 2013 through capital markets, showing that it has access to these markets on a consistent basis
 - 2.5.8. Significant investment in infrastructure including Single European Payments Area (SEPA) compliance and new branch operating models.

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3. MMR

- 3.1. Mortgage advice went live in branches on 3rd February. Non-advised in-branch mortgage sales will cease with effect from 1st April 2014.
 - 3.1.1. There are currently no significant negative compliance indicators in relation to in-branch mortgage sales.
- 3.2. Post Office has established a Quality Assurance Team (QAT) with Bol to ensure the advice given is appropriate. The QAT has confirmed that the quality of advised cases from branches has been good, with a 'reassessed' pass-rate of 98% (based on 64 cases). Prior to reassessment and remedial action, the pass rate was 66%. Only one case was assessed as not meeting the suitability requirements.
- 3.3. We are currently undertaking a post-implementation review of the MMR, to ensure that all relevant regulatory requirements have been met.

4. FCA Mortgage Deep Dive

- 4.1. During Q2 2013/4 the FCA undertook a deep dive on the Post Office Mortgage strategy and distribution, interviewing Bol and POL employees, including Paula Vennells, Nick Kennett, Mortgage Specialists and Post Office's sales supervisory personnel. Feedback was positive with the only call outs being for us to review the structure of our incentive schemes (please see item 4) and in particular the impact of red rated Video Mystery Shopping reviews.

5. Prudential Regulation Authority (PRA) visit to City Branch on 13th March 2014

- 5.1. The PRA requested, as part of its continuous monitoring of Bol UK, a visit to a Post Office branch to gain a better understanding of how the financial services model works. This was a 'formal informal' visit. The PRA met the FS Area Manager, the Branch manager and the Mortgage Specialist. The visit was accompanied by Bol Risk and Compliance.
- 5.2. We await feedback from Bol on the visit.

6. Video Mystery Shopping – Life Insurance “Deep Dive”

- 6.1. There is a continuous focus on sales compliance and monitoring of the risk of mis-selling. Together with Bol, we have conducted a deep dive on Life Insurance
- 6.2. A significant proportion of the Life Insurance mystery shops conducted in January (89%) and February (69%) 2014 were rated 'red'. The majority of these demonstrated failures to follow the approved sales process.
- 6.3. A further 'deep-dive' analysis of the Life Insurance mystery shopping reviews conducted in January 2014 highlighted the following types of problems: (1) no/ineffective status disclosure; (2) mandatory statements not read/not read in full or paraphrased; (3) mandatory system instructions not followed; (4) mandatory health and lifestyle questions not asked/not asked in full; (5) inaccurate or poorly explained product information provided; and (6) specialists used inconsistent/unstructured sales conversations. However, there was no indication that customers are systematically being provided with unauthorised advice in relation to life insurance and thus there is no evidence of significant customer detriment.
- 6.4. A full analysis, detailing the above findings and the resulting risk of customer detriment, was considered by the Customer and Conduct Risk Committee in February 2014. As a result we have developed an action plan, designed to deal with the issues identified by the Life Insurance 'deep-dive' and the results of mystery shopping in general.
- 6.5. The Customer and Conduct Risk Committee has agreed a deadline of the end of September 2014 for there to be significant improvements in the results of mystery shopping.
- 6.6. Further mystery shopping in relation to Life Insurance will be performed in May 2014 to assess whether the actions taken to resolve the issues identified have been effective.

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- 6.7. In addition, a further 'deep dive' on VMS results will be undertaken in March for Credit Card shops involving Bank and POL Compliance and POL T&D resource.

7. Consumer Credit Licence

- 7.1. On 1st April, regulation of Consumer Credit moves from the OFT to the FCA. The FCA is managing a two year programme to get all companies and individuals needing a consumer credit licence approved. In order to continue business all such companies are required to apply for an "interim" consumer credit licence, which Post Office has done.

8. FCA market study – general insurance "add-on" products

- 8.1. In March 2014, FCA published the provisional findings from its market study into general insurance add-on products, to which Post Office contributed. The FCA concluded that (a) competition in the markets for general insurance add-ons is not effective and that this can lead to poor consumer outcomes; and (b) consumers can be significantly overpaying when they buy products as add-ons.
- 8.2. The report also sets out a number of proposed remedies that the FCA believes will strengthen competition in the markets for add-ons by improving the way decisions are presented to consumers and the way add-ons are sold, and by putting pressure on firms to improve product value across both add-on and stand-alone products - these are:
- Imposing a deferred opt-in on add-on sales of Guaranteed Asset Protection (GAP)
 - Banning pre-ticked boxes (so-called 'opt-outs') for the sale of add-ons
 - Requiring firms to publish claims ratios
 - Improving the way add-ons are offered through price comparison websites, focusing in particular on what information consumers can access about add-ons and when this is introduced.
- 8.3. The provisional findings are currently under review to understand the impact, if any, on the distribution of products through the Post Office. Given the products we sell and our distribution model, it is not expected that there will be a significant risk for Post Office.

9. Competitions & Market Authority – preliminary review of SME Banking and Personal Current Accounts

- 9.1. The new Competition & Markets Authority (CMA) is undertaking a "short programme of works" on banking to enable it to decide if it going to carry out a full market investigation. On 26th March the CMA informed Post Office that it is to be included in this preliminary review and will be required to respond to the information request during April and May 2014.
- 9.2. We will liaise with BoI on this as it is the provider of our current account products.

10. Recommendations

- 10.1. The Sub-Committee is asked to note this update. It will be then passed to the ARC for noting.

Nicholas Kennett
Director, Financial Services
March 2014

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AUDIT AND RISK COMMITTEE

Insurance review

1. Purpose

- 1.1 The purpose of this paper is to recommend a review of Post Office's insurance which would consider:
- Current insurance coverage
 - Internal resource on and responsibility for insurance
 - Deductibles (excess) levels
 - Benchmarking of other similar organisations.
- 1.2 This review would be completed in time for the insurance programme renewal which is due in Oct 2014.
- 1.3 It is recommended that claims handling is excluded for reasons set out below.

2. Background

- 2.1 Post Office appointed its own broker, Miller, in July 2012 and set up its own discrete insurance programme in Oct 2012 as part of the RMG separation programme. Before then Post Office was a part of the Royal Mail insurance cover which included use of their captive.
- 2.2 PO has not only reduced the number of claims it receives since separation from RM (from 52 pa to 17 pa) but also the amount per case (from an average £17k to £7k) with only Employers Liability, Public Liability (EL/PL) and Motor claims. It should be noted that even on these policies, we are advised by insurers that our claims are very good given our exposure and business.
- 2.3 Prior to separation claims management was undertaken by Royal Mail on behalf of Post Office from Wolverhampton at a cost of over £100K pa. From October 2012 all new claims relating to incidents occurring post October 2012 are handled by our insurers QBE. There is a dedicated team from QBE and the process is managed in PO by Simon Eldridge (Head of Safety) and overseen by our Broker, Miller. Plexus Law handle all legacy claims which again has resulted in costs being materially lower though this is difficult to quantify.
- 2.4 The combined impact of all the actions taken since separation on claims handling mean that the costs of claims (compensation, admin and legal) are almost £1m pa lower than when part of Royal Mail.

3. Proposed Activities

Insurance cover

- 3.1 The current PO Insurance programme is set out in the Annex, outlining extent of coverage, deductibles, and other comments.

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- 3.2 Whilst PO has insurance cover to meet its key risks, in order to properly ensure the coverage is adequate and appropriate a comprehensive risk review needs to be undertaken to understand the level of exposure (in addition to our legal/contractual agreements). It should be noted that there must be a link between PO's Insurance cover and risk profile, so the review may identify potential gaps in coverage. For example, it may be appropriate to take out Employment Practices Liability which provides protection against claims by employees that their legal rights have been violated (eg discrimination).
- 3.3 This review will also focus on the issues facing PO in securing PI cover (which are mainly around clarity of liabilities of suppliers in particular Fujitsu).
- 3.4 Post Office's deductibles are an enhanced version of what was in place whilst part of RMG with significant deductibles, which is supported by Post Office's low insurance claims experience (see below). Whilst the review will consider the level of deductibles there is the potential that increasing deductible will not provide the equivalent in premium credit as insurers have not built up sufficient data to be fully confident of Post Office's loss history. This is because it has not been possible to separate out historical data when Post Office was part of RM's insurance programme meaning that effectively there is only 18 months of discrete data available – most insurers have asked for 3 to 5 years of discrete data when asked to consider lower deductibles.
- 3.5 Therefore a strategic insurance review with our partners is proposed on a risk based approach which will allow us to review each of the insurance policies and assess risk management and identify where additional work may be required.

Internal resource

- 3.6 In addition a review of the level of internal resource and expertise will be undertaken and which function would be best placed to be the owner. The current position is that it is owned by the finance department with no dedicated resource. Many (but not all) companies the size of Post Office have dedicated resource on insurance. This function is usually part of the finance, legal or company secretariat teams and the review will consider all three of these options.
- 3.7 This part of the review will also cover reviewing the current risk assessments and recording of "near misses".

Claims handling

- 3.8 Given post Office's strong track record in claims handling (see above) and that the insurance industry believe we have a strong claims handling process it is recommended that the review does not cover this area.

4. Options Considered

As mentioned above there is currently no dedicated resource responsible for insurance which means there are three options to conduct this review – to engage our existing broker, Miller; to engage another broker or to employ an interim.

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5. Proposal

- 5.1 As Miller have built up considerable knowledge of Post Office over the last two years and have a good relationship throughout the organisation it is recommended that they are engaged. They have offered someone who knows Post Office well to be seconded for 2 days per week for 3 months.
- 5.2 An interim update will be presented to the ARC in June with the project completed in September so that its findings can be incorporated in the insurance renewal the month after.

6. Commercial Impact/Costs

- 6.1 The estimated cost will be c£30k.

7. Recommendations

- 7.1 The ARC is invited to:
- note the points above;
 - agree expenditure of £30k; and
 - agree the review should progress as above.

**Chris Day
May 2014**

POST OFFICE LIMITED TREASURY
TREASURY RISK MANAGEMENT
FRAMEWORK, POLICIES AND AUTHORITIES

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1. Background and Introduction

- 1.1 This document sets out the framework, policies and authorities to be adopted by Post Office Limited in relation to the company's treasury activities and is an update to the paper presented last year.
- 1.2 Whilst this framework is largely the same as last year, the main changes are higher counter party limit with banks (section 7), no commodity hedging (previously provided by Royal Mail but Post Office's volumes alone make this uneconomic, section 10) and slightly lower hedging of currency (section 8).
- 1.3 The Board adopts a conservative, risk averse approach to the management of treasury risk. The policy framework has been designed to reduce risk and concentrates on four principal areas to achieve this:
- **Market Risk:** to minimise any potential loss due to a change in market factors;
 - **Credit Risk:** to minimise any potential loss due to a change in counterparty credit;
 - **Business Risk:** to minimise any potential loss due to economic factors;
 - **Operational Risk:** to minimise any potential loss due to system, people, legal and other external events.
- 1.4 The principal day to day operational elements of treasury policy and the activities of PO Treasury are the responsibility of the Head of Corporate Finance. The setting of strategy and policy is the responsibility of the Chief Financial Officer and Head of Corporate Finance. Amendments to treasury policies may be proposed by the Treasury Committee but should be approved by the Audit, Risk and Compliance Committee prior to ultimate approval by the Board.
- 1.5 PO Treasury are responsible for the following activities and these activities will only be undertaken by PO Treasury unless an alternative arrangement has been formally approved by the Audit, Risk and Compliance Committee and the Board:
- Short term liquidity management and investment of surplus cash balances ;
 - Management of the enterprise-wide cash forecasting process;
 - Fulfilment of Bank of England Notes Circulation Scheme obligations;
 - Management of short, medium and long term borrowing requirements;
 - Bank relationship management;
 - Execution of corporate disbursements and administration of payments systems;
 - Forward hedging of foreign exchange exposures;
 - Hedging of interest rate exposures.
- 1.6 PO Treasury acts as a centre of excellence in providing general guidance and advice on all operational banking, payments and other treasury related matters.
- 1.7 Reference to PO Treasury includes any treasury related activity performed by all relevant Post Office Limited employees based in either Future Walk, Chesterfield or 148 Old Street, London. An organisation chart of the PO Treasury department and associated Post Office Limited employees is shown in Appendix A.
- 1.8 Reference to the Treasury Committee refers to a panel of senior managers who meet regularly to:
- Review PO Treasury's activities in the period following the previous Committee meeting. The basis for the review of PO Treasury operations will be the most recently produced Treasury Report which will normally be produced monthly;
 - Review any significant activities relating to PO Treasury which have occurred but have not been communicated within the Treasury Report;
 - Review and discuss any potential or proposed amendments to PO Treasury policy or any other material subject or decision which falls within the Committee's sphere of responsibility, as described below;
 - Review any other business as deemed necessary by the Committee.

- 1.9 Where any proposed amendments to PO Treasury policy are submitted at a meeting, it is the intention that authorisation and agreement is sought from the Treasury Committee prior to submission to the Audit, Risk and Compliance Committee and Board for approval.
- 1.10 Decision making authorities of the Treasury Committee are detailed in section 13 below and are designated as either those authorities directly delegated to the Committee and for which no further approval is required, or authorities for which ultimate approval is required from the Audit, Risk and Compliance Committee and Board prior to implementation. An example of the former would include any normal course of business treasury related activity and an example of the latter would be any change to PO Treasury policy.
- 1.11 Reference to the Audit, Risk and Compliance Committee refers to a panel of senior managers who meet regularly to:
- Review the overall risk management framework in place for the Company including its appetite for risk;
 - Oversee the Risk and Compliance Committee activities and receive summary reports as appropriate;
 - Review the Company's overall risk position and periodically invite management to outline risk management strategy and status within their specific business units;
 - Review management's assessment of the degree of risk the Company prudently incurs in achieving a reasonable balance between the cost of managing risk and control systems and the benefits derived;
 - Consider and review areas of specific risk as highlighted by the Risk and Compliance committee. This should include, but is not limited to, sufficient coverage of strategic risk, financial risk, operational risk, technology risk, reputation, regulatory, major change initiatives and people risks;
 - Review legal, regulatory and any other matters that may have a material impact on the financial statements, related Company compliance policies, and programmes and reports prepared to manage and monitor Company compliance policies.
- 1.12 The following sections define the treasury risks to which Post Office Limited is exposed, describes the actions taken to mitigate these risks, outlines the framework of treasury policies to identify, manage and control treasury risks, including the associated authorities and limits, and the governance and reporting mechanisms employed.
- 1.13 The Treasury Committee seeks continuing approval such that the Audit, Risk and Compliance Committee recommends to the Post Office Board the adoption of the framework and policies contained herein.

2. Executive Summary

- 2.1 PO Treasury activities are the responsibility of the Chief Financial Officer and Head of Corporate Finance with oversight from the Audit, Risk and Compliance Committee. PO Treasury policies will be approved by the Audit, Risk and Compliance Committee and Board annually. PO Treasury compliance and performance will be reported to the Audit, Risk and Compliance Committee each quarter.
- 2.2 Compliance with PO Treasury policies is mandatory.
- 2.3 The debt capital structure is designed to ensure the Company has sufficient liquidity to support its long term plans and to minimize any refinancing risk.
- 2.4 Management of banking relationships is undertaken by PO Treasury and any need to conduct any new banking business within the Company must have prior approval from PO Treasury. All facilities are negotiated and approved by PO Treasury.
- 2.5 It is policy to pool all cash resources and where possible accounts will reside in a cash pooling arrangement. All bank accounts must have a written up to date mandate which is notified to PO Treasury and the number of accounts must be kept to a minimum.

- 2.6 It is policy to establish counterparty limits for each of the financial institutions it undertakes business with.
- 2.7 It is policy to minimise foreign exchange risk against forecasted exposures. The business must forecast foreign exchange exposures and report these to PO Treasury on a timely basis, and any changes to the exposure forecast must be reported to PO Treasury promptly. The company hedges its exposure on a rolling monthly basis against minimum hedging targets.
- 2.8 The Company's exposure to commodity price volatility is considered to be immaterial. Therefore commodity prices will not be hedged until such time as the exposure becomes material. The Treasury Committee will monitor the level of the Company's exposure to commodity prices.
- 2.9 It is policy to take advantage of the existing natural hedge in respect of interest rate exposures within the company. If this situation should change the company will manage its interest rate risk through the use of approved interest rate derivatives and will adopt a formal fixed floating debt ratio. The Treasury Committee will monitor interest rate exposure on an ongoing basis.
- 2.10 Derivative instruments and investment trades may only be executed by authorised dealers within or delegated by PO Treasury.
- 2.11 The Group policies set out a number of general rules in relation to banking payment systems and security that must be adhered to. PO Treasury must be made aware of any new proposal to initiate payments using a bank's electronic payment platform to enable a detailed security review to be undertaken.
- 2.12 Cash forecasting must be completed in accordance with PO Treasury instructions and timetables.

3. Treasury Risk Management Approach

- 3.1 The treasury risk management framework has been designed to:
- protect financial asset values;
 - minimise income statement volatility;
 - ensure Post Office Limited can meet its financial obligations as they fall due via appropriate short term liquidity management;
 - set out an appropriate capital structure and secure long term funding to meet overall business objectives and shareholder return requirements.
- 3.2 The key areas of risk that PO Treasury manages to protect asset values and minimise income statement volatility are:
- Liquidity risk – arises from the likelihood of not having sufficient short term funds to meet payment obligations;
 - Funding risk – arises from the possibility of not having appropriate long term funding in place to fulfil corporate requirements and going concern obligations;
 - Counterparty credit exposure risk – arises from investing Post Office Limited funds with financial counterparties;
 - Settlement risk – the risk that operational and business payments are not executed in accordance with agreed policies and procedures, are not settled in a timely manner or are exposed to the possibility of fraud;
 - Foreign exchange risk - arises from the holding of currency balances in the network and cash centres to meet on-demand requirements from customers;
 - Interest rate risk – adverse movements in interest rates will negatively impact the cost of funding (unless a natural hedge exists);

4. Banking and Relationship Management

4.1 Banking Relationships

4.1.1 It is policy to build long term relationships with providers of banking services and facilities in order to maximise mutual advantage. Where procurement law allows preference will be given to banks where a relationship already exists in terms of business opportunities but does not preclude the use of other banks as approved by PO Treasury, should it be appropriate. Any new relationships will be notified to the Treasury Committee at the next available meeting.

4.1.2 Current counterparty relationships, including banks are noted in Appendix B:

4.1.3 Management of the group relationships will rest with the Head of Corporate Finance and Chief Financial Officer. Bank selection will be determined by a number of factors, including service, price, product range, geographic spread and willingness to provide services. The decision to develop a new relationship will rest with the Head of Corporate Finance and/or Chief Financial Officer.

4.2 Bank Facilities

4.2.1 PO Treasury is responsible for the negotiation of all ancillary facilities and changes to existing facilities. Facilities in this respect include overdrafts, foreign exchange facilities, guarantee / cheque negotiation, BACS limits, daylight limits, credit cards, procurement cards and any similar arrangements. Directorates do not have the authority to negotiate or commit to any new banking facilities without PO Treasury approval and are not authorised to undertake any discussions regarding the establishment or modifications to credit lines.

4.3 Interest and Bank Charges

4.3.1 Bank transaction costs will be negotiated by PO Treasury. This will ensure that maximum benefit is achieved. The charges passed across bank accounts will be reviewed by PO Treasury to ensure that the activity levels and unit costs applied by the banks to calculate the total charges levied are in accordance with the agreed tariffs. Errors should be notified directly to the bank.

4.4 Bank Accounts

4.4.1 It is Group policy to minimise the number of bank accounts it operates. The number of accounts should be kept to a minimum and those accounts not being utilised should be closed. PO Treasury will conduct a semi-annual audit to ensure it has an accurate record of bank accounts. This will be reconciled back to internal and bank records.

4.4.2 Where possible all accounts should reside within a cash pooling arrangement.

4.5 Bank Mandates

4.5.1 It is policy to standardise bank mandates wherever possible. PO Treasury will manage and administer all bank mandates centrally and each bank account must be supported by a written up to date mandate.

4.5.2 Authority levels relating to electronic payment systems will be documented separately.

4.5.3 Sole signatory on a bank account is not permitted except in the case of cheques where one signatory may sign for amounts up to £50,000 only.

5. Short Term Liquidity Management

5.1 PO Treasury's first responsibility is to ensure that sufficient liquidity and facilities are available to Post Office Limited to fund its operations. Funding is therefore negotiated and managed centrally and the management of individual cash pools will be dealt with by PO Treasury. Business units will be prevented from operating clearing accounts with banks that are outside these pooling arrangements unless authorised by PO Treasury.

5.2 Objectives

5.2.1 The objective of this policy is to achieve the cost and return benefits of centralising the management of Group cash and borrowings.

5.2.2 Short term liquidity management objectives are met as follows. Post Office Limited has access to a £1.15 bn working capital facility provided by the Department of Business, Innovation and Skills (BIS). Funding requirements must be notified to BIS 2 days in advance. Forecasting variances may lead to a shortfall between the amount drawn down and the actual amount required. The strategy to mitigate the risk of a shortfall between notified and actual funding requirements is to hold a liquid investment reserve of £40m and to have uncommitted facilities of £50m available for drawdown¹.

5.2.3 In addition, Post Office Limited is a member of the Bank of England Notes Circulation Scheme. The scheme allows Post Office Limited to declare and notionally "deposit" cash with the Bank, reducing Post Office Limited's funding requirement on a daily / overnight basis. The operation of the scheme requires the provision of collateral facilities to the Bank. These are currently provided by RBS and total £550m split £350m intraday facility and £200m overnight facility.

5.3 Cash flow forecasting

5.3.1 Cash flow forecasting is an essential tool for Post Office Limited and enables the company to have confidence that the total cash and borrowing facilities are sufficient to provide the liquidity needed to meet its business objectives and loan repayments.

5.3.2 The forecasting is reviewed daily by the Head of Corporate Finance and quarterly by the Treasury Committee. The ARC will be updated by exception.

6. Funding

6.1 Funding Strategy

6.1.1 The Chief Financial Officer and Head of Corporate Finance will recommend to the Board the appropriate debt capital structure for the company. The company will have a debt maturity profile and funding structure adequate to meet its:

- General corporate needs
- Growth strategy
- Going concern obligations

6.1.2 The debt capital structure and maturity profile will be monitored by the Chief Financial Officer and Head of Corporate Finance, and reviewed by the Treasury Committee to ensure that Post Office Limited has appropriate funding available to support its long term plans. Post Office Limited seeks to minimise its refinancing risk by adopting a range of maturities for its debt facilities as appropriate.

6.2 Sources of Funding

6.2.1 The company will aim to maintain liquidity headroom of at least £200m within its total credit facilities. Currently, Post Office Limited is in year three of a three year funding

¹ Note – As facilities are uncommitted, they may not always be available for drawdown. Actual facilities in place are £80m but drawdown is limited to £50m per working capital agreement with Department of Business, Innovation and Skills.

plan which has been agreed with Government. This provides the following:

- Funding of £330m in FY 2014/15;
- Working capital facility of £1.15bn expiring on 31st March 2016.

6.2.2 Further funding has been agreed with government until 2018 which is subject to EU's state aid approval.

6.3 Borrowing Policy

6.3.1 Borrowing is only permitted in sterling.

6.3.2 Borrowing is only permitted as per the funding agreement with Department of Business, Innovation and Skills as follows:

- Working capital facility (as noted above);
- Maximum £50m external facilities;
- Maximum £50m leasing.

6.3.3 Together with facilities to support Post Office Limited's participation in the NCS.

- Maximum £550m.

7. Investment Policy and Counterparty Credit Risk Management

7.1 Surplus funds will be invested by PO Treasury to achieve the best return, subject to counterparty risk. These investments should be realised without capital loss.

7.2 Funds in excess of daily /short term liquidity requirements are deposited with financial institutions. PO Treasury are permitted to use a combination of money market funds, bank deposit accounts and when appropriate, deposits with the Debt Management Office.

7.3 It is the policy of Post Office Limited to establish and monitor limits for each of the financial institutions it undertakes business with. Credit limits by investment type / category are detailed below. The Treasury Committee will be updated on a regular basis and will recommend changes as appropriate.

7.4 Counterparty Limits Table:

Counterparty	Investment Type	Current Limit	New Limit
		£m	£m
IGNIS	MMF	30	50
INVESCO	MMF	30	50
SWIP	MMF	50	50
Blackrock	MMF	50	50
Blackrock LSF	MMF	-	50
RBS	MMF	30	50
Unallocated	MMF	60	50
Total MMF		250	350
Blackrock Gilt	MMF Govt stock/gilts	50	50
Unallocated	MMF Govt stock/gilts	100	100
Total MMF stock/gilts		150	150
RBS	Bank deposit	30	30
Barclays FIBCA	Bank deposit	30	60
Total bank depo		60	90
DMO	Government deposit	Unlimited	Unlimited

7.5 Investment strategy and principles:

- Deposits with money market funds which invest in corporate / institutional funds limited to £350m in total;
- Exposure to MMF counterparties will be capped at £50m per fund per counterparty;
- Aggregate exposure to any one counterparty across all investment types will not exceed £150m;
- Deposits with money market funds investing in Government stock limited to £150m in total. Investments in individual funds to be capped at £50m;
- Where a single counterparty has segregated institutional funds and government stock funds, investments can be made in both funds subject to the limits above;
- Deposits with banks limited to £30m per banking group with the exception of Barclays which retains the majority of operational cash within Post Office Limited cash pools. The number of bank counterparties will remain flexible to provide additional investment capacity;
- Where possible align investment activity with other financial activity with the same counterparty but without creating additional risk;
- Identify when core amounts of cash are available for achieving improved yield by investing over longer time periods, subject to ensuring that short term liquidity requirements are always provided for;
- Maintain sufficient fund alternatives to ensure diversification of risk;
- Unauthorised arbitrage is prohibited - funds should not be specifically drawn down for investment purposes.

7.6 Investment Guidelines

- Ensure the security of funds invested;
- Minimise investment exposure to individual financial counterparties via use of appropriate instruments i.e. money market funds (MMF);
- Diversify MMF risk over a number of counterparties;
- Corporate deposits used for investment of late advised funds and un-forecasted flows;
- Investment is only permitted in sterling denominated funds / accounts.

a) Money Market Funds:

- The fund must be AAA rated;
- The Post Office Limited proportion of the total fund managed must not be greater than 10% of the total fund;
- Funds must have a stable or accumulating net assets value with daily liquidity.

b) Bank deposits:

- Bank must have a long term credit rating of at least single A;
- Bank must be a member of CHAPS (please refer to Appendix C).

7.7 Investment Authorities

- Only PO Treasury is authorised to invest surplus funds;
- Chief Financial Officer is authorised to approve counterparty limits;
- Chief Financial Officer is authorised to approve investment instruments;
- Head of Corporate Finance is authorised to approve counterparties.

7.8 Maturity and investment limits are as shown in the table below:

Investments	Amount	< £300m	< £100m	< £50m	<£300m	<£50m	> £50m
	Maturity	< 1 month	< 3 months	< 6 months	< 1 year	> 1 year	> 1 year
	Authority	One of Treasury authorisation panel	One of Treasury authorisation panel	One of Treasury authorisation panel	Head of Corporate Finance	Chief Financial Officer and one other Board member	Post Office Limited Board
	Head of Corporate Finance is also authorised to invest with a maturity of up to 5 years for the purpose of providing collateral for the Notes Circulation Scheme						

7.9 Exposure to financial counterparties primarily results from the following transaction types:

- Individual contracts to support Post Office Limited financial services activity. Exposure is primarily generated through the clearing of debit card and cheque receipts, processing of benefit payments and collections associated with ATM withdrawals. Total exposure of approximately £420m;
- Corporate banking and treasury activity. Principally investment of surplus funds and settlement processing. Total exposure of approximately £220m;
- Over the counter cash transaction services. Withdrawals via Post Office Limited branch network for retail banking customers. This creates exposures equal to the amount paid out by Post Office Limited on behalf of the bank. Total exposure of approximately £40m.

7.10 Counterparty strategy and principles:

- Continue to grow over the counter business subject to appropriate counterparty credit checks;
- Consolidate corporate banking services into a small number of service providers;
- Maintain banking relationships required for geographic purposes;
- Ensure sufficient investment funds are available to diversify risk;
- Head of Corporate Finance and/or Chief Financial Officer to approve counterparty selection for all contracts involving financial institutions (except the appointment of new over the counter customers);
- Counterparty selection will consider the risk arising from existing exposures to a particular counterparty when contracts are renewed/awarded, including the appointment of new over the counter customers.

8. Foreign Exchange Exposure Management

- 8.1 Post Office Limited foreign exchange risk principally arises from the holding of currency balances in the network and cash centres to meet “on demand” requirements from customers. All currencies are purchased from FRES. The risk arises from the time of purchase from FRES to the sale of currency to the customer. The size of balances on hand is determined by historic demand.
- 8.2 Post Office Limited holds balances in approximately 70 currencies. On average, currency holdings are circa £58m but can peak at over £100m during holiday periods.
- 8.3 The foreign exchange exposure management objective is to minimise the impact on the income statement of movements in foreign exchange rates on currency balances held to satisfy on-demand transactions by customers.

8.4 Foreign exchange risk management policy

- Typically only currency exposures of >£5m equivalent will be hedged and the hedging of exposures below £5m equivalent is at the discretion of the Head of Corporate Finance;
- Only US\$ and Euro are hedged which account for 80% of holdings. Previously Aus \$ and Can \$ were hedged but this not considered to be economic and normally account for <5% of holdings combined
- At least 80% (previously 100%) of qualifying exposures will be hedged based on the average of (1) the previous period's actual holdings and (2) the forecast for one month forward;
- Hedges will be closed out and reset to the last working day of each month / financial period end;
- Hedging will be conducted through counterparties appointed by the Treasury Committee;
- Trades will be executed at a pre-arranged margin with all counterparties;
- The maximum maturity of financial instruments used to hedge foreign exchange exposures will be 6 weeks;
- Foreign currency balances can only be hedged using foreign currency forwards and swaps;
- FX hedging instruments can only be used to hedge exposures generated by holding currencies to meet on-demand transactions by customers.

8.5 The suitability and effectiveness of the foreign exchange risk management policy will be reviewed at each Treasury Committee meeting. Any proposed changes will be minuted and presented to the Audit, Risk and Compliance Committee for approval and submission to the Board.

8.6 Foreign exchange risk management authorities

- Only PO Treasury is permitted to transact foreign exchange hedging;
- The Chief Financial Officer is authorised to amend the list of approved FX hedging instruments;
- Head of Corporate Finance is authorised to approve financial counterparties for hedging;
- Head of Corporate Finance is authorised to determine the currencies to be hedged;
- Transactions to hedge exposures not created by currency holdings to meet on-demand requirements must be approved by the Chief Financial Officer, up to £50m and Post Office Limited board above £50m.

8.7 Accounting for foreign exchange hedging instruments

Exchange gains and losses on currency balances together with gains and losses resulting from revaluing associated hedges will be recognised in the income statement as and when they occur. Hedge accounting and the designation of hedging instruments to underlying exposures will not be undertaken due to the short duration of the hedges.

9. Interest Rate Exposure Management

9.1 Adverse movements in interest rates will negatively impact Post Office Limited's cost of funding.

9.2 Post Office Limited funding is via a £1.15bn floating rate working capital facility from BIS maturing in 2016. Interest is calculated at LIBOR + 0.5%. Post Office Limited earns commission (credited to revenue) at a rate of LIBOR – 0.125% on the balances of benefit payments held by JP Morgan. This arrangement expires in 2015 with an option to extend for a further 2 years. In general, the balance on benefit payments is at least equal to Post Office Limited borrowing requirement as the balances are considerably larger than the facility. The commission (interest) receivable on balances creates a natural hedge against the interest payable on the working capital facility.

9.3 Interest rate risk management policy is to continue to utilise the natural hedge offset opportunity provided through LIBOR based floating rate interest payable on the working capital facility and LIBOR based interest receivable on the balance of benefits paid on behalf of government.

9.4 The suitability and effectiveness of the interest rate risk management policy will be reviewed at each Treasury Committee meeting. Any proposed changes will be minuted and presented to the Audit, Risk and Compliance Committee for approval and submission to the Board.

9.5 No hedging instruments for interest rate risk management are currently authorised.

10. Commodity Price Exposure Management

10.1 Post Office Limited is exposed to movements in the price of diesel, gas and electricity used throughout the business. Post Office used to participate in Royal Mail's hedging programme.

10.2 Currently it is agreed that no hedging of commodity price exposures will be conducted as the size of annual expenditure is not material and hedging at these volumes would not be economic. In total Post Office's commodity bill is <£10m pa.

10.3 If this situation changes and it is believed to be economic to do so, PO Treasury will hedge commodity exposures forward to a maximum of 3 years based on forecast future usage.

10.4 Permitted hedging instruments are spot purchases, currency deposits, forward contracts, call options, matched options (e.g. cylinders) and swaps. Futures will not be used without specific authority of the Chief Financial Officer.

10.5 Accounting for commodity hedges

10.5.1 Post Office Limited will designate commodity cash flow hedges against forecast underlying exposures. Unrealised gains and losses on hedges will be deferred in reserves. This will be recycled to the income statement when the hedge matures to match forecast expenditure.

10.6 Approvals

- Only PO Treasury is permitted to transact hedges to protect against commodity price movements;
- Commodity hedging counterparties are approved by the Chief Financial Officer;
- Commodity hedge transactions are approved by the Head of Corporate Finance.

10.7 The suitability and effectiveness of the commodity price exposure management policy will be reviewed at each Treasury Committee meeting. Any proposed changes will be minuted and presented to the Audit, Risk and Compliance Committee for approval and submission to the Board.

11. Payments

11.1 The following paragraphs set out, in outline, the recommended policies and best practice in relation to the authorisation and control of payments. PO Treasury is available to provide more detailed guidance or assistance in specific instances if required.

11.2 Manual cheque payments

11.2.1 Signing mandates are managed through PO Treasury and must be notified to the bank in respect of any account on which cheques or similar payments are to be issued.

11.2.2 Cheques up to a value of £50,000 may be signed by one signatory. Cheques of amounts greater than £50,000 must be signed by two authorised signatories.

11.2.3 There should be adequate segregation of duties with regard to the preparation of payment instructions and cheques and written procedures governing the processing of payments.

11.2.4 Cheque books should be kept physically secure when not in use.

11.2.5 Paying-in books should also be kept physically secure when not in use. To prevent credits being made to unauthorised accounts, only pre-printed paying-in slips should be used when paying in cheques.

11.3 Computer generated cheques

There should be adequate physical security over the hardware and software involved in the preparation of computer generated cheques. Detailed records should be kept of cheque stationery utilised and any missing cheque numbers investigated. A monetary limit should be set for the maximum value of any computer generated or machine signed cheque.

11.4 Manually instructed payments

11.4.1 Where any use is made of electronic payment systems via a bank staff must ensure that adequate written control procedures exist to ensure that the bank will only respond to verified requests from authorised personnel, these include:

- the use of code words;
- answer-back arrangements with the bank calling back to an authorised signatory (other than an authorised signatory who has signed the request);
- telephonic requests for transfers to be supported by a written request, signed in accordance with the mandate, received by the bank prior to dispatch of funds;
- transfer requests should only be sent on company headed notepaper, or pre-printed forms unique to the company.

11.4.2 PO Treasury must be made aware of any proposal to commence making use of electronic payment systems, to enable a detailed security review to be undertaken.

11.4.3 Indemnities to banks for electronic transfers

11.4.4 If any bank requests any Post Office Limited employee to sign an indemnity giving protection to the bank in respect of payment instructions actioned by the bank, then this document must be forwarded to PO Treasury for review prior to signature.

11.5 Electronic transfers

11.5.1 Electronic Funds Transfer (BACS/CHAPS etc) is the preferred means of payment. Where such systems are in use, care must be taken to ensure that there is adequate physical security over the system to prevent unauthorised access. The networking of electronic payment systems should be discussed with both PO Treasury and IT Departments.

11.5.2 It is the responsibility of PO Treasury to ensure that there is adequate segregation of duties in relation to initiating, authorising and releasing payments.

11.5.3 The authorisation process must be fully documented. Non-compliance with the agreed authorisation procedures will be referred to the Chief Financial Officer and Audit, Risk and Compliance Committee and is considered a serious breach of control.

11.5.4 BACS limits will be negotiated with the bank by PO Treasury and will be communicated to the relevant business unit. Any request for an increase to a BACS limit must be conducted through PO Treasury.

11.5.5 The recommendations of the bank with regard to the control environment surrounding the payment system must be adhered to in all respects.

11.5.6 PO Treasury must be made aware of any proposal to commence using computer links to initiate payments to enable a security review to be undertaken if appropriate.

12. Guarantees / Group Support

- 12.1 Guarantees that are provided by Post Office Limited create a contingent financial exposure.
- 12.2 In general Post Office Limited will not enter into bank guarantees. If a guarantee is required for any reason the company should look to provide support in the form of a Letter of Comfort in the first instance, failing this an internal parent company guarantee at no cost to Post Office Limited. Bank guarantees should be resisted strongly given underlying credit support for the company.
- 12.3 Only the Chief Financial Officer is authorised to issue bank guarantees or similar instruments.

13. Treasury Governance and Reporting**13.1 Governance**

13.1.1 PO Treasury risks are governed through the following structures:

13.1.2 **Post Office Limited Board:** Authority to approve policies and approval limits relating to treasury risk management resides with the Board. Treasury risk management includes but is not limited to the following: short term liquidity management, long term funding, counterparty, foreign exchange and interest rates. The board will delegate authorities to facilitate the operation of treasury risk management and the daily operation of the treasury function.

13.1.3 **Audit, Risk and Compliance Committee:** Financial risk management policies and approval limits are recommended to the Board for approval by the Audit, Risk and Compliance Committee.

13.1.4 **Treasury Committee:** Meets on a quarterly basis to review financial risks, report on and recommend changes to policy to the Audit, Risk and Compliance Committee as required. The Treasury Committee is composed of the Chief Financial Officer, Head of Corporate Finance and Head of Commercial Finance.

13.1.5 The Board has delegated the following specific authorities to the Chief Financial Officer and Head of Corporate Finance.

- | | |
|----------------------------|--|
| Chief Financial Officer: | <ul style="list-style-type: none"> • Approval of investment instrument limits • Approval of counterparty selection criteria • Approval of counterparties • Approval of counterparty limits |
| Head of Corporate Finance: | <ul style="list-style-type: none"> • Approval of counterparties • Approval of counterparty limits (within approved investment instrument limits) |

13.1.6 The daily operation of treasury activity is delegated to the panels as shown on Appendix D. In all cases members of these panels will be appointed by the Treasury Committee.

13.1.7 Authority levels for write offs are shown at Appendix F.

13.2 Treasury risk management reporting

13.2.1 The Treasury Report will be produced on a monthly basis. The contents of the report will include analysis of investments and loans, forecasting accuracy and variance analysis, period end bank balances, NCS utilisation, accounts receivable analysis, foreign exchange risk management and a summary of all current PO Treasury workstreams.

13.2.2 The Treasury Committee will meet on a quarterly basis. It will review the Treasury Report and consider any other treasury risk management issues as required.

13.2.3 Policy breaches will be immediately reported to the Chief Financial Officer.

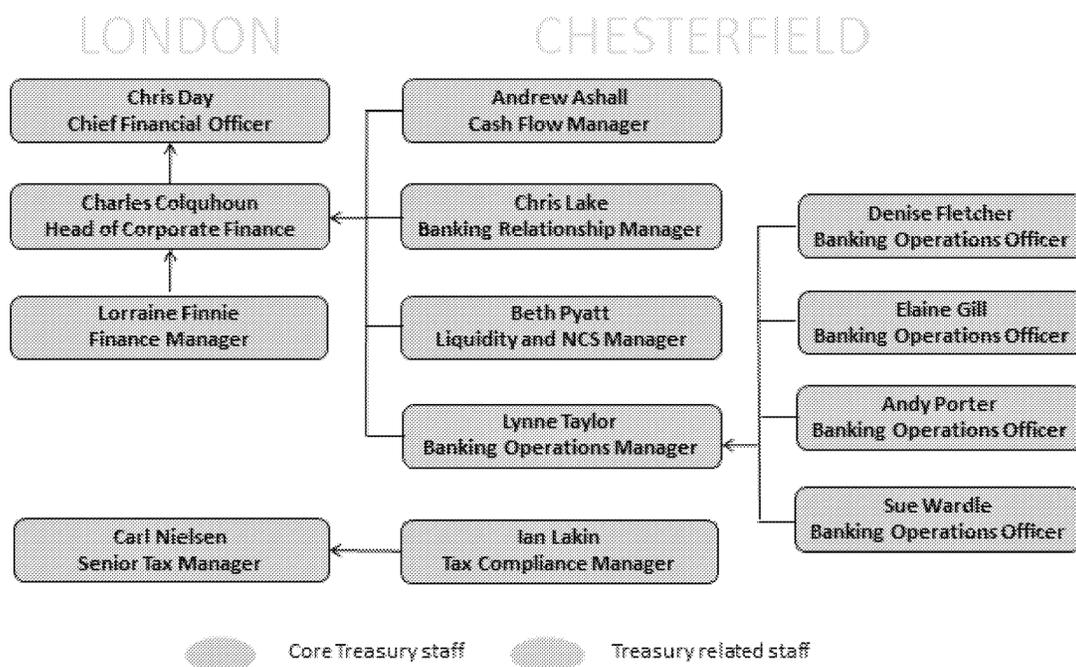
- 13.3 Authorities to drawdown under established facilities are laid out in Appendix E.
- 13.4 An additional authority matrix is shown in Appendix F that relates to various items which arise during the normal course of business and for which individual write-off authorities are required. Examples of such items, which will normally be provided for, include:
- ATM cash trapping and retract fraud;
 - Travellers Cheque fraud;
 - Camelot scratchcards failures in stock control due to master data errors.

14. Recommendation

- 14.1 The Audit and Risk Committee is asked to note and agree the framework, policies and authorities set out in this paper above.

Chris Day
May 2014

Appendix A: Organisation Chart



Appendix B: Summary of Counterparty Relationships, Services & Exposures

Counterparty	Owner	Service	Maximum Exposure & Duration	Comment
Barclays	Treasury	Corporate banking	Nil	
		Corporate deposits	£60m (o/n)	
IPSL (via contract with Barclays)	FSC	Clearing of cheques received through network. Cheque clearing contract signed with Barclays but managed by IPSL	£160m (2 day clearing)	As this is a clearing process, risk lies with banks on which cheques are drawn i.e. this is disaggregated over a number of counter parties
CO-OP	FSC	Postal order clearing	£nil	Post Office Limited is a net payer as CO-OP is paying bank for PO's cashed
	FSC	Camelot lottery payments / collection	£nil	Post Office Limited is net payer due to purchases of lottery tickets
Lloyds	Treasury	Scottish widows (SWIP) Money market fund	£50m	Investment of short term surplus cash
Citi	Treasury	Uncommitted loan facility £30m	£nil	
National Australia Bank Group – Clydesdale	Supply	Sale of GBP notes to Clydesdale to support their note issuance.	£30m	Exposure attached to settlement by Clydesdale for notes purchased
		Sale of £50 notes		
Ignis	Treasury	Money market Fund	£30m	Investment of short term surplus cash
Invesco	Treasury	Money market Fund	£30m	Investment of short term surplus cash
HSBC	Treasury	Bank accounts to support debit card clearing	£1m	Overnight exposure relating to clearing of debit / credit card transactions
Global Payments – (via contract with HSBC)	FSC	Clearing of card payments received through network	£60m	As this is a clearing process, risk lies with banks on which debit cards are issued i.e. this is disaggregated over a number of counter parties
Link / Bank of Ireland	FSC	ATM cash servicing	£90m	Average overnight exposure £90m. Can peak at £130m after bank holidays
JP Morgan	FSC	Processing of benefits settlements	£90m	Overnight exposure £90m. Intraday exposure can be as high as £150m
RBS	Treasury	Intra-day and overnight facilities and provision of RTGS account to support Post Office Limited membership of note circulation scheme	£nil	
	Treasury	Corporate banking	£nil - £5m	
		Uncommitted loan facility £50m	£nil	
Santander	FSC	Small business banking	£nil	

Appendix C: CHAPS Banks

Bank of America (N.A)

Bank of England

Bank of Scotland (HBOS)

Barclays Bank PLC

Citibank N.A

CLS Bank International

Clydesdale Bank PLC

The Co-operative Bank PLC

Danske Bank

Deutsche Bank A.G

HSBC Limited

J.P. Morgan Chase Bank

Lloyds TSB Bank PLC

National Westminster Bank PLC

The Royal Bank of Scotland PLC

Santander UK PLC

Standard Chartered

State Street Bank

UBS A.G.

Appendix D: Authorisation Panels

	Authorities	Current Composition
Treasury Authorisation Panel	Investment and borrowing approval	Charles Colquhoun Louise Fairhurst Lorraine Finnie Carl Nielsen Ruth Pearson Ian Lakin
Dealing Panel	Execution of approved daily investment / borrowing transactions	Andrew Ashall Charles Colquhoun Louise Fairhurst Martin Knights Carl Nielsen Ruth Pearson Beth Pyatt Ryan Skidmore
Banking Control Panel	Opening and closing bank accounts - any 2 BCP signatories following Treasury Committee approval Maintenance of bank mandates - any 2 BCP signatories following Treasury Committee approval Other banking instructions - any 2 BCP signatories	Alison Bolsover Dawn Brooks Lorraine Finnie Paul Lebeter Carl Nielsen Mark Wood
Banking Authorisation Panel *	Authorisation of payment instructions	Matrix securely maintained centrally within PO Treasury
Payment Panel *	Release of payments - <£50k any 1 payment panel member - >£50k any 2 payment panel members	Matrix securely maintained centrally within PO Treasury

* In respect of both the Banking Authorisation Panel and the Payment Panel the lists are extensive and complex owing to the number of bank accounts used within Post Office Limited. The full listings are therefore not replicated here but are maintained and held within the PO Treasury department.

Appendix E: Facility Drawdown Authority Levels**External Borrowings**

Amount	<£50m	<£50m	<£50m
Maturity	Overnight	up to 6 months	over 6 months
Authority	1 from Treasury authorisation panel	Head of Corporate Finance	CFO

Leasing and Contract Hire

Amount	<£50m	<£50m
Maturity	up to 8 years	over 8 years
Authority	Head of Corporate Finance + CFO	CFO

Working Capital Loan Facility with BIS

Amount	<£500m	£500m - £1.15bn	£500m - £1.15bn
Maturity	up to 12 mths	up to 12 mths	over 12 mths
Authority	1 from Treasury authorisation panel	Head of Corporate Finance	CFO

Appendix F: Individual Write-off Authority Levels

Authorities to write off provided-for items relating to external fraud and data errors:

Amount	<£1k	£1 - £10k	£10 - £100k	> £100k
Authority	FSC Team Leader	FSC Senior Manager of relevant work area	Head of FSC	CFO