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<b>To:</b> General Managers (and nominated representatives) Head of Risk and Control Head of Compliance Head of Sales	<b>From:</b> Martin Ferlinc National Audit & Inspections Manager	<b>CC:</b> Head of Product Management & Marketing Head of Client Accounting and Cash Management Profit & Performance Manager Money Laundering Reporting Officer (MLRO) Retail Cash Manager Internal Audit & Risk Management Director
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**Date: 29 October 2004**

**Post Office® branch auditing – Period 6 report (2004/05)**

## **1 Introduction**

This report provides a summary of the issues revealed at the audits undertaken by Audit & Inspections at Post Office® branches by the end of the sixth period of 2004/05. The report will be used as an input to Rod Ismay’s report to the Post Office Ltd Board or Executive Committee (as appropriate) and the newly formed Risk & Compliance Committee.

Further to the comments in the last report, and following further feedback, it has been decided that this report will be produced quarterly, with interim reports (covering significant changes to findings outlined in previous reports or reporting on emerging issues) supplied in single screen e-mail. The appendix to this report has also been streamlined and, while it will only be circulated with each quarterly report, an updated version will remain available each month, on request. Details of the level of audit activity, by audit type and against plans, will be reported annually, but is also available on request, monthly.

## **2. Executive summary**

The total of all cash account losses revealed at audit in the first six months of the year has amounted to £2.8m (from approx. 1000 audits). While the shortages revealed at the majority of these audits would be made good by the subpostmaster or might be rectified by error notices, £1.9m of the total amount is based on the

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findings of just 20 branches audited. Although in some of these cases, there were indications of errors being made, which would be rectified by an error notice, there is also a significant risk that the losses identified in most of these cases will not be recovered. It is also a concern that, in spite of the size of amounts of discrepancies, a precautionary suspension was not made in 35% of these cases.

Following the audit of Blackwood, which confirmed a loss of £436k, a post incident review took place, led by Rod Ismay. The output of this review was to put forward a number of recommendations. This included a review of exception reporting, to aid the earlier identification of significant financial concerns, and more through follow up processes to reported issues (including the type of financial concerns that are visible and do not require an audit to initiate action), covering escalation and reporting processes.

A programme of cash check audits at direct managed branches, with the aim of auditing 5% of these branches by the end of November, has not revealed any financial irregularities to date but has continued to expose failures by branch managers to deploy supervisory controls of stocks. This provides a clear opportunity for misuse of funds to occur. There is also continued concern that there are branch managers who are falsely declaring full compliance to controls (as part of the self assessment process within the Annual Certificate of Compliance).

While the level of conformance against a range of controls tested at audit rose to 93%, the conformance to anti-money laundering controls dropped in period six (to 76%, compared with 80% in periods four and five).

Some actions from previous reports remain outstanding, with recommendations detailed in section 6.

**3 Summary of findings at audits of Post Office® branches - Financial**

The findings in period six are consistent with those described in previous periods, with £717k revealed at 150 audits in the period. Blackwood branch accounted for 61% of this total with the result of the audit and the circumstances of the loss reaching a level of £436k prompting a post incident review and subsequent recommendations, led by Rod Ismay, Head of Risk Control (his report dated 8 October refers).

The following table details the 20 audits, undertaken in 2004/05, that have revealed losses in excess of £25k.

FAD	Branch name	Audit Date	Shortage (£k)	Agent/Clerk Suspended	Comments
004948	Sevenoaks DMB	21/04/2004	516	Yes	Member of staff admitted

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364632	Blackwood	23/09/2004	436	Yes	System issues relating to Bureau claimed
228704	Glengormley	15/04/2004	151	No	Amount authorised in Suspense for error
090137	Cowley Road	13/05/2004	103	Yes	
113002	Leytonstone	01/04/2004	96	No	Admission by subpostmaster's brother
123900	Shortheath Rd	15/09/2004	70	Yes	£59k declared shortage not made good
202311	Riby Square	13/05/2004	64	Yes	Cash figure inflated
291323	Osmondthorpe	19/05/2004	55	Yes	Cash produced from private safe
057900	Boxalls Lane	08/09/2004	55	Yes	Cash figure inflated
281306	Holmewood Estate	06/07/2004	53	Yes	£22k authorised for Suspense £30k error notice not brought to account
172013	Banstead	20/05/2004	40	No	Bureau re-evaluation error
191238	Fegg Hayes	04/06/2004	39	Yes	£40k cash short. Claimed taken home to count
243201	Greenholm Road	02/06/2004	36	Yes	£35k shortage held in Suspense without authority

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FAD	Branch name	Audit Date	C/A Agent/Clerk Shortage (£k)	Suspended	Comments
177005	Kings Cross	18/06/2004	36	No	Personal cheques discovered
482611	Albany Road	30/09/2004	35	No	RLM aware of rolling loss & error notice
349549	Bower Hinton	26/05/2004	33	Yes	Subpostmaster claimed money destroyed in error
397641	Madeley	09/09/2004	33	No	Unauthorised amount in Suspense
202114	Stebbing	11/05/2004	30	Yes	Cash figure inflated
203246	Parkfield Road	17/06/2004	27	Yes	Cash borrowed. Cash figure inflated
216137	Dalton Barracks	07/09/2004	26	No	Amounts authorised in Suspense

**4 Summary of findings at audits of Post Office® branches – Conformance**

The overall conformance score across all controls tested was 93.9%. This compares to 92.5% in period 5 and 91.6% for last year.

The levels of conformance against the areas tested as core at all audits were generally consistent with that report in previous months except for compliance to anti-money laundering controls. This dropped in period six to 75.6%, compared with 80.8% in period four and 80.2% in period five, although this is an improvement against the results last year (of 62.9%).

**5 Annual Certificate of Compliance – Directly managed branches**

Up to the end of period six, 263 branches had been involved in this self-assessment process (which means that 422 branches have been involved since it was introduced in January 2004). However, around 10% of those branches involved have failed to submit a completed self-assessment form (these branches are detailed in the appendix to this report).

15% of branch managers, who returned a self-assessment, have declared full conformance to all the controls within the assessment exercise. However, during the recent programme of financial audits at directly managed branches, sample checks of the self-assessment were carried out and revealed that some declarations were either incorrectly or falsely declared.

Considering both the responses in the self-assessment exercise and the examination made in follow up visits, there is a significant concern at the levels of non-compliance to the policy on supervisory control of stocks. The programme of surprise checks of counter stocks, by branch managers, is a key financial control at directly managed branches and failure to deploy this control not only creates an environment where

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there is an opportunity to steal cash but increases the risk of internal theft going undetected until a significant amount has accumulated.

A review of the Annual Certificate of Compliance form is currently being finalised, with a view to highlight the key controls and for this to be re-communicated to branch managers when the rolling programme of the Annual Certificate of Compliance is re-launched in January 2005.

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**6 Recommended actions**

Some actions outlined in previous reports appear to be outstanding. These have been amalgamated into a table of new actions, detailed below:-

Ref	Action	Owner	Timescale
AR 06	To align processes for managing losses at multiples with the contract and Liability for Losses policy, developing an escalation processes for breaches.	Richard Barker	July 2004
01/06	To review the table in section 3 of this report and comment on likelihood of recovery of loss revealed and reasons for non-suspension, where appropriate.	Geoff May/Eddie Herbert	June 2004
AR 10	To review risks against each control tested at audit and identify the key controls (providing the input to Rod Ismay, to include in his review of prioritisation of compliance coverage).	Keith Woollard/ Jonathan Hewitt	Aug 2004 – revised to 30 Nov 2004
02/06	To ensure that branch managers, that have failed to return their self- assessment (detailed in the appendix to this report), submit it before the end of November.	Stuart Stevens	30 Nov 2004
03/06	To ensure that BMs are aware of the importance of the key control of a programme of surprise supervisory checks of stocks (detailed in Section 3 of the Liability for Losses policy for DMBs)	Stuart Stevens	30 Nov 2004
04/06	To agree an approach for reporting and responding to non conformance issues relating to the annual certificate of compliance for DMBs.	Stuart Stevens/ Martin Ferlinc	30 Nov 2004
05/06	To confirm revised policies and/or processes following the recommendations within the Blackwood report	Rod Ismay	30 Nov 2004

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