

Confidential and legally privileged draft

Initial Complaint Review and Mediation Scheme

Suspense Account – second response

Issue

Second Sight has raised the following question of Post Office:

“Could any SPMRs have been charged by Post Office Ltd for amounts that become incorporated in suspense account balances that were subsequently taken into profit by POL or any of its Counterparty Companies, or that remain as credit balances on the balance sheet of POL or any of its Counterparty Companies?”

Post Office responded to this question in its paper of 29 July 2014. Second Sight has now raised further questions on this subject.

Summary

Second Sight's principal concern is that credit amounts¹ in the Suspense Account are absorbed by Post Office as profit rather than being returned to branches to balance out losses in those branches.

Whether the cost of the unresolved discrepancy between Post Office and a client (whether held in the Suspense Account or otherwise) falls on a branch is not necessarily dependant on the position between Post Office and its client but principally turns on the actions of the branch in following, or not, the correct branch accounting process.

As set out in Post Office's previous paper, so long as a Subpostmaster submits the applicable evidence from their branch's records to show there was no error on their part (ie. they have followed the correct branch accounting process), Post Office will not charge that branch (or will withdraw any related charge) arising from a discrepancy even where a client maintains that there is a discrepancy.

Post Office's processes are therefore designed so that Subpostmasters are not disadvantaged by the operation of its Suspense Account and, if operated correctly, Post Office will not take into its own profit money that should have been credited to branches.

The Suspense Account

- 1 | The Suspense Account² is an accounting tool for temporarily holding disputed differences on
 2 | payments^[R1] moving between Post Office and its clients. These amounts include not only
 3, 4, 5 | differences on the transfer of "customer monies" to and from clients (such as bank account
 6 | deposits) but also differences on payments due ~~by~~ Post Office to clients as the clients share
 7 | of commissions paid by customers for the services it provides to clients (for example,
 8 | commission share on travel insurance policies sold) due to Post Office on the sale of travel-
 | insurance).
- 7 | The operation of the Suspense Account in relation to holding disputed shares of commission
 8 | to clients ~~the payments for services~~ is outside the scope of this note and of the Scheme as
 | these payments do not affect branch accounting.

¹ Second Sight has made clear that it is only interested in credit amounts so they are the focus of this paper.

² There are in fact a number of different accounting ledgers that hold sums in suspense for different clients, products and services but for the sake of this paper we refer to them collectively as the Suspense Account.

Page 1 Comments

RI1 The suspense account only holds the difference that is disputed. Eg. if POL thinks we owe £100 and the client says £80 then the suspense account holds £20. On first reading I read the wording as possibly inferring all £100 was held in suspense. On second reading I decided it was OK. Can I just check your understanding to ensure that you are clear it is the difference of £20 which goes in here. I think I would prefer it if you added the words “disputed differences on” in front of “the transfer of customer money” and in front of “payments due by Post Office”

Rod Ismay, 22/01/2015 03:43 PM

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The operation of Post Office's Suspense Account is not a discrete issue that can be examined in isolation. It is just one mechanism in a wider range of reconciliation processes used to identify, assess and correct discrepancies between accounting records held by branches, Post Office and clients.

The question posed by Second Sight is very general. It potentially relates to all the products, services and relationships that Post Office manages, each of which has a different operating and reconciliation process. Providing one universal explanation of how the reconciliation processes (including the operations of the Suspense Account) work in practice is not possible given all these permutations.

Nevertheless, this paper endeavours to further explain the broad principles behind the operation of the Suspense Account. It also includes a few illustrative examples of those principles in action.

Credits to the Suspense Account

Second Sight has asked Post Office to focus on credits in its Suspense Account. In relation to branch accounting, a credit to the Suspense Account can occur in two ways:

- Transactions initiated in a branch which result in Post Office paying money to a client (eg. a customer pays a utility bill at a branch and Post Office pays a sum to the value of the bill to the utility company client).

A credit will occur when the records on Horizon (as generated by a branch) show that a **greater** amount is due **to** the client than the client's records show, leading to a client refusing to accept the extra amount. If the discrepancy over the extra amount is not resolved in short order, it may then be moved to the Suspense Account as a credit.

- Transactions initiated in a branch which result in Post Office receiving money from a client (eg. where a customer withdraws cash from their bank account at a branch and the client bank then reimburses Post Office to the value of the withdrawal).

A credit will occur when the records on Horizon (as generated by a branch) show that a **smaller** amount is due **from** the client than the client's records show, leading to the client paying an extra amount to Post Office which Post Office does not consider to be due. If the discrepancy over the extra amount is not resolved in short order, it may then be moved to the Suspense Account as a credit.

Credits in the Suspense Account that remain unresolved for 3 years are moved to the Post Office P/L Account – effectively Post Office absorbs these credits as profit. The operation of a suspense account in this way is standard practice for most businesses.

Second Sight is concerned that an unresolved positive ^{RI2}discrepancy in Post Office's favour at the client level may be placed in the Suspense Account as a credit and then be absorbed as profit by Post Office when in fact it reflects a loss in a branch and should therefore have been returned to the branch to balance out that loss.

Whether a positive discrepancy arising from a client reconciliation (or part thereof) is returned to a branch depends on a number of factors: the nature of the underlying error/dispute, whether a transaction correction has already been issued to a branch, whether the branch has disputed the transaction correction (so that it has been withdrawn or suspended), etc.

Page 2 Comments

RI2 Wouldn't it be better to use CREDIT throughout as that is the phrase SS have used too.

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9 The general principles followed by Post Office when considering whether to return a positive
10 discrepancy to a branch is to make an enquiry with the branch and explain the difference that
has been identifiedare:

11 1. ~~If a branch has followed the correct accounting process in branch (which means that
the branch's accounts will balance with no gain or loss), then Post Office will bear any
loss^{R13} resulting from a discrepancy between the branch records and the customer's
records.—~~

12 2. If upon FSC explaining the particular difference to the branch, the branch confirms or
realises that they made an error in accounting and are able to explain that, then FSC
would return the credit to the branch

13 3. If the branch locates missing paperwork or is otherwise able to help identify the
impacted customer (to whom the credit relates) then FSC will make the necessary
payment to the client with the details of the customer

14 4. If a branch has followed the correct accounting process in branch (which means that
the branch's accounts will balance with no gain or loss (except where other unrelated
issues cause a gain or loss at the same time), then Post Office will bear the loss^{R14}
resulting from a discrepancy between the branch records and the client 's records.

15, 16 5. If an error has been made in branch, whereby the branch did not take enough money
from the customer or gave too much money to the customer, compared to the
recorded value of the transaction then pursuant to the terms of the Subpostmaster
17 Contract the branch is liable for any loss arising from that error. Formal escalation
processes are in place for banking miskeys to enable Post Office to seek customer
acknowledgement via their bank to recover keying errors and these are typically
successful with the goodwill of the customer, but in the extreme situation where the
customer refuses or where the branch does not realise it has made a mistake then
there would not be a credit centrally to be returned to the branch and the branch
would in that extreme have to make it good and has no entitlement to have any
positive discrepancy returned to their branch.

18 ~~Where the position is unclear, Post Office assumes, in a Subpostmaster's favour, that the
branch has followed the correct accounting process.~~

In line with these general principles, Post Office will assess whether any positive discrepancy
should be returned to a branch before moving that discrepancy into the Suspense Account as
a credit. A credit put into a Suspense Account has therefore been determined, based on the
19, 20, 21 information available at the time, and the enquiries made, to ~~either be due to Post Office or to
22, 23 a client, —it is not due~~ to a branch. The credit is held in the Suspense Account for 3 years in
case any further information comes to light (either from the branch, the client or a customer)
that allows the underlying discrepancy to be resolved. As such, when Post Office takes a
credit in the Suspense Account into profit after 3 years, it is not taking any money properly
due to a branch³.

The exact implementation of this rule varies from product to product so it is not possible to
describe a universal process map for how this happens. However, below Post Office has
explained how this works in relation to two types of transactions that are thought to be of
24 particular interest to Second Sight. These are set out below.

³ Post Office may be taking into profit money that is properly due to a client but that is a matter between Post Office and its client that does not affect the position of a branch.

Page 3 Comments

RI3 In this case there won't be a loss to bear. It is a CREDIT (positive) difference from POL point of view. Shouldn't we say "...then Post Office will continue to hold the credit in anticipation of an enquiry from the customer or client when they become aware that the customer's account has not been updated

Rod Ismay, 22/01/2015 04:09 PM

RI4 In this case there won't be a loss to bear. It is a CREDIT (positive) difference from POL point of view. Shouldn't we say "...then Post Office will continue to hold the credit in anticipation of an enquiry from the customer or client when they become aware that the customer's account has not been updated

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25 Before explaining these, Post Office also notes that credits in suspense are not a consequence of actions by POL to issue charges to branches. Credits arise due to a difference between how the branch recorded a transaction locally versus the downstream summarisation of data or paperwork arising from those transactions. Assuming the branch paid out or took in money to the same value as that of the transaction they recorded, then the branch would balance and there would be no discrepancy or disadvantage to the branch. If a difference arose where the client view exceeded the branch view, and if that did subsequently lead to a charge from POL to the branch, then evidence would be provided and the branch would be able to challenge the specific Transaction Correction.

26 [The narrative in the sections titled "Summary" and "Client Reconciliation" of draft emailed on 29 July 2014 at 12.00 may be useful too]

Example 1: Bank deposits

Post Office offers personal banking services to customers including allowing them to make cash deposits into their accounts with their own banks.

Where the bank deposit is conducted using a paying in slip⁴, branch staff must manually enter the value of the deposit on Horizon. The bank's record of the transaction is taken from the paying in slip that is passed from branch to IPSL who act as the clearing agent and intermediary to the banks for Post Office⁵~~to the bank~~.

29, 30 One type of error in this process that can give rise a Suspense Account credit is where a paying-in slip is lost before reaching ~~IPSL the client bank~~. Without the paying in slip, IPSL
31, 32, ... ~~do the bank may~~ not know ~~that~~ an amount has been to be deposited by a customer's
35, 36 account nor the details of the customer's account to whom it should be credited. Without this
37 information, the bank will only request payment for the deposits notified by IPSL and Post Office retains the difference in suspense pending enquiries with the relevant branch a bank will decline to accept money from Post Office in respect of the deposit.

This leads to the Horizon records showing a greater value of deposits (ie. payments due from Post Office to the bank) than the bank's records. If the discrepancy (being the extra amount
38 that is due to the bank when the customer is identified but the bank refuses to take) cannot be resolved, it may be transferred into the Suspense Account as a credit.

In this scenario, on identification of the discrepancy and usually long before any credit is moved to the Suspense Account, Post Office would contact the branch to see if they could explain what happened with the particular deposit in question.⁶

If the branch has in fact conducted the deposit transaction correctly at the counter (ie. the amount of cash taken from the customer equals the value of the transaction recorded on Horizon by the branch) the branch's accounts will balance with no loss or gain. The resolution of the discrepancy is therefore solely a matter between Post Office and the client bank. If, down the line, the discrepancy is moved to the Suspense Account as a credit and then taken into Post Office's profit after 3 years, this will not disadvantage the Subpostmaster.

⁴ This depends on the identity of the customer's bank. A minority of banks still require customers to use paying in slips; most banks now use a chip and pin system.

⁵ This is actually Post Office's transaction handler.... **ROD TO PROVIDE DETAILS**

⁶ This type of error is commonly resolved by the branch recognising that they had simply forgotten to remit out the paying in slip.

Page 4 Comments

RI5 What we discussed was an error in a deposit not a deposit when no deposit occurred. I don't think that would happen. What does happen is the situation of keying noughts erroneously on the end of a deposit value. That is what leads to the miskey escalation process that I added earlier in the note. For that reason I don't think these last 4 paragraphs are right or are needed.

Rod Ismay, 22/01/2015 04:38 PM

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39 ^(RIS) Alternatively, the branch may not have conducted the deposit transaction correctly; an extreme example being where a deposit is recorded on Horizon but, in fact, no deposit occurred. Post Office is reliant on the branch to identify this error. Post Office has no way of knowing the cash deposit recorded in the branch accounts did not actually take place – the only information available to Post Office are the branch's accounts that would show a completed deposit. This error would normally manifest itself as a general cash shortage at the end of the branch's trading period (as the branch accounts would record the receipt of cash from a customer for a deposit but the cash would never have actually been physically received). If the branch identifies the error, a transaction correction would be sent to the branch. This would update the branch records (by effectively removing the erroneous deposit), bringing them in line with the bank records and thereby eliminating the discrepancy. There would therefore be no amount to transfer into the Suspense Account as a credit. If the branch does not identify the error, then Post Office may hold the discrepancy as a credit in its Suspense Account before taking the credit into profit after 3 years. It is accepted that this leads to Post Office taking payment twice – once from the Suspense Account credit and once from the branch when it makes good the cash shortfall at the end of its trading period. However, this outcome is a product of the branch's mistakes – first, in processing an incorrect transaction and, secondly, in not notifying Post Office of the error. Post Office therefore does not consider that it has acted improperly in operating its Suspense Account in this manner.

Example 2: Cash dispensed from ATMs

- 40 Credit differences can arise on ATMs and are in respect of balancing errors and unidentified retracts in the ATMs. In each case, branch by branch, Post Office FSC would contact the branch to explain that the bank had reported a different dispensed value to the one recorded by the branch in Horizon.
- 41 The bank would not be aware that a retract had happened until a customer or branch flags an issue. The value recorded by the bank would therefore be the total intended to be dispensed, not reflecting that some had been retracted.
- 42 If the branch had had identified and accounted for retracts then a difference would arise and would be proper to be there. The branch books, in that case, would properly align to the cash on hand and it would be evident to all that there was a customer retract to be resolved. That value would then be held in suspense pending resolution with the customer. If, however, the customer never came forward or could not otherwise be identified then the value would ultimately be released to profit.
- 43 It would not disadvantage a Subpostmaster.

44 Given the impracticality of identifying and narrating every transaction in these accounts, we set out below two examples of specific clients where Post Office has released credits to Profit & Loss. In both cases we do not consider that a branch would have been disadvantaged and we explain why.

45 Personal Banking Clients

46 Branches take cash deposits on behalf of customers of a wide range of banks. Some banks have a VocaLINK relationship with Post Office and the deposits can be processed by way of the customer inserting their debit card in the pinpad. Some others (typically banks that Post Office has worked with a long time) have not migrated the Post Office relationship to LINK and so the branch has to take a paying in slip from the customer.

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- 47 Such paying in slips are then sent to IPSL for processing. This then initiates the settlement proposal from which Post Office makes payments to the relevant banks.
- 48 If the paying in slips are not despatched by the branch to IPSL or if branches take card based deposits for non VocaLINK enabled banks, then there will not be payment request initiated for Post Office to pay the relevant bank.
- 49 It means Post Office has a credit in its accounts, which needs paying to the bank but where the relevant customer information is missing and so it would end up in suspense at the bank if it were paid over.
- 50 On the basis of the IPSL view of the data, Post Office makes a lower settlement to the relevant bank than the Horizon data would suggest. Post Office then, however, seeks to identify who the impacted customer is in order that the difference can be paid as soon as possible to the bank with the relevant details for the bank to update the correct customers account.
- 51 The branch is not impacted by this. So long as the branch keyed the value of the deposit correctly (consistently between the paying in details and the cash taken) then there is no scenario that the branch would become disadvantaged. It is the customer who is at risk of being disadvantaged.
- 52 Post Office FSC match the data from IPSL against the deposit data fed through from Horizon to try to identify the originating branch in order that the paperwork may be located or that the branch may recall the customer in question.
- 53 In the event that these enquiries do not identify the customer then Post Office can do no more. There would be no case of a TC being sent to a branch. The understanding would be that the branch had properly accounted for the deposit. It is a downstream issue that has failed to ensure the bank updates the customer's account.
- 54 **The narrative for this response should also be validated with Greg Lewis in Financial Services in respect of bank relationships.**
- 55 Aon Commission Creditor
- 56 The largest amount taken to profit by far in the 4 years reported on is in respect of Aon. This had nothing to do with branch accounting, it was wholly independent of whether branches may have taken wrong payments from customers and it did not lead to any TC's.
- 57 The client contract with Aon had complex pricing arrangements within it. This led to a difference of opinion between Post Office and Aon as regards the commission which was due from Post Office to Aon for policies sold.
- 58 Post Office initially paid a lower amount based on the initial Excel based pricing model that was developed for the new contract. However, further analysis revealed that additional payments may need to be made. A separate paper is available on this.
- 59 Post Office then posted an accrual for potential extra payments, but after wider commercial negotiations with Aon, a lower amount was agreed. The residual value of the accrual was therefore moved to Client Suspense and subsequently released to profit.

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60 | Given that Post Office had previously taken a cautiously higher cost to P&L in anticipation of a higher payment to Aon, the release (3 years later) effectively offset an earlier loss borne by the company.

61 | There was no impact on Subpostmasters.

62 | **INSERT EXAMPLE FROM ROD**

These examples support Post Office's general position that Subpostmasters are not disadvantaged by the operation of the Suspense Account if they act in accordance with Post Office's policies and procedures. It is recognised that these are only two examples but as can be seen above, the number of permutations and types of errors is vast. If Second Sight has concerns over the operation of the Suspense Account in relation to specific transactions or circumstances then Post Office will be happy to look into this in more detail.

Suspense Account data

As requested, enclosed with this paper is a spreadsheet showing all amounts taken from the Suspense Account into profit over the last 4 years. The figures in the spreadsheet include both "customer monies" and payments for services as described above. Each line item may represent a single unreconciled transaction or series of unreconciled transactions.

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