

Corporate governance

The shares in Post Office Limited (the Post Office) were transferred from Royal Mail Group Limited to Royal Mail Holdings plc on 1 April 2012, and the Post Office has operated independently since that date.

Corporate governance principles

As the Post Office is not a company whose shares are 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.

During the year, the Post Office has further established a full Board and Committee structure and has set principles for good governance which follow the provisions of the Code, 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 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 association.

A strong link remains between Royal Mail Group Limited and the Post Office: the Post Office has a strategic agreement in place to continue to supply Royal Mail Group Limited products and services through its network. That link is currently reinforced in the corporate structure by a common group holding company (Royal Mail Holdings plc) which holds shares in both Post Office Limited and Royal Mail Group Limited.

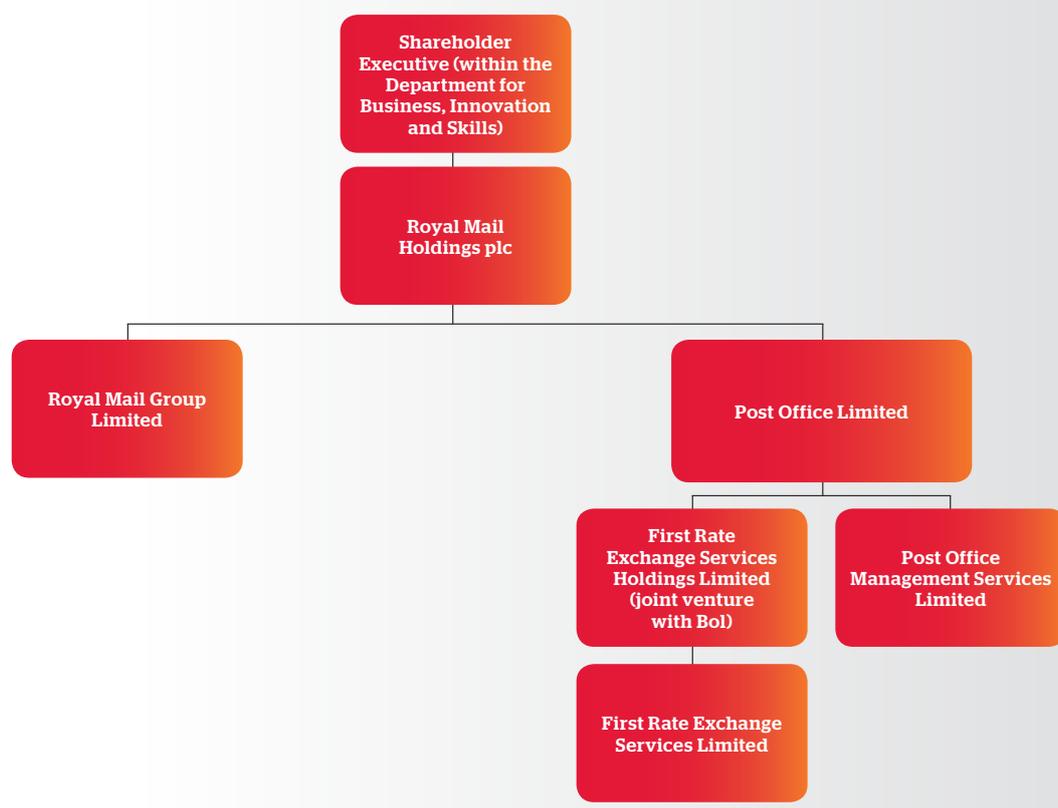
Neither Royal Mail Holdings plc nor BIS, through its Shareholder Executive (ShEx), have any day-to-day involvement in the operations of the Post Office or the management of its branch network and staff.

The Board

Alice Perkins was appointed as Chairman of the Board in July 2011, marking the first step on the road to building an independent Board for the Post Office. Neil McCausland joined in September 2011 as the Senior Independent Director, and in the year under review a further four Non-Executive Directors have been appointed, each bringing particular skills and experience relevant to the business targets of growth, modernisation, customer focus and business efficiency.

The Board is unusual in having a female Chairman and Chief Executive and being equally balanced between men and women. The Board comprises two Executive Directors and six independent

Legal ownership structure



Non-Executive Directors, including the Chairman. This provides a strong level of independent challenge to decision-making and enables the Post Office to call on a wide range of experience and opinion. Short biographies of all members of the Board appear on pages 40-41.

The Nominations Committee liaises with ShEx in BIS to obtain the Special Shareholder's consent for all Directors' appointments. The Remuneration Committee agrees 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 six months' notice of termination to be given by the Director and 12 months' notice to be given by the organisation.

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. All Non-Executive Directors are entirely independent of the Post Office, having no other connection or financial interest other than as customers and taxpayers.

Board meetings

The Board meets at least eight times a year, with an additional strategy away-day, and has a formal schedule of matters reserved to it.

The Board's responsibilities include setting the Post Office's strategic aims, putting in place the leadership to put them into effect, supervising the management of the business and reporting to the Shareholder. During the year to 31 March 2013, the Board has focused on financial performance, network transformation, and the people and capability of the business. Over the last six months, the Board's primary focus was on setting the strategic direction for the business in preparation for completion, during 2013-14, of the Strategic Plan and Funding Agreement with the government for the period after March 2015.

During the year under review, the Board established sub-committees which met regularly to undertake more detailed reviews in specialist financial reporting areas, as recommended by the Code. Such focus areas included accounting policy and practices, risk and controls, pensions, executive remuneration, the processes for evaluation of performance, and the nomination and appointment of new Directors or the removal of Directors from the Board. The full terms of reference for the Board sub-committees can be found on the Post Office website.

The table on the following page shows the attendance of the Directors at meetings of the Board and its principal committees during the year.

Non-Executive Directors' terms of office

Director	Date of appointment	Term of office	Unexpired term at 31 March 2013	Committee memberships
Alice Perkins	21 July 2011	Rolling 12-month contract	n/a	Nominations (Chair), Remuneration
Tim Franklin	19 September 2012	4 years	3 years, 172 days	ARC
Virginia Holmes	4 April 2012	3 years	2 years, 4 days	Pensions (Chair), Nominations, Remuneration
Neil McCausland	22 September 2011	4 years	2 years, 175 days	(Chair), ARC, Nominations
Alasdair Marnoch	23 May 2012	3 years	2 years, 53 days	ARC (Chair)
Susannah Storey	18 April 2012	3 years	2 years, 18 days	ARC, Pensions

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Director	Board	ARC	Remuneration Committee	Nominations Committee	Pensions Committee	Mutualisation Committee
Alice Perkins	8/8	-	4/4	2/2	-	3/3
Chris Day	8/8	-	-	-	7/7	3/3
Tim Franklin*	5/5	2/3	-	-	-	2/2
Virginia Holmes	8/8	-	4/4	2/2	7/7	2/3
Neil McCausland	8/8	4/4	4/4	2/2	-	3/3
Alasdair Marnoch*	7/7	4/4	-	-	-	3/3
Susannah Storey*	8/8	3/3	-	-	6/6	2/3
Paula Vennells	8/8	-	-	-	-	3/3

* From date of appointment.

Board sub-committees

Audit, Risk and Compliance Committee

The Audit, Risk and Compliance Committee (ARC) is made up of four Non-Executive Directors and is chaired by Alasdair Marnoch. The ARC considers Post Office Limited'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.

One of the ARC's primary responsibilities during the period was to review both the half-year trading statement and the full-year financial statements to assess the validity of assumptions made, the accounting policies used and 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 will take some time, and is a key focus area for the coming year. The development of risk management and control procedures and the establishment of a full internal audit programme are areas of high priority.

In this period, a new Head of Internal Audit was appointed and the transition from using the Royal Mail Group Limited's internal audit function to building a new internal team began.

The ARC works with both the internal audit team and Ernst & Young, the external auditor. The appointment and terms of engagement of the external auditor, including the proposed fee structure, were considered and their independence assessed. The Audit Committee considered the scope and planning of the external financial audit and assessed the effectiveness of the audit process. There is no current intention to change the existing audit relationship, but the ARC will continue to monitor the independence of the auditor and will, in future years, consider

whether the audit should be put out to competitive tender, in line with best practice applying to listed companies.

Remuneration Committee

The Remuneration Committee is made up of three Non-Executive Directors and is chaired by Neil McCausland, the Senior Independent Director. The committee is responsible for making recommendations to the Shareholder on the remuneration of the Executive Directors in accordance with the articles of association. In doing so, it also 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 in 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 Human Resources and Corporate Services Director, with other members of the Human Resources team and with external consultants. In the year under review, advice was primarily obtained from New Bridge Street 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 the Special Shareholder's consent. Further details of the schemes now in place, and a table setting out the remuneration paid to all Directors in the year to 31 March 2013, are provided in the Directors' remuneration report on page 49.

Nominations Committee

The Nominations Committee is made up of three Non-Executive Directors and is chaired by Alice Perkins, the Chairman. It met for the first time in December 2012, with Director appointments up to that time having been made according to specific criteria, following discussions with the Special Shareholder.

The primary role of this committee is to recommend to the Board any changes in Board membership and manage the process for recruiting and replacing Directors. The Board is complete and no immediate changes are expected. 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 will also oversee the process for Board and committee performance evaluation, and monitor talent and diversity

(see page 26). The Chief Executive may attend meetings, at the invitation of the Chairman, to discuss matters relating to the talent and diversity policies.

Pensions Committee

The Pensions Committee is made up of two Non-Executive Directors and one Executive Director and is chaired by Virginia Holmes.

With the pensions transfer in April 2012 (see page 33), government assumed the obligations for past service liabilities of the Royal Mail Pension Plan (RMPP) in return for a substantial transfer of assets. The transfer was made possible following European Union approval for UK Government state aid.

As part of the transfer, the pension fund was sectionalised, with the Post Office assuming responsibility for that part of the pension fund which relates to Post Office employees and pensioners.

The Board has delegated authority to the Pension Sub-Committee to appoint professional advisers, to enter into negotiations with the trustees of the RMPP on the forthcoming valuation of the funds, to agree the investment strategy for the Post Office section, and to monitor funding levels and investment performance. The committee reports back to the full Board so that its work can dovetail with executive recommendations and union negotiations on pay and benefits.

In August 2012, the committee recommended to the Board the appointment of Aon Hewitt as its investment adviser. Working with Aon Hewitt and with Towers Watson, its actuarial adviser, the committee has satisfied itself as to the fair value of assets transferred into the Post Office section at 1 April 2012. The committee has agreed a revised investment strategy with the trustees of the RMPP, with the aim of maintaining the long-term sustainability of the scheme and protecting against an unmanageable increase in liabilities for the Post Office in the future.

Mutualisation Sub-Committee

The Mutualisation Sub-Committee is chaired by Alice Perkins and its membership is the same as that of the full Board. It met for the first time on 4 July 2012, the week in which the government published the response to its consultation 'Building a Mutual Post Office'. The committee is responsible for ensuring that the work to develop proposals for the mutualisation of Post Office Limited is provided with strategic direction, has the appropriate level of stakeholder involvement and has adequate support.

The focus of the committee has been to consider the financial, cultural and business implications of mutualisation to ensure that progress on mutualisation supports and enables the successful delivery of the Post Office's transformation programme. The committee looks at mutual ways of working to improve the performance of the business and the Post Office's progress towards mutualisation.

Performance evaluation

The Board intends to carry out an annual evaluation of the effectiveness of the Board and of the Board sub-committees. The initial performance evaluation will take the form of an assessment by the Chairman. External evaluations will be completed every three years.

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. The committee 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 that have arisen within the business and require senior-level resolution. Twice yearly, it reviews the results of personal performance assessments undertaken throughout the organisation.

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

The Terms of Reference of the ExCo have been set out in writing, and are available to download from the Post Office website.

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 meet the demands of a new business with ambitious plans for expansion in its chosen markets.

The Board takes ownership of risk management through its Audit, Risk and Compliance Committee (ARC). The business' Risk and Compliance Committee reports into the ARC and is responsible for:

- review and challenge of risk management;
- approval and endorsement of policies to mitigate risk; and
- development of the risk management framework.

This committee is chaired by the Director of HR and Corporate Services and reports to the Post Office ExCo. The committee comprises members of the ExCo and other senior managers.

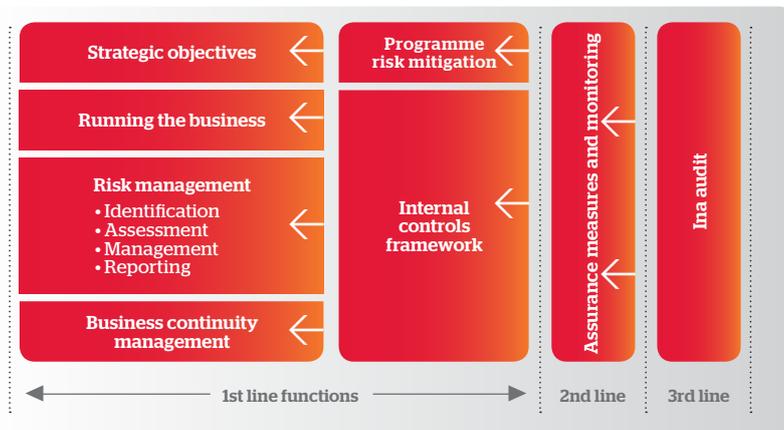
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During the year under review, the Post Office set up its own Internal Audit department as part of a 'three lines of defence' model (see diagram below). Internal Audit provides independent assurance and advice on the risk management framework and its future strategy and evolution, and reports directly to the ARC.

Compliance with the business' regulatory responsibilities in Financial Services is managed through established joint regulatory risk committees with the Post Office's partner, the Bank of Ireland (UK) plc.

Risk framework

The Post Office has set out the components of risk management in its risk framework. This framework is described at high level in the diagram below.



The framework utilises a 'three lines of defence' model to establish accountability and responsibility for the effective operation of this framework.



1st line of defence is responsible for managing risk in day-to-day business operations.

2nd line of defence comprises central functions which oversee regulatory compliance and provide advice on the operation of the framework.

3rd line of defence provides independent assurance in respect of the Post Office's regulatory risk management.

The risk framework is supported by the Risk and Compliance team, with dedicated resources in place to administer the tools and committees in use to manage risk.

Progress

Over the past 12 months, each directorate has gone through a process of identifying and assessing the risks associated with achievement of its respective objectives. In addition, the key strategic programmes of the business capture their own risks.

The top 12 risks from each of these sources, together with the respective mitigation plans, are reviewed by the Risk and Compliance Committee to assess the robustness of risk assessment and management.

The above assessment will be supplemented in the first quarter of the new financial year with a top down assessment of the Company's risks by the Post Office Executive Committee.

Risk appetite

Over the next 12 months, the Post Office will be fully developing its risk appetite statements for each of the key risks, 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 development of risk management, the Post Office is bringing together a wide range of business continuity arrangements throughout the business under one central policy and governance framework to ensure that the Post Office is capable of withstanding any significant threat to its ongoing operations.