



Royal Mail's regulatory  
reporting audit  
for the year ending  
31 March 2013

Statement

Publication date:

28 March 2013



# Contents

Section		Page
1	Executive Summary	1
2	Approval of auditor and terms of engagement for 2012/13	2
Annex		Page
1	Statutory Notification: proposed approval of appointment of auditor and auditor's terms of engagement	6
2	Audit engagement documents	9

## Section 1

# Executive Summary

## Proposal

- 1.1 In March 2012, we set out the basis for a new regulatory framework in the postal sector in the 'Securing the Universal Postal Service – decision on the new Regulatory Framework' statement ('the March Statement').<sup>1</sup> As part of the new framework we put in place new regulatory financial reporting requirements on Royal Mail Group Ltd ('Royal Mail').
- 1.2 The new regulatory financial reporting requirements were set out in the USP Accounting Condition ('USPAC') which was published as Annex 10 of the March Statement.
- 1.3 The USPAC requires Royal Mail to select and appoint an auditor upon Ofcom giving their approval to the appointment and the terms of the engagement.<sup>2</sup> Royal Mail have advised us that they propose to select Ernst & Young LLP ('Ernst & Young') as auditor for the financial year ending 31 March 2013.
- 1.4 In the February Consultation<sup>3</sup> we proposed to approve the appointment of Ernst & Young as auditor for the financial year ending 31 March 2013, and their terms of engagement.
- 1.5 We consulted on this matter in accordance with para 4(3) of Schedule 6 to Postal Services Act 2011.
- 1.6 This Statement sets out our final decision to approve the appointment of Ernst & Young as auditor for the financial year ending 31 March 2013, and their terms of engagement.

## Impact Assessment

- 1.7 Under the Communications Act 2003, we are required to carry out an impact assessment where a proposal in connection with the carrying out of our functions is "important". A proposal is "important" if its implementation is likely to involve a major change in the activities carried on by Ofcom or have a significant impact on persons carrying on business in the markets we regulate, or the general public. We do not consider that this decision is "important" in this sense.

---

<sup>1</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/statement.pdf>

<sup>2</sup> 'Securing the Universal Postal Service – decision on the new Regulatory Framework', Annex 10 – Notification of the USP accounting obligation, para 1.3.5, 1.4.5 and 1.6.5.  
<http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/annex10.pdf>

<sup>3</sup> Royal Mail's regulatory reporting audit for the year ending 31 March 2013, consultation: 21 February 2013, <http://stakeholders.ofcom.org.uk/binaries/consultations/rm-reporting/summary/condoc.pdf>

## Section 2

# Approval of auditor and terms of engagement for 2012/13

## Introduction

- 2.1 Our objectives for imposing new regulatory financial reporting requirements set out in the USPAC were to:
- monitor the financial sustainability of universal service provision;
  - monitor the efficiency of universal service provision;
  - understand how costs and revenues are apportioned to different products and services; and
  - monitor the relative profitability of different product groups sharing activities and costs.<sup>4</sup>
- 2.2 The USPAC requires Royal Mail to secure from a qualified independent auditor:
- an appropriate audit opinion on the annual regulatory financial statements and other information required under the USPAC; and
  - a statement as to whether or not Royal Mail has complied with notification requirements with regard to material changes to the Costing Manual and the Accounting Methodology Manual.<sup>5</sup>
- 2.3 The USPAC also requires Ofcom's approval of the appointment of the auditor and terms of their engagement.<sup>6</sup>
- 2.4 As we explained in the March Statement<sup>7</sup>, these conditions aim to enhance the level of assurance that audit provides to Ofcom and the market, by giving Ofcom more control over the scope, the nature of the opinion and the methodology of the audit, and also potentially enhance legal recourse in the event of any issues with the audit. We also decided that these requirements would lead to a more productive audit relationship that would help address issues in a more efficient and expedient way.
- 2.5 The February Consultation included two proposals:
- to approve the selection of Ernst & Young as auditor for the year ending 31 March 2013; and

---

<sup>4</sup> Securing the Universal Postal Service – decision on the new Regulatory Framework, para 11.6

<sup>5</sup> For the financial year 2012-13, there is no Accounting Methodology Manual, and so the notification obligations on Royal Mail relate only to the Costing Manual. We consider it appropriate for the terms of engagement to reflect this. Royal Mail is required to provide the first full version of the Accounting Methodology Manual on 31 May 2013 (see USPAC 1.6.8(c)).

<sup>6</sup> 'Securing the Universal Postal Service – decision on the new Regulatory Framework', Annex 10 – Notification of the USP accounting obligation, para 1.3.5, 1.4.5, 1.5.6 and 1.6.5.

<sup>7</sup> Securing the Universal Postal Service – decision on the new Regulatory Framework, para 3.314 to 3.316

- to approve the terms of the engagement between Ernst & Young and Royal Mail, set out in a letter from Ernst & Young to Royal Mail ('draft Audit engagement letter') and a letter from Ernst & Young to Ofcom ('draft Regulator's Notice') (see Annex 2);

2.6 We invited comments on our proposals by way of responses to the questions we posed. A response was received from Royal Mail Group Limited only.

*Question 1: Do you agree with our proposal to approve Ernst & Young as auditor for the year ending 31 March 2013?*

### **Response**

2.7 Royal Mail agreed with the proposal to approve Ernst & Young as auditor for the year ending 31 March 2013.

*Question 2: Do you agree with our proposal to approve the terms of the engagement related to the audit - See the draft engagement letter and the draft Regulator's Notice from Ernst & Young (set out in Annex 3)?*

### **Response**

2.8 Royal Mail agreed with the proposal to approve the terms of the engagement related to the audit.

2.9 Royal Mail submitted that this approval should be given for more than one year, unless the auditor is changed, or there is a significant change in the terms of their engagement. The USPAC<sup>8</sup> requires Royal Mail to appoint a Qualified Independent Auditor on an annual basis and Ofcom to approve the appointment and terms of engagement. We therefore only consulted on a proposal to approve for one year. Whilst this Statement relates only to the approval of the 31 March 2013 regulatory financial statements, we may seek at a later date to consider whether, and if so how, to enable approval to be given for more than one year.

## **Decision**

### **Selection of auditor**

2.10 Royal Mail proposed to select Ernst & Young as Qualified Independent Auditor for the year ending 31 March 2013. We proposed to approve the appointment of Ernst & Young, which would enable Royal Mail to proceed with the appointment.

2.11 We consider Ernst & Young to be a person meeting the definition of "Qualified Independent Auditor" in the USPAC, i.e. "a person who is eligible for appointment as a statutory auditor under Part 42 of the Companies Act 2006 and, if the appointment were an appointment as a statutory auditor, would not be prohibited from acting by section 1214 of that Act (independence requirement)". We consider Ernst & Young to have the ability to undertake the work concerned – they have been both statutory and regulatory auditor of Royal Mail for a number of years.

<sup>8</sup> Securing the Universal Postal Service – decision on the new Regulatory Framework', Annex 10 – Notification of the USP accounting obligation, para 1.3.5, 1.4.5 and 1.6.5.  
<http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/annex10.pdf>

- 2.12 We are aware of no reasons not to approve Ernst & Young as auditor for the year ending 31 March 2013. Accordingly, we have decided to approve the appointment of Ernst & Young as auditor for the year ending 31 March 2013.

### Terms of engagement

- 2.13 Our key requirements for the audit arrangement are as follows:
- auditor to have a duty of care to Ofcom as well as Royal Mail;
  - audit reports to be addressed to Ofcom as well as Royal Mail; and
  - Ofcom to be in a position to address regulatory reporting issues and concerns directly with the auditor.
- 2.14 As we explained in the March Statement<sup>9</sup>, these requirements will enable us to have more control over the scope and the methodology of the audit and potentially further legal recourse in the event of any issues with the audit.
- 2.15 They will also allow us to benefit from the auditor's independent view of the challenges that Royal Mail may face in meeting their new regulatory reporting requirements.
- 2.16 This will lead to a more productive audit relationship that would help address issues, such as data quality and the appropriate audit opinion standard, in a more efficient and expedient way.
- 2.17 As we explained in the March Statement<sup>10</sup>, these requirements will therefore provide us and the market with more confidence in the audited regulatory accounts and the methodologies Royal Mail has applied in preparing those accounts.
- 2.18 Accordingly, we have decided to approve the draft Audit engagement letter and the draft Regulator's Notice from Ernst & Young (set out in Annex 2), because in our view they meet the key requirements we have set out above. This enables Royal Mail to proceed with appointing the Qualified Independent Auditor on those terms.

### Legal tests

- 2.19 We consider that in making this decision, we are acting in accordance with our principal duty in section 29 of the Act and our general duties in section 3 of the Communications Act 2003.
- 2.20 We have set out below our assessment of how our proposals meet the specific legal tests set out in the Act. In particular, we explain why giving our approval to the appointment of Ernst & Young on the terms set out in Annex 2:
- is objectively justifiable;

---

<sup>9</sup> Annex 3, paragraphs A3.314 to A3.316  
<http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/statement.pdf>

<sup>10</sup> Annex 3, paragraphs A3.314 to A3.316  
<http://stakeholders.ofcom.org.uk/binaries/consultations/review-of-regulatory-conditions/statement/statement.pdf>

- does not discriminate unduly against particular persons or a particular description of persons;
  - is proportionate to what it is intended to achieve; and
  - is transparent in relation to what it intended to achieve.
- 2.21 Our approval is objectively justifiable, because we have a statutory duty to approve the choice of auditor by Royal Mail and their terms of engagement, and we have set out our reasons for doing so above.
- 2.22 Our approval does not discriminate unduly against particular persons or a particular description of persons. It applies to Royal Mail only and we have set out the reasons for our approval of Ernst & Young above.
- 2.23 Our approval is proportionate to what it intends to achieve, because it is no more than necessary to ensure that the requirements of the USPAC and our relevant decisions in the March Statement are met.
- 2.24 Finally, our approval is transparent, because we clearly set out our proposals and our reasons for proposing them, and we provided copies of the draft Audit engagement letter and the draft Regulator's Notice from Ernst & Young (set out in Annex 2).

## Annex 1

# Statutory Notification: approval of appointment of auditor and auditor's terms of engagement

## NOTIFICATION OF APPROVAL TO THE APPOINTMENT OF A QUALIFIED INDEPENDENT AUDITOR AND THE TERMS OF THE ENGAGEMENT OF THE QUALIFIED INDEPENDENT AUDITOR UNDER THE USP ACCOUNTING CONDITION IN ACCORDANCE WITH SECTION 53 OF, AND PARAGRAPH 4 OF SCHEDULE 6 TO, THE POSTAL SERVICES ACT 2011

### Background

- (A) On 21 February 2013, OFCOM published a notification in accordance with section 53 of, and paragraph 4 of Schedule 6 to, the Act setting out their proposals to give approval to the appointment of a qualified independent auditor and the terms of the engagement of the qualified independent auditor under the USP Accounting condition (the "**First Notification**").
- (B) A copy of the First Notification was sent to the Secretary of State in accordance with Schedule 6 paragraph 5(1)(a) of the Act.
- (C) In the First Notification (and the accompanying consultation document), OFCOM invited representations about any of the proposals set out therein by 22 March 2013.
- (D) By virtue of section 53 of, and paragraph 4(8) of Schedule 6 to, the Act OFCOM may give effect, with or without modifications, to a proposal with respect to which they have published a notification only if they—
  - (i) have considered every representation about the proposal that is made to them within the period specified in the First Notification; and
  - (ii) have had regard to every international obligation of the United Kingdom (if any) which has been notified to them for this purpose by the Secretary of State.
- (E) OFCOM received one response to the First Notification and have considered that representation made to them in respect of the proposals set out in the First Notification (and the accompanying consultation document); and the Secretary of State has not notified OFCOM of any international obligation of the United Kingdom for this purpose

### DECISION

1. OFCOM hereby, in accordance with section 53 of, and paragraph 4 of Schedule 6 to, the Act—and pursuant to its functions under USPAC 1.3.5, 1.4.5, 1.5.6 and 1.6.5— gives its approval to the appointment and the terms of engagement set out in paragraph 2 below for the purposes of Royal Mail securing—

(a) an appropriate audit opinion by a Qualified Independent Auditor under USPAC 1.3.4, 1.4.4 and 1.5.5; and

(b) a statement by a Qualified Independent Auditor under USPAC 1.6.4.

2. The approval is—
  - (a) for Ernst & Young to be appointed as the Qualified Independent Auditor for financial statements and information relating to the first Financial Year (and, in relation to quarterly updates of the Costing Manual for the Reported Business, the Financial Quarters comprised therein) ending on 31 March 2013; and
  - (b) of the terms of engagement for the Qualified Independent Auditor as per the draft Audit engagement letter and the draft Regulator's Notice, which are set out in Annex 2 to the accompanying statement.
3. The effect of, and OFCOM's reasons for making, this decision are set out in the accompanying statement.

### OFCCOM'S DUTIES AND LEGAL TESTS

4. OFCCOM is satisfied that this decision satisfies the general test in paragraph 4(2) of Schedule 6 to the Act.
5. In making this decision, OFCCOM has considered and acted in accordance with its principal duty in section 29 of the Act and its general duties in section 3 of the Communications Act 2003.

### INTERPRETATION

6. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them in this Notification and otherwise any word or expression shall have the same meaning as it has been ascribed for the purpose of the USPAC.
7. In this Notification—
  - (a) "**Act**" means the Postal Services Act 2011 (c.5);
  - (b) "**Ernst & Young**" means Ernst & Young LLP, whose registered company number in England and Wales is OC300001;
  - (c) "**OFCCOM**" means the Office of Communications;
  - (d) "**Royal Mail**" means Royal Mail Group Ltd, whose registered company number in England and Wales is 04138203; and
  - (e) "**USPAC**" means the USP accounting condition set out in the Schedule to the notification dated 27 March 2012 at Annex 10 to the statement entitled '*Securing the Universal Postal Service – Decision on the new regulatory framework*', published by OFCCOM on 27 March 2012;
8. For the purpose of interpreting this Notification—
  - (a) headings and titles shall be disregarded;
  - (b) expressions cognate with those referred to in this Notification shall be construed accordingly;
  - (c) the Interpretation Act 1978 (c. 30) shall apply as if this Notification were an Act of Parliament.

Signed by

A handwritten signature in black ink, appearing to read 'David Brown', with a stylized flourish at the end.

**David Brown**

**Competition Finance Director**

A person duly authorised by OFCOM under paragraph 18 of the Schedule to the Office of Communications Act 2002

**28 March 2013**

## Annex 2

# Audit engagement documents

### DRAFT LETTER

The Directors  
Royal Mail Group Ltd  
100 Victoria Embankment  
London  
EC4Y 0HQ

DATE:

TBC

For the attention of Matthew Lester

### **Royal Mail Group Ltd (“the Company”) Audit of the regulatory financial statements for the year ended 31 March 2013**

Dear Matthew,

#### **Introduction**

We are writing this letter to confirm the eligibility and the terms of engagement for our appointment as auditors for the purposes of the Company complying with its obligations to secure an appropriate audit opinion by a ‘Qualified Independent Auditor’ under USPAC 1.3.4, 1.4.4, 1.5.5 and 1.6.4 in respect of the specific Regulatory Financial Statements for the year ended 31 March 2013 to which those refer, as well as the information to which those obligations refer for the year ended 31 March 2013 on the basis directed by OFCOM from time to time, and a statement by a ‘Qualified Independent Auditor’ under USPAC 1.6.4. as to whether or not the Company has complied with the requirements set out in USPAC 1.6.3 with regard to the Costing Manual for the Reported Business for the year ended 31 March 2013.

This engagement letter together with the terms of business as attached (“terms of business”) constitute the entire agreement (the “Contract”) between us with respect to our engagement. In the event of any inconsistency, the terms of this engagement letter will prevail.

We also set out the respective areas of responsibility of the directors of the Company (“the Directors”) and ourselves, in respect of the audit of the Services. This letter (with all its attachments) applies only to the audit report on the Regulatory Financial Statements and the scope of our work will be limited accordingly.

If any additional work or report is required, separate engagement terms and conditions will need to be agreed.

OFCOM is not a party to the Contract. On condition that OFCOM accepts in writing a notice in the form appended (“the Regulator’s Notice”), we will accept duties and responsibilities to OFCOM in respect of our audit work, our audit report and our audit opinion on the specific Regulatory Financial Statements. Any such agreement will be on the basis that, amongst other things, the Company and OFCOM agree that our aggregate liability to the Company and OFCOM is limited to the maximum amount which would have been payable to the Company alone in respect of any breach of our obligations to the Company. References to rights and obligations between OFCOM and the auditors in relation to the Services are included in the Engagement Letter for the purpose only of the Regulator’s Notice and are not intended to create rights or obligations between OFCOM and the Company.

We confirm that we are a person who is eligible for appointment as a statutory auditor under Part 42 of the Companies Act 2006 and, if the appointment were an appointment as a statutory auditor, would not be prohibited from acting by section 1214 of that Act (independence requirement), as defined by the expression 'Qualified Independent Auditor' in USPAC 1.1.2(r).

### **Terminology**

Words or expressions used in this letter have the following meanings:-

"Company"	Royal Mail Group Ltd;
"Contract"	The Engagement Letter together with the terms of business as attached;
"Engagement Letter"	This letter dated [TBC] from Ernst & Young LLP to the Directors of Royal Mail;
"OFCOM"	The Office of Communications – the Regulator of the Company;
"Other Information"	Those of the financial statements/information set out in Column 1 of Tables 9, 10 and 11 in Section 10 of the RAG in relation to which the auditing basis set out in Column 2 is "Not applicable";
"PPIA"	'Properly Prepared In Accordance with the RAG', which is an audit opinion that provides reasonable assurance that a financial statement and information, taken as a whole, have been prepared, in all material respects, in accordance with the detailed requirements prescribed by the RAG;
"RAG"	The Regulatory Accounting Guidelines, Issue No. 1, set out in the Schedule to the direction dated 27 March 2012 at Annex 11 to the statement entitled ' <i>Securing the Universal Postal Service – Decision on the new regulatory framework</i> ', published by OFCOM on 27 March 2012;
"Regulator's Notice"	The letter dated [TBC] from Ernst & Young LLP to OFCOM;
"Royal Mail"	Royal Mail Group Ltd, whose registered company number in England and Wales is 04138203;
"USPAC"	The USP accounting condition set out in the Schedule to the notification dated 27 March 2012 at Annex 10 to the statement entitled ' <i>Securing the Universal Postal Service – Decision on the new regulatory framework</i> ', published by OFCOM on 27 March 2012; and
"we"/"us"/"our"	Ernst & Young LLP, whose registered company number in England and Wales is OC300001.

For the purpose of interpreting this letter, headings and titles shall be disregarded, and expressions cognate with those referred to in this letter shall be construed accordingly.

## Responsibilities of the Directors

The Directors are required to ensure that the Company complies with all of the terms of its USPAC. The Directors are required to prepare Regulatory Financial Statements in accordance with the Company's USPAC and the RAG issued by OFCOM.

The Directors are also required to:

- Report to OFCOM changes in the Company's activities which may be material in relation to the Company's ability to finance its regulated activities;
- Undertake the transactions entered into by the business consisting of the carrying out of the regulated activity and
- Keep proper accounting records which comply with the USPAC and RAG

We refer to the above as "the Specific Obligations".

In the absence of regulatory accounting principles, it is the responsibility of the Company to agree the methodology on which the regulatory financial statements are prepared with OFCOM.

The Directors are also responsible for ensuring that the Company maintains accounting records which disclose with reasonable accuracy, at any time, the financial position of the Company, and for preparing Regulatory Financial Statements which present the results of the Company fairly in accordance with the USPAC. They are also responsible for making available to us, as and when required, all of the Company's accounting records, all other relevant records, including minutes of all directors', management and shareholders' meetings, and such information and explanations which we consider necessary for the performance of our duties as auditors.

## Our Responsibilities

We agree to act as the Qualified Independent Auditor required by USPAC 1.3.4, USPAC 1.4.4, USPAC 1.5.5 and USPAC 1.6.4 below:

- USPAC 1.3.4      "Royal Mail must secure an appropriate audit opinion by a Qualified Independent Auditor in respect of each of the financial statements and information required under USPAC 1.3.1(a),(b),(c) and (f), on the basis directed by OFCOM from time to time. Royal Mail must include that audit opinion in the financial statement and information in question."
- USPAC 1.4.4      "Except for the financial statements and information required under USPAC 1.4.1(b), (c), (j) and (k), Royal Mail must secure an appropriate audit opinion by a Qualified Independent Auditor in respect of each of the financial statements and information required under USPAC 1.4.1, on the basis directed by OFCOM from time to time. Royal Mail must include that audit opinion in the financial statement and information in question."
- USPAC 1.5.5      "Royal Mail must secure an appropriate audit opinion by a Qualified Independent Auditor in respect of each of the financial statements and information required under USPAC 1.5.2 (a),(d),(f) and (g), on the basis directed by OFCOM from time to time. Royal Mail must include that audit opinion in the financial statement and information in question."
- USPAC 1.6.4      "Royal Mail must secure a statement by the Qualified Independent Auditor on an annual basis setting out whether or not Royal Mail has complied with the requirements set out in USPAC 1.6.3."

It is our responsibility to form an independent opinion, based on our audit, on whether the specific Regulatory Financial Statements and information in respect of which the Company must secure an appropriate audit opinion for the year ended 31 March 2013 under USPAC 1.3.4, 1.4.4 and 1.5.5 have been prepared on the basis directed by OFCOM from time to time. It is also our responsibility to form an independent opinion, based on our audit, as to whether or not the Company has complied with the requirements set out in USPAC 1.6.3. with regard to the Costing Manual for the Reported Business

for the year ended 31 March 2013. The auditing bases currently directed by OFCOM are those prescribed by Section 10 of the RAG, that is to say PPIA.

It is our responsibility to report our opinions in a written report addressed to the Company and OFCOM (in order to meet the requirements of the USPAC to the Regulator).

Our report will be made in accordance with the engagement letter, solely to the Company and OFCOM in accordance with the USPAC. Our audit work will be undertaken so that we might state to the Company and OFCOM those matters we have agreed in the Engagement Letter to state to them in our report in order to (a) assist the Company to meet its obligations under the USPAC to procure such a report and (b) to facilitate the carrying out by OFCOM of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we will not accept or assume responsibility to anyone except as set out in this Engagement Letter for our audit work, for our report, or for the opinions we will form. Our report will contain a disclaimer of liability to all other parties but we will confirm acceptance in our report of responsibility in respect of our audit work to (a) the Company; and (b) if OFCOM has agreed to the Regulator's Notice by signing the written notice appended, to OFCOM.

Our report will be addressed to the Company and OFCOM to meet the requirements of the USPAC and will state whether, in our opinion, the Regulatory Financial Statements are properly prepared in accordance with conditions USPAC 1.3.1, USAPC 1.4.1, USPAC 1.5.2 and USPAC 1.6.3. The Company (and where OFCOM signs the written notice appended, and only to the extent that OFCOM is the person publishing or making available the information concerned OFCOM), acknowledge and agree that:

- wherever the Regulatory Financial Statements or other Regulatory Information covered by the Independent Accountants' report are published or otherwise made available in full, our audit report will also be published or otherwise made available in full as part of that communication;
- wherever substantial extracts from the Regulatory Financial Statements or other Regulatory Information covered by the Independent Accountants' report are published or otherwise made available, and reference is made to the fact that they are audited or otherwise examined by an Independent Accountant, there will be explicit statements by OFCOM: a) that the information published is only an extract; and b) about the limitation of scope of the Independent Accountants' report and the duty of care owed by the Independent Accountants; and c) referring to where the full set of Regulatory Financial Statements can be found or otherwise obtained; and
- wherever any other information is referenced from the Regulatory Financial Statements or other Regulatory Information covered by the Independent Accountants' report, there will be an explicit reference by OFCOM to the source of that information and the limitation of scope of the Independent Accountants' report and the duty of care owed by the Independent Accountant. We understand that in order to comply with this condition, Ofcom may retain a general notice on its website to be used as a cross-reference in Ofcom publications that includes information extracted from the Regulatory Financial Statements.

Where OFCOM does not sign a written notice in the form appended, the Company will procure that these events take place in the circumstances identified.

#### **Relationship between OFCOM and the Company**

For the avoidance of doubt, nothing in this Engagement Letter is intended to nor does it affect or in any way alter the relationship or the rights and obligations between the Company and OFCOM as set out in the USPAC and all relevant legislation.

#### **Scope of our audit**

Our audit will be performed with regard to the guidance contained in '*Audit 05/03: Reporting to Regulators of Regulated Entities*' issued by the Institute of Chartered Accountants in England & Wales.

Our audit will be conducted in accordance with Statements of Auditing Standards issued by the Auditing Practices Board except that, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we will not evaluate the overall adequacy of the presentation of the

information, which would have been required if we were to express an audit opinion under Auditing Standards. Our audit will include such tests of transactions and of the existence, ownership and valuation of assets and liabilities as we consider necessary. We shall obtain an understanding of the accounting and internal financial control systems to the extent necessary in order to assess their adequacy as a basis for the preparation of the Regulatory Financial Statements and to establish whether appropriate accounting records have been maintained by the Company.

We shall expect to obtain such appropriate evidence as we consider sufficient to enable us to draw reasonable conclusions therefrom. The nature and extent of our procedures will vary according to our assessment of the Company's accounting system and, where we wish to place reliance on it, the internal financial control system and may cover any aspect of the business operations.

The Regulatory Financial Statements are prepared by disaggregating balances recorded in the general ledgers and other accounting records of the company maintained in accordance with the Companies Act 2006 and used, in accordance with that Act, for the preparation of the company's statutory financial statements.

Our audit includes assessing the compliance with the RAG of significant estimates and judgements made by the Directors in the preparation of the Regulatory Financial Statements and whether the accounting policies are in compliance with the RAG, appropriate to the Company's circumstances, consistently applied, and adequately disclosed.

Our audit will involve us obtaining evidence about all the information and explanations (including the amounts and disclosures) in each financial statement and information in question sufficient to provide reasonable assurance that it, taken as a whole, has been prepared, in all material respects, in accordance with the detailed requirements prescribed by the RAG.

We will read the Other Information contained within the Regulatory Financial Statements, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the Regulatory Financial Statements. We will not perform any audit procedures nor provide any other assurance on the Other Information.

We will plan our work to gain reasonable assurance that the specific Regulatory Financial Statements are free from material error, whether caused by fraud or other mis-statement.

The concept of materiality affects our audit planning and our consideration of matters arising from our audit. We take into account both qualitative and quantitative factors when assessing materiality.

The Services are separate from our audit work on the statutory financial statements of the Company which is carried out in accordance with our statutory obligations under the Companies Act 2006. Our audit report on those statutory financial statements is intended for the sole benefit of the Company's shareholders as a group, to whom it is addressed, and not for any other purpose. Our audits of the Company's statutory financial statements are not planned or conducted in contemplation of the requirements of anyone other than such shareholders and, consequently, our audit work is not intended to address or reflect matters in which anyone other than such shareholders may be interested.

We do not and will not, by virtue of this report or otherwise in connection with this engagement, assume any responsibility whether in contract, tort (including negligence) or otherwise in relation to our audits of the Company's statutory financial statements required by the Companies Act 2006; we and our employees shall have no liability whether in contract, tort (including negligence) or otherwise to any parties other than the Company and its members in relation to our audits of the Company's statutory financial statements.

The nature and format of the Regulatory Financial Statements are determined by the requirements of OFCOM. It is not appropriate for us to assess, and accordingly we will not make any assessment on, whether the nature of the information being reported upon is suitable or appropriate for OFCOM's purpose, whether or not OFCOM signs the written notice in the form appended. It is a matter for OFCOM to consider whether the information being reported upon is appropriate for its own purposes

and we will not give any implicit or explicit affirmation that the information being reported upon is suitable for OFCOM's purpose.

### **Meetings with OFCOM**

We are willing to attend meetings with OFCOM to discuss the Services, if requested to do so, provided that we can agree appropriate terms on which such meetings are held. For the avoidance of doubt appropriate terms will include meeting only on a tri-partite basis in the absence of specific consent of the Company allowing us to meet with the OFCOM.

### **Management representations**

The information used by the Directors in preparing the Regulatory Financial Statements will invariably include facts or judgements which are not themselves recorded in the accounting records. As part of our normal audit procedures, we shall request appropriate directors or senior officials/management of the Company to provide written confirmation each year of such facts or judgements and any other oral representations which we have received during the course of the audit on matters having a material effect on the Regulatory Financial Statements. We will also ask the Directors to confirm in that letter that all important and relevant information has been brought to our attention.

### **Detection of fraud, error and non-compliance with laws and regulations**

The responsibility for safeguarding the assets of the Company and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with the Directors. However, we shall endeavour to plan our audit so that we have a reasonable expectation of detecting material mis-statements in the Regulatory Financial Statements or accounting records (including any material mis-statements resulting from fraud, error or non-compliance with law or regulations), but our examination should not be relied upon to disclose all such material mis-statements or frauds, errors or instances of non-compliance as may exist.

### **Timetable**

We will agree a timetable with you, which will enable you to meet your obligations in relation to the filing of regulatory financial statements, and any other deadline notified to us. As you will appreciate, however, any such timetable will be based on the assumption that we will receive the appropriate co-operation and assistance.

### **Additional services**

This letter deals with our responsibility in respect of regulation, under the USPAC. A separate engagement letter covers our responsibilities as statutory auditors to the group.

### **Fees**

We will agree our 2012-13 Regulation audit fees with the Audit and Risk Committee of Royal Mail Group Ltd.

### **Other requirements**

In order to assist us with the examination of the Regulatory Financial Statements, we shall request early sight of all documents or statements which are due to be issued with those Regulatory Financial Statements.

Once we have issued our report we have no further direct responsibility in relation to the Regulatory Financial Statements for that financial year.

### **Preparation of Regulatory Financial Statements**

Assistance with the preparation of Regulatory Financial Statements does not form a part of the audit function, but we shall discuss the Company's accounting principles with the management and/or the Directors and we may propose adjusting entries for their consideration.

### **Other services**

We shall not be treated as having notice, for the purposes of our regulatory audit responsibilities, of information provided to members of our firm other than those engaged on the audit (for example information provided in connection with accounting, taxation and other services).

### **Fiduciary responsibilities**

Because our audit work under the terms of this engagement is directed at forming an opinion on the Company's Regulatory Financial Statements our audit procedures will not normally extend to assets or documents of title in respect of assets that are in the Company's possession but owned by others.

**Terms and conditions**

The attached Terms and Conditions set out the duties of all parties in respect of the Services. The Terms and Conditions amongst other things:

- a) limit our liability to a maximum aggregate amount of £2m. Where OFCOM accepts in writing a notice in the form appended (and on that basis we accept duties and responsibilities to OFCOM), this limitation shall be allocated between the Company and OFCOM. In such circumstances such allocation will be entirely a matter for the Company and OFCOM, who shall be under no obligation to inform Ernst & Young LLP of it, provided always that if (for whatever reason) no such allocation is agreed, neither the Company nor OFCOM shall dispute the validity, enforceability or operation of the limit of liability on the grounds that no such allocation was agreed; and
- b) limit the period within which a claim may be brought.

Ernst & Young LLP alone will be responsible for the performance of the engagement contract formed by this letter. You therefore agree that you will not bring any claim in respect of or in connection with this engagement whether in contract, tort (including negligence), breach of statutory duty or otherwise against any partner or employee of Ernst & Young LLP. The foregoing exclusion does not apply to any liability that cannot be excluded under the laws of England and Wales.

We appreciate the opportunity to be of assistance to the Company. If this Contract accurately reflects the terms on which the Company has agreed to engage us, please sign below on behalf of the Company and the companies detailed on the attached schedule and return it to me.

Yours faithfully.

Kathryn Barrow  
for and on behalf of Ernst & Young LLP

Agreed and accepted for and on behalf of Royal Mail Group Ltd

By: \_\_\_\_\_

Matthew Lester

\_\_\_\_\_

Date

---

Chief Financial Officer

---

Date

Attachments

1. Copy letter
2. General Terms and Conditions for Audit and Review Engagements

## **General Terms and Conditions for Audit and Review engagements**

### ***Our relationship with you***

- 1 We are a member of the global network of Ernst & Young firms (Ernst & Young Firms), each of which is a separate legal entity.
- 2 We may subcontract portions of the Services to other Ernst & Young Firms, who may deal with you directly. Nevertheless, we alone will be responsible to you for the Reports, the performance of the Services, and our other obligations under this Agreement.

### ***Your responsibilities***

- 3 You shall be responsible for your personnel's compliance with your obligations under this Agreement.

### ***Our reports***

- 4 You may not rely on any draft Report.

### ***Limitations***

- 5 You agree that our total liability in respect of any loss shall be limited to the lower of the figures produced by the operation of Sections 6 and 7.
- 6 Our liability to you in respect of breach of contract or breach of duty or fault or negligence or otherwise whatsoever arising out of or in connection with this Agreement and the Services shall be limited in total to £2 million (or, if greater, the total amount of the fees charged by us to you under this Agreement) to cover claims of any sort whatsoever (excluding interest and costs) arising out of or in connection with this Agreement and the Services.

Where there is more than one party to this Agreement (other than us), the limit of liability will have to be allocated among you. It is agreed that, save where an allocation is expressly agreed between you and stated in the Engagement Letter, the limit of liability will be allocated such that you will each have an equal share of it. You shall not dispute the validity, enforceability or operation of the limit of liability on the ground that no allocation was expressly stated in the Engagement Letter.

- 7 If we are liable to you (or to any others for whom Services are provided) under this Agreement or otherwise relating to the Services, for loss or damage to which any other persons have also contributed, our liability to you shall be several, and not joint, with such others, and shall be limited to our fair share of that total loss or damage, based on our contribution to the loss and damage relative to the others' contributions. No exclusion or limitation on the liability of other responsible persons imposed or agreed at any time shall affect any assessment of our proportionate liability hereunder, nor shall settlement of or difficulty enforcing any claim, or the death, dissolution or insolvency of any such other responsible persons or their ceasing to be liable for the loss or damage or any portion thereof, affect any such assessment.
- 8 You shall make any claim relating to the Services or otherwise under this Agreement no later than 3 years after the act or omission alleged to have given rise to the claim
- 9 The limitations in Sections 5 to 8 will not apply to any liability (including vicarious liability) for death or personal injury or arising as a result of fraud on our part nor to any liability which cannot lawfully be excluded or limited.
- 10 You may not make a claim or bring proceedings relating to the Services or otherwise under this Agreement against any other Ernst & Young Firm or our or its subcontractors, members, shareholders, directors, officers, partners, principals or employees (Ernst & Young Persons). You shall make any claim or bring proceedings only against us.

### **Indemnity**

- 11 We disclaim all responsibility for any consequence whatsoever should any third party rely on any Report unless Ernst & Young has given its prior written consent. To the fullest extent permitted by applicable law and professional regulations, you shall indemnify us, the other Ernst & Young Firms and the Ernst & Young Persons against all claims by third parties (including your affiliates) and resulting liabilities, losses, damages, costs and expenses (including reasonable external and internal legal costs) arising out of or relating to the Services or this Agreement. On behalf of yourself and your affiliates, you release us, the other Ernst & Young Firms and the Ernst & Young Persons from all claims and causes of action (together, 'Claims'), pending or threatened, that you or they may have arising out of the Services or this Agreement to the extent such Claims result from or arise out of any misrepresentation or fraudulent act or omission by you, your employees or agents on your behalf. The limitations in Sections 5 to 11 are intended to benefit the other Ernst & Young Firms and all Ernst & Young Persons, who shall be entitled to enforce them.

### **Confidentiality**

- 12 Except as otherwise permitted by this Agreement, neither of us may disclose to third parties the contents of this Agreement or any information provided by or on behalf of the other that ought reasonably to be treated as confidential and/or proprietary (to include reports, letters, information and advice that we provide to you, other than our Audit Report). Either of us may, however, disclose such information to the extent that it must be disclosed under applicable law, legal process or professional regulations. You agree that if you receive any request under the Freedom of Information Act 2000 (where you are subject to it) for disclosure of information provided by us, you will promptly notify us of such request prior to any disclosure.

If circumstances arise such that we disclose information to the Serious Organised Crime Agency (SOCA), due to the restrictions imposed by law we may be prevented from discussing such matters with you or from proceeding with the Services pending consent from SOCA. If this arises we shall have no liability to you as a result of any suspension or termination of the Services.

We shall not be treated as having notice of information which may have been provided to Ernst & Young Firms or Ernst & Young Persons (as defined in Section 10) who are not involved in this engagement.

- 13 Either of us may use electronic media to correspond or transmit information and such use will not in itself constitute a breach of any confidentiality obligations.
- 14 Unless prohibited by applicable law, we may disclose Client Information to other Ernst & Young Firms and Ernst & Young Persons to facilitate performance of the Services, to comply with regulatory requirements, to check conflicts, or for quality, risk management or financial accounting purposes.
- 15 You agree that, if a regulatory or governmental authority responsible for auditor oversight asks or orders us to produce information or documents in our files relating to your affairs, including our working papers or other work product, we may provide these materials to it. Except where prohibited by law, we will advise you of the request or order.
- 16 You shall cause all of your foreign subsidiaries and affiliates included in your consolidated financial statements to provide any authorization, to the fullest extent permissible under applicable law, to permit compliance with requests from regulatory or governmental authorities for production of documents or information in a foreign public accounting firm's, associated person's or our possession, custody and control that was obtained in the conduct of the Services by such firm or person.

### **Data protection**

- 17 We may collect, use, transfer, store or otherwise process (collectively, 'Process') Client Information that can be linked to specific individuals (Personal Data). We may Process Personal Data in various jurisdictions in which we and the other Ernst & Young Firms operate (which are listed at [www.ey.com](http://www.ey.com)). We will Process the Personal Data in accordance with applicable law and

professional regulations including (without limitation) the Data Protection Act 1998. We will require any service provider that Processes Personal Data on our behalf to adhere to such requirements.

- 18 You warrant that you have the authority to provide the Personal Data to us in connection with the performance of the Services and that the Personal Data provided to us has been processed in accordance with applicable law.

***Solicitation and hiring of Ernst & Young personnel***

- 19 Our auditor independence may be impaired if you solicit or hire certain Ernst & Young personnel. This may either delay the provision of the Services or cause us to resign from the engagement. You shall not, during the term of this Agreement and for 12 months following its termination, for any reason, without our prior written consent, solicit to employ or nominate for a position on your Board of Directors or a financial reporting oversight role, or hire or appoint to your Board of Directors or a financial reporting oversight role, any professional employee of Ernst & Young or of any other Ernst & Young Firm who is or has been involved directly or indirectly with the performance of the Services for the current or prior financial year. A person in a financial reporting oversight role exercises, or is in a position to exercise, influence over the financial statements and anyone who prepares the financial statements.

***Fees and expenses generally***

- 20 Royal Mail Group Ltd will pay our professional fees and specific expenses in connection with the Services as detailed in the Engagement Letter. You shall also reimburse us for other reasonable expenses incurred in performing the Services. Our fees are exclusive of taxes or similar charges, as well as customs, duties or tariffs imposed in respect of the Services, all of which you shall pay (other than taxes imposed on our income generally).
- 21 If we are required by applicable law, legal process or government action to produce information or personnel as witnesses with respect to the Services or this Agreement, you shall reimburse us for any professional time and expenses (including reasonable external and internal legal costs) incurred to respond to the request, unless we are a party to the proceeding or the subject of the investigation.

***Force majeure***

- 22 Neither you nor we shall be liable for breach of this Agreement (other than payment obligations) caused by circumstances beyond your or our reasonable control.

***Term and termination***

- 23 This Agreement applies to all Services performed at any time (including before the date of this Agreement).
- 24 Either party may terminate our appointment as auditor in accordance with the provisions of the Companies Act 2006 or, if these provisions are not applicable, we may terminate this Agreement, or any particular Services, immediately upon written notice to you.
- 25 You shall pay us for all work-in-progress, Services already performed, and expenses incurred by us up to and including the effective date of the termination of this Agreement. Payment is due within 30 days following receipt of our invoice for these amounts.

***Governing law and dispute resolution***

- 26 This Agreement, and any non-contractual obligations arising out of this Agreement or the Services, shall be governed by, and construed in accordance with, the laws of England and Wales.
- 27 If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our

Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

Any dispute relating to this Agreement or the Services shall be subject to the exclusive jurisdiction of the English courts, to which each of us agrees to submit for these purposes.

**Miscellaneous**

- 28 This Agreement constitutes the entire agreement between us as to the Services and the other matters it covers, and supersedes all prior agreements, understandings and representations with respect thereto, including any confidentiality agreements previously delivered.
- 29 Both of us may execute this Agreement (and modifications to it) by electronic means and each of us may sign a different copy of the same document. Both of us must agree in writing to modify this Agreement.
- 30 You represent that the person signing this Agreement on your behalf is expressly authorized to execute it and to bind you and any of your affiliates or others for whom Services are performed to its terms.
- 31 We retain ownership in the working papers compiled in connection with the Services.
- 32 Neither of us may assign any of our rights, obligations or claims under this Agreement.
- 33 If any provision of this Agreement (in whole or part) is held to be illegal, invalid or otherwise unenforceable, the other provisions shall remain in full force and effect.
- 34 If there is any inconsistency between provisions in different parts of this Agreement, those parts shall have precedence as follows (unless expressly agreed otherwise): (a) the Engagement Letter, (b) these General Terms and Conditions and (c) other annexes to this Agreement.
- 35 We may use your name publicly to identify you as a client, but we may refer to you in connection with the Services only if it is a matter of public knowledge that we are providing them (or have provided them).

Ofcom  
Riverside House  
2a Southwark Bridge Road  
London  
SE1 9HA

**Regulator's Notice: Audit of the regulatory financial statements of Royal Mail Group Ltd ("the Company") for the year ended 31 March 2013**

Dear Sirs,

We refer to our engagement letter with the Company dated "XXX" relating to our appointment as auditors for the purposes of the Company complying with its obligations to secure an appropriate audit opinion by a 'Qualified Independent Auditor' under USPAC 1.3.4, 1.4.4, 1.5.5 and 1.6.4 in respect of the specific Regulatory Financial Statements for the year ended 31 March 2013 to which those refer, as well as the information to which those obligations refer for the year ended 31 March 2013 on the basis directed by OFCOM from time to time, and a statement by a 'Qualified Independent Auditor' under USPAC 1.6.4 as to whether or not the Company has complied with the requirements set out in USPAC 1.6.3 with regard to the Costing Manual for the Reported Business for the year ended 31 March 2013. A copy of the engagement letter is attached as Appendix 1 to this letter.

In the Engagement Letter we set out the basis on which we will act as auditors reporting on the Regulatory Financial Statements of the Company, together with the respective areas of responsibility of the directors of the Company and ourselves in respect of that audit and the scope of our audit. We also set out in the Terms and Conditions the agreed extent of our liability to the Company in respect of our work. We confirm in the Engagement Letter that we will address our report on the Regulatory Financial Statements to the Company and, in order to meet the requirements of the USPAC, to you as well but we clarify that in our report we will deny liability in respect of our audit work and our report to any party except (a) the Company; and (b) if OFCOM has agreed to the Regulator's Notice by signing this written notice, OFCOM.

You have confirmed your interest in our audit of the Regulatory Financial Statements in your capacity as the Company's Regulator and your interest in the scope of our engagement agreed with the Company. You have asked us to accept responsibility for our audit work and our report to you as well as to the Company so that there is no denial of responsibility to you in our report. This letter ("the Regulator's Notice") sets out the basis on which we are willing to accept such a responsibility, in return for your agreement to the terms of this letter including the following:

1. Our duties and responsibilities to you and your obligations to us will be those set out in the Engagement Letter as if incorporated into this letter. This sets out, amongst other things, terms relating to the disclosure of the Regulatory Financial Statements and other Regulatory Information covered by the Independent Accountants' Report.
2. Our aggregate liability to you will be strictly limited to £2m in the event of any breach of our obligations to you under the Regulator's Notice.
3. You do not wish to acquire rights against us in respect of use of the audit report for any purposes other than as the Company's Regulator and accept the disclaimer of liability to any Third Party (being a person other than the Company or the Regulator) as set out in the Engagement Letter.
4. You accept that the nature and format of the Regulatory Financial Statements are determined by your requirements and that it will be for you to consider whether the information on which we report as auditors is suitable or appropriate for your needs and purposes.
5. You will not be bound by any amendment to the Engagement Letter, whether written, oral or arising from the Engagement Letter, which is not formally accepted by you in writing.

Please acknowledge your acceptance of the terms and conditions of this letter by signing the confirmation below and returning a copy of it and the Engagement Letter to us at the above address.

Royal Mail's regulatory reporting audit

Kathryn Barrow  
for and on behalf of Ernst & Young LLP

I have read the above letter and confirm acceptance of its terms and conditions on behalf of OFCOM

Signed  
Name and position  
Cc: Matthew Lester, Royal Mail Group Ltd  
Enclosure: Copy of the Engagement Letter.