The 100 Group

Investor Relations and Markets Committee

Joanna Osborne
FRC's Financial Reporting Review Panel
8th Floor
125 London Wall
London
EC2Y 5AS

07 November 2016

Dear Joanna

Follow up to the meeting between the 100 Group and the FRRP

Thank you for meeting with me and Russ Houlden from the 100 Group on 8th April 2016, where we continued the dialogue around ways of working together with the overall aim of advancing the FRC's clear and concise reporting initiative.

In that meeting we agreed to field test a discussion between the FRRP and a company's Board on the principles to consider when forming a conclusion on a disclosure judgement (a "principles discussion"). The objective of the field test was to see if such a discussion is resource intensive for the FRRP and if the judgements always results to a decision on materiality.

The IR&M committee and Royal Mail have been preparing for a principles discussion and before we progress this to the next step we wanted to share with you the results of the preparation work.

Alongside their auditors, Royal Mail management recalibrated their loans and derivatives disclosure through a clear and concise reporting lens. Management documented their thinking and decisions which they presented alongside a proposed pro forma disclosure (please see appendix A). We are pleased with the results and the process that management went through and welcome your thoughts on the revised disclosure.

After considering the above, we no longer think a principles discussion with the FRRP is required. However, if you would like to continue with the principles discussion field test I am more than happy to arrange this with you.

In our view, by being challenged to really consider the disclosure ahead of a principles discussion with the FRRP, management and the auditors delivered a clear and concise disclosure.

In the past we have discussed the importance of the three way relationship between 100 Group members, the Big Four, and the FRC. We think all three stakeholders need to embrace the learnings from the above exercise.

- 100 Group > to take the time to consider disclosures through a clear and concise reporting lens. Doing this as preparation for a principles discussion with the FRRP is a great incentive.
- Big Four > to not rely on the mantra that more disclosure is better. Working with companies on the clear and concise reporting initiative should be embedded in their 'fair, balance and understanding' statement.
- FRRP > to not solely focus on instances of missing or under disclosure in communications with companies. To challenge companies on whether a disclosure is clear and concise and provide a support mechanism such as principles discussion.

We share the 100 Group FR committee’s view that, in general, the disclosures relating to pensions and financial instruments would benefit the most from clear and concise reporting.

We are committed to working with you and the Lab on driving the clear and concise reporting initiative.

Please feel free to contact me if you wish to discuss the views contained within this letter.

Yours sincerely

Matthew Lester

Chairman, The 100 Group: Investor Relations and Markets Committee
c/o Royal Mail Group
100 Victoria Embankment
London, EC4Y 0HQ

21. Financial assets and liabilities risk management

In considering the financial assets and liabilities of the Group, Management use judgement to assess the materiality to users of the financial statements, at a Group level, of each of the disclosure areas highlighted in IFRS 7 'Financial instruments: Disclosures'. This assessment is based on both the magnitude and nature of the financial instruments involved and informs the level of disclosure of the risk management objectives and policies in place across the Group provided in this note.

The following table summarises the disclosures:

Disclosure requirement
a) Classification, carrying amount and fair values of financial assets and liabilities – Carrying amounts and fair value of each category of financial assets and liabilties.
b) Foreign currency risk management – How Management address the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.
c) Commodity price risk management - How Management address the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices.
d) Interest rate risk management - How Management address the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.
e) Liquidity risk management - How Management address the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.
f) Credit risk management - How Management address the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.
g) Sensitivity analysis –How the income statement and balance sheet would have been affected by changes in commodity prices and exchange rates in the reporting year.

a) Classification, carrying amount and fair value of financial assets and liabilities

The following table shows the classification, carrying amount and fair value of the Group's financial assets and liabilities.

	Level	Classification	At 26 March 2017 Carrying Amount £m	At 26 March 2017 Fair Value £m	At 27 March 2016 Carrying Amount £m	At 27 March 2016 Fair Value £m
Financial assets						
Cash			xx	xx	198	198
Cash equivalent investments			xx	xx	170	170
Money market funds		Loans and receivables	xx	xx	120	120
Short-term deposits – bank		Loans and receivables	xx	xx	50	50
Cash and cash equivalents			xx	xx	368	368
Financial assets – investments (current) – bank deposits		Loans and receivables	xx	xx	-	-
Financial assets – pension escrow investments (non-current) – RMSEPP pension escrow – money market funds		Loans and receivables	xx	xx	20	20
Derivative assets – current	2		xx	xx	5	5
Derivative assets – non-current	2		xx	xx	2	2
Total financial assets			xx	xx	395	395
Financial liabilities						
Obligations under finance leases (current)		Amortised cost	xx	xx	(84)	(84)
€500 million bond		Amortised cost	xx	xx	(392)	(424)
Obligations under finance leases (non-current)		Amortised cost	xx	xx	(136)	(138)
Derivative liabilities – current	2		xx	xx	(33)	(33)
Derivative liabilities – non-current	2		xx	xx	(8)	(8)

	Level	Classification	At 26 March 2017 Carrying Amount £m	At 26 March 2017 Fair Value £m	At 27 March 2016 Carrying Amount £m	At 27 March 2016 Fair Value £m
Total financial liabilities			xx	xx	(653)	(687)
Net total financial liabilities			xx	xx	(258)	(292)

The ‘Level’ classification in the table is explained in the ‘Fair value measurement of financial instruments’ section of ‘Significant accounting policies’.

The main purposes of these financial instruments are to raise finance and manage the liquidity needs of the business’ operations. The Group has various other financial instruments such as trade receivables and trade payables, which arise directly from operations and are not considered further in this note.

No speculative trading in financial instruments has been undertaken during the current or comparative reporting years, in line with Group policy.

21. Financial assets and liabilities risk management (continued)

b) Foreign currency risk

Foreign currency transaction risk
UKPIL is exposed to foreign currency risk due to interest payments on the €500 million bond, certain obligations under Euro denominated finance leases, trading with overseas postal administrations and various purchase contracts denominated in foreign currency. GLS’ functional currency is the Euro and it also has some exposure to non-Euro currencies, principally in emerging European markets.

Where possible, exposures are netted internally and any remaining exposure is hedged using a combination of external spot and forward purchase and sale contracts. Hedging will not normally be considered for exposures of less than £1 million and hedging is normally confined to 80 per cent of the forecast exposure, where forecast cash flows are highly probable.

The following table shows for each hedge programme, the risk and the percentage hedged of the next 12 months’ exposure:

		Percentage of next 12 months’ exposure that has been hedged	
Hedge programme	**Risk**	At 26 March 2017	At 27 March 2016
Air conveyance	US$/£ exchange rate movements	xx	n/a
Capital programmes	€/£ exchange rate movements	xx	100%
Overseas postal administrations	SDR/£ exchange rate movements	xx	69%

The next 12 months’ exposure is calculated as the combination of the cost of settling liabilities during the next 12 months and the cost of revaluing unsettled liabilities at the end of 12 months.

Foreign currency translational risk
The Group’s functional currency is Sterling. GLS Euro profits are converted at the average exchange rate for the year, which can result in reported growth or decline that does not relate to underlying performance. GLS’ balance sheet is converted at year end exchange rates, and movements related to foreign currency translation are taken to equity.

The €500 million bond issued in July 2014 acts as a hedge of part of the translation exposure created by the net assets of GLS. Royal Mail also entered into €xx million of Euro denominated finance leases during the year (2015-16 €37 million) which similarly act as a hedge of the net assets of GLS. The remaining net assets of GLS in excess of the bond and lease payables are not hedged. Foreign currency exchange differences arising from the translation of the net assets of GLS, the €500 million bond and the Euro denominated finance lease payables, at closing Sterling/Euro exchange rates, are deferred into equity. These exchange differences would be released from equity to the income statement as part of the gain or loss if GLS was sold. During the year foreign currency exchange losses on the bond of £xx million (2015-16 £26 million) and foreign exchange losses on the lease payables of £xx million (2015-16 £2 million) were deferred into equity. There was no hedge ineffectiveness in the current or prior reporting years.

The net total financial liabilities are held in various different currencies as summarised in the table below. The majority of the non-Sterling financial assets and liabilities (other than the €500 million bond and certain finance leases) are held within cash or derivatives.

	Sterling £m	US$ £m	Euro £m	Other £m	Total £m
Net total financial assets/(liabilities) at 26 March 2017	xx	xx	xx	xx	xx
Net total financial (liabilities)/assets at 27 March 2016	13	(10)	(290)	29	(258)

c) Commodity price risk

UKPIL is exposed to fuel price risk arising from operating one of the largest vehicle fleets in Europe - which consumes over 130 million litres of fuel per year - and a jet fuel price risk arising from the purchasing of air freight services. The Group’s fuel risk management strategy aims to reduce uncertainty created by the movements in the oil and foreign currency markets. The strategy uses forward commodity price swaps in US Dollar or Sterling and forward currency purchase contracts to manage these exposures.

In addition, the Group is exposed to the commodity price risk of purchasing electricity and gas. The Group’s risk management strategy aims to reduce uncertainty created by the movements in the electricity and gas markets. These exposures are managed by locking into fixed price contracts with suppliers and using forward commodity price swaps in Sterling.

As the GLS business relies on the use of subcontractors, responsible for purchasing their own fuel, GLS has no direct exposure to diesel costs. The only other significant commodity exposure within GLS is electricity, which is fragmented across its European bases. In view of the other highly hedged positions, the Group takes the view that the unhedged exposure arising from the commodities in GLS does not add significant risk to the Group.

21. Financial assets and liabilities risk management (continued)

d) Interest rate risk

The Group's policy is to manage its net interest expense using an appropriate mix of fixed and floating rate financial instruments, combined with external hedging of interest rate risk, as appropriate, to keep a high percentage of its gross debt fixed. At 26 March 2017 there was [no] external hedge of interest rate risk (2015-16 none). Interest on financial instruments classified as floating rate is re-priced at intervals of less than one year. Interest on financial instruments classified as fixed rate is fixed until the maturity of the instrument.

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

	At 26 March 2017					
	Average effective interest rate %	Within 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m	Total £m
Fixed rate						
Financial liabilities						
€500 million bond	xx	xx	xx	xx	xx	xx
Obligations under finance leases	xx	xx	xx	xx	xx	xx
Total		xx	xx	xx	xx	xx
Floating rate						
Cash at bank	xx	xx	xx	xx	xx	xx
Cash equivalent investments – money market funds	xx	xx	xx	xx	xx	xx
Cash equivalent investments – bank deposits	xx	xx	xx	xx	xx	xx
Financial assets – pension escrow investments (non-current)						
RMSEPP pension escrow – money market funds	xx	xx	xx	xx	xx	xx
Total		xx	xx	xx	xx	xx
Non-interest bearing						
Cash at bank or in hand		xx	xx	xx	xx	xx
Derivative assets		xx	xx	xx	xx	xx
Derivative liabilities		xx	xx	xx	xx	xx
Total		xx	xx	xx	xx	xx
Total financial assets		xx	xx	xx	xx	xx
Total financial liabilities		xx	xx	xx	xx	xx
Net total financial assets/(liabilities)		xx	xx	xx	xx	xx

	At 27 March 2016					
	Average effective interest rate %	Within 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m	Total £m
Fixed rate:						
Financial liabilities:						
€500 million bond	2.5	-	-	-	(392)	(392)
Obligations under finance leases	3.3	(84)	(52)	(71)	(13)	(220)
Total		(84)	(52)	(71)	(405)	(612)
Floating rate:						
Cash at bank	0.3	77	-	-	-	77
Cash equivalent investments – money market funds	0.6	120	-	-	-	120
Cash equivalent investments – bank deposits	0.6	50	-	-	-	50
Financial assets – pension escrow investments (non-current):						
RMSEPP pension escrow – money market funds	0.5	-	-	20	-	20
Total		247	-	20	-	267
Non-interest bearing						
Cash at bank or in hand		121	-	-	-	121
Derivative assets		5	2	-	-	7
Derivative liabilities		(33)	(8)	-	-	(41)
Total		93	(6)	-	-	87
Total financial assets		373	2	20	-	395

	At 27 March 2016				
Total financial liabilities	(117)	(60)	(71)	(405)	(653)
Net total financial assets/(liabilities)	256	(58)	(51)	(405)	(258)

Drawings under the syndicated bank loan facilities are at floating rate. There were [no] balances outstanding at 26 March 2017 (£nil at 27 March 2016). The total interest-bearing financial assets of the Group (excluding the non-current investments) of £xx million (2015-16 £247 million), which consist of the fixed and floating rate cash and cash equivalent investments, plus current financial asset investments, are at short-dated fixed or variable interest rates with an average maturity of xx days (2015-16 an average maturity of 6 days). These short-dated financial instruments are maturity- managed to obtain the best value out of the interest yield curve.

21. Financial assets and liabilities risk management (continued)

Obligations under finance leases are either unsecured or secured on the leased assets. The average interest rate is xx.x per cent (2015-16 3.3 per cent). The average maturity date is xxxx (2015-16 more than five years).

The pension escrow investment represents a money market fund investment established to provide security to the Royal Mail Senior Executives Pension Plan (RMSEPP), in support of a deficit recovery plan agreed with the Trustee in June 2013. The next scheduled review point in the agreement is 30 September 2018 and the investment is therefore disclosed as maturing in two to five years.

e) Liquidity risk

The Group’s primary objective is to ensure that the Group has sufficient funds available to meet its financial obligations as they fall due. This is achieved by aligning short-term investments and borrowing facilities with forecast cash flows. Borrowing facilities are regularly reviewed to ensure continuity of funding. The unused facilities for the Group of £xx million expire in xxxx (2015-16 £1,050 million expiring in 2020-2021).

Below is a summary of the gross (undiscounted) contractual cash flows of the Group’s financial liabilities. The cash flows for the €500 million bond and Euro denominated finance leases represent the undiscounted total amounts payable (interest and nominal repayment) which have been converted to Sterling at 26 March 2017 market forward exchange rates. For derivatives that are settled gross, these cash flows represent the undiscounted gross payment due and do not reflect the accompanying inflow. For derivatives that are settled net, these cash flows represent the undiscounted forecast outflow.

	At 26 March 2017					
	Gross loans and borrowings commitments £m	Gross finance lease instalments £m	Sub-total £m	Gross payments on derivatives settled gross £m	Gross payments on derivatives settled net £m	Total £m
Amounts falling due in:						
One year or less or on demand (current)	xx	xx	xx	xx	xx	xx
More than one year (non-current)	xx	xx	xx	xx	xx	xx
More than one year but not more than two years	xx	xx	xx	xx	xx	xx
More than two years but not more than five years	xx	xx	xx	xx	xx	xx
More than five years	xx	xx	xx	xx	xx	xx
Total	xx	xx	xx	xx	xx	xx
Less interest	xx	xx	xx	n/a	n/a	n/a
Less exchange rate adjustment	xx	xx	xx	n/a	n/a	n/a
Net total	xx	xx	xx	n/a	n/a	n/a

	At 27 March 2016					
	Gross loans and borrowings commitments £m	Gross finance lease instalments £m	Sub-total £m	Gross payments on derivatives settled gross £m	Gross payments on derivatives settled net £m	Total £m
Amounts falling due in:						
One year or less or on demand (current)	9	87	96	8	33	137

			At 27 March 2016			
More than one year (non-current)	521	242	763	1	8	772
More than one year but not more than two years	9	56	65	1	8	74
More than two years but not more than five years	29	78	107	-	-	107
More than five years	483	108	591	-	-	591
Total	530	329	859	9	41	909
Less interest	(89)	(108)	(197)	n/a	n/a	n/a
Less exchange rate adjustment	(49)	(1)	(50)	n/a	n/a	n/a
Net total	392	220	612	n/a	n/a	n/a

f) Credit risk

The level of credit granted to customers is based on a customer's risk profile, assessed by an independent credit referencing agent. The credit policy is applied rigidly within the regulated products area to ensure that UKPIL is not in breach of compliance legislation. Assessment of credit for non-regulated products is based on commercial factors, which are commensurate with the Group's appetite for risk. An analysis of aged debt is included within Note xx.

The Group's exposure to credit risk from other financial assets arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments. At 26 March 2017 xx per cent of financial assets (2015-16 97 per cent) were held with AA or above rated counterparties.

GLS operates a decentralised credit management model whereby each country is responsible for managing the credit risk associated with its customers. Where appropriate, external credit checks are performed for new and existing customers, taking into account the customer profile, expected volume of business and consequent risk to the respective GLS companies.

None of the financial assets is either past due or considered to be impaired.

21. Financial assets and liabilities risk management (continued)

g) Sensitivity analysis

As a result of the mix of fixed and variable rate financial instruments and the currency and commodity hedge programmes in place, the Group has no material exposure to profit risk from interest rate risk, exchange rate risk or commodity price risk (2015-16 £nil million risk). The Group has an exposure to the exchange rate risk on translating the GLS net assets into Sterling on consolidation and an offsetting exposure on translating the €500 million bond and Euro denominated finance leases into Sterling at each balance sheet date. The impact of a five per cent strengthening of Sterling during the reporting year would have been to reduce the Group net assets by £xx million (2015-16 £5 million).