Royal Mail Holdings plc

Report and Accounts
Year Ended 26 March 2006

Royal Mail Group is unique in reaching everyone in the UK through its mails, Post Office® and parcels businesses – which directly employ almost 193,000 people in the UK.

Every working day Royal Mail collects, processes and delivers around 84 million items to 27 million addresses for prices that are amongst the lowest in Europe; each week we serve nearly 28 million customers through our network of 14,376 Post Office® branches and each year our domestic and European parcels businesses – General Logistics Systems and Parcelforce Worldwide – deliver some 337 million parcels.

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Chairman's Statement

A record year for service to customers – but major challenges ahead

Royal Mail has delivered a year of record high quality of service to its customers. Financial performance has also been outstanding, especially in the face of competition, with an operating profit of £355 million – an increase of 17.5% compared with last year – on record revenues of more than £9 billion.

Parcelforce Worldwide has made a full-year profit for the first time ever and Post Office Limited has performed strongly to cut its losses in a year that finally saw the end of pension and benefit books. General Logistics Systems (GLS), Royal Mail's European parcels business, made a record profit and grew its revenues in a market where competition has intensified strongly.

Our determination to share success with our people and reward them for excellent performance has been underlined with a £418 Share in Success payment to people across the company, including, for the first time, subpostmasters who are the backbone of our retailing network. The reward, which will be paid this month, amounts to a pay out of nearly £100 million and follows last year's payment of £1,074 to our people for successful delivery of the three-year Renewal Plan. Yet it doesn't seem that long ago when many doubted the company, which was losing well over £1 million a day in 2002, would again be profitable or capable of hitting customer service targets.

We still have a mountain to climb. But last year showed that Royal Mail Group and its people have consolidated the gains we made during the Renewal Plan. There was always a danger that we could have slipped back, that hard-won gains would have crumbled – but we've sustained our turnaround and must continue to do so. That's a big achievement in itself.

Crucially, we need to embark swiftly on the modernisation of Royal Mail. This is the key challenge the whole organisation is facing. It's an even more daunting task than the Renewal Plan we accomplished and it will test us all.

Putting in new technology and replacing obsolete equipment, in time and to budget; further streamlining our operations and bringing our people with us at all times; increasing the focus on customers so that we deliver even better service in a market where rivals are after our business – all this will be incredibly stretching. It will mean a great deal of hard work.

Meanwhile, we have to keep pumping cash into our pension fund – perhaps as much as £750 million a year – in order to fund our pension commitments to employees and clear a deficit that has now reached £5.6 billion. To put the deficit into stark perspective, it outstrips the Group's pre deficit net asset value of £2.3 billion by £3.3 billion. We have to find the money to clear the deficit. It's a challenge that every one of us in the company can't ignore.

And as hard as anything we do, the task of restructuring the Post Office network must be tackled to deal with chronic losses on operations of some £2 million a week. It means creating a sustainable future for the rural service, where the majority of the 7,854 branches are fundamentally loss-making and have needed every penny of the £150 million of funding made available by the Government to stay open. We await a decision on future funding from the Government but it's down to us to give the 500 directly managed branches in high streets and shopping malls - currently losing £50 million a year – a much stronger financial base, as well as making the busiest urban branches – directly managed or privately owned – much more attractive to visit by our customers.

It's all going to be very tough. But it's encouraging that the building blocks we need are beginning to slot into place. A vital part of our plans was securing, after lengthy negotiations with Postcomm, a price control that allows significant investment in the business and gives us the ability to increase the cash payments into our pension fund whose deficit now totals £5.6 billion.

We have made tremendous progress in discussions with the Government – Royal Mail Group's shareholder – on our investment case for the future. We put a commercial plan to the Government which we are confident will enhance the value of the organisation for the shareholder. It is not a Government subsidy but a clear investable case for our shareholder and I'm pleased to say that we have reached agreement in principle with Government on this investment case as a whole. There remains, inevitably, a huge amount of detail to be worked through over the coming weeks, including ensuring we get the right incentive scheme in place for our people. We know taking our people with us is central to our plans. We believe giving them a stake in the company would be a huge incentive for our people to achieve the efficiency gains essential if we are to compete successfully to retain and win customers in the face of tough competition and importantly we know this is something they want and would respond to. This commercially focused investment from our shareholder will give us an opportunity to modernise and transform a business which is vital to the success of UK plc.

We can't take anything for granted. The mail market opened to full competition and bulk mailers, already active, have in the last 12 months handled more than one billion letters under access agreements with Royal Mail. Our postmen and postwomen are still delivering this mail but we've lost revenue as it is transported directly into our mail centres. We face the prospect of access volumes climbing to three billion items per annum within the next two years, which would amount to around one in seven of the letters we currently handle.

We need to be more efficient. In the letters business, we need a £2 billion investment programme with financing both from the Government and revenues we generate from turnover to replace ageing and obsolete equipment and put in place new technology giving us the efficiencies, capabilities and a more flexible cost base in order to compete successfully and provide the service our customers need.

Chairman's Statement (continued)

The Post Office network also needs investment to give it a sustainable future. We are seeing new revenues from the range of new products introduced in the last couple of years in the network – the most recent have been the Instant Saver account and a credit card – but we have also lost annual revenues worth £327 million as a result of the loss of traditional benefits payments. The Post Office Card Account, used by 4.2 million pensioners and benefit recipients, will be phased out by 2010, and the future of the rural network and the level of future financing available post 2008 lie in Government hands. We continue to discuss with our shareholder the best way to secure Post Office services going forward. Balancing the need to run the network as efficiently as possible while meeting the social need fulfilled by branches in communities nationwide is a difficult challenge but it is one we are embracing.

The UK parcels market has become even more competitive in the last year. But the hard work the business and its people have put into restructuring its operations and the focus on delivering high quality service to its 21,000 business customers has paid off with the first full year of profitability. Parcelforce Worldwide will have to continue to work hard to ensure it stays profitable in a market that gets tougher every year.

The star performer in the Group in terms of profitability is GLS which saw a 37% increase in profits to £100 million on revenues which grew strongly to more than £1 billion. It's an outstanding example of the achievements which flow from a dedicated focus on customers and efficiency.

In fact, it's what the whole of Royal Mail is seeking to do. Our number one priority remains to deliver consistent, excellent quality of service to our customers. Underpinning that is an unceasing drive to run all our operations as efficiently as possible - and making the right investments in our operations will be crucial to achieving higher productivity. The key to everything we do is our people. We believe that to give them a real stake in the business will be a powerful incentive for increasing yet further their commitment and dedication. We have made tremendous progress and have reached agreement in principle with the Government on the investment case to achieve all this. The investment case will give us the means to build a successful future. Then it will be down to everyone in Royal Mail to climb that mountain.

Allan Leighton

Chairman

17 May 2006

The prior year figures quoted have been restated for the impact of the transition to International Financial Reporting Standards. All references to operating profit are before exceptional items.

Chief Executive's Statement

A solid base to launch transformation

Royal Mail Group's outstanding performance last year shows we now have the solid base needed to launch the transformation of the company.

There is a long way to go from the base camp we have consolidated and it will be essential to bring our people with us, all the way. It is going to be a very tough challenge, more difficult than anything we have achieved so far. But we know we are capable of success. The task for us now is to get on with the enormous changes needed to ensure we compete successfully in markets where there are already many competitors. It is going to require a huge commitment from all of us.

Competition and the threat it poses are now part of daily life across Royal Mail. We delivered record customer service last year but we have to do better. A total focus on our customers, consistently delivering to them the service they expect and pulling out all the stops to be flexible and responsive to their needs and concerns, must become ingrained into everyone's daily life if we are to compete successfully. We will develop our products and services and create new ones to benefit our customers. But we remain a people company and we will only ever be as good as the performance and commitment we all give.

It's right, then, to praise our people for the record performance they have delivered in 2005-06. Over the last year, 94.1% of First Class letters arrived the day after posting, a record performance well ahead of anything we've previously achieved and just over a full percentage point above the 93.0% target. Second Class mail was ahead of target too with a 98.8% performance and the large bulk of business mail services also hit or exceeded their targets. It's a world-class performance by our people and they can take pride in what they have achieved. I am proud of them.

It was also an outstanding financial performance with the £355 million operating profit – up 17.5% compared to last year - triggering a £418 Share in Success payment to our people. They have shown a real commitment to ensuring the operational changes we made in the three-year Renewal Plan are now firmly embedded. And they understand, that with competition growing, we cannot afford to slip back.

All four of Royal Mail Group's businesses improved their financial performance last year. In Letters, there was a decline in inland addressed mail with the impact exacerbated by some bulk mail customers switching to lower-priced services. The impact of these adverse effects was offset by a below-inflation price rise and the business made a £344 million operating profit, a £1 million improvement on last year. This performance masks the losses Royal Mail continues to make in fulfilling its Universal Service "one-price goes anywhere" Obligation as we continue to lose money on First and Second Class stamped letters.

With competition intensifying and clear signs that the letters market may well decline further, the need for Royal Mail to drive efficiency changes is unmistakable. Improving efficiency in a declining market is much tougher than making productivity gains in a growing one. A key challenge we face is to make rapid progress by investing in new technology and modernising the way we work.

We remain determined to give a high priority to ensuring the integrity of the mail. We have introduced this year new management processes, inclusion of mail integrity onto our performance management scorecards, an accountable director and revised and updated policies. Last year was the first full year that we applied the vetting powers, which Royal Mail sought and was granted, to check if applicants were attempting to conceal any past criminal convictions. It has armed us with an additional layer of security. We have also reduced the number of casual employees to around 500 - in marked contrast to the almost 20,000 employed in the autumn of 2004 and have deployed a new quarterly audit of the security of the mail in all our mail centres and delivery offices. Our policy remains - zero tolerance to any form of wrongdoing.

Post Office Ltd made an operating loss of £111 million but this was a £12 million improvement on the previous year and represented a real achievement as it showed solid progress in the business's drive to replace lost revenue from pension and benefit book payments with growing income from alternative products such as travel, car and home insurance, HomePhone, foreign currency, a credit card and loans and savings products. But losses of some £2 million a week are unsustainable long-term in the Post Office network. Restructuring is essential and we continue to discuss with Government the best ways of creating a stable, sustainable network; we are hopeful these discussions will come to fruition this autumn.

Parcelforce Worldwide's £5 million operating profit – the first full year operating profit the business has ever made – is the result of a long haul involving a focus on business customers, exiting from loss-making contracts and cutting costs, while all the time focusing on delivering quality service by well-motivated people. It's a fantastic achievement but we are in no way complacent as maintaining profitability in an intensely competitive market is a further tough challenge faced by the business.

General Logistics Systems (GLS) 37% improvement in operating profit to £100 million with a 9.6% margin on revenue which grew strongly by 13.6% is another fantastic performance by a company widely recognised as an outstanding competitor in the European parcels market. It is now established as a significant contributor to the Group's profits but we know it can improve its performance further and this is the challenge it faces.

The Group's overall operating profit of £355 million was a fine achievement but it should also be noted that while the margin on our revenue was a creditable 3.9%, it is well below the returns some of our biggest rivals in mail are achieving.

Chief Executive's Statement (continued)

The building blocks for Royal Mail Group's modernisation are beginning to fall into place. We have made enormous progress in securing the funds we need to modernise this business, service the pension fund deficit which needs around £750 million of cash every year and restructure the Post Office network which loses around £100 million a year. We have reached an agreement in principle with the Government on our overall investment case and have secured a price control agreement with Postcomm. Together, these would allow us to modernise the business while making increased payments to the pension fund under a funding plan that satisfies the independent pension fund trustees. We are also having a constructive dialogue with the Government on restructuring the Post Office network, against a backdrop of Government business across our counters declining to less than 10% of overall business in our branches in three years' time.

The years ahead will be harder than anything we've been through before. Every area of our business – letters, parcels and the services we provide in Post Office branches – is under increasing competitive pressure. The days when the company could rely on customers beating a path to our door have gone forever.

That's why it's so important that Royal Mail Group has secured the agreement in principle of our shareholder to our investment plan. We will be working to agree the details over coming weeks, including putting the right incentive in place to reward our people for future success. We believe that a stake in Royal Mail Group – an equal stake for everyone – will motivate our people and help deliver the transformation we need. Our people are fundamental to our modernisation plans and we have stressed their role in the commercial investment plan we have submitted the shareholder.

I am also very determined that we make further improvements to benefit them. I want everyone to enjoy working for the company and that means ensuring they are motivated, they have the right working environment, the tools to do the job and they are treated properly at all times. Securing the means to tackle the pension deficit is also fundamental to our strategy and it remains a key action point for us. Rewards, benefits and a real stake in future success are crucial – but they all have to be earned. It's not going to be easy.

But our vision remains – to be demonstrably the best and most trusted mail company in the world. The challenges are huge but last year we did indeed take another major step towards realising our goal.

Adam Crozier

Chief Executive

17 May 2006

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Annual Review 2005-06

Over the past year, the postal market in the UK changed forever – since 1 January 2006, Royal Mail has been facing full competition. Our future success now depends on competing effectively in a market where customers have real choice.

Competition changes everything but we cannot afford to lose the momentum we built up over our three-year Renewal Plan and have sustained over the last year. Improving service to customers has continued to be the number one priority of everyone in the Company during 2005-06. Quality of service performance for both First Class and Second Class mail has been above target levels for over a year - with 94.1% of First Class mail arriving the day after posting. Providing a consistent high quality service to customers and giving them value-for-money will continue to be the top priorities in the current year as these are key to keeping customers, and winning new ones, in a competitive marketplace.

Royal Mail values every letter and takes the security of the mail extremely seriously. The vast majority of our people are scrupulously honest and trustworthy, and over 99.93% of our annual mailbag of 22 billion items arrives safely at the correct destination.

Our people – our greatest asset

Royal Mail's people are our greatest asset and we are committed to making the Royal Mail a great place to work. Engaging and involving our people is the key to this and that is why we want them to have a stake in the Company. We hold regular Worktime Listening and Learning sessions to hear and discuss how we are tackling the challenges we face and the direction in which the Company is moving as well as raising issues of concern to our people.

We have improved basic pay for postmen and postwomen to over £310 per week and in March 2006 we agreed a ground-breaking productivity scheme with the Communication Workers Union which will set the scene for higher basic pay. The scheme means that pay will improve as efficiency improves, giving postmen and postwomen, for the first time, a chance to influence the size of their pay packet. In addition we have implemented a 2.9% increase in their basic pensionable pay.

We continued to tackle bullying and harassment over the past 12 months. By June 2005, we achieved our target of completing diversity training of 175,000 people in just over 18 months. This was the largest undertaking of its kind by a UK employer. Our efforts in working to create an inclusive culture throughout the Company where everyone feels valued and respected were recognised in July 2005 when Royal Mail was awarded the Centrica Diversity Award in the Business in the Community National Awards for Excellence. Royal Mail also won a bronze award from Race for Opportunity in recognition of its efforts to support and fully harness the talents of the diverse mix of people we employ and to ensure equal opportunities for everyone in the business.

We continue to tackle absenteeism across the business, with improved support for people who are off sick and rewarding those people who do not take any unplanned sick leave. Following the success of our initiatives last year, including a prize draw to recognise good attendance, we saw a significant increase in the number of people at work on any one-day. We intend to run a similar scheme going forward to raise attendance levels further.

We also recognise our people who go that bit further in the course of their jobs by inviting customers to nominate Royal Mail postmen and postwomen who are the unsung heroes in their local community. These individuals could be '1st Class' charity fundraisers in their spare time, have performed a public-spirited act or dealt with an emergency whilst out delivering or collecting the mail. They could also simply be someone who has shown a resounding dedication to delivering a great service to customers. The 2005-06 overall winner was Helen MacKenzie from Scotland, who helped save the life of a man whose arm became trapped in machinery.

Supporting good causes

Royal Mail's people have a long history of giving their time and fundraising for good causes and in March 2005 Help the Hospices was chosen as the organisation's first ever major supported charity, following a Company-wide poll. As part of a two-year partnership with the national charity of the UK hospice movement, Royal Mail has pledged to match money raised by its people, up to a limit of £250,000. With the help of its people, Royal Mail hopes to raise £1m overall for Help the Hospices over the course of the partnership.

Fundraising initiatives have so far included the sale of Christmas angel decorations through larger Post Office® branches, and the publication of 'Unseen UK', a unique collection of photographs taken by postmen and postwomen around the country. The images range from the everyday to the bizarre – from buildings, letterboxes and landscapes to wildlife and people, and of course dogs. Proceeds from the sale of the book are going to Help the Hospices.

Every site across the business has been twinned with a nearby hospice so Royal Mail people are involved directly in their local communities through their fundraising activities and volunteering. A network of community co-ordinators have been appointed across the business to make it as easy as possible for our people to get involved as they want, whether working on a regular or a one-off basis with their local hospice.

Additional funds are being raised for the hospice movement through Royal Mail's award-winning payroll giving scheme – the largest of its kind in the UK. Over the past 15 years, Royal Mail's postmen and postwomen have donated more than £27.5m to a wide range of charities through regular payroll giving.

Annual Review (continued)

New opportunities through online shopping

Online shopping has continued to grow over the past 12 months, and Royal Mail continues to provide a range of services to support the home shopping market, from warehousing and direct marketing expertise to delivery to all 27 million addresses across the UK and return services. At Christmas, Royal Mail delivered around 2 billion items to customers in the run-up to 25 December, including a record breaking 70 million items that had been ordered over the internet – 15 million more than the previous year.

The growing popularity of online shopping has seen retailers review their use of catalogues as a sales tool. A Royal Mail survey of 20 leading retailers conducted last year revealed that catalogues are increasingly being used for generating online orders as well as traditional sales. Nearly two thirds of the retailers surveyed sent catalogues or brochures to drive online sales – double the number of five years ago.

Stamp celebrations

Royal Mail's stamps have celebrated a wide range of occasions over the past 12 months. The wedding of HRH Prince Charles and Mrs Camilla Parker Bowles in April was commemorated by the issue of a miniature sheet capturing two images of the couple in a relaxed and informal mood. This proved a popular souvenir of the event, with record numbers of stamps sold on a Saturday, the day of the wedding.

Sporting triumphs were also celebrated on stamps during the year. London's successful bid to host the greatest sporting event in the world in 2012, the Olympics, was marked by a set of stamps capturing images of athletes in motion.

The England cricket team's victory in the Ashes competition was marked by the issue of four stamps featuring images of the squad. This was the first time that living people other than the Royal Family had appeared so prominently on a set of Royal Mail special stamps.

Royal Mail teamed up with the United States Postal Service to launch a set of stamps featuring classic characters from timeless children's illustrated stories. These included Paddington Bear, the Enormous Crocodile and the Very Hungry Caterpillar, which, true to its character, took two 'bites' out of the stamp on which it appeared – the first time Royal Mail has issued a stamp with holes in it.

Young letter writers

Royal Mail's young letter writers competition has attracted over 5 million entries since it began 29 years ago – the biggest letter-writing competition of its kind in the UK. Primary school children throughout the UK are invited to enter the competition, and this year children were invited to write a First Class letter to anyone, anywhere. The judging panel includes literacy and education specialists who have the hard task of picking the winner.

Post Office Limited – a challenging future

The 14,400-strong network of Post Office® branches continued to grow the range of products and services it offers to the 28 million weekly customers, as well as through sales via the Post Office® website and telephone orders, as the amount of Government business undertaken through the Post Office® has declined. We have also undertaken a programme of sales training for our people to give them the skills to sell more of our products.

The Post Office®, in response to a request from the Department of Trade and Industry, has tested a range of innovative ways – other than the traditional village branch office – of providing Post Office® services in rural areas. These have included partnerships with local service providers such as the police, mobile services as well as 'hub and spoke' arrangements where a subpostmaster running a branch in a larger village provides Post Office® services in smaller communities in premises such as a pub or village hall.

Over the last year, the Post Office® has extended its financial services products with the launch of a new instant saver account as well as its 'two in one' credit card. The unique feature of the card is a loan-like facility, offering customers the flexibility to make larger purchases at a discounted fixed rate of interest, together with a competitive rate of interest for regular purchases. This builds on our success in other financial services – last year we handled 14 million foreign currency transactions, making us the UK's number one provider of foreign exchange services. We are also the largest independent provider of travel insurance, with annual sales totalling more than one million policies.

Since November, Nationwide 'Flexaccount' personal current account customers have been able to withdraw their cash and check their balances at any Post Office® branch free of charge. This is part of our continued commitment to work closely with banks and building societies to increase accessibility to their services through our branches. More than one million customers a day currently withdraw cash through the Post Office® network. The Post Office® now provides current account banking services to 10 UK banks – with over 22 million current account holders able to access their cash, free of charge, at a Post Office® branch. Our vision is to be able to offer free access to cash for all current account holders.

Post Office® customers can now buy gift vouchers for a wide range of high street retailers through a partnership with The Gift Voucher Shop. The vouchers, which include those for 'enjoyment' and 'experience' days, can be purchased from any Post Office® branch or ordered over the telephone and the internet. This makes it easy for customers to find and send a gift they can be sure their family and friends will really want.

Annual Review (continued)

The Post Office® entered the home telephony market in January 2005 with its HomePhone service. Twelve months after launch, the fixed-line residential service had signed up over 260,000 live customers and is currently signing up more than 4,000 customers a day. Building on this presence in the telecoms market, the Post Office® launched a directory enquiries service in January 2006 – with call costs cheaper than the two largest rival numbers in the market based on a one-minute call from most UK landlines.

Parcels – in the UK and around the world

In the parcels market, Parcelforce Worldwide has continued to establish itself as a key player in the competitive, non-regulated express parcels delivery service. It delivers some 45 million parcels a year, to customers in 239 countries and territories across the world. Achieving a full year operating profit - £5 million - for the first time was a fantastic achievement by the business.

Parcelforce Worldwide is the UK partner of General Logistics Systems (GLS), our European parcels business. GLS handles over 1 million parcels a day through its network of nearly 700 depots and central transhipment points. Its core operation is business-to-business parcels deliveries and it has 220,000 customers in 34 states across Europe. GLS's 37% improvement in operating profit was another fantastic performance, underlining the business's reputation as one of the most admired parcel companies in Europe.

Operating and Financial Review

Introduction

Royal Mail Holdings plc (the Parent) is a public limited company wholly owned by the UK Government. It became a plc on 26 March 2001. The framework for change was the Postal Services Act 2000 that created a commercially focused company with a more strategic relationship with the Government. The Postal Services Act also established a new regulatory regime with an independent Regulator, Postcomm, and a reformed consumer body, Postwatch. Royal Mail Holdings plc together with its subsidiaries, associates and joint ventures comprise 'the Group'.

The Group has over 370 years experience of providing the public with postal services - through our trusted brands we reach everyone every working day in mail, parcels and express services and through our Post Office® branches. Our market place is, however, rapidly changing: Government revenue, such as benefit payments, is being lost from Post Office Limited whilst the UK mails market has been fully liberalised since January 2006, resulting in full competition.

We are providing new services to meet these challenges – from a range of new Post Office® financial services including personal loans and a 'two-in-one' credit card, to electronic 'stamps', online shopping fulfilment and mail-related data tools to help companies improve their marketing performance. Our continued aim is to put the customer at the heart of everything we do by - increasing value through excellent quality of service, our unique reach to every address in the UK, enhancing our trusted brands, becoming easier to do business with, retaining our profitable business, and developing innovative products and services for our customers.

Performance Highlights

In the following analysis, all references to operating profit are before exceptional items.

Financial highlights

Summary of results £m unless stated otherwise	2006	2005
External turnover	9,056	8,956
Operating profit*	355	302
Return on sales (%)*	3.9%	3.4%
Exceptional items:	(143)	(210)
Share in Success costs	(91)	(218)
Other	(52)	8
Profit before interest and taxation	212	92
Net finance income	100	75
Profit before taxation	312	167
Taxation credit/(charge)	83	(16)
Profit after taxation	395	151

*before exceptional items.

Key non-financial highlights

Area	Key Performance Indicators	2006	2005
Customer service	1st Class Stamp & Meter	94.1%	92.8%
	No. of Complaints (millions)	1.63	1.94
	Post Office Limited Customer Service Index	94%	94%
Great Place to Work	Employee Survey "Great Place to Work"	64%	62%
	RIDDOR Accidents/1000 staff	26.7	28.6
	Sick Absence	4.9%	5.6%
Good corporate citizen	CO2 Emissions/1000 items	19.9	21.8
	Donations (£m)	1.3	1.9

Governance

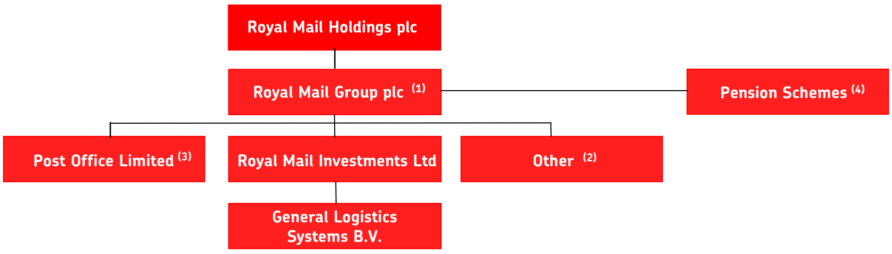
The EU Accounts Modernisation Directive (AMD) requires a mandatory addition to the existing Directors' Report to provide an enhanced review of a company's business for accounting years beginning from 1 April 2005. The Directive states that the review should provide a balanced and comprehensive analysis of the development, performance and position of the Company's business. The analysis should include both financial and, where appropriate, non-financial key performance indicators (KPIs) relevant to the particular business. It is recognised that to the extent that this information appears in the Operating and Financial Review (OFR), it does not need to be discussed in the Directors' Report.

Although our reporting dates mean that the Group does not have to comply with the Directive until 2007, in line with our commitment to comply with best practice and achieve the highest standards of Corporate Governance, the Group has moved towards full compliance with the new requirement early via an enhancement of the OFR. The report provides a 'snapshot' of the Company at a moment in time addressing the requirements of the EU AMD, including the principal risks and uncertainties facing the organisation.

Operating and Financial Review (continued)

Legal Structure

Royal Mail Holdings plc is directly owned by the Department of Trade and Industry and is the ultimate parent company. It primarily operates within the United Kingdom, having a number of subsidiaries and participating in several joint ventures, but also has presence in most European countries, mainly through its General Logistics Systems business unit. It is organised into four principal operating units – Royal Mail, Post Office Limited, General Logistics Systems and Parcelforce Worldwide. Its basic legal structure is as follows:



[1] Comprising Royal Mail and Parcelforce Worldwide
[2] Other includes Royal Mail Pension Trustees Limited (100% owned), Romec Limited (51% owned), NDC 2000 Limited (51% owned), Quadrant Catering Limited (51% owned), Camelot Group plc (20% owned) and Camelot International Services Limited (20% owned) plus other non-trading central businesses
[3] Owns Midasgrange Limited (50% owned venture with Bank of Ireland) and First Rate Travel Holdings Limited (50% owned)
[4] Royal Mail Group plc is the sponsoring employer for the Royal Mail Pension Plan, the Royal Mail Senior Executive pension Plan and the Royal Mail Retirement Savings Plan.

Our Operating Units

Royal Mail

Royal Mail collects and delivers over 84 million letters and packages to 27 million addresses every working day, in line with its unique Universal Service Obligation. It is also responsible for designing and producing the UK's stamps and philatelic products.

Post Office Limited

The Post Office®'s national network of branches is at the heart of communities across the country. They provide a trusted access point for everyday products, services and information in: postal services, financial services, travel, banking, telephony, bill payments, Government information, retail and the secure transportation of cash.

General Logistics Systems B.V. (GLS)

GLS is a pan-European company providing reliable, high-quality parcel and express services as well as value-added logistics solutions.

Parcelforce Worldwide

Parcelforce Worldwide is a leading provider of collection and delivery services for urgent packages and parcels within the UK and throughout the world, providing both business and private addresses with a range of timed delivery options.

Other

Other Group businesses comprise Postcap (Guernsey), our captive insurer (100% owned), Royal Mail Pension Trustees, our pension administrators (100% owned), Romec, our facilities management operation (51% subsidiary), NDC, our building engineering services operation (51% subsidiary), Quadrant, our catering services (51% associate), and Camelot UK national lottery operator (20% associate).

Our pension schemes

Royal Mail Group plc's pension assets and liabilities are materially larger than its other operating assets and it is one of the most exposed UK corporates to pension scheme volatility, particularly with respect to movements in equity values and bond rates.

Royal Mail Group plc is the sponsoring employer for the Royal Mail Pension Plan, the Royal Mail Senior Executive Pension Plan and the Royal Mail Retirement Savings Plan. These plans together constitute the sixth largest pension scheme in the UK. The key facts and figures include:

- 170,000 active members; 105,000 deferred; 174,000 retired;
- Accounting deficit under IAS19 'Employee benefits' of £5.6bn;
- Assets of £21.8bn – comprising equities £17.2bn, bonds £2.7bn, property £1.8bn, other £0.1bn and liabilities of £27.4bn;
- Pensionable payroll of £2.7bn; and
- Key accounting assumptions:
  - Discount rate 4.9%
  - Inflation 2.8%
  - Salary increases 3.8%
  - Overall expected return on assets 7.1%
  - Increase in pensions 2.8%

Operating and Financial Review (continued)

Operating Unit facts and figures

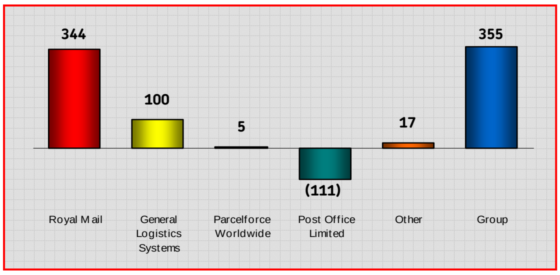
Unit and % of Group external revenue	No. of employees	Region	Revenue (£m) Profit (£m)* Margin (%)	Facts and Figures	Vision
Royal Mail 75.7% of Group external revenue	174,202	UK	Revenue £6,859m Profit £344m Margin 5.0%	• 113,000 pillar boxes • 70 Mail Centres • 1,400 delivery offices • Over 30,000 vehicles • 33,000 bicycles • Over 84 million items handled every day • Deliver to 27 million addresses a day • 1st Class Quality of Service – 94.1% • 2nd Class Quality of Service – 98.8%	...to be 'demonstrably the best and most trusted postal services company in the world'
Post Office 9.3% of Group external revenue	11,327	UK	Revenue £838m Loss (£111m) Margin (13.2%)	• Handle equivalent of 17p in every £1 transacted in the UK through the Post Office network • 14,376 branches, of which 6,522 urban branches (including 495 directly managed) and 7,854 rural branches • Approx 61,000 customer facing colleagues - including those employed by Post Office Ltd, by subpostmasters and/or by franchisees • 3.7bn transactions a year • Nearly 28 million customers a week, making over 45 million visits a week • UK's leading supplier of foreign currency • Customer Satisfaction Index – 93.9%	...to 'sell products and services that are important to our customers simply and at a profit' backed up by a business approach of being 'community minded and profit driven, and putting customers at the heart of the business'
GLS General Logistics Systems 11.5% of Group external revenue	11,045	Europe	Revenue £1,037m Profit £100m Margin 9.6%	• 29 hubs • 667 depots • 17,700 vehicles • Over 1 million parcels handled every day	...to provide 'service, flexibility, quality and reliability', with local expertise and knowledge of different cultures being integral to the end-to-end service
Parcelforce Worldwide 3.5% of Group external revenue	4,092	UK	Revenue £314m Profit £5m Margin 1.6%	• 2 national hubs • 48 depots • 1,600 vehicles • 160,000 parcels delivered every day, 250,000 every day in December • Parcelforce 24 Quality of Service – 96.1%, delivered on time and with electronic proof of delivery	To be the UK's most trusted worldwide carrier
Other	3,348 Wholly owned 4,852 Part owned	UK	Revenue* £8m Profit £17m * For subsidiaries only	PostCap (Guernsey) – captive insurers (100% subsidiary) Royal Mail Pensions Trustees – pension administrators (100% subsidiary) Romec - facilities management operation (51% subsidiary) NDC - building engineering services operation (51% subsidiary) Quadrant - catering services (51% associate) Camelot, UK national lottery operator (20% associate).	

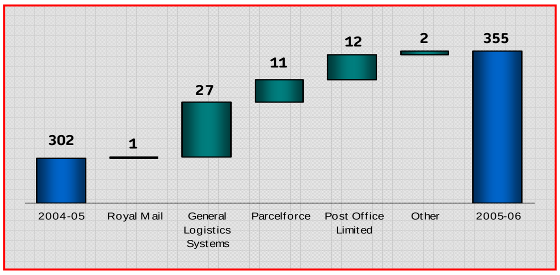
* before exceptional items

Operating and Financial Review (continued)

Group financial analysis
In the following analysis, all references to operating profit are before exceptional items.

This year we report an operating profit of £355m compared to £302m for 2004-05, an increase of £53m or 17.5% mainly driven by the performance of our unregulated parcels businesses. All operational business units contributed to this increase, with General Logistics Systems improving profitability by £27m (37.0%), Post Office Limited by £12m (9.8%), Parcelforce Worldwide by £11m (>100%) and Royal Mail Letters by £1m (0.3%).



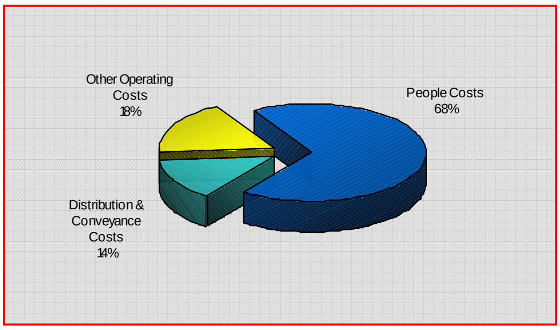


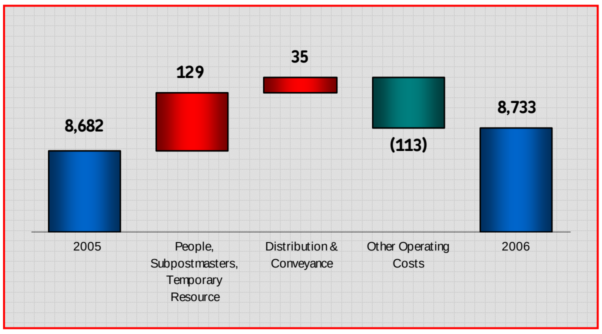
External revenue
Group external revenue increased by £100m (1.1%) from £8,956m to £9,056m driven primarily by increases in Royal Mail and GLS.

Royal Mail increased its revenue by £96m (1.4%) of which £118m arose from domestic mail price increases of 1.7%, £95m (1.4%) from non-addressed and international products, offset by underlying inland addressed mail volume decline of £50m (0.7%), a £5m (0.1%) negative mix impact and a £62m (0.9%) negative impact relating to customers switching to the cheaper Downstream Access products.

General Logistics Systems increased its revenue by £124m (13.6%) from £913m to £1,037m, mainly due to volume growth. Parcelforce Worldwide increased its revenue by £16m (5.4%) from £298m to £314m reflecting higher volumes from increases in national account products and favourable product mix. Post Office Limited reported a revenue decrease of £138m (14.1%) from £976m to £838m, primarily as a result of the expected erosion of traditional benefits volumes, partially offset by new revenues.

Costs (excluding exceptional items)
Total costs of £8,733m have increased by £51m (0.6%), which is well below inflation.





People costs of £5,968m represent 68.3% of the Group's cost base and have increased year-on-year by £129m (2.2%). This is partly due to pay increasing for the majority of our frontline people from 1st April 2005 of 3.8% being offset by decreases in overtime, contract labour and subpostmasters' costs. During December 2004, the status of Romec Limited changed from a joint venture to a subsidiary, which impacted how we accounted for Romec costs. This change had the effect of increasing people costs in the current year by around £70m compared to prior year (accounting for 54% of the £129m increase), with a corresponding reduction to non-people costs.

Distribution and conveyance costs of £1,218m, representing 13.9% of the Group's cost base, have increased by £35m (3.0%), driven mainly by increased volumes in GLS.

Other operating charges of £1,547m representing 17.7% of the Group's cost base have decreased by £113m (6.8%) due to continuing efficiency improvements in a number of areas, including central support functions and property costs.

Operating and Financial Review (continued)

Pensions

Pension charges within operating profit	2006 £m	2005 £m
Operating Profit before exceptionals	529	489
Exceptionals (relating to redundancy)	24	22
Operating profit	553	511

The last full triennial valuation of the pension schemes as at March 2003 confirmed a substantial funding deficit due principally to changes in asset valuations, lower discount rates, a fall in the expected long-term investment returns and increased life expectancy of employees and pensioners. The IAS 19 deficit has increased this year from a liability of £3,958m in 2005 to £5,588m. The increase in the deficit of £1,630m during the year mainly relates to an actuarial loss of £1,659m, which principally arose from the lower discount rate assumption and revised mortality assumptions. Full pension disclosures are made in note 14 to the accounts.

Pension cash funding: Group contributions	2006 £m	2005 £m
Regular pension contributions	343	187
Funding of pension deficit	113	138
Payments relating to redundancy	209	5
Net cash payments	665	330

Payments into our pension scheme more than doubled from £330m in 2005 to £665m in 2006, mainly driven by regular contributions increasing by £156m (83%) and redundancy related £204m. In addition, further payments of £44m relating to redundancy and £34m relating to the deficit - taking total deficit contribution to £147m - were made in the first week of 2006-07.

Share of profits in associates and joint ventures

The Group's share of profits in associates and joint ventures of £32m (2005 £28m) comprises profits of £41m (2005 £39m) from Camelot, POL's Bureau de Change joint venture (First Rate Exchange Services Limited), Quadrant our catering associate and G3 Worldwide Mail N.V. (Spring), offset by a loss of £9m (2005 loss of £11m) from Bank of Ireland's financial services venture with Post Office Limited. The losses from Post Office Financial Services were expected and are a result of sales and marketing expenditure to promote new products.

Net exceptional items (including operational exceptional items and profits/(losses) relating to business and property disposals)

Net exceptional costs of £143m (2005 £210m) comprise £91m (2005 £218m) relating to the Share in Success payments, £44m (2005 £23m) for impairment and £75m (2005 £36m) for redundancy costs, offset by profits of £67m (2005 £67m) from property and business disposals.

Net finance income

Net finance income of £100m (2005 £75m) comprises notional pension interest of £101m (2005 £59m), interest earned on investments of £48m (2005 £55m) and other interest receivable of £3m (2005 £3m), offset by interest payable on loans of £48m (2005 £36m) and other interest payable of £4m (2005 £6m). Interest earned on investments decreased by £7m due to lower average investment balances, because of the funding of POL's loss making social network, offset by higher interest rates. Interest payable increased primarily due to higher average borrowings in our Post Office® network needed to fund benefits payments. The notional pension finance income has increased by £42m due to higher returns on pension scheme assets more than offsetting interest cost on higher pension scheme liabilities.

Taxation

The taxation credit of £83m (reported rate -27%) comprises £25m current tax payable on overseas profits; a £7m deferred tax credit with respect to overseas operations; a UK current tax charge of £11m and a UK deferred tax credit of £112m. Last year a charge of £16m was recorded comprising £8m current tax charge with respect to UK operations; a £12m current tax charge on overseas profits; a £19m UK deferred tax charge and a £23m overseas deferred tax credit. The negative reported rate is mainly due to the increased amount of deferred tax asset recognised.

Operating and Financial Review (continued)

Cash flow and capital expenditure

The Group made significant payments with respect to costs recorded in 2004-05, the last year of the Renewal Plan, of £486m, mainly Share in Success £218m, and pension top-ups £208m. The adjacent table is a summary of the Group cash flow statement.

Summary of cash flows	2006 £m	2005 £m
Cash utilised in operations	(10)	(220)
Dividends from JVs and associates	30	19
Capital expenditure and disposals	(170)	(132)
Tax, interest and other	4	23
Business acquisitions and disposals	(17)	(2)
Movements in borrowing	(16)	287
Net cash outflow	(179)	(25)
Add back:		
Share in Success relating to prior year	218	-
Other exceptionals relating to prior year	268	243
In year cash flow	307	218

Cash utilised in operations is £10m (2005 £220m), which comprises:

- Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) inflows of £497m (2005 £422m);
- Working capital inflows of £17m (2005 £387m outflow);
- Share in Success payments of £218m relating to last year's Renewal Plan; and
- Other payments relating to exceptional items of £306m (2005 £255m), including pension top ups of £209m (2005 £5m) and further rationalisation costs of £97m (2005 £250m).

Dividends received from joint ventures and associates of £30m (2005 £19m) are mainly from First Rate Travel Services Limited £17m (2005 £10m), Quadrant, £4m (2005 £2m) and Camelot, £7m (2005 £5m).

Capital expenditure net of disposals of £170m (2005 £132m) comprises £243m (2005 £227m) of expenditure, including motor vehicles of £56m, further payments with respect to the International Mail Centre near Heathrow of £36m, £42m for GLS projects, and £76m for property and equipment improvements with the remaining £33m on software and other intangibles, offset by inflows of £73m (2005 £95m), mainly from surplus property disposals. Tax, interest and other inflows in the year of £4m (2005 £23m) comprise net interest inflows of £1m (2005 £10m), tax recovered of £4m (2005 £13m) offset by the net purchase of other financial assets of £1m (2005 £nil). The net £17m outflow from business acquisitions and disposals (2005 outflow of £2m), relates to deferred consideration payments of £22m and £1m payment on the acquisition of the remainder of GLS Stafetten A/S, offset by inflows from the sale of RM Netherlands of £2m and receipts of £4m in respect to the outsourcing of IT operations to the Prism Alliance.

Provisions

Provisions at the end of March 2006 were £111m (March 2005 £172m). The decrease of £61m comprises cash spend of £99m, and transfers to short-term pension creditors of £48m, offset by £86m of new provisions relating to rationalisation and onerous property contracts.

Special reserves

During the period, £147m of the Rural Network reserve has been used by Post Office Limited, representing the financing required during the period to maintain the rural network of Post Office® branches.

Group strategy

The following supports our Operating Units' objectives:

Customers

Our customers are at the heart of everything we do. The key to winning and keeping customers is to provide a consistently high quality of service (QofS) – this has been the number one priority of everyone in the business over the past year, and it is at the heart of our strategy moving forward. That means delivering a high quality of service and mail integrity, developing products that really match the needs of our customers and provide value for money, as well as becoming easier to do business with.

People

The 'Great Place to Work' initiative, which has been established within the organisation since 2003, works on the basis that we can only move forward and succeed as a business if we involve our people in making change happen. The plan focuses on engaging and involving people in managing and improving their workplace.

Profitability and cash flow

Ensuring a sustainable and reasonable level of profitability and cashflow is key so we can reinvest in our future and eventually provide a commercial return to our stakeholder. The Group is seeking to address the historic underinvestment it has seen in its Letters business, along with continuing to develop better and more efficient ways of working. This will help to ensure we are flexible and efficient enough to succeed in a competitive marketplace.

Corporate citizenship

Corporate Social Responsibility in the Group is doing the right thing for our people, our business and the communities we operate in.

We do the right thing because our:

- customers want to buy from companies that share their values:
- colleagues want to work for companies that provide a healthy and safe environment and whose values align to theirs; and
- communities want companies that create the incomes, the jobs and contribute to the cohesion that builds the neighbourhoods where people want to live and work.

These key strategies and objectives are communicated widely across the Group, embedded into its day-to-day activities and measured on a timely basis by appropriate KPI's and monitored by the Royal Mail Holdings Board and its sub Committee. The major KPI's are highlighted below:

Customer Service	Great Place to Work	Profitability and Cash flow	Good Corporate Citizen
Customer	**People**	**Financial**	**Environmental**
QofS targets	Employee survey	Turnover	CO_2 emissions/1000 items
Number of complaints	**Health & Safety**	Operating profit*	**Social & Community**
Customer service index	RIDDOR/1000 staff	Return on sales*	Business and employee donations
	Sick absence	Operating cashflow	

* before exceptional items

Operating and Financial Review (continued)

Treasury management

The Group operates a central Treasury function that manages some £1bn of current asset investments, £866m of borrowings and £829m of cash primarily in the Post Office® network, in accordance with investment restrictions set by the Government. It also acts as internal banker for the Group's business units. The Group finances its operations largely through retained profits and borrowings.

Group Treasury derives its authority from the Royal Mail Holdings plc Board, and provides quarterly monitoring reports for their review. The Treasury function only has the authority to undertake financial transactions relating to the management of the underlying business risks and it does not engage in speculative transactions and does not operate as a profit centre. All strategies are risk averse, and the treasury policy has remained unchanged during the year. The principal financial instruments for liquidity management are deposits and short-term borrowings; and for commodity and currency hedging are spot/forward purchases, and swaps.

The Group is financed from the following facilities provided by the DTI and HM Treasury:

Borrower	Purpose	Facility end date	Facility £m	Utilised £m	Average loan maturity date
Royal Mail Group plc	Acquisition funding	2021-2025	500	500	2023
Royal Mail Group plc	Restructuring and working capital	2007-2009	844	Nil	-
Post Office Limited	Network cash repayable on demand	2010	1,150	360	2006

The terms of the Government borrowing facility and the associated Framework Agreement impose strict constraints on the separation of cash funds within the Royal Mail Group and the purposes for which they can be used.

The principal treasury risks arising from the Group's activities are currency, counterparty, commodity (fuel) and liquidity risk. These are managed as follows:

- the Group is exposed to foreign currency risk due to Royal Mail International's obligation to pay overseas postal operators for carrying UK mail abroad, revaluation of the currency balances held to operate the Bureau de Change services within Post Office Limited and various sales and purchase contracts denominated in foreign currency. Hedging programmes managed by Group Treasury mitigate these risks. Where possible, exposures are netted internally and any remaining exposure is hedged using a combination of external spot and forward contracts;
- the Group's obligation to pay overseas postal operators is denominated in Special Drawing Rights (SDRs) – a basket currency comprising of US Dollar (USD), Japanese Yen, Sterling and euro. The Group has a policy of matching receipts and payments for individual currencies where possible and then hedging any material net exposure. The policy is that up to 80% of the forecast net exposure is hedged with agreement of the internal business unit. Group Treasury operates a rolling 18-month programme, which is subsequently reviewed on a quarterly basis. There has been no external hedge in place throughout the financial year 2005-06 due to there being no material net exposure;
- Bureau de Change balances are grouped into baskets of closely correlated currencies. Each currency basket (e.g. USD or euro) is then sold forward creating a liability to match the underlying asset;
- significant foreign currency risk arising from sales and purchase contracts, primarily in USD and euro, may be hedged up to 100% depending upon the reliability of the forecast of the underlying cash flows;
- the Group does not hedge the translation exposure created by the net assets of its overseas subsidiaries;
- the Group is exposed to fuel risk arising from operating one of the largest vehicle fleets in Europe, which consumes over 150 million litres of fuel per year, and a jet fuel risk 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 operates within the parameters set by the Board, which allow the use of over-the-counter derivative products to manage these exposures; and
- counterparty risk is managed by limiting aggregate exposure to any individual counterparty based on their financial strength.

These exposures are reviewed regularly and adjusted as appropriate.

The policies for financial assets - investments and derivative financial instruments are shown in note 2.

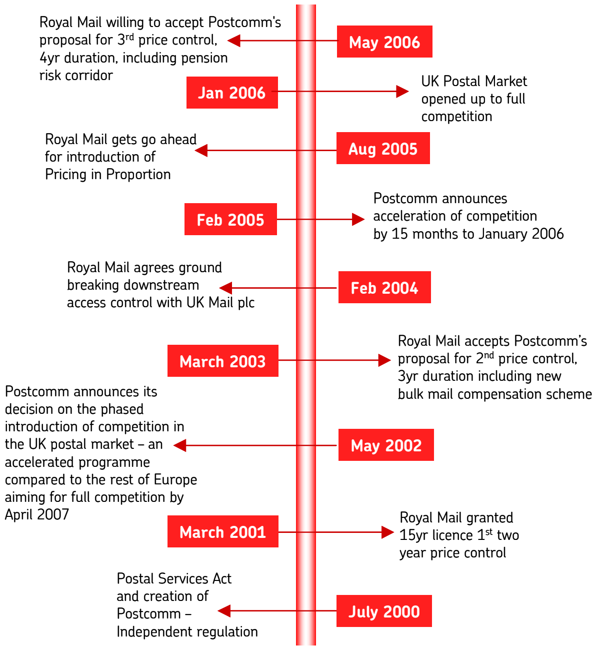
Operating and Financial Review (continued)

Business environment

Regulation

Until the last few years, Royal Mail had enjoyed a monopoly status in the UK letters industry. However, in 2000 the Postal Services Act created an independent postal Regulator – Postcomm – and allowed Royal Mail to have greater commercial freedom. Postcomm regulates the prices of nearly 90% of Royal Mail's letters business, controls the terms and conditions for nearly all its services, fixes the quality of service targets in its Licence with Royal Mail Group plc and determines compensation arrangements.

An overview of significant regulatory events since Postcomm was created is highlighted below:



Post Office Limited is increasingly subject to regulation in financial services and in telephony. Post Office Limited is an appointed representative of the Bank of Ireland, which in turn is regulated directly by the Financial Services Authority.

It is the Group's policy to be fully compliant with the regulatory framework in which we operate. During 2005-06 we have continued to strengthen our compliance activities working in close liaison with our Regulators.

Competition

All of the Group's business units now operate in a competitive marketplace.

- Parcelforce Worldwide and GLS have been operating in an open market since their inception;
- Post Office Limited, due to reduction in income from benefit payments and a significant and continuing decrease in Government use, has developed new revenue streams from financial services products (including car insurance, a 'two-in-one' credit card, a personal loan etc.), its HomePhone and directory enquiries services etc. These products are, however, in direct competition with services offered by banks, insurance and telephony companies, as are many of the services it has traditionally offered, e.g. bill payments, renewal of car tax discs, travel services etc;
- Royal Mail has faced competition via 'Downstream Access' (DSA) agreements with companies since February 2004. DSA allows competitors to collect and sort mailings of 4,000 items or more, before handing them over to us via our mail centres. Our postmen and women then deliver these items the 'final mile' and last year we delivered over 1 billion DSA items – the volume Postcomm had anticipated Royal Mail reaching within four years. Since January 2006, the UK mail market has been fully liberalised so competitors are able to offer customers the opportunity of an end-to-end service for collection, sorting and delivery of their mail. While Royal Mail has to maintain its universal service obligation, competitors have no such obligation and are therefore able to target the most profitable areas of the letters business; and
- Royal Mail's previous monopoly position has created an imbalance in prices, which do not reflect the cost of handling the mail. For Royal Mail to compete effectively in an open market, its postage prices need to reflect its costs. Rebalancing these prices will benefit some users more than others but it would stimulate innovative pricing structures giving consideration to customer base, presentation, timing and planning of postings, location of both posting and delivery, speed of posting and mechanisation of posting.

Changing markets

On top of this liberalisation, the market faces changes including:

- e-substitution – the role of mail is changing as people are increasingly using a wider number of channels for communication, including email, mobile telephone calls and texting etc. This offers an opportunity as well as a challenge to keep mail relevant to customers;
- e-fulfilment - the use of the Internet as a sales channel has and continues to increase demand for end-to-end delivery of packets and parcels at affordable prices; and
- advertising/Direct Mail – the use of mass mail advertising campaigns tends to reflect the health of the UK economy. Companies are also developing as more innovative, targeted campaigns based on greater sales intelligence and greater integration with other mediums.

While these changes present risks and challenges to Royal Mail they also present significant opportunities to work with our customers to deliver the service they need for their companies to succeed.

Macroeconomics

There are a number of macroeconomic issues that will impact the Group over 2006-07:

- Gross Domestic Product (GDP) in 2006-07 is forecast to come in below trend at 2%. These low rates of increase may impact letter traffic growth over the next 2 years;
- overall inflation is low, this will impact on both our prices, as our prices are based on an RPI-x formula, but also our costs;
- gas, electricity and oil prices are set to remain high, which will add to the Group's costs; and
- despite increasing unemployment and a poor economic outlook in certain areas of the country, full employment will continue elsewhere - leading to a challenge to contain high rates of natural turnover of our people.

Corporate Social Responsibility

Corporate Social Responsibility (CSR) is a key component in supporting the business to be recognised as a responsible organisation that seeks to optimise the beneficial impacts inherent in our business and reduce the negative impacts. Through improving our CSR performance and ensuring it is integrated into the way we work, we can make ourselves more productive and competitive, we are working to reduce the number of accidents, reduce our production of CO_2 and make our people healthier. We recognise that the route to achieving and sustaining our goals is through our people and our relationship with customers, business partners, suppliers, communities and other stakeholders.

A more comprehensive overview of our CSR will be found in the 2006 Corporate Social Responsibility report, published in September 2006.

Key Relationships

Royal Mail has several key relationships that are critical to its day-to-day activities and its overall success.

People - Our people are the lifeblood of the organisation and brands. Without their continued support and dedication it will be impossible to function on a day-to-day basis and embrace the change within our markets. Training, diversity, flexible resourcing and making the business a great place to work are some of the ways we continue to improve this relationship.

Unions – The Communications Workers Union (CWU) represents non-managerial staff, with the Communication Managers Association (CMA) representing managerial staff. The Company's policy is to work with the CWU and CMA to engage staff in the development and execution of business decisions.

Pension trustees – Our pension trustees comprise an independent body of 10 people including employees, union representatives, pensioners and independent members. They take professional advice, including from Watson Wyatt LLP (actuary) and PricewaterhouseCoopers LLP. They are responsible for full and interim valuations and agreeing with Royal Mail appropriate funding for the pension schemes. The pension trustees now face increasing regulation from the pensions regulator, which was created in the Pensions Act 2004.

Subpostmasters - The vast majority of Post Office Limited's 14,376 Post Office® branches are operated by subpostmasters and franchise partners. The National Federation of Subpostmasters (NFSP) represents subpostmasters and currently has approximately 9,300 members. Post Office Limited conducts annual remuneration negotiations with the NFSP and work closely to support a viable network. The NFSP is separately a very active body lobbying Government, regulators and consumer bodies. There are several major retailers who are also significant partners operating between them around 1,700 branches across the country. Post Office Limited liaises closely with these companies to maintain successful working relationships. It is through effective partnership with these various organisations that the business takes into account the interests of agents and seeks to support the achievement of their sales potential and longer-term network viability.

Customers – The Group's businesses and brands are used or recognised by almost everyone in the UK – from the largest of companies to individuals. However, the 30 largest customers generate almost 14% of Group turnover and consequently Royal Mail is reliant on a small customer base. As competition increases the Group will have to continue to simplify ways of doing business and design products around customers' needs. Customers are offered standard terms and conditions for the markets and countries in which the Group operate.

Suppliers – The Group has a wide range of suppliers, with its primary reliance on those relating to outsourcing of non-core services, such as IT support. It works in partnership with its suppliers to ensure the right products/services are delivered at the right time at competitive costs. A central purchasing team monitor compliance to Group policy in awarding contracts or new business and adheres to agreed credit terms.

The Regulator: Postcomm - 90% of Royal Mail letters' revenues are price-controlled and the price control is set periodically by Postcomm in the form of a cap on the average price of a basket of products. The price increases or reductions allowed by Postcomm through the price control have a very material impact on the likely levels of cash flow the company can generate. Postcomm also investigates compliance with licence conditions and has broad powers to publicly reprimand or fine the Company if it finds it in breach of those conditions.

The consumer body: Postwatch – Postwatch's role is to act as a consumer advocate in postal matters. Its public views on the effect of Royal Mail's policies and management actions on customers can have a damaging effect on Royal Mail's reputation, regardless of the quality of service achieved. This can translate into increased customer complaints.

Shareholder – The Group is a plc that is 100% owned by the Government. The Shareholder Executive (within the Department of Trade and Industry) manages the shareholder relationship with Royal Mail as a commercial shareholder. While management of the company therefore lies with the Board of Directors, the shareholder is kept up-to-date through quarterly performance reviews and is asked annually to approve the Company's business plan. Any new funding required by the company can only come from Government and can only be approved by the Shareholder Executive if it meets market economic investor principles.

Operating and Financial Review (continued)

Segmental analysis – revenue and profitability

In the following analysis, all references to operating profit are before exceptional items.

Group external revenue of £9,056m (2005 £8,956m) and operating profit before exceptionals of £355m (2005 £302m) are made up as follows:

	External revenue		Operating profit/(loss)	
Business unit performance	2006 £m	2005 £m	2006 £m	2005 £m
Royal Mail	6,859	6,763	344	343
General Logistics Systems	1,037	913	100	73
Parcelforce Worldwide	314	298	5	(6)
Post Office Limited	838	976	(111)	(123)
Other businesses	8	6	17	15
Group	9,056	8,956	355	302

A further analysis of results, on a unit-by-unit basis, is shown below:

Royal Mail	2006 £m	2005 £m
External revenue	6,859	6,763
Operating profit before exceptionals	344	343

External revenue grew by £96m (1.4%) to £6,859m, which is primarily a result of average price increases of 1.7%, partially offset by a decline in inland addressed volumes of 0.7% including stamps, meters and Mailsort. The price increases are across most products as permitted by the price control set in 2003, which allows Royal Mail to increase its prices by RPI-1%.

Royal Mail's £1m operating profit improvement from £343m to £344m is due to a 1.4% improvement in revenue growth (but versus a 3.2% growth in the corresponding period last year). The revenue growth of £96m is mainly due to tariff increases of £118m (1.7%) arising mainly from domestic mail, £95m (1.4%) from non-addressed and international products, offset by underlying inland addressed mail volume decline of 0.7% (£50m), a £5m (0.1%) negative mix impact and a 0.9% (£62m) negative impact relating to customers switching to the cheaper Downstream Access products. There is limited scope to reduce operational costs in the short term due to our Universal Service Obligations.

General Logistics Systems	2006 £m	2005 £m
External revenue	1,037	913
Operating profit before exceptionals	100	73

External revenue rose by 124m (13.6%) from £913m to £1,037m. The growth results from strong increases in domestic core parcel volumes and the continuing expansion of the European network, including acquisitions in Poland and Italy.

Operating profit increased by £27m (37.0%), from £73m last year to £100m this year, driven by a combination of increased revenue, and a continuing focus on cost control and operational efficiency.

Parcelforce Worldwide	2006 £m	2005 £m
External revenue	314	298
Operating profit/(loss) before exceptionals	5	(6)

External turnover rose by £16m (5.4%) in difficult market conditions as Parcelforce Worldwide saw the benefits of its refocused commercial direction.

Service focus continues to be on delivering high levels of reliability and also improving customer access via the web, telephone contact, and staff training. As a result Parcelforce Worldwide continues to enjoy growth particularly in the business to consumer market. Operational efficiency improved by 16% compared to last year. Operating costs are 1.7% higher than last year but this includes absorbing 7% additional volumes. The second half of the year saw an acceleration of unit cost improvement as revisions introduced in the first half of the year began to take effect. Strong improvements in vehicle and logistics costs have in part been offset by higher fuel costs and international conveyance costs as international volumes have risen. Operating profit of £5m has improved by £11m 183% from the loss of £6m in 2005. This is the first time that Parcelforce Worldwide has generated a full year operating profit reflecting the success of the refocused direction and dedication from all of its people.

Post Office Limited	2006 £m	2005 £m
External revenue	838	976
Operating loss before exceptionals	(111)	(123)

Revenue decreased by £138m (14.1%) due to reduced traditional benefit revenue as a result of migration to direct payment and reduced revenue from motoring services, mostly due to migration by the DVLA to payment via the internet partly offset by new product initiatives such as Homephone and Post Office Financial Services, and further growth in banking revenue.

Although Post Office Limited saw substantial revenue losses it succeeded in reducing losses from £123m to £111m. The loss of the traditional benefits income of £168m (35%) was offset by attracting new revenue streams, primarily from Telephony, Banking and Financial Services activity, together with continued improvements in overall cost efficiency. The £111m loss includes the cost of maintaining the uneconomic part of the rural network. Had this activity been funded by an arm's length commercial contract with Government, Post Office Limited would have made a profit.

Other businesses	2006 £m	2005 £m
External revenue	8	6
Operating profit before exceptionals	17	15

Other Group businesses comprise Postcap (Guernsey), our captive insurer (100% owned), Royal Mail Pension Trustees, our pension administrators (100% owned), Romec, our facilities management operation (51% subsidiary), NDC, our building engineering services operation (51% subsidiary), Quadrant, our catering services (51% associate), Camelot UK national lottery operator (20% associate).

External revenue from subsidiaries has increased to £8m (2005 £6m). Operating profit is £2m higher primarily due to increased profits in Quadrant of £3m, Romec £1m, offset by decreased profits in Camelot and NDC. The results of other associates and joint ventures not held centrally are included within Post Office Limited's and Royal Mail's results.

Way forward

The Group has registered a strong profit growth in the first year post Renewal Plan whilst at the same time delivering excellent quality of service. This is also the fourth consecutive year of underlying growth in profitability, driven this year by our unregulated parcels businesses which continue to increase volumes, revenues, margin and profit; Post Office Limited reducing its losses in the face of significant volume and revenue decline; and Royal Mail managing its costs to mitigate the material loss of volumes to lower priced access products. However, this performance needs to be considered in the context that the Group still only generates a 3.9% return on sales, which is considerably below that of our competitors, and that both Royal Mail and Post office Limited continue to support significant loss making products or sectors – Royal Mail continues to make losses on stamps, whilst part of the Post Office Limited network continues to make losses.

Royal Mail has recently indicated to Postcomm that it is ready to accept Postcomm's proposals for the third price control for the next four years, but finds itself further burdened by restrictions on its ability to change its non-price terms at a time when markets are being opened and flexibility will be key. It also expects to see further volume loss to Downstream Access over and above the 1 billion loss in 2005-06. However, Royal Mail continues to drive efficiencies, but now must significantly invest in its network to ensure it can continue to do so and compete with domestic and European rivals.

Post Office Limited expects to lose further revenues over the short term and will continue to try to find new revenues and reduce its cost base – this is becoming increasingly difficult. Our parcels businesses are expected to grow, albeit at lower rates than experienced in the past, due in part to the industry-wide consolidation that is taking place.

But our biggest hurdles by far are tackling our £5.6bn pension deficit whilst ensuring that the Group has an appropriate financing package to permit Royal Mail to invest in its network, provide a long term sustainable solution to Post Office Limited's loss-making branches, the rebalancing of prices within Royal Mail, and to provide adequate headroom to manage the significant commercial risks with respect to liberalisation and the loss of traditional revenues within Post Office Limited.

Operating and Financial Review (continued)

Risks Disclosures

The Group uses a business-wide framework for the identification, assessment, treatment, monitoring and reporting of risk. The process helps support the business objectives by linking into business strategy, identifying and reacting to emerging risks, developing cost effective solutions to risk and, where appropriate, exploiting risks to gain competitive advantage.

Group-level risks have been identified and are being managed to support the long-term sustainability of the Group:

The Group operates in an environment subject to regulation, which imposes restrictions on operations and the risk of penalties for non-compliance

The Postal Services Commission (Postcomm) issued to Royal Mail a 15-year operating licence in March 2001. The Licence contains material restrictions on the operation of Royal Mail's business, including restricting its freedom to set its own prices and requiring it to permit competitors access to its downstream delivery network. If Royal Mail breaches certain licence conditions it may be subject to compensation payments and fines. There is inevitable uncertainty as to how the regulatory regime will affect Royal Mail in the future, possibly to the detriment of the Group's profitability.

Royal Mail, unlike other postal licence holders, is obliged by its licence to provide a 'Universal Service', resulting in a higher, less flexible cost base than its competitors

Royal Mail's licence requires it to comply with the Universal Service Obligation (USO). This means that a letter must be delivered within the UK for the same price irrespective of the distance or remoteness of the destination. The USO also requires one delivery of mail for every UK household and business, and one collection of mail, six days a week. This is still a requirement for us in the now fully liberalised market, resulting in a higher and less flexible cost base in comparison to our competitors. However, the USO ensures Royal Mail has the largest, distribution network in the country – which may present future opportunities.

Liberalisation of the UK's postal markets may lead to competitors 'cherry picking' the most profitable customers, which could adversely affect revenues and profitability

As of 1 January 2006 Royal Mail was subject to full competition. Rival companies have been able to collect, sort and then access our network via 'Downstream Access' since 2004. However, a fully liberalised UK mail market means that competitors can by-pass our network altogether. With 80% of Royal Mail's revenue coming from its business customers, it will be these customers that competitors target but without the licence stipulation of a USO.

Ease of entry into, and exit from, the UK postal market could distort the market leading to volume volatility

A number of competitors who are not established postal service providers may initially enter the UK postal market and then rapidly exit. If this is the case it will distort the market and be increasingly difficult to plan and accurately forecast the future capacity requirements.

The increasing substitution by alternatives to mail delivery services could lead to declining volumes, which would have an adverse impact on profit

Business mail is an integral part of our business, delivering items for organisations such as Government departments, utilities, financial services, local authorities and charities. Technologies such as e-mail and the Internet can be used to send information or make available such information faster and, in many cases, at a lower cost than traditional mail services. Many organisations are now giving incentives to customers to take up these alternatives. If substitution continues, mails volumes will decrease resulting in the associated fall in revenue. Due to the USO however, Royal Mail will need to continue to maintain a comprehensive delivery network. As a result costs will not decrease in line with decreasing volumes. This would have an adverse impact on profitability.

Royal Mail is largely dependent on the Regulator for its pricing, which could result in pricing inflexibility

Royal Mail's prices for most of its letters products are determined by price control reviews and negotiations with Postcomm. Although such prices are well defined by a regulatory formula, Royal Mail's ability to rebalance its prices to better reflect the costs of handling the mail is dependent on Postcomm. Royal Mail has some of the cheapest stamp prices in Europe, as historically business mail has subsidised the losses made on stamped mail. Unless the applicable regulatory restraints permit Royal Mail to recover from this imbalance, there is a risk that Royal Mail will always lose money on stamped mail, whilst its competitors cream-skim more profitable products such as business mail.

Royal Mail derives a significant amount of its revenue from a relatively small number of customers; if a number of these were lost it would have an adverse impact on profit

Competitors are successfully targeting larger customers and the most profitable areas of this business, yet will not be required to comply with the Universal Service Obligation (USO). Also, socioeconomic changes are leading to a decline in mail volumes. Due to the USO, however, costs may not decrease in line with falling volumes. This may have an adverse impact on profitability unless the Group can flex its operational cost base.

If the UK's economy slows or goes into recession this is likely to have a detrimental impact on the Group's profits

The global economy is in the midst of a radical transformation, with far-reaching and fundamental changes for the pattern of economic activity. These changes pose challenges and opportunities for the UK and all advanced economies. Historically there has been a correlation between the state of the UK economy and level of revenue, if the economy continues to slow or goes into recession it will have a direct impact on mail volumes, and consequently on the Group's profits.

The Group has a unique relationship with the Government, which may be affected by any future change in Government policy

The Government is Royal Mail's only shareholder. The influence of public policy considerations on Government thinking may adversely affect the Group's ability to promote an effective business strategy. This is particularly significant in the case of Post Office Limited, which is frequently viewed as a public service provider but is required to run its branch network as a commercial business. The Government's policy in relation to the social value of rural Post Office® branches may have a prejudicial effect on Post Office Limited's ability to run an efficient and profitable retail network, since rural branches are fundamentally unviable without material financial support from the Government. Furthermore, a change in Government or its thinking may lead to a different perception of the business and different requirements, which may have an impact on the long-term strategy of the business.

The Group is subject to changes in both domestic and European regulation and legislation, which could expose it to possible additional costs

Various recent proposed changes to European or domestic law will have a direct impact on the Group; such as the European Working Time Directive, International Financial Reporting Standards, speed restrictions on our vehicles and increased liberalisation of the market for postal service providers. Any future changes may have a material impact on the Group and its individual business units.

Post Office Limited is now an appointed representative of the Bank of Ireland who are authorised and regulated by the FSA and has to satisfy them that it is meeting the relevant regulatory requirements. It is also subject to anti-money laundering regulations issued under the Proceeds of the Crime Act and enforced by HM Revenue and Customs. In 2005 Post Office Limited entered the telecommunications market and is licensed as a telephone service provider by OFCOM. OFCOM has issued a Code of Conduct that service providers must adhere to.

The business is people centred and depends on quality employees to be able to deliver its objectives

Royal Mail is one of the largest employers in the UK, employing about 193,000 people throughout its UK operations. Currently employment within the UK is at an all time high leading to potential skills shortages and competition between employers for staff. This combined with the fact that some areas of the country in which Royal Mail operates have a high natural turnover in staff, could lead to a potential shortage in the number and/or quality of available new recruits.

Without a continued change of culture within the organisation future development may be affected

The nature of the organisation relies on a large number of unionised people to ensure continuity and quality of service. The business has undergone a huge amount of operational change, and while this has produced a return to profitability it has also coincided with a changing market place; both in terms of financial pressures from competition and regulation and increased customer expectations. Due to these emerging pressures future growth and development needs to be supported by a cultural change within the organisation. Without a flexible, efficient and cooperative culture, Royal Mail could quickly become loss-making in an open market as mail volumes decline, labour rates increase, and customers have a choice of postal operator. In the event of significant industrial action this could have a major detrimental effect on the Group's reputation and profits.

The Group relies on a number of key suppliers and could be at risk from adverse changes in price or performance

There are certain critical suppliers to the Group. If for some reason any of them were unable to meet their service obligations or were to increase prices significantly, this would adversely impact Royal Mail's operations and results.

The Group's business activities are time critical. This means that if certain infrastructure facilities were disrupted it would have an impact on our business and operating results

The Group operates 14,376 retail outlets and a complex nationwide network delivering to every postal address in the UK. The business is subject to a number of operational risks outside its control, including natural disasters, fire, flood, explosion, possibility of work stoppages or civil unrest, transport infrastructure disruption, power failures, breakdown or failure of equipment, health pandemics, terrorism and the normal hazards associated with running a complex infrastructure. Any such disruption would have an adverse impact on business and operating results.

Insufficient investment in the operational network could affect productivity levels and our ability to compete effectively in a liberalised market

To maintain and improve on our business and operational performance, large on-going investments in infrastructure are required. An historic underinvestment has lead to equipment and technology nearing the end of its life cycle without being replaced with new technology. A continued lack of investment in the Group's operational network could lead to an inability to compete effectively in an open market, due to deterioration in productivity levels or an inability to improve productivity in comparison to its competitors.

The Group's brands are amongst the most recognised and most trusted in the UK; however, our reputation may be adversely affected by reports of poor customer service

The Group's brands - Royal Mail, Post Office® and Parcelforce Worldwide are some of the most well-known and trusted brands in the UK and therefore major intangible assets of the Group. Negative perceptions of these brands and may lead to a loss in confidence and potential loss in revenue, profits and cash flow.

Operating and Financial Review (continued)

The Group operates a substantial treasury operation, which is subject to financial exposures

Group Treasury is responsible for the liquidity of the Group and its subsidiaries. The Group is exposed to foreign currency risk and fuel price risk. The former is due to Royal Mail international division's obligation to pay overseas postal operators for carrying UK mail abroad and the balances held to operate the bureau de change services within Post Office Limited. The fuel price risk arises from operating one of the largest vehicle fleets in Europe, which consumes over 150 million litres of fuel per year, and a jet fuel risk from the purchasing of air freight services.

If the treasury strategy is inappropriate to cover the Group's exposures this could result in funds not being readily available when required to pay liabilities or having a negative impact on profit due to increased costs.

The Group has a pension scheme deficit, which is subject to any volatile movements in actuarial assumptions and equity values

Royal Mail operates the 6th largest occupational pension scheme within the UK. It has some 170,000 active members and 279,000 pensioners/deferred pensioners. Due to its relative size to the Company (£5.6bn of pension liability compared to £2.3bn company net assets excluding the pension deficit), and the longer life expectancy of people, even minor changes to assumptions used to calculate pension costs and liabilities could have a severe impact on the Group's balance sheet. This, combined with the fact that asset values are dependent on the UK equity markets, means that there can be large volatility in the pension costs recorded in the income statement and the deficit recorded in the balance sheet.

Royal Mail Group plc's balance sheet has liabilities that exceed its assets, which could lead to various exposures, not least that the Licence to operate could be terminated

Royal Mail Group plc's negative balance sheet is due to the pensions deficit exceeding the Company's assets. This may lead to a number of remote risk exposures: Royal Mail's postal licence could be terminated with 24 hours' notice, and certain commercial customer and supplier agreements may be terminated.

Frank Schinella

Acting Group Finance Director

17 May 2006

The prior year figures quoted have been restated for the impact of the transition to International Financial Reporting Standards.

Royal Mail Holdings plc Board

Non Executive Directors

ALLAN LEIGHTON (53) joined the Board in April 2001 as a Non Executive Director, becoming Chairman in March 2002. He is also a Director of Post Office Limited, and a member of the GLS Supervisory Board.

Allan began his career with Mars Confectionery and moved to Pedigree Petfoods as Sales Director. In 1992 he became Group Marketing Director of Asda Stores Limited, and Chief Executive in 1996, becoming President and CEO of Wal-Mart Europe when Wal-Mart bought Asda in 1999. He is currently Chairman of BHS Limited, Non Executive Director of BSkyB, Selfridges & Co, and George Weston Ltd. Allan is also Chairman of Race for Opportunity.

DAVID FISH (57) joined the Board in January 2003. He is Chairman of the Remuneration Committee, and a member of the Nomination Committee.

David was a member of the Mars Inc Operating Board from 1994 to 2001 and Joint President of Masterfoods Europe. He has also been President of Snackfoods Europe, and held European Vice-President positions in marketing and personnel. He is currently Chairman of United Biscuits Group (Investments) Limited and Chairman of Christian Salvesen.

RICHARD HANDOVER (60) joined the Board in January 2003. He is Chairman of the Nomination Committee, and a member of the Remuneration Committee.

Richard was Chairman of WH Smith plc until January 2005. He is currently Chairman of the Adult Learning Inspectorate and is a Non Executive Director of the Nationwide Building Society.

SIR MICHAEL HODGKINSON (62) joined the Board in January 2003. He is the Senior Independent Director, and a member of the Remuneration Committee. In May 2003 he was appointed Chairman of Post Office Ltd and Chair of the Corporate and Social Responsibility Governance Committee, and is Post Office Limited's nominated director on the Bank of Ireland Board.

Sir Mike was Chief Executive of BAA plc until retiring in June 2003. He is currently a Board Member and Chairman of the Finance Committee of Transport for London, a Non Executive of FKI plc and Non Executive Chairman of First Choice Holidays plc.

JOHN NEILL CBE (58) joined the Board in January 2003 and is a member of the Audit and Risk Committee.

John has been Group Chief Executive and Deputy Chairman of the Unipart Group of companies since 1987. He was formerly a Director of the Court of the Bank of England, and is Non Executive Director of Charter plc. He is also Vice- President of the Society of Motor Manufacturers and Traders and a Director of the SMMT industry forum, and Business in the Community.

BARONESS MARGARET PROSSER (68) joined the Board in November 2004 and is a member of the Nomination Committee and Audit and Risk Committee.

Margaret has been a Member of the House of Lords since 2004. She is a Non Executive Director of the Trade Union Funds Managers and has been Chair of the Women and Work Commission since July 2004. She is also Chair of the Women's National Commission.

HELEN WEIR (43) joined the board in January 2006 and is a member of the Audit & Risk Committee.

Helen has been Group Finance Director at Lloyds TSB Group since 2004. Prior to that she was Group Finance Director of Kingfisher, she is a member of the Accounting Standards Board.

BOB WIGLEY (45) joined the Board in April 2003, and is Chairman of the Audit and Risk Committee.

Bob is Chairman of Merrill Lynch's business in Europe, the Middle East and Africa, and a Deputy Chairman of Business in the Community.

Executive Directors

ADAM CROZIER (42) joined the Company in February 2003. He is Group Chief Executive, and leads the Group Executive Team. During the year he also had direct day-to-day control of the Letters Business.

Adam was Chief Executive of the Football Association from 2000-2003. Between 1988 and 1999 he held a number of senior roles at Saatchi and Saatchi Advertising, including that of Joint Chief Executive from 1995.

IAN GRIFFITHS (55) joined the Company as Managing Director of the Letters Business in February 2006. He is a member of the Group Executive Team.

Ian was previously at GKN from 1975. Ian was a member of the senior GKN Driveline management team since 1990 during which time he was responsible for operations in the US and for global marketing and engineering. He was appointed Chief Executive GKN Driveline in 2000 and to the Board in 2001 as Managing Director GKN Driveline. In October 2004 he became responsible for the Group's worldwide Driveline, Powder Metallurgy and Auto Components operations. Ian is also Non-executive Director of Ultra Electronics Holdings plc.

Royal Mail Holdings plc Board (continued)

ALAN COOK CBE (52) joined the Company in March 2006 as Managing Director of Post Office Ltd, having been a non-executive Director of Post Office Ltd since February 2005. He is a member of the Group Executive Team.

Before joining as MD of Post Office Limited, Alan was Chief Executive of National Savings and Investments, prior to which he had been Chief Operating Officer of the Prudential Assurance Company. Alan is also currently serving on the Council of the Institute of Financial Services.

TONY McCARTHY (50) joined the Company in January 2003 and is Group Director, People and Organisational Development. He is a member of the Group Executive Team, the Pensions Committee and the Corporate and Social Responsibility Governance Committee.

Tony had previously been Group Human Resources Director of BAE Systems, where he had worked in a variety of HR roles since 1978.

DAVID BURDEN (59) joined the Company in November 2002, was appointed to the Board in July 2004, and is Group Technology Director. He is a member of the Group Executive Team and chairs the Corporate Risk Management Committee.

David was previously Group Executive General Manager, Technology and Services at Qantas Airways Ltd in Sydney, responsible for IT, purchasing, property, motor transport and fuel services. He was a member of the Executive Committee throughout the transition from Government ownership to a successful listed public company.

JONATHAN EVANS OBE (54) joined the Company directly from university in 1974 and has been Company Secretary since 1999, having held a wide range of management positions throughout the Group. He is a member of the Group Executive Team, and Pensions Committee, Secretary to the Audit and Risk, Remuneration and Nomination Committees, a Trustee Director of the Royal Mail Pension Plan and a member of the GLS Supervisory Board.

Directors who resigned during the year

MARISA CASSONI (Group Finance Director) resigned from the Board on 17 November 2005.

DAVID MILLS (Chief Executive of Post Office Limited) resigned from the Board on 31 December 2005.

Directors' Report

The Directors present the Group accounts for Royal Mail Holdings plc. These accounts relate to the 52 weeks ended 26 March 2006 (2005 52 weeks ended 27 March 2005).

Principal activities

The Group provides a nationwide and international distribution service, principally of mails and parcels. The Group also provides access to a wide range of financial and retail services through its network of Post Office® branches across the United Kingdom.

Review of the business and future developments

A review of the Group's business and future developments is presented in the Chairman's Statement, Chief Executive's Statement, Annual Review and the Operating and Financial Review.

Results and dividends

The profit before taxation amounted to £312m (2005 £167m). After taxation, the profit was £395m (2005 £151m). Of the profit after taxation, £nil (2005 £nil) is attributable to minority interests. The Directors do not recommend a dividend (2005 nil dividend).

Political and charitable contributions

During the year the Group made charitable contributions of £1m (2005 £2m). No political contributions were made in the year (2005 £nil).

Research and development

Research and development expenditure during the year amounted to £1m (2005 £1m).

Policy on the payment of suppliers

The policy of the Company and its principal operating subsidiaries is to use their purchasing power fairly. Payment terms are agreed in advance for all major contracts. For lower value transactions, the standard payment terms of the supplier apply. It is the Company's policy to abide with the agreed terms. The Company and its principal operating subsidiaries in the UK have sought to comply with the DTI's Better Payment Practice Code. Copies of this can be obtained from the DTI. As the Company is a non-operating company, the creditor days are zero. The creditor days of the operating subsidiaries can be found in their accounts.

Land and buildings

In the opinion of the Directors, the aggregate market value of the Group's land and buildings exceeds the net book value, based upon a historic cost accounting policy, of £1,125m (2005 £1,157m) by £660m (2005 £466m).

Financial instruments

Details of financial instruments are shown in note 29.

Directors and their interests

The Directors of the Company and details of changes during the year are given on pages 27 and 28. The Secretary of State appoints the Chairman; all other Directors are appointed by the Company with the Secretary of State's consent.

HM Government is the Company's sole shareholder and accordingly the Directors have no interest in shares of the Company.

Qualifying third party indemnity provisions for Directors

At the time the Directors' Report was approved under section 234A of the Companies Act 1985, a partial qualifying third party indemnity provision was and remains in force for the benefit of all Directors of the Company and was and remains in force for the benefit of one or more persons who were then Directors of the Company. The indemnity is granted under article 129 of the Company's Articles of Association. The indemnity is partial in that it does not allow the Company to cover the costs of an unsuccessful defence of a third party claim.

People

Royal Mail Group employs almost 193,000 people (2005 over 196,000) in our UK wholly owned subsidiaries. A reconciliation to the Group headcount is shown in note 4 to the accounts. Our people are our strategic strength and competitive advantage.

The Group's policy is to encourage effective communication and consultation between our people, particularly on matters relating to strategy, financial and economic factors that may influence the Group's performance. This is achieved through the use of an extensive range of communication channels, including magazines, briefings, open forums and an intranet website. Our people have various bonus schemes, significant elements of which are based on business-related targets.

We actively encourage continuous training and skill development for all our people to ensure achievement of corporate and individual objectives. Management development and training programmes have been designed to attract and retain the best. The Group has worked with the unions to introduce several innovative working practices to improve efficiency.

An Equal Opportunities policy is maintained in all respects including disability, age, religion, colour, sex, nationality, ethnic origin, sexual orientation, race, creed and marital status.

In 2002, the Chairman created a programme to make Royal Mail Group a 'Great Place to Work' and made it a priority for everyone across the business. The purpose of the programme is to encourage people to contribute to improving their working environment, to equip our people with the skills they need, to develop pride in and understanding of the business and to drive respect for colleagues - in short, to ensure people considerations are at the heart of all major business decisions. The programme is ongoing and will remain an integral part of our people strategy.

Directors' Report (continued)

Our people strategy will ensure we realise our potential as an organisation through the strength of our people by developing a high-performing, sustainable culture where everyone feels involved and valued. It focuses on seven key areas:

- creating interesting, meaningful jobs with more flexible working patterns;
- identifying and developing in all our people a set of core behaviours that determine how we treat each other, our customers and our Shareholder;
- building a fluid, innovative and adaptive organisation to improve our response to environmental and market changes;
- developing a high-performance culture in which everyone understands their contribution and is motivated to achieve their full potential;
- defining, recruiting and developing the core capabilities we need to thrive in a competitive, deregulated market;
- recruiting, attracting and developing the leadership and management capability we need to deliver our goals; and
- enhancing our ability to attract and retain the talent required to compete successfully.

Our intention is to underpin our people strategy with a measurement system that will objectively demonstrate the value of our people and their contribution to the success of our business.

Currently, the way we monitor our progress towards becoming a 'Great Place to Work' is by using Have Your Say, our employee opinion survey, launched in January 2003. This is carried out on a rolling basis, across all employees and the results are reviewed monthly right through the business – from local level up to Board level.

Corporate Social Responsibility

Royal Mail is committed to carrying out its activities in a socially responsible manner in respect of the environment, employees, customers and local communities. A Corporate and Social Responsibility (CSR) Governance Committee reports to the Board, which publishes an annual report of its activities. Further details of our CSR governance structure and activities will be available in our 2006 CSR Report, due to be published in September 2006.

Disabled employees

The Group's policy is to give full consideration to applications for employment from disabled persons. Employees who become disabled whilst employed receive full support through the provision of training and special equipment to facilitate continued employment where practicable. The Group provides training, career development and promotion to disabled employees wherever appropriate.

Going concern

After analysis of the financial resources available and cash flow projections for the Group, the Directors consider that it is appropriate to prepare the financial statements on a going concern basis.

Auditors

A resolution to reappoint Ernst & Young LLP as auditors will be put to the Annual General Meeting.

By Order of the Board

Jonathan Evans

Company Secretary

17 May 2006

Corporate Governance

Statement by the Directors on compliance with the Combined Code

The Board is committed to high standards of Corporate Governance and supports the Combined Code on Corporate Governance (the Code), published in July 2003, which took effect for Royal Mail on 29 March 2004. The following statement is intended to explain our governance policies and practices in light of the Code principles and provisions in so far as they are appropriate to a public company with a single shareholder, and to provide insight into how the Board and management run the business for the benefit of the Shareholder. The Company has fully complied with the provisions of the Code.

The Board

The Board is responsible for setting the objectives and strategy of the Group and for monitoring performance. The Board currently comprises a Non Executive Chairman, six Executive Directors and seven Non Executive Directors. There is currently a vacancy for a Group Finance Director. The biographies of each of the Directors, setting out their current roles, commitments and previous experience, are on pages 27 and 28. The Board usually meets monthly, and has defined those matters that are reserved exclusively for its consideration. These include the approval of financial statements, acquisitions and disposals, material agreements, non-recurring projects, major capital expenditure and strategic plans. It also delegates responsibilities to the Board Committees detailed below. For each scheduled meeting of the Board, the Company Secretary, on behalf of the Chairman, collates and circulates the papers, aiming to allow sufficient time for the Directors to review the information provided. The Board is confident that all its members have the knowledge, talent and experience to perform the functions required of a Director of the business. Executive Directors have rolling 12-month contracts and Non Executive Directors are generally appointed for a three-year term.

The Board considers that each of the seven Non Executive Directors is independent. This means that in the view of the Board, they have no links to the Executive Directors and other managers, and no business or other relationship with the Company that could interfere with their judgement. Sir Michael Hodgkinson is the Senior Independent Director. There is also a clear division of responsibilities between the Chairman and the Chief Executive. Performance evaluation of the Board, its Committees and individual Directors takes place on an annual basis. The Board initiated a systematic approach to the evaluation of the effectiveness of the Board, its Committees and individual Directors. This was undertaken by the Chairman and implemented in collaboration with the Committee Chairmen and with the support of the Company Secretary. The evaluation was conducted by way of a formal questionnaire that enabled Directors' perspectives on the effectiveness of the Board and Committees to be fed back to the Chairman and the full Board. Performance evaluations of Board Committees were conducted on behalf of the Chairman by the Chairmen of the respective Board Committees. The Non Executive Directors, led by the Senior Independent Director, reviewed the performance of the Chairman and the Executive Directors.

Directors may take independent professional advice in the furtherance of their duties, at the Group's expense. All Directors have access to the advice and services of the Company Secretary, the appointment and removal of whom is a matter for the Board as a whole.

All Directors, appointed by the Board, are required by the Company's Articles of Association to be elected by the Shareholder at the first AGM after their appointment. On appointment, the Directors take part in an induction programme where they receive information about the Royal Mail Group, the role of the Board and matters reserved for its decision, the terms of reference and membership of the principal Board Committees, the Company's Corporate Governance arrangements and the latest financial information about the Group. This is supplemented by visits to key business locations. The Company engages in two-way communication with the Shareholder to discuss information on its strategy, performance and policies. The Board receives feedback on these meetings from the Directors attending the meeting.

During the year, the Directors attended the following number of meetings of the Board and its main Committees:

Corporate Governance (continued)

Number of meetings	Board	Audit and Risk Committee	Remuneration Committee	Nomination Committee
Number of meetings during the year	12	7	9	6
Non Executive				
Allan Leighton	11			
David Fish	12		9	6
Richard Handover	10		9	6
Sir Michael Hodgkinson	12		9	
John Neill	10	7		
Baroness Margaret Prosser	12	5		2
Helen Weir[1]	3	1		
Bob Wigley	11	7		
Executive				
Adam Crozier	12			
David Burden	12			
Alan Cook[1]	1			
Ian Griffiths[1]	2			
Tony McCarthy	12			
Former Directors				
Marisa Cassoni[2]	8			
David Mills[3]	9			

1. Attended all Board and respective sub committee meetings since becoming a Director during the year
2. Resigned 17 November 2005
3. Resigned 31 December 2005

Outside appointments

The Board believes that there are significant benefits to both the Company and the individual from Executive Directors accepting Non Executive Directorships of companies outside of the Group, and for which the Director may retain the fees (see the Directors Remuneration Report on page 42 for details). The Board's policy is normally to limit Executive Directors to no more than one Non Executive Directorship.

The following Committees deal with specific aspects of the Group's governance. The terms of reference for each of the principal Committees are available on the Company's website (www.royalmailgroup.com) or on written request from the Company Secretary:

Corporate Governance (continued)

Group Executive Team

Chair	Adam Crozier, Group Chief Executive
Membership	David Burden, Group Chief Information Officer Alan Cook, MD, Post Office Limited Jonathan Evans, Company Secretary Mary Fagan, Group Corporate and Government Affairs Director Ian Griffiths, MD Royal Mail Letters Vanessa Leeson, MD Parcelforce Worldwide Tony McCarthy, Group Director People & Organisational Development Alex Smith, Director of Strategy Group Finance Director
Role	The Group Executive Team comprises all Executive Directors of Royal Mail Holdings plc and Royal Mail Group plc and certain other senior executives of the Group. Its responsibilities include: • to develop and monitor deployment of the Group's strategy, annual operating plans and budgets for Board approval; • to review operational activities, and set policies where these are not reserved to the Board; and • to allocate resources, both people and financial, across the Group. The Holdings Board has delegated authority to the Investment Committees of the Group Executive Team to make investment decisions of up to £20m.

Audit and Risk Committee

Chair	Bob Wigley, Non Executive Director
Membership	John Neill, Non Executive Director Baroness Margaret Prosser, Non Executive Director Helen Weir, Non Executive Director The Board is confident that the collective experience of the Audit and Risk Committee members enables them, as a group, to act as an effective Audit and Risk Committee. The Committee also has access to the financial expertise of the Group and its auditors, and can seek further professional advice at the Company's expense if required.
Role	The Committee, which is assisted by the Corporate Risk Management Committee, provides a forum for reporting by both internal and external auditors and is responsible for a wide range of matters including: • to monitor the integrity of the financial statements of the Company; • to review the Company's internal financial control system and, unless addressed by the separate Risk Management Committee or by the Board itself, internal control and risk management systems; • to monitor and review the effectiveness of the Company's Internal Audit function; • to make recommendations to the Board for Shareholder approval in general meetings, in relation to the appointment of the external auditors, and to approve the remuneration and terms of engagement of the external auditors; • to monitor and review the external auditors' independence, objectivity and the effectiveness of the audit process; • to develop and implement policy on the engagement of the external auditors to supply non-audit services; and • where the Audit and Risk Committee's monitoring and review activities reveal cause for concern or scope for improvement, to make recommendations to the Board on action needed to address the issue or to make improvements.

Corporate Governance (continued)

Remuneration Committee

Chair	David Fish, Non Executive Director
Membership	Richard Handover, Non Executive Director Sir Michael Hodgkinson, Non Executive Director
Role	The Committee's responsibilities include: • to determine and recommend for the Board's approval, the framework for the remuneration of the senior executives of the Company; • to determine the individual remuneration packages for the Chairman, the Executive Directors and the Company Secretary, subject where necessary to the consent of the Secretary of State; and • to agree the targets for any performance-related incentive schemes applicable to Executive Directors and senior executives.

Nomination Committee

Chair	Richard Handover, Non Executive Director
Membership	David Fish, Non Executive Director Margaret Prosser, Non Executive Director
Role	The Committee's responsibilities include: • to lead a formal, rigorous and transparent process both for appointments to the Board of the Company, and for appointments to subsidiary boards. Some appointments will be subject to the consent of the Secretary of State, as provided in the Articles; • to advise the Board on succession planning for the positions of Chairman, Chief Executive and all other Board appointments and other senior appointments; and • to keep under review the balance of membership and ensure that the Boards have the required mix of skills, knowledge and experience.

In addition to the principal Committees above there are also the following Committees:

Corporate and Social Responsibility Governance Committee

Chair	Sir Michael Hodgkinson, Non Executive Director
Membership	Tony McCarthy, Group Director People & Organisational Development Director Corporate and Social Responsibility Head of Environment Head of Health and Safety Other senior executives across the Group
Role	The Corporate and Social Responsibility Governance Committee reports to the Board and has responsibilities including: • to act on behalf of the Group Executive Team to provide an overview of the social environmental and ethical impacts of the Group's activities; and • to make recommendations on minimum Corporate and Social Responsibility standards and policies.

Corporate Governance (continued)

Pensions Committee

Chair	Group Finance Director
Membership	Tony McCarthy, Group Director People & Organisational Development Jonathan Evans, Company Secretary
Role	The Committee's responsibilities include: • to review funding, benefits, scheme structure and strategic developments impacting on the Group's occupational pension schemes; and • to represent the Group in discussions with the Trustees of the Group's occupational pension schemes.

Non-audit services provided by the external auditors

In some cases the nature of advice required makes it more timely and cost effective to select the external auditors who already have a good understanding of the Group. In order to maintain the objectivity and independence of the external auditors, the Board has determined what work can be provided by the external auditors and the approval processes associated with them. The Audit and Risk Committee monitors the level of non-audit fees paid to the external auditors.

Internal control

Overview

The Directors are responsible for the Group's system of internal control and risk management, as well as the timely review of its effectiveness. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material misstatement or loss.

The Group's approach to internal control is based on the underlying principle of line management accountability for control and risk management. There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group in accordance with the guidance detailed by the Turnbull Committee as part of the Code, including financial and operational risks and risks to reputation. The Board regularly reviews this process. The process has been in place throughout the year and up to the date of approval of these accounts. The responsibility for joint ventures and associates rests, on the whole, with the senior management of those operations. The Company monitors its investments and exerts influence through Board representations.

The Board has reviewed the effectiveness of the system of risk management and internal control. The key elements include a review of Internal Audit reports, regular confirmations from local management and communications from the Chair of the Audit and Risk Committee on the outcome of Audit and Risk Committee meetings.

Audit and Risk Committee

The Committee reports to the Board and meets as a minimum on a quarterly basis to monitor and review the effectiveness of the control environment. The Committee reviews the scope of work, authority and resources of the Internal Audit and Risk Management function.

Corporate Risk Management Committee

This is a sub-committee of the Audit and Risk Committee. It sets the framework for risk management within the Group and ensures integration with strategic planning. It also facilitates regular reporting of key risks and the actions to manage the risks to a desired level. The members of this Committee include David Burden (Chair), the Group Treasury Director, the Internal Audit and Risk Management Director, the Director Corporate and Social Responsibility and other senior executives from across the Group.

Key control processes

The key processes used to assess the effectiveness of systems are ongoing and include the following:

- the business units have authority to manage within the limits set by the Board and within the scope of reserved powers. The Group's Code of Business Standards sets the principles of professionalism and integrity for our people;
- discussion and approval by the Board of the strategic direction, plans and objectives of the Group and each operating company, and the risks to achieving them;
- reviews and approval by the Board of budgets and forecasts;
- monthly reviews of performance by reference to key performance indicators, updated forecasts and information on the key risk areas;
- at least quarterly reviews by the Audit and Risk Committee of the scope and results of internal audit work across the Group. The scope of the work covers all key activities of the Group and concentrates on higher risk areas;
- reviews of the scope of the work of the external auditors by the Audit and Risk Committee and any significant issues arising;
- reviews by the Audit and Risk Committee of accounting policies and delegated authority levels; and
- consideration by the Audit and Risk Committee of the major risks facing the Group and procedures to manage them.

Risk Management process

There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. This process has been in place throughout the year under review, and up to the date of approval of the Annual Report and Accounts, and accords with the Turnbull guidance. The effectiveness of the process is reviewed annually by the Audit and Risk Committee, which then reports to the Board.

The process consists of:

- formal identification by management at each level of the Group through a self assessment process of the key risks to achieving their business objectives and the controls in place to manage them. The likelihood and potential impact of each risk is evaluated;
- certification by management that they are responsible for managing the risks to their business objectives and that the internal controls are such that they provide reasonable but not absolute assurance that the risks are appropriately identified, evaluated and managed;
- quarterly reporting and review by the management of each business unit of risk management activities and action taken to address non-compliance with controls or to improve their effectiveness; and
- independent assurance by Internal Audit as to the existence and effectiveness of the risk management activities described by management.

The system of internal control and risk management is embedded into the operations of the Group, and the actions taken to mitigate any weaknesses are carefully monitored.

Directors' Remuneration Report

Information not subject to audit

This report provides the information required by the Directors' Remuneration Report Regulations 2002 (the Regulations). The Company confirms that throughout the year it has complied with the principles in Section 1 of the Combined Code on Corporate Governance (the Code).

The Royal Mail Group strategic plan commits to extensive transformational change to ensure that its customers are offered high-quality and cost-effective services. The Board believes that an effective remuneration strategy is essential to support the plan by ensuring that the company has people of the right calibre and skills to meet the considerable challenges the company faces. Incentives which create an identity of interest between employees and the Shareholder form a vital part of this strategy.

The Remuneration Committee

The Board retains overall accountability for the framework and costs of executive remuneration and the terms of the service contracts offered to all Executive Directors, which require the consent of the Secretary of State for Trade and Industry. The Secretary of State also approves the remuneration of Non Executive Directors. The Remuneration Committee's role is to develop the remuneration policy for Executive Directors and their immediate reports and specifically to make recommendations on their salary, benefits, bonuses and other terms and conditions of employment. The Committee also recommends appropriate compensation on the cessation of employment, giving careful consideration to what compensation should be paid taking into account the circumstances of the particular case and ability of the individual to mitigate.

The Remuneration Committee is made up wholly of independent Non Executive Directors. Membership of the Committee is disclosed on page 34. The Chief Executive, Adam Crozier, and the Director People & Organisational Development, Tony McCarthy, may attend these meetings by invitation but are not present at the discussion of their own remuneration.

Advice to the Remuneration Committee

The Committee calls for information and advice from inside and outside the Group. It takes advice from those independent, professional organisations that are best able to assist its consideration of the particular topics under discussion.

During 2005-06, advice on the performance of key executives was given by the Chairman and the Chief Executive. Information on the external marketplace was given by Monks Partnership (a trading name of PriceWaterhouse Coopers), Deloitte, and Watson Wyatt Limited. Internal support is primarily provided by the Director People & Organisational Development, Tony McCarthy, and from the Company Secretary, Jonathan Evans. Other advice and information has been provided by specialists from People & Organisational Development and Finance.

During the year, advice was given to the Company by Watson Wyatt Limited on pension and actuarial matters.

Remuneration policy

The Company's policy on Directors' remuneration is that:

- the overall remuneration package should be sufficiently competitive to attract and retain executives of the necessary quality in a complex business and a competitive market place, who will deliver success for the Shareholder and high levels of customer service, safety and environmental performance;
- a significant proportion of the remuneration package should be dependent on performance in both the short and the long-term; and
- the system of remuneration should establish an identity of interest between senior executives, customers and the Shareholder.

The policy for senior executives takes into account pay and employment conditions elsewhere in the Group.

The Committee regularly reviews the structure of the package and its competitiveness against appropriate marketplaces. The Committee aims to ensure that the package is proportionate and effective, and that it is developed in accordance with accepted best practice. During 2005-06, as part of its regular review, the Committee has given particular consideration to annual and long-term incentive arrangements.

The main components of remuneration

The main components for Executive Directors are: basic salary, an annual performance-related bonus, a Long-Term Incentive Plan, pension and other benefits. The Committee believes that there should be a continuing emphasis on those elements of remuneration that are performance-related.

Base salaries

The Committee believes that base salaries should be set at levels that are sufficient to recruit and retain high calibre executives. In making its judgement, the Committee is informed by a variety of data aimed at making a fair comparison with enterprises of a similar size and complexity to Royal Mail. This data is provided by independent consultancies. Increases are recommended where the Committee believes that it is necessary to reflect contribution, increased individual responsibilities and market levels. All increases are approved by the Secretary of State.

Performance-related, personal annual bonus 2005-06

The Chairman and Executive Directors may earn a performance-related bonus for achievement of financial and customer targets.

In the case of the non-executive Chairman a bonus of up to £180,000 is payable. The level of bonus has not changed since the Chairman was appointed in March 2002.

The Remuneration Committee concluded that it was in the Shareholder's interest to encourage performance from executive directors above the level of the budget and accordingly, in line with market practice and with the consent of the Secretary of State, have put in place bonus arrangements for above target performance.

The percentages of base salary available through the bonus plan are as follows:

	Threshold level	On-target level	Maximum
Chief Executive	30%	60%	100%
Other Executive Directors	24%	48%	80%

The on-target level bonus of 60% for the Chief Executive is a reduction from the previous 75% level. For other executive directors, the on-target level has increased from 40% to 48%.

The measures used are annual operating profit before exceptional items and quality of service.

The quality of service measures are as follows:

- First Class stamped and metered
- Second Class stamped and metered
- Mailsort 2
- Mailsort 3
- Special Delivery
- 2^{nd} Class PPI
- Parcelforce 24
- Post Office Limited new products sold

Quality Targets are those in the Postcomm licence agreement and a number of these, including First Class stamped and metered, have been increased since last year. The first six of these quality measures account for the overwhelming bulk of mail and include the key products of interest to the general public.

The annual operating profit before exceptional items and the basket of quality measures are weighted so that if the on-target or threshold levels are achieved against all measures they each make up 50% of the bonus. At the maximum level, the weighting moves to 60% on profit and 40% on quality of service. Each measure in the bonus plan is independent of the others. In the case of the Managing Directors of the Letters business and of Post Office Limited, 30% of their bonus is related to the profit and quality measures relating to the Group and 70% to the profit and quality measures of their particular businesses.

Bonuses for intermediate amounts are calculated pro rata.

The Executive Directors are also entitled to a Share in Success payment at the same level as that paid to all other employees.

Long-Term Incentive Plan 2005-06

The Company operates a Long-Term Incentive Plan (LTIP) for the Executive Directors and certain other senior employees. The objectives of the LTIP are to incentivise the delivery of the long-term business goals of the Group and to reward success in achieving or exceeding these goals.

The Remuneration Committee has extensively consulted the Government on the most appropriate form of this incentive, but while the discussions with Government on the strategic plan continue, the LTIP has not yet been finalised.

The discussions with Government have taken the previous LTIP as a model. The previous LTIP had the following key features:

- Annual Company Performance Awards which accrued on a sliding scale above a threshold level of performance and begin at 12.5% of annual base salary. For on-target performance, the Company Award was 25% of annual base salary and for exceptional performance this rose in accordance with a stepped scale to a maximum of 37.5%;
- Bonus Awards. A bonus award could be made each year by the Remuneration Committee. They were equivalent to the amount of annual bonus waived by the employee. An employee had the discretion to waive a maximum of one half of any annual bonus up to the on-target level. In the new plan, if a bonus above on-target would otherwise be payable, then three quarters of this additional amount will be compulsorily waived; and

- A final enhancement. At the end of the performance period the amounts which had been set aside as both Annual Company Performance Awards and as Bonus Awards could be further increased depending on a further performance factor. If the on-target level was achieved then an additional one third was added. In the case of exceptional performance then up to a maximum addition of 100% could be added.

Other than the requirement that three quarters of any annual bonus earned above the on-target level must be waived and an award of equivalent value be made in the LTIP, it is envisaged that the potential rewards that can be earned under the plan will be broadly similar to the previous arrangement.

The Company has made an estimate in its accounts for a Company Award for 2005-06 due under the new LTIP and is making an appropriate recommendation to the Secretary of State. This award will not exceed 37.5% of the participants' base salary.

Benefits

Benefits include the provision of company cars, health insurance, or the cash equivalent of any benefits not taken.

Pensions

The Group has a liability to pay pensions in respect of Directors' services and for some Executive Directors makes contributions to pension schemes for this purpose. The Company has set up a retirement pension arrangement, which will provide benefits to Directors whose contributions to the Company scheme are restricted by the Inland Revenue earnings cap. Following the recent changes in pensions legislation the Company will continue to apply the previous earnings cap, indexed by inflation each year, as a constraint on the amount of salary which is pensionable through the Company scheme.

Fixed and performance-related elements of Executive Directors' remuneration (excluding pensions)

For 2004-05, 42.5% of Directors' potential annual earnings related to fixed elements, whilst 57.5% related to annualised performance elements. For the CEO 37% was fixed and 63% was variable. The current Long-Term Incentive Plan is still under discussion but is expected to be broadly similar in terms of potential payments as the current plan. The annual bonus plan was changed in 2005-06 to include a stretch element for performance above target and the percentage of total remuneration at risk to performance is therefore higher than in the previous year.

Service contracts

The Committee's policy is that Executive Directors appointed to the Board are offered notice periods of one year. The Committee has a defined policy on compensation and mitigation, to be applied in the event of a Director's contract being prematurely terminated. In such circumstances, steps would be taken to ensure that poor performance is not rewarded.

The rolling service contracts and letters of appointment of the Directors include the following terms:

	Date of contract	Expiry date of current service contract [1]	Unexpired term (months)
Non Executive Chairman			
Allan Leighton	25 March 2005	25 March 2008	24
Executive Directors			
Adam Crozier	1 February 2003		12
Ian Griffiths	6 February 2006		12
Alan Cook	1 March 2006		12
Tony McCarthy	6 January 2003		12
David Burden	1 July 2004		12

The Non Executive Directors do not have service contracts. The dates of the current Non Executive Director appointments are as follows:

Non Executive Directors			
Sir Michael Hodgkinson[2]	1 January 2003	30 June 2006	3
David Fish[2]	1 January 2003	30 June 2006	3
Richard Handover[2]	1 January 2003	30 June 2006	3
John Neill[2]	1 January 2003	30 June 2006	3
Baroness Margaret Prosser	1 November 2004	31 October 2007	19
Bob Wigley[3]	1 April 2003	30 June 2006	3
Helen Weir	1 January 2006	31 December 2008	33

Directors' Remuneration Report (continued)

[1] All Executive Directors have a contracted 12-month notice period from the Company; the Director must give six-months notice. The standard term for compensation for loss of office is a maximum payment of 12-months basic salary, which may be subject to mitigation. The Company is committed for the full three-year term for Non Executive Directors, including the Chairman.

[2]With the consent of the Secretary of State, the director agreed to extend the contract by up to 6 months.

[3]With the consent of the Secretary of State, the director agreed to extend the contract by up to 3 months.

Non Executive Directors

The fees paid to the Non Executive Directors are determined by the Executive Directors and approved by the Secretary of State. Independent market surveys are consulted in determining them. Fees may comprise a basic fee for Board membership and, as appropriate, additional fees for the membership or chairmanship of the Audit and Risk, Remuneration and Nomination Committees. Details of the fees are given below.

Audited information

Directors' remuneration, excluding pensions and Long-Term Incentive Plan, was as follows:

	Current annual salary/fees	Salary/ fees	Annual performance bonus: Performance-related bonus	Annual performance bonus: Deferred into LTIP	Annual performance bonus paid	Deferred bonus from prior years	Benefits	Compensation for loss of office	Total excluding pensions and Long-Term Incentive Plan: 2006	Total excluding pensions and Long-Term Incentive Plan: 2005
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Non Executive Chairman										
Allan Leighton	25	21	180	-	180	-	-	-	**201**	330
Executive										
Adam Crozier	615	568	454	(248)	206	-	16	-	**790**	704
Ian Griffiths[1]	500	73	36	(18)	18	-	15	-	**106**	-
Alan Cook[1]	250	21	-	-	-	-	1	-	**22**	-
Tony McCarthy	335	331	198	(108)	90	-	33	-	**454**	406
David Burden	275	272	163	(89)	74	-	13	-	**359**	255
Non Executive										
Sir Michael Hodgkinson	83	79	-	-	-	-	-	-	**79**	72
David Fish	45	41	-	-	-	-	-	-	**41**	36
Richard Handover	45	41	-	-	-	-	-	-	**41**	36
John Neill	35	34	-	-	-	-	-	-	**34**	32
Baroness Margaret Prosser	40	35	-	-	-	-	-	-	**35**	13
Helen Weir[1]	35	9	-	-	-	-	-	-	**9**	-
Bob Wigley	43	40	-	-	-	-	-	-	**40**	35
Former Directors										
Marisa Cassoni[2]	-	260	-	-	-	-	17	379	**656**	428
David Mills[2]	-	310	-	-	-	-	20	486	**816**	381
Elmar Toime	-	-	-	-	-	-	-	-	**-**	1,377
Total 2006	2,326	2,135	1,031	(463)	568	-	115	865	**3,683**	-
Total 2005	2,033	2,227	981	(406)	575	458	125	720	-	4,105

[1]Ian Griffiths, Alan Cook and Helen Weir joined the Board on 7 February 2006, 1 March 2006 and 1 January 2006, respectively.

[2]Marisa Cassoni and David Mills left the Board on 17 November 2005 and 31 December 2005, respectively.

The figures in the table represent emoluments earned and receivable as Directors during the financial year, whenever paid. Such emoluments are normally paid in the same financial year with the exception of the annual, performance-related bonus, which is paid in the year following that in which it is earned and the amount deferred into LTIP.

Payments to former Directors

Marisa Cassoni, former Group Finance Director, had been with the Company for over four years but did not wish to commit to another three years in her role. It was agreed that Marisa would leave the Company on 31 December 2005. In accordance with her contract she was paid £346,500 base pay in lieu of her notice period and was allowed to keep her car and private medical insurance benefits until the end of the financial year. Reasonable outplacement costs were also met and her accumulated FURBS pension rights, accrued over her time with the Company, of £651,473 is being held awaiting instructions.

After three and a half years with the Group, David Mills agreed with the Company that he did not wish to remain with Group during its next stage of development. He stepped down from the Holdings Board on 31 December 2005 and left the Company at the end of the financial year on 26 March 2006. Within the terms of his contract, he was paid £365,017 base pay in lieu of notice and £80,000 in respect of annual bonus for 2005-06. His benefits ceased at the end of the financial year. Reasonable outplacement costs were also met.

The Company is grateful for the contribution made by Marisa Cassoni and David Mills.

Performance-related, personal annual bonuses for 2005-06

As agreed with the Secretary of State, the Remuneration Committee has the role of authorising the annual performance-related bonuses for the Chairman and the Executive Directors.

The details of the scheme are outlined on page 38. For 2005-06, the Remuneration Committee concluded that the financial performance was between the on-target and the maximum and that the majority of the quality of service targets set for the Group had been met or exceeded, triggering payment of 73.8% of maximum bonus potential to the Chief Executive and Executive Directors. As the Company had exceeded its financial target and had overall exceeded its quality targets it was decided to award the Non-Executive Chairman a bonus of £180,000.

Each of the Executive Directors are also entitled to a Share in Success payment of £418.

Company Awards and Bonus Awards in respect of the Long-Term Incentive Plan at 26 March 2006

The Company has made an estimate in its accounts for a Company Award for 2005-06 due under the new LTIP and is making an appropriate recommendation to the Secretary of State. This award will not exceed 37.5% of the participants' base salary.

The Directors have waived over half of their bonus and it is anticipated that an equivalent Bonus Award will be made in 2006-07 as set out in the table below:

	Bonus Awards to be made in 2006-07 in respect of 2005-06 £000	Total £000
Executive		
Adam Crozier	248	248
Tony McCarthy	108	108
David Burden	89	89
Ian Griffiths	18	18
Alan Cook	-	-

The Long Term Incentive Plan for 2002-2005 was paid during the year. Full disclosure was made in last years accounts.

Non Executive Directors

The fees of the Chairman and the Non Executive Directors are agreed with the Secretary of State, and are currently £20,000 per annum and £30,000 per annum respectively.

As a result of a review undertaken by the Board in the light of the greater role for Board Committees arising from recent reviews of the Combined Code on Corporate Governance and emerging market practice, with effect from 1 October 2005 a new fee structure was adopted which increased the annual payment for committee membership from £2,500 to £5,000 and the fee for chairmanship from £5,000 to £10,000 in the case of the Remuneration and Nominations Committees and from £7,500 to £12,500 in the case of the chairman of the Audit and Risk Committee. Sir Michael Hodgkinson receives additional fees of £37,500 (2005 £37,500) for his position as Chairman of Post Office Limited and £10,000 for his role as Senior Independent Director. Sir Michael is also a Non Executive Director of the Bank of Ireland, the fee for which he has agreed to waive.

Executive Directors outside appointments

The Executive Directors may retain fees from their Directorships. The annual fees due to Executive Directors in respect of their Non Executive Directorships are shown in the table below:

	Directorship	2006 £	2005 £
Ian Griffiths	Ultra Electronics Holdings plc	33,000	29,000

Pensions

The Group normally offers its most senior people membership of the Royal Mail Senior Executive Pension Plan (RMSEPP). Details of the RMSEPP are set out in note 14 to the accounts. The Plan is a funded, Inland Revenue-approved final salary occupational pension scheme. The scheme provides for a two-thirds final pensionable salary at a normal retirement age of 60, subject to the necessary pensionable service and Inland Revenue earnings cap. Pensions in payment are increased annually in line with Retail Prices Index (RPI), subject in some cases to a cap. Pensions are also payable to dependants on the death of the member and a lump sum is payable if death in service occurs.

For senior executives whose membership of the RMSEPP is restricted by the earnings cap, pension provision is made by a combination of the Company scheme and an appropriate Funded Unapproved Retirement Benefits Scheme (FURBS) or equivalent. Ian Griffiths receives a cash supplement of 40% of base pay above the earnings cap. Alan Cook is not a member of the Company scheme and receives a cash supplement of 40% of base pay less the equivalent member pension contributions payable under the Company scheme. The Company has made provision for retirement pension arrangements at a rate of 40% of base pay above the earnings cap for Adam Crozier and David Burden. A reserve has been established for the additional pension for Tony McCarthy to provide the total retirement pension, including the pension from his previous employer's pension scheme, of two-thirds of base pay at normal retirement age. The total provision for Adam Crozier, Tony McCarthy and David Burden at the year end is £1,421,447 (2005 £674,379). Marisa Cassoni's reserve amounted to £535,193 at the end of March 2005.

Disclosure of Directors' pension transfer values is required under two separate requirements:

- Stock Exchange Listings Rules: the requirements are the same as disclosed in last year's accounts and are designed to indicate the increase in the value of Directors' accrued benefits during the period. The transfer value is calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 and excludes Directors' contributions; and
- Directors' Remuneration Report Regulations 2002: this is designed to assess the change in transfer values during the year, taking into account movement in investment market conditions. Falls in market values may generate a negative movement in the transfer values.

The transfer values disclosed represent a potential liability of the pension plan rather than any remuneration due to the individual and cannot be meaningfully aggregated with annual remuneration, as it is not money the individual is entitled to receive.

The pension entitlements (under Stock Exchange Listing Rules) of the Directors at the year end were:

	Age at year end	Accumulated accrued benefit at 26 March 2006 £000	Increase in accrued benefits during the period* £000	Increase in accrued benefits during the period (net of inflation)* £000	Transfer value* of increase before inflation less Directors' contributions £000
Executive Directors					
Adam Crozier	42	60	6	4	32
Ian Griffiths	55	1	1	1	7
Tony McCarthy[1]	49	51	11	10	122
David Burden	59	12	4	4	68

* Excluding any increase arising from the transfer-in of pension entitlements accrued with previous employers.

[1] Restated to reflect the detailed calculations of the pension promise agreed in 2005.

	Age at year end	Transfer value at 27 March 2005 or at date of appointment to Board if later £000	Plus transfers-in received £000	Sub total £000	Transfer value* at 26 March 2006 £000	Movement in the period less Directors' contributions £000
Executive Directors						
Adam Crozier[2]	42	342	-	342	581	233
Ian Griffiths	55	-	-	-	8	7
Tony McCarthy[1]	49	368	-	368	720	339
David Burden	59	132	-	132	247	109

* The Royal Mail Senior Executive Pension Plan transfer value basis was changed in 2005.

[1] Restated to reflect the detailed calculations of the pension promise agreed in 2005.

[2] Adam Crozier's transfer-in service credit was recalculated in the year.

By Order of the Board

Jonathan Evans

Company Secretary

17 May 2006

Statement of Directors' responsibilities in respect of the Group accounts

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable UK law and those International Financial Reporting Standards (IFRSs) as adopted by the European Union that present fairly the financial performance, financial position and cash flows of the Group for that period.

In preparing those accounts Directors are required to:

- select suitable accounting policies and apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
- state that the Group has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements.

Directors are responsible for ensuring that proper accounting records are kept which disclose with reasonable accuracy, at any time, the financial position of the Group, and which enable them to ensure that the accounts comply with the Companies Act 1985 and article 4 of the IAS Regulation. Directors are also responsible for ensuring that the assets of the Group are safeguarded and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent Auditor's Report to the members of Royal Mail Holdings plc

We have audited the Group financial statements of Royal Mail Holdings plc for the year ended 26 March 2006 which comprise the Group income statement, the Group balance sheet, the Group cash flow statement, the Group statement of recognised income and expense and the related notes 1 to 31. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Royal Mail Holdings plc for the year ended 26 March 2006 and on the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors are responsible for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union as set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' Report is not consistent with the Group financial statements, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding director's remuneration and other transactions is not disclosed.

We review whether the Corporate Governance statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's Corporate Governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group financial statements. The other information comprises only the Chairman's Statement, the Chief Executive's Statement, the Annual Review, the Operating and Financial Review, the Directors' Report, the Corporate Governance statement, the Internal Control statement, the unaudited part of the Directors' Remuneration Report and the Statement of Directors' responsibilities. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements.

Opinion

In our opinion the Group financial statements:

- give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 26 March 2006 and of its profit for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.

Ernst & Young LLP
Registered auditor
London
17 May 2006

Group income statement for the years ended 26 March 2006 and 27 March 2005

	Notes	2006 £m	2005* £m
Revenue	5	9,056	8,956
People costs	4	(5,968)	(5,839)
Royal Mail Group people:			
Wages and salaries		(4,530)	(4,330)
Pensions		(529)	(489)
Social security		(326)	(319)
Subpostmasters		(507)	(544)
Temporary resource		(76)	(157)
Distribution and conveyance costs	5	(1,218)	(1,183)
Other operating costs	5	(1,547)	(1,660)
Share of post tax profit from associates and joint ventures	12	32	28
Operating profit before exceptional items		355	302
Operating exceptional items	6	(210)	(277)
Operating profit		145	25
Profit/(loss) on disposal of businesses		6	(3)
Profit on disposal of property, plant and equipment		61	70
Profit before financing and taxation		212	92
Finance costs	5	(52)	(42)
Finance income – net pensions interest	5	101	59
– other	5	51	58
Profit before taxation		312	167
Taxation credit/(charge)	7	83	(16)
Profit for the financial year from continuing operations		395	151
Profit attributable to:			
Equity holder of the parent company		395	151
Minority interest		-	-

* Results are restated for the transition to IFRSs, apart for IAS 32 and IAS 39, which were adopted on 28 March 2005 – see note 31.

Group statement of recognised income and expense for the years ended 26 March 2006 and 27 March 2005

	Notes	2006 £m	2005 £m
Translation differences on foreign currency net investments		-	8
Actuarial (losses) and gains on defined benefit schemes	14	(1,659)	411
Gains on cash flow hedges taken to equity during the year		3	-
Transfers to income statement on cash flow hedges		(10)	-
Transfers to the balance sheet – on the carrying amount of non financial assets and liabilities		(1)	-
Taxation on items taken directly to equity	7/21	(26)	367
Net (expense)/income recognised directly in equity		(1,693)	786
Profit for the financial year		395	151
Total recognised (expense)/income for the period		(1,298)	937
Attributable to:			
Equity holder of the parent company		(1,298)	933
Minority interest		-	4
Effects of changes in accounting policy:			
Loss on first time adoption of IAS 32 and IAS 39		(3)	-

Group balance sheet at 26 March 2006 and 27 March 2005

	Notes	2006 £m	2005* £m
Non-current assets			
Property, plant and equipment	8	1,594	1,591
Goodwill	9	132	131
Intangible assets	10	42	21
Financial assets - investments	29	5	7
Investments accounted for using the equity method	12	124	131
Other receivables	18	6	14
Deferred tax assets	7	393	334
		2,296	2,229
Current assets			
Inventories	16	27	27
Trade and other receivables	17	1,093	1,091
Financial assets - investments	29	694	691
- derivatives	29	3	-
Cash and cash equivalents	19/29	1,161	1,340
		2,978	3,149
Non-current assets held for sale	13	11	-
Total assets		5,285	5,378
Current liabilities			
Trade and other payables	24	(2,014)	(2,352)
Income tax payable		(7)	-
Financial liabilities – interest bearing loans and borrowings	22/29	(361)	(375)
– derivatives	29	(3)	-
Provisions	23	(58)	(124)
		(2,443)	(2,851)
Non-current liabilities			
Financial liabilities - interest bearing loans and borrowings	22/29	(505)	(506)
Retirement benefit obligation	14	(5,588)	(3,958)
Provisions	23	(53)	(48)
Deferred tax liabilities	7	(3)	(5)
Other payables	25	(32)	(48)
		(6,181)	(4,565)
Total liabilities		(8,624)	(7,416)
Net liabilities		(3,339)	(2,038)
Equity			
Retained earnings	21	(4,270)	(3,085)
Hedging reserve	21	-	-
Foreign currency translation	21	8	8
Other reserves	21	919	1,035
Equity attributable to equity holder of parent company		(3,343)	(2,042)
Minority interest	21	4	4
Total equity		(3,339)	(2,038)

*Results are restated for the transition to IFRSs, apart for IAS 32 and IAS 39, which were adopted on 28 March 2005 – see note 31.

The accounts on pages 46 to 101 were approved by the Board of Directors on 17 May 2006 and signed on its behalf by:

Allan Leighton

Adam Crozier

Group cash flow statement for the year ended 26 March 2006 and 27 March 2005

	Notes	2006 £m	2005* £m
Cash flow from operating activities			
Operating profit before exceptional items		355	302
Depreciation and amortisation		174	148
Other non-cash movements (profits from associates and joint ventures)		(32)	(28)
		497	422
Changes in working capital and other non cash items		17	(387)
Decrease in stock		-	5
(Increase)/decrease in receivables		(7)	125
Increase in payables		91	53
Decrease in client balances		(75)	(444)
Increase/(decrease) in provisions		8	(126)
Cash payments in respect of exceptional items: Share in Success	(a)	(218)	-
other	(a)	(306)	(255)
Cash utilised in operations		(10)	(220)
Income tax recovered		4	13
Net cash outflows from operating activities		(6)	(207)
Cash flows from investing activities			
Proceeds from sale of property, plant and equipment		73	95
Dividends received from associates and joint ventures		30	19
Investment income (interest) received		53	52
Purchase of property, plant and equipment		(210)	(219)
Payment of deferred consideration in respect of prior years' acquisitions		(22)	(2)
Proceeds from sale of business		6	-
Purchase of business		(1)	(4)
Purchase of intangible assets		(33)	(4)
Proceeds from sale of other financial assets		2	-
Purchase of other financial assets		(3)	-
Net cash outflow from investing activities		(105)	(63)
Net cash outflow before financing activities		(111)	(270)
Cash flows from financing activities			
Payment of capital element of finance lease liabilities		(1)	(34)
Finance costs (interest) paid		(52)	(42)
Repayment of borrowings		(15)	(4)
New borrowings		-	325
Net cash (outflow)/inflow from financing activities		(68)	245
Net decrease in cash and cash equivalents		(179)	(25)
Cash and cash equivalents at the beginning of the period		1,340	1,365
Cash and cash equivalents at the end of the period	19	1,161	1,340

*Results are restated for the transition to IFRSs, apart for IAS 32 and IAS 39, which were adopted on 28 March 2005 – see note 31.

(a) Cash flows relating to operating exceptional items charged in both current and prior years

The net cash outflows relating to the above were as follows:

Net cash outflow relating to:	2006 £m	2005 £m
Current year exceptional items	38	12
Prior year exceptional items	486	243
Total	524	255

The net cash outflow of £524m comprises the £96m in respect of exceptional provisions, including £1m relating to pensions redundancy liabilities, a further £208m relating to the settlement of the prior year pension redundancy liabilities, £2m in respect of other costs which were recorded within creditors, and £218m Share in Success payment.

Notes to the Group accounts

1. Authorisation of financial statements and statement of compliance with IFRSs

The Group's financial statements for the year ended 26 March 2006 were authorised for issue by the Board on 17 May 2006 and the balance sheet was signed on the Board's behalf by Allan Leighton and Adam Crozier. Royal Mail Holdings plc is a public limited company owned by HM Government.

The Group's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union as they apply to the financial statements of the Group for the year ended 26 March 2006. The principal accounting policies adopted by the Group are set out in note 2.

2. Accounting policies

The adoption of IFRS has resulted in changes to the Group's accounting policies. The amended accounting policies are:

Basis of preparation and accounting

This is the first year in which the Group has prepared its financial statements under IFRSs and the comparatives have been restated from UK Generally Accepted Accounting Practice (UK GAAP) to comply with IFRSs. The Group issued its preliminary IFRSs financial statements for 2005 and the reconciliations to IFRSs from the previously published UK GAAP financial statements in November 2005, and these are published on the Royal Mail website and in note 31.

The Group financial statements are presented in sterling and all values are rounded to the nearest million pounds except when otherwise indicated.

Royal Mail Group plc is exposed to the risk of being fined by its industry Regulator and of being required to pay compensation to certain customers, as a result of failing to meet operational targets set by the Regulator in the Company's licence. The amount of such fines and compensation will be determined by the Regulator after further representations from the Company and no further information is being disclosed on the grounds that it can be expected to prejudice the outcome of that process.

Funding

Royal Mail Group plc

Royal Mail Group plc has net liabilities at 26 March 2006, primarily because of the pension deficit within its main pension plan, the Royal Mail Pension Plan. Consequently, Royal Mail Group plc is in default of its borrowing facilities with Government, but has received formal waivers from the Department of Trade and Industry, in its capacity as lender.

Royal Mail Group plc is profitable, even though it has to bear losses relating to stamped mail and carry out its Universal Service Obligations, but it now faces considerable cash requirements with respect to its proposed investment in plant and equipment and funding its pension deficit at a time when the market has been opened up to full competition.

It is therefore currently in discussion with its Shareholder around a new funding package, which will enable the transformation of the Company to take place and permit appropriate discussion with its pension Trustee with respect to the funding of its pension deficit. The Directors of Royal Mail Group plc believe that the financing package will be delivered shortly. If new financing is not made available, the Directors will have to review the cash requirements of its strategic plan that will result in a delay to the planned benefits. On the basis of careful consideration of cash flow projections the Directors have concluded that it is appropriate that the accounts have been prepared on a going concern basis.

Post Office Limited

Post Office Limited had net liabilities as at 26th March 2006 and, as explained in the Directors' Report and Operating Financial Review, continues to operate at a loss, primarily because of supporting the loss-making rural network.

To become viable in the longer term, new profitable business areas are being developed to replace the lost contribution from traditional income sources, significant cost reduction programmes are being implemented and continuing support for any loss-making rural network required by Government policy is being sought from Government.

However, until the above activities have been successfully completed, Post Office Limited will continue to be dependent on financial support from its parent company, Royal Mail Group plc, its ultimate parent company Royal Mail Holdings plc, and from the Government.

During the year, the Post Office Limited has produced a five-year strategic plan and its future financing is underpinned by:

- two tranches of rural network funding of £150m per annum for 2006-07 and 2007-08 for which state aid clearance has now been obtained;
- an existing short-term funding agreement of £145m with its parent through to March 2007;
- a new additional short-term funding agreement of £231m with its parent through to March 2008;
- an understanding that Government will agree a long-term funding arrangement; and
- Government being committed to a timetable, route map and consultation processes and, for any additional financing, that the necessary state aid applications will be commenced as soon as practical.

It is understood that the above process will specifically address the following financing issues:

- extending the existing working capital facility of £1.15bn which expires in March 2010; and
- providing a funding solution for the loss-making parts of the network.

Whilst the process referred to above is not expected to be completed for several months, after careful consideration, the Directors are confident that a satisfactory long-term resolution will be achieved during 2006-07 and that the Group will be able to meet future liabilities as they fall due.

Accordingly, on that basis, the Directors consider that it is appropriate that the accounts have been prepared on a going concern basis.

2. Accounting policies (continued)

Basis of consolidation

The consolidated financial statements comprise the accounts of Royal Mail Holdings plc and its subsidiary undertakings. The financial statements of the major subsidiaries are prepared for the same reporting year as the parent Company, using consistent accounting policies.

All intragroup balances and transactions, including unrealised profits arising from intragroup transactions, have been eliminated in full. Transfer prices between business segments are set on a basis of charges reached through a negotiation with the respective businesses.

Subsidiaries are consolidated from the date on which control is obtained by the Group and cease to be consolidated from the date on which control is no longer held by the Group. Where there is a loss of control of a subsidiary, the consolidated financial statements include the results for the part of the reporting year during which the Group has control.

Investments in associates and joint ventures

The Group's investments in its associates and joint ventures are accounted for under the equity method of accounting. Under the equity method, the investment is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of the net assets of the associate/joint venture, less any impairment in value. The income statement reflects the Group's share of post tax profits of the associate/joint venture.

Any goodwill arising on acquisition of an associate, representing the excess of the cost of the investment compared to the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities acquired, is included in the carrying amount and not amortised. To the extent that the net fair value of the associate's identifiable assets, liabilities and contingent liabilities is greater than the cost of the investment, a gain is recognised and added to the Group's share of the associate's profit or loss in the period in which the investment is acquired.

Revenue

Mails revenue

Account revenue is derived from specific contracts and recognised when the mail delivery is substantially complete. Prepaid revenue mainly relating to stamp and meter income is recognised when the sale is made, adjusted to reflect a value of stamp and meter credits held but not used by the customer.

Parcelforce Worldwide revenue

Account revenue is derived from specific contracts and recognised when the delivery of an item is substantially complete.

Post Office Limited revenue

Revenue is recognised when retail and financial services are provided.

General Logistics Systems

Revenue is derived from specific contracts and is recognised at the time of delivery.

Distribution and conveyance

Distribution and conveyance costs relate to third party costs incurred in carrying mail. These include conveyance by rail, road, sea and air, together with costs incurred by international mail carriers and Parcelforce Worldwide delivery operators. These costs are disclosed separately on the face of the income statement.

Operating profit before exceptional items.

Operating profit is the profit arising from the normal, recurring operations of the business. This incorporates revenue, people costs, operating costs including distribution and conveyance, and the Group's post tax share of profits from associates and joint ventures. Operating exceptional items are separately identified.

Operating exceptional items

Operating exceptional items are material items of income and expenditure which due to the nature of the events giving rise to them, require separate presentation on the face of the income statement or in a note to allow a better understanding of financial performance in the year, in comparison to prior years.

Operating profit

Operating profit is the profit arising from the normal, recurring operations of the business and after charging operating exceptional items defined above. It excludes the non operating items for profit or loss on disposal of businesses and profit or loss on disposal of surplus property, plant and equipment. These items are not part of the normal recurring operations of the business but are material, so are presented separately on the face of the income statement to allow a better understanding of financial performance in the year, in comparison to prior years.

Goodwill

Business combinations on or after 29 March 2004 are accounted for under IFRS 3 'Business Combinations' using the purchase method. Any excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities is recognised in the balance sheet as goodwill and is not amortised.

After initial recognition, goodwill is stated at cost less any accumulated impairment losses. Goodwill arising from business combinations is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. An impairment loss is recognised in the income statement for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

For the purpose of these impairment reviews, goodwill is allocated to the related cash generating units as monitored by management.

Goodwill arising on the acquisition of equity accounted entities is included in the cost of those entities and therefore not reported in the balance sheet as goodwill.

2. Accounting policies (continued)

Intangible assets

Intangible assets acquired as part of a business combination are capitalised separately from goodwill if the fair value can be measured reliably on initial recognition. Intangible assets acquired separately or generated internally are initially recognised at cost and are assessed to have either a finite or indefinite useful life. Those with a finite life are amortised over their useful life and those with an indefinite life are reviewed annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. An impairment loss is recognised in the income statement for the amount by which the carrying value of the asset exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Finite lives of intangible assets are in the range of 1-6 years. Amortisation of intangible assets with finite lives is taken annually to the income statement.

Property, plant and equipment

Property, plant and equipment is recognised at cost, including attributable costs in bringing the asset into working condition for its intended use. Depreciation of property, plant and equipment is provided on a straight-line basis by reference to original cost and to the remaining useful economic lives of assets and their estimated residual values. The useful lives and residual values are reviewed annually and adjustments, where applicable, are made on a prospective basis. The lives assigned to major categories of property, plant and equipment and remaining lives are:

	Average remaining lives	Range of asset lives
Land and buildings:		
Freehold land	Not depreciated	Not depreciated
Freehold buildings	14 years	Up to 50 years
Leasehold land and buildings	9 years	The shorter of the period of the lease, 50 years or the estimated remaining useful life
Plant and machinery	5 years	3-15 years
Motor vehicles and trailers	3 years	1-12 years
Fixtures and equipment	2 years	2-15 years

Property that the Group has identified as surplus is classified as 'available for sale'. When authority to market property categorised in this manner has been approved and the property is vacant and therefore available for immediate occupation, the property is transferred in line with IFRS 5 into 'Non-current assets held for sale', a separate category on the balance sheet. Such properties are expected primarily to generate economic cash flow by sale of the asset rather than by operational activities.

Leases

Finance leases, where substantially all the risks and rewards incidental to ownership of the leased item have passed to the Group are capitalised at the inception of the lease with a corresponding liability recognised for the fair value of the leased item or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Leases where substantially all the risks and rewards of ownership of the asset are retained by the lessor, are classified as operating leases and rentals are charged to the income statement over the lease term. The aggregate benefit of incentives are recognised as a reduction of rental expenses over the lease term on a straight-line basis.

Inventories

Inventories are valued at the lower of cost and net realisable value after adjusting for obsolete or slow moving stock. In the case of Post Office® Counter Services, inventories include retail stocks and lottery products.

Trade and other receivables

Trade receivables are recognised and carried at original invoice amount less an allowance for any non-collectable amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

Cash and cash equivalents

Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity date of three months or less. In addition the Group use Money Market funds as a readily available source of cash, which are bought and sold on a daily basis to meet the cash requirements of the business. These funds are also categorised as cash equivalents.

For the purpose of the cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of bank overdrafts.

2. Accounting policies (continued)

Financial assets - investments

Financial assets within the scope of IAS 39 'Financial Instruments: Recognition and Measurement' are classified as; financial assets at fair value through income statement; loans, and receivables; held to maturity investments; or as available for sale financial assets, as appropriate. The Group determines the classification of its financial assets at initial recognition and re-evaluates this designation at each financial year end. When financial assets are recognised initially, they are measured at fair value, being the transaction price plus, in the case of financial assets not at 'fair value through the income statement', any directly attributable transactional costs. The Group has followed the transitional provisions of IFRS 1 'First time Adoption of IFRS' to adopt IAS 32 'Financial Instruments: Disclosure and Presentation' and IAS 39 'Financial Instruments: Recognition and Measurement' from 28 March 2005, the first day of the 2005-06 financial year, and not restate comparative amounts on first applying IAS 32 and IAS 39. The comparative disclosures therefore reflect the requirements of FRS 13 'Derivatives and other Financial Instruments: Disclosures'.

The subsequent measurement of financial assets depends on their classification as follows:

Financial assets at fair value through the income statement (held for trading)
Financial assets are classified as held for trading if they are acquired for sale in the short term. Derivatives are also classified as held for trading unless they are designated as hedging instruments. Assets are carried in the balance sheet at fair value with gains or losses on 'financial assets at fair value through the income statement' recognised in the income statement.

Held-to-maturity investments
Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as 'held to maturity' when the Group has the positive intention and ability to hold to maturity. Held to maturity investments are carried at amortised cost using the effective interest rate method. Gains and losses are recognised in the income statement when the investments are derecognised or impaired, as well as through the amortisation process. Investments intended to be held for an undefined period are not included in this classification. Prior to 28 March 2005, the Group held such investments at historic cost less any provision for impairment, except Government gilt-edged securities, which were stated at market value and will now be categorised as 'held for trading'.

Loans and receivables
Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, do not qualify as trading assets and have not been designated as either 'fair value through the income statement' or available for sale. Such assets are carried at amortised cost using the effective interest rate method if the time value of money is significant. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available for sale financial assets
'Available for sale financial assets' are non-derivative financial assets that are designated as such or are not classified in any of the three preceding categories. After initial recognition, available for sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised, or until the investment is deemed to be impaired at which time the cumulative gain or loss previously reported in equity is included in the income statement.

The fair value of quoted investments is determined by reference to bid prices at the close of business on the balance sheet date. Where there is no active market, fair value is determined using valuation techniques. These include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; and discounted cash flow analysis and pricing models. Otherwise assets will be carried at cost.

Income tax and deferred tax

The charge for current taxation is based on the results for the year as adjusted for items that are non-assessable or disallowed. It is calculated using rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date, between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences except:

- initial recognition of goodwill;
- the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction affects neither the accounting profit nor taxable profit or loss; and
- taxable temporary differences associated with investments in subsidiaries, associates and interest in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Other than stated below, deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carry-forward of unused tax assets, and unused tax losses can be utilised. Deferred tax assets are not recognised in respect of:

- deductible temporary differences arising from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor the taxable profit or loss; and
- deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary difference will be utilised.

2. Accounting policies (continued)

The carrying amount of deferred tax assets is reviewed at each balance sheet date and increased or reduced to the extent that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the tax asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date. Deferred tax balances are not discounted.

Deferred tax is charged or credited directly to equity if it relates to items that are credited or charged to equity. Otherwise it is recognised in the income statement.

Supplier payment policy

The policy of the Company and its principal operating subsidiaries is to use their purchasing power fairly. Payment terms are agreed in advance for all major contracts. For lower value transactions, the standard payment terms of the supplier apply. It is the Company's policy to abide with the agreed terms. The Company and its principal operating subsidiaries in the UK have sought to comply with the DTI's Better Payment Practice Code. Copies of this can be obtained from the DTI. As the Company is a non-operating company, the creditor days are zero. The creditor days of the operating subsidiaries can be found in their accounts.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Pensions and other post-retirement benefits

Membership of occupational pension schemes is open to most permanent UK employees of the Group. All members of defined benefit schemes are contracted out of the earnings-related part of the State pension scheme. Overseas subsidiaries make separate arrangements for the provision of pensions and other post-retirement benefits.

The plans' assets of the defined benefit schemes are measured at fair value. Liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term. Full actuarial valuations are carried out at intervals not normally exceeding three years as determined by the Trustees and are updated at each balance sheet date. The resulting defined benefit asset or liability is presented separately on the face of the balance sheet.

For defined benefit schemes, the amounts charged to operating profit and included as part of people costs are the current service costs and any gains and losses due on settlements and curtailments. Past service costs are charged to operating profit immediately if benefits have vested. If the benefits have not vested immediately, the costs are recognised by equal annual instalments over the period until vesting occurs. The net difference between the interest costs and the expected return on plan assets is recognised as finance costs or finance income respectively. Actuarial gains and losses are recognised immediately in the statement of recognised income and expense (SORIE). Any deferred tax movement associated with the actuarial gains and losses is also recognised in the SORIE.

For defined contribution schemes, the Group's contributions are charged to operating profit as part of people costs in the period to which the contributions relate.

Research and development

Expenditure on research is written off in the year it is incurred. Development costs are capitalised where they meet the criteria required under IFRS. If these criteria are not met, then the costs are recognised in the income statement as they are incurred.

Foreign currencies

The functional and presentational currency of Royal Mail Holdings plc is sterling (£). The functional currency of the overseas subsidiaries in Europe is mainly the euro (€).

The assets and liabilities of foreign operations are translated at the rate of exchange ruling at the balance sheet date. The trading results of foreign operations are translated at the average rates of exchange for the reporting period, being a reasonable approximation to the actual transaction rate. The exchange differences arising on the translation, since the date of transition to IFRS, are taken directly to the foreign currency translation reserve in equity.

Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the income statement, except when hedge accounting is applied and for differences on monetary assets and liabilities that form part of the Group's net investment in a foreign operation. These are taken directly to equity until the disposal of the net investment, at which time they are recognised in profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in foreign currency are translated using the exchange rates at the date when the fair value is determined.

Derivative financial instruments

The Group uses derivative instruments such as foreign currency contracts in order to manage the risk profile of any underlying risk exposure of the Group, in line with the Group's treasury management policies. Such derivative financial instruments are initially stated at fair value.

For the purpose of hedge accounting, hedges are classified as cash flow hedges where they hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a forecasted transaction.

In relation to cash flow hedges to hedge the foreign exchange risk of firm commitments that meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion is recognised in the income statement.

2. Accounting policies (continued)

When the hedged firm commitment results in the recognition of a non financial asset or non financial liability, then, at the time the asset or liability is recognised, the associated gains or losses that had previously been recognised in equity are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same year in which the hedged firm commitment affects the net profit/loss, for example when the future sale actually occurs.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement in the period.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement for the year.

In accordance with the exemption under IFRS 1, comparative information has been prepared under previous UK GAAP (FRS13) and not IAS 32 and IAS 39. As a consequence derivative assets and liabilities were not included in the balance sheet at 27 March 2005. The comparative information in the financial statements is presented in line with the accounting policy followed under UK GAAP as follows.

The Group uses forward foreign currency contracts to reduce exposure to foreign exchange rates. The Group's policy is that its derivative instruments qualify for hedge accounting when the following criteria are met:

- the instrument must be related to a foreign currency asset or liability that is probable and whose characteristics have been identified;
- it must involve the same currency as the hedged item; and
- it must reduce the risk of foreign currency movements on the Group's operations.

The contracted rates are used to record the hedged item. As a result, gains and losses are offset against the foreign exchange gains or losses on the related financial assets and liabilities. Where the instrument is used to hedge a committed or probable future transaction, gains or losses are not recognised until the transaction occurs.

In addition, over-the-counter derivative products are used to manage both the commodity and foreign exchange risks associated with the fuel procurement policy. Further details on financial instruments can be found in note 29 to the accounts.

Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at the fair value of the consideration received, less directly attributable issue costs.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in the income statement when the liabilities are derecognised or impaired, as well as through the amortisation process.

Segmental information

The Group discloses segmental results as required by IAS 14 'Segment Information'. The Group's primary reporting format is by business segments and its secondary format is by geographical segments. The operating segments are organised and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves largely different markets.

Royal Mail is the Group's letters business and delivers letters to all addresses in the United Kingdom. Royal Mail offers a number of products to both business and domestic users.

Parcelforce Worldwide is the parcels business unit operating within the UK.

Post Office Limited is a limited company responsible for the 'High Street' Post Office® 'counters' branches offering a series of retail services to its customers.

General Logistics Systems is the European parcels business, which via its subsidiaries and partners offers its services in 34 European countries.

Transfer prices between business segments are set on a basis of charges reached through negotiation with the respective businesses.

2. Accounting policies (continued)

New standards and interpretations not applied

During the year, the International Accounting Standards Board (IASB) and International Financial Reporting Interpretations Committee (IFRIC) have issued the following standards and interpretations with an effective date for accounting periods beginning on or after the date of these financial statements:

International Accounting Standards (IAS/IFRSs)	Effective date
IFRS 1 Amendment relating to IFRS 1	1 January 2006
IFRS 4 Insurance Contracts (Amendments to IAS 39 and IFRS 4 – Financial Guarantee Contracts)	1 January 2006
IFRS 6 Exploration for and Evaluation of Mineral Assets	1 January 2006
IFRS 6 Amendment relating to IFRS 6	1 January 2006
IFRS 7 Financial Instruments: Disclosures	1 January 2007
IAS 1 Amendment – Presentation of Financial Statements: Capital Disclosures	1 January 2007
IAS 21 Amendment – the Effects of Changes in Foreign Exchange Rates - net investment in a Foreign Operation	1 January 2006
IAS 39 Fair Value Option	1 January 2006
IAS 39 Amendments to IAS 39 – Transition and Initial Recognition of Financial Assets and Financial Liabilities (Day 1 profits)	1 January 2006
IAS 39 Cash Flow Hedge Accounting	1 January 2006
IAS 39 Amendment to IAS 39 and IFRS 4 – Financial Guarantee Contracts	1 January 2006
International Financial Reporting Interpretations Committee (IFRIC)	
IFRIC 4 Determining whether an Arrangement contains a Lease	1 January 2006
IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds	1 January 2006
IFRIC 6 Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment	1 December 2005
IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies	1 March 2006
IFRIC 8 Scope of IFRS 2	1 May 2006
IFRIC 9 Reassessment of Embedded Derivatives	1 June 2006

The Directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application.

Upon adoption of IFRS 7 'Financial Instruments: Disclosure', the Group will have to disclose additional information about its financial instruments, their significance and the nature and extent of risks they give rise to. More specifically, the Group will need to disclose the fair value of its financial instruments and its risk exposure in greater detail. There will be no effect on reported income or net assets.

3. Segmental information

The Group discloses its segmental results into five classes of business: Royal Mail, Parcelforce Worldwide, Post Office Limited, General Logistics Systems and other businesses. The latter comprises two fully owned subsidiaries – Postcap (Guernsey) Limited and Royal Mail Pensions Trustees Limited, two part owned subsidiaries – Romec Limited and NDC 2000 Limited - and the Group's investments in the following associates – Quadrant Catering Limited, Camelot Group plc and Camelot International Services Limited.

Analysis of segment revenue by class of business and geographic area of origin

	Year to 26 March 2006			Year to 27 March 2005 £m		
	Total revenue	Revenue between segments	Segment revenue	Total revenue	Revenue between segments	Segment revenue
Royal Mail	6,966	(107)	6,859	6,873	(110)	6,763
Parcelforce Worldwide	319	(5)	314	313	(15)	298
Post Office Limited	1,174	(336)	838	1,287	(311)	976
Other businesses	8	-	8	6	-	6
Total UK operations	8,467	(448)	8,019	8,479	(436)	8,043
General Logistics Systems (principally Europe)	1,037	-	1,037	913	-	913
Total revenue from continuing operations	9,504	(448)	9,056	9,392	(436)	8,956

Transfer prices between business segments are set on a basis of charges reached through a negotiation with the respective businesses.

Analysis of segment result by class of business and geographic area of origin

Year to 26 March 2006 £m

	Operating profit before exceptional items	Less share of profit from joint ventures and associates	Operating exceptional items	Profit on disposal of property plant and equipment	Profit on disposal of businesses	Segment result
Royal Mail	344	(1)	(152)	53	6	250
Parcelforce Worldwide	5	-	(2)	-	-	3
Post Office Limited	(111)	(19)	(56)	8	-	(178)
Other businesses	17	(12)	-	-	-	5
Total UK operations	255	(32)	(210)	61	6	80
General Logistics Systems (principally Europe)	100	-	-	-	-	100
Segment result from continuing operations	355	(32)	(210)	61	6	180

Not included in the segment result is share of profit from joint ventures and associates £32m (2005 £28m), net pensions interest of £101m (2005 £59m), other finance income £51m (2005 £58m), finance costs of £52m (2005 £42m) and taxation credit of £83m (2005 charge of £16m), which when added reconciles to the 'profit for the financial year from continuing operations' in the income statement of £395m (2005 £151m).

Year to 27 March 2005 £m

	Operating profit before exceptional items	Less share of profit from joint ventures and associates	Operating exceptional items	Profit on disposal of property plant and equipment	Loss on disposal of businesses	Segment result
Royal Mail	343	-	(251)	56	(3)	145
Parcelforce Worldwide	(6)	-	8	-	-	2
Post Office Limited	(123)	(17)	(34)	14	-	(160)
Other businesses	15	(11)	-	-	-	4
Total UK operations	229	(28)	(277)	70	(3)	(9)
General Logistics Systems (principally Europe)	73	-	-	-	-	73
Segment result from continuing operations	302	(28)	(277)	70	(3)	64

3. Segmental information (continued)

Analysis of net assets/(liabilities) by class of business

	Year to 26 March 2006 Assets £m	(Liabilities) £m	Year to 27 March 2005 Assets £m	(Liabilities) £m
Royal Mail	2,000	(6,162)	1,943	(5,020)
Parcelforce Worldwide	111	(396)	121	(314)
Post Office Limited	1,179	(957)	1,322	(985)
Other businesses	75	(56)	62	(44)
Total UK operations	3,365	(7,571)	3,448	(6,363)
General Logistics Systems (principally Europe)	457	(174)	406	(168)
Unallocated	1,463	(879)	1,524	(885)
Total assets/(liabilities)	5,285	(8,624)	5,378	(7,416)

The above analysis may differ to individual company statutory accounts, mainly due to unallocated assets and liabilities and the exclusion of intercompany balances.

'Non-current assets held for sale' of £11m (2005 £nil) have been allocated to Royal Mail £8m, (2005 £nil), Post Office Limited £2m (2005 £nil), and Parcelforce Worldwide £1m (2005 £nil).

Unallocated assets and liabilities comprise the following items:

	Year to 26 March 2006 Unallocated assets £m	Unallocated (liabilities) £m	Year to 27 March 2005 Unallocated assets £m	Unallocated (liabilities) £m
Cash	361	-	484	-
Financial assets - investments	699	-	698	-
Interest receivables/(payables)	7	(1)	8	-
Loans and borrowings	-	(865)	-	(879)
Derivative financial assets/(liabilities)	3	(3)	-	(1)
Current tax	-	(7)	-	-
Deferred tax	393	(3)	334	(5)
Total	1,463	(879)	1,524	(885)

3. Segmental information (continued)

Other segment information

	Year to 26 March 2006			
	Additions		Non-cash expenses	
	Property, ntandequipment	ngibleassets	Depreciation/ amortisation	Impairment
	£m	£m	£m	£m
Royal Mail	164	27	(148)	(11)
Parcelforce Worldwide	2	-	-	(1)
Post Office Limited	11	15	(1)	(31)
Other businesses	-	-	-	(1)
Total UK operations	177	42	(149)	(44)
General Logistics Systems (principally Europe)	42	-	(25)	-
Total	219	42	(174)	(44)

	Year to 27 March 2005			
	Additions		Non-cash expenses	
	Property, lantandequipment	ngibleassets	Depreciation/ amortisation	Impairment
	£m	£m	£m	£m
Royal Mail	190	-	(131)	-
Parcelforce Worldwide	4	-	-	(4)
Post Office Limited	8	-	(1)	(19)
Other businesses	-	-	-	-
Total UK operations	202	-	(132)	(23)
General Logistics Systems (principally Europe)	22	-	(16)	-
Total	224	-	(148)	(23)

4. People costs and Directors' emoluments

(a) People costs – including Directors' emoluments (see note (b))

	2006 £m	2005 £m
Wages and salaries	4,530	4,330
Pensions (see note 14)	529	489
Social security	326	319
Subpostmasters	507	544
Temporary resource	76	157
Total	5,968	5,839

The staff numbers, calculated on a headcount basis, were:

	Period end employees		Average employees	
	2006	2005	2006	2005
Royal Mail	174,202	176,030	176,415	174,431
Parcelforce Worldwide	4,092	4,363	4,183	4,715
Post Office Limited	11,327	12,145	11,774	12,510
Other businesses	3,348	3,906	3,588	4,296
UK wholly owned subsidiaries	192,969	196,444	195,960	195,952
Partially owned subsidiaries	4,852	4,944	4,854	4,963
Overseas, including GLS	11,045	10,768	10,671	10,408
Group total	208,866	212,156	211,485	211,323

	2006	2005
Number of subpostmasters at the end of the year	11,608	12,020

(b) Directors' emoluments

	2006 £000	2005 £000
Directors' emoluments	3,683	4,105
Amounts receivable under Long-Term Incentive Plans	463	3,832

Number of Directors accruing benefits under defined benefit schemes	4	5

5. Revenues and expenses

Revenue:

	2006 £m	2005 £m
Revenue - rendering of services	9,056	8,956
Finance income	152	117
Total revenue	9,208	9,073

Expenses:

(a) Group operating profit before exceptional items is stated after charging:

	2006 £m	2005 £m
Pensions charge:	529	489
Cash	343	314
Non-cash	186	175

5. Revenues and expenses (continued)

	2006 £m	2005 £m
Depreciation and amortisation:	174	148
Depreciation of owned property, plant and equipment	149	126
Depreciation of property, plant and equipment under finance leases and hire purchase agreements	18	21
Amortisation of intangible assets	7	1
Distribution and conveyance costs:	1,218	1,183
Operating lease charges on vehicles	66	93
Other distribution and conveyance	1,152	1,090
Property, facilities and maintenance costs	254	329
Computers and telephones costs	276	317
Consultancy, marketing and legal fees	174	186
Research and development expenditure	1	1
Operating lease charges on property, plant and equipment (excluding vehicles)	179	178
Regulatory body costs:	20	20
Postcomm	9	10
Postwatch	11	10
(b) Finance costs	(52)	(42)
Interest payable on DTI borrowings	(48)	(36)
Other interest payable	(4)	(6)
Finance income	152	117
Interest received on investments	48	55
Other interest receivable	3	3
Net pensions interest (note 14)	101	59

Included within finance income is £5m (2005 £6m) relating to income on assets at fair value through the income statement. The remaining finance income (excluding net pensions interest) of £46m (2005 £52m) is interest income on financial assets not at fair value through the income statement. All finance costs £52m (2005 £42m) are on financial assets that are not at fair value through the income statement.

(c) Auditors' remuneration

	2006 £'000	2005 £'000
Auditors' remuneration:		
Audit of statutory financial statements	2,026	1,686
Audit of regulatory accounts	303	287
Other assurance services	787	570
Tax services	368	602
Total auditors' remuneration	3,484	3,145

6. Operating exceptional items

	2006 £m	2005 £m
Operating exceptional items:		
Share in Success	(91)	(218)
Provision for restructuring (note 23)	(75)	(36)
Impairment of property plant and equipment (note 8)	(17)	(23)
Impairment of intangible assets (note 10)	(15)	-
Impairment of goodwill relating to associates (note 12)	(9)	-
Impairment of property subsequent to categorisation as non-current assets held for sale (note 13)	(3)	-
Total operating exceptional items	(210)	(277)

The £75m restructuring charge is all in respect of employee related costs (2005 £34m employee related and £2m other operating costs respectively). Of the above impairments, £31m (2005 £19m) relates to Post Office Limited (see note 3). Due to ongoing losses, the carrying value of asset purchases made by Post Office Limited during the year have been impaired to recoverable amount. The £9m impairment of goodwill relating to associates comprises £8m for G3 Worldwide Mail N.V. (Spring) and £1m for Camelot International Services Limited.

The Share in Success scheme was launched during 2002. Under the scheme, eligible employees received a one-off discretionary payment on the successful completion of the Group's three-year Renewal Plan. The cost of the three-year scheme was charged to the income statement in 2004-05. A second Share in Success scheme was launched during 2005. Eligible employees and subpostmasters receive a one-off discretionary payment if a specific profit target is met.

7. Income tax

The major components of income tax (credit)/expense for the years ended 26 March 2006 and 27 March 2005 are:

	2006 £m	2005 £m
Tax charged in the consolidated income statement		
Current income tax		
Current UK income tax charge	21	28
Foreign tax	25	12
Adjustments in respect of current income tax of previous years	(10)	(20)
Deferred income tax		
Relating to origination and reversal of temporary differences	(119)	(4)
Income tax (credit)/expense reported in the consolidated income statement	(83)	16
Tax charged to equity		
Income tax related to items charged or credited directly to equity		
Deferred income tax related to actuarial gains/(losses) in the pension deficit	58	(326)
Current income tax relief for pension deficiency payment	(32)	(41)
Income tax debit/(credit) reported in equity	26	(367)

7. Income tax (continued)

A reconciliation between tax expense and the product of accounting profit multiplied by the UK rate of Corporation Tax for the years ended 26 March 2006 and 27 March 2005 is as follows:

	2006 £m	2005 £m
Accounting profit before tax from continuing operations	312	167
At UK standard rate of Corporation Tax of 30%	93	50
Overseas current tax rates	8	4
Tax overprovided in previous years	(10)	(21)
Non-deductible expenses	19	17
Associates' profit after tax charge included in Group pre-tax profit	(7)	(7)
Net decrease in tax charge resulting from recognition of deferred tax assets	(169)	(5)
Profit from asset disposals eligible for relief	(17)	(20)
Other	-	(2)
At the effective income tax rate of (27)% (2005: 10%)	(83)	16
Tax (credit)/charge in the income statement	(83)	16

Deferred tax relates to the following:

	Balance sheet		Income statement	
	2006 £m	2005 £m	2006 £m	2005 £m
Liabilities				
Accelerated capital allowances	(3)	(5)	2	(4)
Assets				
Deferred capital allowances	36	-	36	-
Provisions	11	25	(14)	25
Pensions temporary differences	317	282	93	(44)
Losses available for offset against future taxable income	10	9	1	9
Goodwill qualifying for tax allowances	19	18	1	18
Gross deferred tax assets	393	334		
Net deferred tax asset	390	329		
Consolidated income statement			119	4

The Group has unrecognised deferred tax assets of £1,380m (2005 £970m) relating to the retirement benefit obligation, £224m (2005 £245m) relating mainly to fixed asset timing differences, and £113m (2005 £108m) relating to tax losses in subsidiaries that are available to offset against future taxable profits. The Group has capital losses carried forward, the tax effect of which is £12m (2005 £11m). The Group has rolled over capital gains of £83m (2005 £78m); no tax liability would be expected to crystallise should the assets into which the gains have been rolled be sold at their carrying value, as it is anticipated that a capital loss would arise.

At 26 March 2006, there was no recognised or unrecognised deferred income tax liability (2005 £nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries, associates or joint ventures as the Group has no liability to additional taxation should such amounts be remitted due to the availability of double taxation relief or other exemptions.

8. Property, plant and equipment

	Land and buildings						2006
Cost	Freehold £m	Long leasehold £m	Short leasehold £m	Plant and machinery £m	Motor vehicles £m	Fixtures and equipment £m	Total £m
At 28 March 2005	1,498	254	476	743	199	798	3,968
Exchange movements	1	-	-	-	-	-	1
Reclassification	(10)	3	7	-	-	-	-
Additions	62	7	16	54	60	20	219
Disposal of subsidiaries	-	-	-	(1)	-	-	(1)
Disposals	(14)	-	(5)	(2)	(29)	(7)	(57)
Reclassification to assets held for sale	(47)	(4)	-	-	-	-	(51)
At 26 March 2006	1,490	260	494	794	230	811	4,079
Depreciation and impairment							
At 28 March 2005	704	147	220	423	111	772	2,377
Exchange movements	-	-	-	-	-	-	-
Reclassification	-	-	-	-	-	-	-
Charge for the year	42	7	25	51	30	12	167
Impairment	6	-	6	-	-	5	17
Disposal of subsidiaries	-	-	-	(1)	-	-	(1)
Disposals	(8)	-	(5)	(2)	(28)	(7)	(50)
Reclassification to assets held for sale	(21)	(4)	-	-	-	-	(25)
At 26 March 2006	723	150	246	471	113	782	2,485
Net book value							
At 26 March 2006	767	110	248	323	117	29	1,594
At 28 March 2005	794	107	256	320	88	26	1,591

Depreciation rates are disclosed within the accounting policies. No depreciation is provided on freehold land, which represents £131m (2005 £144m) of the total cost of properties. The net book value of the Group's property, plant and equipment held under hire purchase contracts and finance leases amounts to £54m (2005 £72m) all relating to plant and machinery. The net book value of the Group's property, plant and equipment includes £73m (2005 £128m) in respect of assets in the course of construction.

	Land and buildings						2005
Cost	Freehold £m	Long leasehold £m	Short leasehold £m	Plant and machinery £m	Motor vehicles £m	Fixtures and equipment £m	Total £m
At 29 March 2004	1,494	246	457	693	190	779	3,859
Exchange movements	3	-	-	2	-	1	6
Reclassification	(48)	5	43	-	-	-	-
Additions	84	11	-	47	60	22	224
Acquisition of subsidiaries	7	-	-	3	-	1	11
Disposals	(42)	(8)	(24)	(2)	(51)	(5)	(132)
At 27 March 2005	1,498	254	476	743	199	798	3,968
Depreciation and impairment							
At 29 March 2004	691	141	203	375	136	763	2,309
Exchange movements	1	-	-	1	-	1	3
Reclassification	(11)	2	9	-	-	-	-
Charge for the year	41	6	26	48	18	8	147
Impairment	6	2	7	-	4	4	23
Disposals	(24)	(4)	(25)	(1)	(47)	(4)	(105)
At 27 March 2005	704	147	220	423	111	772	2,377
Net book value							
At 27 March 2005	794	107	256	320	88	26	1,591
At 29 March 2004	803	105	254	318	54	16	1,550

8. Property, plant and equipment (continued)

Impairment of property, plant and equipment

An impairment loss of £17m (2005 £23m) was recognised as an operating exceptional item (note 6), to reduce the carrying amount of certain asset purchases during the year to their recoverable amount. Of the impairment loss, £15m (2005 £19m) related to Post Office Limited (due to its loss-making activities), £1m (2005 £4m) to Parcelforce Worldwide and £1m (2005 £nil) to properties.

9. Goodwill

Cost	2006 £m	2005 £m
At 28 March 2005 and 29 March 2004	475	479
Exchange movement	-	7
Additions	1	22
Disposal of business	-	(33)
At 26 March 2006 and 27 March 2005	**476**	475
Impairment losses		
At 28 March 2005 and 29 March 2004	344	372
Exchange movement	-	5
Disposal of business	-	(33)
At 26 March 2006 and 27 March 2005	**344**	344
Net book value		
At 26 March 2006 and 27 March 2005	**132**	131
At 28 March 2005 and 29 March 2004	131	107

The carrying value of goodwill arising on business combinations of £132m (2005 £131m) at the balance sheet date, includes £131m (2005 £130m) relating to the General Logistics Systems ('GLS') business segment. In line with the accounting policy (see note 2), this goodwill has been reviewed for impairment. An impairment loss is recognised for the amount by which the carrying value of an asset or cash generating unit exceeds the recoverable amount. The recoverable amount is the higher of net realisable value and value in use. The carrying value of GLS, excluding interest bearing and tax related assets and liabilities, is £283m at year end (see note 3) and the operating profit before exceptional items is £100m for the year (see note 3). The carrying value represents a multiple of 2.8 on operating profit before exceptional items. The net realisable value of GLS, for the purposes of the impairment review (i.e. the 'fair value less costs to sell'), has been assessed with reference to earnings multiples for quoted entities in a similar sector. On this basis, the net realisable value of GLS has been assessed to be in excess of the carrying value. No reasonable possible change in the earnings multiples referenced would reduce the net realisable value to below the carrying value.

From 29 March 2004, the date of transition to IFRS, goodwill is no longer amortised but subject to annual impairment reviews.

10. Intangible assets

	2006				2005			
Cost	Master franchise licences £m	Customer listings £m	Software licences £m	Total £m	Master franchise licences £m	Customer listings £m	Software licences £m	Total £m
At 28 March 2005 and 29 March 2004	19	6	-	25	19	-	-	19
Additions	-	-	42	42	-	-	-	-
Acquisition of subsidiaries	-	1	-	1	-	6	-	6
At 26 March 2006 and 27 March 2005	**19**	**7**	**42**	**68**	19	6	-	25
Amortisation								
At 28 March 2005 and 29 March 2004	4	-	-	4	3	-	-	3
Impairment	-	-	15	15	-	-	-	-
Amortisation	4	3	-	7	1	-	-	1
At 26 March 2006 and 27 March 2005	**8**	**3**	**15**	**26**	4	-	-	4
Net book value								
At 26 March 2006 and 27 March 2005	**11**	**4**	**27**	**42**	15	6	-	21
At 28 March 2005 and 29 March 2004	15	6	-	21	16	-	-	16

The intangible assets recognised in the Group's balance sheet do not have indefinite lives.

The net book value of intangible assets at 26 March 2006 consists of:

- master franchise licences of £11m. These are being written down on a straight-line basis over their remaining economic life of between 2 and 5 years;
- customer listings of £4m. These are being written down on a straight-line basis over their remaining economic lives of between 1 and 4 years; and
- software costs of £27m. These are being written down on a straight-line basis over their remaining economic lives of between 1 and 5 years.

The amortisation charge of £7m relating to intangible assets is aggregated within 'other operating costs' within the income statement and disclosed in note 5 to the accounts.

11. Business combinations

The acquisition method of accounting has been used. There have been no material acquisitions during the year and therefore the following disclosures have been made on an aggregated basis.

The following table sets out the identifiable assets and liabilities acquired at their provisional fair value to the Group, which was consistent with their book values.

	2006 £m	2005 £m
Property, plant and equipment	-	11
Current assets		
Debtors	-	37
Cash and bank	-	6
Total assets	-	54
Liabilities		
Trade creditors	-	(40)
Net assets acquired	-	14
Minority interest	-	(4)
Carrying value of investment in related joint venture/associates at date of change in status to subsidiary undertaking	-	(10)
Intangible assets arising on acquisition	1	6
Goodwill arising on acquisition	1	22
Carrying amount of investment	2	28
Discharged by:		
Purchase consideration paid in the year	1	4
Deferred purchase consideration	1	24
Fair value of consideration	2	28

Fair values have been assigned to the identifiable assets and liabilities acquired, as detailed above. The in year acquisitions comprise £1m in respect of the remaining 9% shareholding of GLS Stafetten A/S (giving the Group 100% ownership) in April 2005 and £1m relating to customer listings for GLS Italy in December 2005. Profits generated from these acquisitions are not material for 2005-06.

The prior year acquisitions represent GLS Poland £20m, and the acquisition of franchisee businesses in GLS Italy, namely DGE Vicenza £5m and DGE Firenze £3m.

12. Investments accounted for using the equity method

	2006 £m	2005 £m
Investments in associates	72	90
Investments in joint venture	52	41
Investments accounted for using the equity method	124	131

(a) Investments in associates

	At 28 March 2005 £m	Impairment £m	Share of post tax pre dividend profit from associates £m	Dividends £m	At 26 March 2006 £m
Share of net assets in associates	65	-	4	(13)	56
Goodwill relating to associates	25	(9)	-	-	16
Net investments in associates	90	(9)	4	(13)	72

During the year impairments of £9m, relating to goodwill with respect to G3 Worldwide Mail N.V. (Spring) £8m, and Camelot International Services Limited (CISL) £1m, were made and are recognised as operating exceptional items (note 6).

12. Investments accounted for using the equity method (continued)

	At 29 March 2004 £m	Reclassification £m	Share of post tax pre dividend profit from associates £m	Dividends £m	At 27 March 2005 £m
Share of net assets in associates	32	38	4	(9)	65
Goodwill relating to associates	25	-	-	-	25
Net investments in associates	57	38	4	(9)	90

	2006 £m	2005 £m
Current assets	116	118
Non-current assets	33	37
Share of gross assets	149	155
Current liabilities	(92)	(87)
Non current liabilities	(1)	(3)
Share of gross liabilities	(93)	(90)
Share of associates' net assets	56	65
Share of associates' revenue and profit:		
Revenue	1,084	1,032
Profit after tax	4	4

Details of the Group's 2005-06 and 2004-05 principal associate investments and their reporting dates are:

Company	Reporting date	Proportion of shares held	Country of incorporation
Quadrant Catering Limited	30 September 2005	51%	UK
Camelot Group plc	31 March 2006	20%	UK
Camelot International Services Limited	31 March 2006	20%	UK
G3 Worldwide Mail N.V. (Spring)	31 December 2005	24.5%	Netherlands
Midasgrange Limited	31 March 2006	50%	UK

The Group has accounted for its share of operating profits of associates for the financial years 2005-06 and 2004-05 using the equity method and has included estimates of the operating profits of Quadrant Catering Limited and G3 Worldwide Mail N.V. (Spring), from their reporting date to March 2006 and March 2005 respectively, to ensure that the reported share of profits of associates aligns with the Group's financial year.

The amounts shown in the reclassification column for 2004-05 relate to:

- the change in status during the year of Midasgrange Limited, from a joint venture to an associate of the Group; and
- the change in status during the year of GLS Poland and NDC 2000 Limited from associates to subsidiaries of the Group.

There are no significant restrictions on the ability of associates to transfer funds to the Group in the form of cash dividends, repayment of loans or advances.

12. Investments accounted for using the equity method (continued)

(b) Investments in joint ventures

	At 28 March 2005 £m	Reclassification £m	Share of post tax pre dividend profit from joint ventures £m	Dividend £m	At 26 March 2006 £m
Share of net assets in joint ventures	40	-	28	(17)	51
Goodwill relating to joint ventures	1	-	-	-	1
Net investments in joint ventures	41	-	28	(17)	52

During the 2005-06 financial year, the Group's only joint venture investment is a 50% interest in First Rate Exchange Services Holdings Limited (formerly First Rate Travel Services Holdings Limited), whose principal activity is the provision of Bureau de Change. The Group accounted for this investment using the equity method.

	At 29 March 2004 £m	Reclassification £m	Share of post tax pre dividend profit from joint ventures £m	Dividend £m	At 27 March 2005 £m
Share of net assets in joint ventures	73	(47)	24	(10)	40
Goodwill relating to joint ventures	2	(1)	-	-	1
Net investments in joint ventures	75	(48)	24	(10)	41

Share of joint ventures' assets and liabilities	2006 £m	2005 £m
Current assets	162	101
Non-current assets	2	2
Share of gross assets	164	103
Current liabilities	(113)	(63)
Non-current liabilities	-	-
Share of gross liabilities	(113)	(63)
Share of joint ventures' net assets	51	40
Share of joint ventures' revenue and profit		
Revenue	55	124
Profit after tax	28	24

12. Investments accounted for using the equity method (continued)

During the 2004-05 financial year the Group held investments in three joint ventures being:

Company	Reporting date	Proportion of shares held	Country of incorporation
First Rate Exchange Services Holdings Limited	31 March 2006	50%	UK
Midasgrange Limited	31 March 2006	50%	UK
Romec Limited	31 December 2005	51%	UK

The Group accounted for these investments using the equity method.

The amounts shown in the reclassification column in 2004-05 relates to the change in status of Midasgrange Limited from a joint venture to an associate and Romec Limited from a joint venture to a subsidiary.

13. Non current assets held for sale

Net book amount	Freehold £m	Long leasehold £m	Total £m
At 28 March 2005	-	-	-
Reclassification from property, plant and equipment	26	-	26
Impairment	(3)	-	(3)
Disposals	(12)	-	(12)
At 26 March 2006	11	-	11

Freehold and leasehold properties that are being actively marketed and are fully vacant (indicating that a sale is highly probable and the property is available for immediate sale), are classified as 'non current assets held for sale' on the basis that their primary recovery is through sale and not occupancy. The expected disposal of these properties is as a result of the Group continuing to rationalise its portfolio and exit surplus properties. These properties are expected to be disposed of within one year.

During the year, a gain of £20m (2005 £nil) was recognised in the income statement in relation to the disposal of such property.

Any impairment is as a result of reassessing the carrying values of properties after they have been reclassified to 'non-current assets held for sale'. During the year, an impairment of £3m was recognised as an operating exceptional item (note 6).

Properties held as 'non-current assets held for sale' have been allocated to Royal Mail, Post Office Limited and Parcelforce Worldwide for segmental reporting purposes.

14. Employee benefits - pensions

The Group operates pension schemes as detailed below.

Name	Eligibility	Type
Royal Mail Pension Plan (RMPP)	UK employees	Defined benefit
Royal Mail Senior Executive Pension Plan (RMSEPP)	UK senior executives	Defined benefit
Royal Mail Retirement Savings Plan (RMRSP)	UK employees	Defined contribution
Various other small-scale schemes operated by overseas subsidiaries	Overseas subsidiary employees	Defined contribution

Defined Contribution

A charge for the defined contribution schemes of £2m (2005 £1m) was recognised in operating profit before exceptional items within the income statement. The Company contributions to these schemes was £1m (2005 £1m).

Defined Benefit

Both RMPP and RMSEPP are funded by the payment of contributions to separate trustee administered funds. The latest full actuarial valuations of both schemes were carried out as at 31 March 2003 using the projected unit method. The next full valuations are due to be carried out as at 31 March 2006.

The regular future service contributions for RMPP, expressed as a percentage of pensionable pay, are expected to increase from 12.6% to 20%. For RMSEPP, contributions are at 20.9% and future rates will be discussed with the Trustee during the 2006 actuarial valuation. Payment of £113m (2005 £138m) was made during the year to fund the deficit in the schemes. It is anticipated that further such payments will be made in future as required. A current liability of £47m (2005 £208m) has been recognised for payments to the pension schemes relating to redundancy. During the year, payments of £209m (2005 £5m) relating to redundancy were made.

The following disclosures relate to the RMPP and RMSEPP defined benefit scheme plans:

a) Major assumptions

The size of the pension deficit, which is large in the context of the Group and its finances, is materially sensitive to the assumptions adopted. Small changes in these assumptions could have a significant impact on the deficit and overall income statement charge. The major assumptions were:

	At 26 March 2006 % pa	At 27 March 2005 % pa
Rate of increase in salaries	3.8	4.2
Rate of increase in pensions and deferred pensions	2.8	2.7
Discount rate	4.9	5.5
Inflation assumption	2.8	2.7
Expected average rate of return on assets	7.1	7.4

Mortality

Over recent months the Group and the RMPP Trustee have discussed potential changes to the mortality assumptions to be adopted for the 2006 actuarial valuation. These discussions have been based on an analysis carried out by the Trustee of the experience of the plan's pensioner population up to 31 March 2005. The Trustee has proposed a particular mortality basis - based on the 1992 series mortality tables allowing for 'medium cohort' projections of future improvements - and this has been applied to RMPP at the current year end. For consistency, the same improvement has been assumed for RMSEPP. This differs from the prior year, when assumptions consistent with the latest full actuarial valuations were used. The table below illustrates how these assumptions have changed.

Average expected life expectancy from age 60:	2006	2005
For a current 60 year old male RMPP member	26 years	22 years
For a current 60 year old female RMPP member	29 years	25 years
For a current 40 year old male RMPP member	28 years	24 years
For a current 40 year old female RMPP member	30 years	27 years

14. Employee benefits – pensions (continued)

b) Plans' assets and expected rates of return

The assets in the plans and the expected rates of return were:

At 26 March 2006

	Market value £m	Long-term rate of return expected % pa
Equities	17,190	7.7
Bonds	2,682	4.2
Property	1,835	5.9
Other assets	140	3.8
Fair value of plans' assets	21,847	
Present value of plans' liabilities	(27,435)	
Deficit in schemes	(5,588)	

At 27 March 2005

	Market value £m	Long-term rate of return expected % pa
Equities	13,376	8.0
Bonds	2,006	4.8
Property	1,639	6.4
Other assets	336	3.7
Fair value of plans' assets	17,357	
Present value of plans' liabilities	(21,315)	
Deficit in schemes	(3,958)	

The pension plans have not invested in any of the Group's own financial instruments nor in properties or other assets used by the Group.

14. Employee benefits – pensions (continued)

c) Recognised charges

An analysis of the separate components of the amounts recognised in the income statement and statement of recognised income and expense (SORIE) is as follows:

	2006 £m	2005 £m
Analysis of amounts recognised in the income statement		
Analysis of amounts charged to operating profit before exceptional items:		
Current service cost	527	482
Loss due on settlements	-	6
Total charge to operating profit before exceptional items	527	488
Analysis of amounts charged to operating exceptional items:		
Loss due to curtailments	24	22
Total charge to operating profit	551	510
Analysis of amounts charged/(credited) to finance income:		
Interest on plans' liabilities	1,162	1,068
Expected return on plans' assets	(1,263)	(1,127)
Total net credit to finance income	(101)	(59)
Total charge to income statement before deduction for tax	450	451
Analysis of amounts recognised in the statement of recognised income and expense (SORIE)		
Actual return on plans' assets	4,684	2,170
Less: expected return on plans' assets	(1,263)	(1,127)
	3,421	1,043
Other actuarial losses	(5,080)	(632)
Actuarial (losses)/gains and recognised in SORIE before deduction for tax	(1,659)	411

14. Employee benefits – pensions (continued)

d) Movement in plans' assets and liabilities

Changes in the present value of the defined benefit pension obligations are analysed as follows:

	2006 £m	2005 £m
Plans' liabilities at beginning of period	(21,315)	(19,594)
Current service cost	(527)	(482)
Settlements	-	(76)
Curtailment costs*	(48)	(208)
Finance cost	(1,162)	(1,068)
Employee contributions	(162)	(151)
Actuarial loss (recognised in SORIE)	(5,080)	(632)
Benefits paid	859	896
Plans' liabilities at end of period	(27,435)	(21,315)

*The curtailment costs in the income statement are recognised on a consistent basis with the associated compensation costs. Estimates of both are included, for example, in any redundancy provisions raised. The curtailment costs above represent the costs associated with those people paid compensation in respect of redundancy in 2005-06. This may occur in an accounting period subsequent to the recognition of costs in the income statement.

Changes in the fair value of the plans' assets are analysed as follows:

	2006 £m	2005 £m
Plan assets at beginning of period	17,357	15,200
Company contributions paid	664	329
Movement in company contributions accrued	(161)	343
Employee contributions	162	151
Finance income	1,263	1,127
Settlements	-	60
Actuarial gain (recognised in SORIE)	3,421	1,043
Benefits paid	(859)	(896)
Plans' assets at end of period	21,847	17,357

e) History of experience gains and losses

	2006 £m	2005 £m	2004 £m
Fair value of assets	21,847	17,357	15,200
Present value of liabilities	(27,435)	(21,315)	(19,594)
Deficit in schemes	(5,588)	(3,958)	(4,394)

	2006	2005
Actuarial gains arising on assets	3,421	1,043
Actuarial losses arising on liabilities	(5,080)	(632)
Total actuarial gains and losses (recognised in SORIE)	(1,659)	411

The cumulative amount of actuarial gains and losses recognised since transition to IFRSs at 29 March 2004 in the statement of recognised income and expense is £1,248m loss (2005 £411m gain). The Directors are unable to determine how much of the pension scheme deficit recognised in transition to IFRSs is attributable to actuarial gains and losses since inception of the pension schemes. Consequently, the Directors are unable to determine the cumulative amount of actuarial gains and losses that would have been recognised in the statement of recognised income and expense since inception of the pension schemes, before transition to IFRSs.

15. Employee benefits – annual leave

Under IAS 19 'Employee benefits' businesses are required to recognise for all short-term accumulating compensated absences such as holiday entitlement earned but not taken at the balance sheet date. The business' holiday entitlement coincides with the financial year. Employees are allowed to carry forward untaken leave outstanding at the year end if this is approved by the business. The impact of these provisions within IAS 19 on the Group's financial statements is to recognise an annual leave accrual in the balance sheet at 26 March 2006 of £39m (2005 £42m) and to reflect a release to the income statement in respect of the year-on-year movement of £3m (2005 £2m charge).

16. Inventories

	2006 £m	2005 £m
Supplies (uniforms, fuel, printing and stationery, mailbags)	16	15
Merchandise (Post Office Limited retail and lottery products)	10	8
Materials (engineering spares)	1	4
Total inventories at the lower of cost and net realisable value	27	27

During the year £nil (2005 £1m) of inventory items were written off.

17. Current trade and other receivables

	2006 £m	2005 £m
Trade receivables (net of bad debt provision of £24m (2005 £30m))	836	737
Other prepayments and accrued income	257	354
Total	1,093	1,091

Details of related party transactions can be found in note 27.

18. Non-current other receivables

Other non-current receivables of £6m (2005 £14m) mainly represent amounts receivable from employees in respect of the 'home computer' initiative originally launched in November 2003.

19. Cash and cash equivalents

	2006 £m	2005 £m
Cash within the Post Office® network	782	849
Other cash in hand	18	7
Cash at bank	29	34
Short-term deposits	332	450
Total	1,161	1,340

Cash in the Post Office® network and in hand of £800m (2005 £856m) is non-interest bearing. Cash at bank of £29m (2005 £34m) earns interest at either floating or short-term fixed rates based upon daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months depending on the immediate cash requirements of the Group and earn interest at the respective short-term deposit rates. The fair value of cash, short-term deposits and cash equivalent current asset investments is £1,161m (2005 £1,340m). At 26 March 2006, the Group had available £1,634m (2005 £1,634m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met. These are detailed in note 22.

20. Share capital

Authorised	2006 £	2005 £
Ordinary shares of £1 each	100,000	100,000
Special Rights Redeemable Preference Share (Special Share) of £1 each	1	1
Total	100,001	100,001

Allotted and called up	2006 £	2005 £
Ordinary shares of £1 each	50,000	50,000
Special Rights Redeemable Preference Share (Special Share) of £1 each	1	1
Total	50,001	50,001

The Special Share can be redeemed at any time by its holder (the Secretary of State). The Company cannot redeem the Special Share without the prior consent of the Secretary of State. No premium is payable on redemption. Subject to, and in accordance with, the provisions of the Postal Services Act 2000, the Secretary of State can at any time require the Directors to declare and pay a dividend to the Secretary of State or its nominee.

On distribution in a winding up of the Company, the Secretary of State is entitled to repayment of the capital paid up on the Special Share in priority to any repayment of capital to any other member. The Special Share does not carry any rights to vote.

In accordance with section 63(7) of the Postal Services Act 2000, for the purposes of the Companies Act 1985, the shares issued to the Secretary of State shall be treated as if their nominal value had been fully paid up.

21. Total equity

	Distributable reserves								
	Retained earnings £m	Mails £m	Rural Network £m	Foreign Currency Translation reserve £m	Hedging reserve £m	Other reserves £m	Equity holder of the parent £m	Minority interest £m	Total equity £m
At 28 March 2005	(3,085)	801	171	8	-	63	(2,042)	4	(2,038)
Restatement for the effect of IAS 32 and IAS 39 at 28 March 2005	(11)	-	-	-	8	-	(3)	-	(3)
Restated balance at 28 March 2005	(3,096)	801	171	8	8	63	(2,045)	4	(2,041)
Profit for the financial year	395	-	-	-	-	-	395	-	395
Actuarial losses on defined benefit schemes	(1,659)	-	-	-	-	-	(1,659)	-	(1,659)
Taxation on items taken directly to equity	(26)	-	-	-	-	-	(26)	-	(26)
Transfer of Rural Network reserve	147	-	(147)	-	-	-	-	-	-
Transfer of interest income	(39)	35	4	-	-	-	-	-	-
Translation differences	-	-	-	-	-	-	-	-	-
Gain on cash flow hedge deferred into equity	-	-	-	-	3	-	3	-	3
Gain transferred from equity to income during the year	-	-	-	-	(10)	-	(10)	-	(10)
Gain transferred from equity to the initial carrying value of non financial asset	-	-	-	-	(1)	-	(1)	-	(1)
Transfer of unrealised gain	8	-	-	-	-	(8)	-	-	-
At 26 March 2006	(4,270)	836	28	8	-	55	(3,343)	4	(3,339)

	Distributable reserves								
	Retained earnings £m	Mails £m	Rural Network £m	Foreign Currency Translation reserve £m	Hedging reserve £m	Other reserves £m	Equity holder of the parent £m	Minority interest £m	Total equity £m
At 29 March 2004	(4,118)	765	311	-	-	63	(2,979)	-	(2,979)
Profit for the financial year	151	-	-	-	-	-	151	4	155
Actuarial gain on defined benefit schemes	411	-	-	-	-	-	411	-	411
Taxation on items taken directly to equity	367	-	-	-	-	-	367	-	367
Transfer of Rural Network reserve	151	-	(151)	-	-	-	-	-	-
Transfer of interest income	(47)	36	11	-	-	-	-	-	-
Translation differences	-	-	-	8	-	-	8	-	8
At 27 March 2005	(3,085)	801	171	8	-	63	(2,042)	4	(2,038)

The Mails reserve was created in Royal Mail Group plc on 3 February 2003, following directions issued by the Secretary of State for Trade and Industry under section 72 of the Postal Services Act 2000. The amounts allocated to the reserve are to be applied as if they were profits available for distribution and they are to be principally used to provide financial assistance to Post Office Limited and security for loans to Royal Mail Group plc.

The Rural Network reserve was initially set up during 2003-04 to provide funding for a three-year period to maintain the rural network of Post Offices. The Rural Network Reserve has been reduced by £147m (2005 £151m), representing the financing required during the year.

The Foreign Currency Translation reserve has been created to record the gains and losses arising from the translation of assets and liabilities of subsidiaries denominated in currencies other than the reporting currency from 29 March 2004.

21. Total equity (continued)

The Hedging reserve is used to record gains and losses arising on cash flow hedges from 28 March 2005.

Other reserves represent the unrealised gains arising from the acquisition of interests in associates and joint ventures in prior years. In the year £8m has transferred to retained earnings in respect of the impairment of the investment in G3 Worldwide Mail N.V. (Spring) (see note 12).

The transfer of interest income relates to income recorded in the income statement, which has been earned on the assets that support the Mails and Rural Network reserves.

22. Financial liabilities

2006

	Loans £m	Finance lease/hire purchase agreements £m	Deferred consideration	Derivative liabilities £m	Total £m
Amounts falling due in:					
One year or less or on demand	361	1	3	3	368
More than one year	505	1	-	-	506
More than one year but not more than two years	1	1	-	-	2
More than two but not more than five years	2	-	-	-	2
More than five years	502	-	-	-	502
Total	866	2	3	3	874

2005

	Loans £m	Finance lease/hire purchase agreements £m	Deferred consideration £m	Derivative liabilities £m	Total £m
Amounts falling due in:					
One year or less or on demand	375	1	16	n/a	392
More than one year	506	2	8	n/a	516
More than one year but not more than two years	1	1	8	n/a	10
More than two but not more than five years	2	1	-	n/a	3
More than five years	503	-	-	n/a	503
Total	881	3	24	-	908

In accordance with the exemption under IFRS 1, 'First time adoption of IFRS', comparative information has been prepared under previous UK GAAP (FRS 13) and not IAS 32 and IAS 39. As a consequence, derivative liabilities were not included in the March 2005 balance sheet. In order to comply with IAS 32 and IAS 39 the derivatives would have been valued at fair value and included in the March 2005 balance sheet on this basis. The fair value of derivative liabilities at 27 March 2005 was £1m – all due within one year.

2006

Analysis of loans and facilities	Loans £m	Further facility £m	Total facility £m	Average interest/interest range of loan %	Average maturity date of loans drawn Year
DTI loans to Royal Mail Group plc	500	844	1,344	5.8	2023
HM Treasury loans to Post Office Limited	360	790	1,150	4.8	2006
Committed facilities	860	1,634	2,494		
Miscellaneous bank loans in overseas subsidiaries	6	-	6	3.1-6.9	2010
Total	866	1,634	2,500		

22. Financial liabilities (continued)

	Loans £m	Further facility £m	Total facility £m	Average interest/interest range of loan %	2005 Average maturity date of loan Year
DTI loans to Royal Mail Group plc	500	844	1,344	5.8	2023
HM Treasury loans to Post Office Limited	360	790	1,150	5.0	2005
Committed facilities	860	1,634	2,494		
Short-term loan from associate	14	-	14	4.8	2005
Miscellaneous bank loans in overseas subsidiaries	7	-	7	3.1-6.9	2009
Total	881	1,634	2,515		

The short-term loan from the associate was repaid during the year.

The miscellaneous bank loans in overseas subsidiaries are either unsecured or secured on various assets (mainly property) of the overseas subsidiaries. The loans are repayable in variable and fixed amounts over their maturity periods.

The obligations under finance leases and hire purchase contracts are either unsecured or secured on various assets of the overseas subsidiaries. These are repayable in variable and fixed amounts over their maturity periods. The average interest rate is 6% (2005 6%). The average maturity date is within one to two years (2005 – within one to two years).

The deferred consideration is unsecured and is repayable over the maturity period. The deferred consideration is non-interest bearing (2005 non interest bearing) and the average maturity date is within one year (2005 within one year).

The Group has various borrowing facilities available to it. The undrawn committed facilities available at 26 March 2006, in respect of which all conditions precedent had been met at that date, are as follows:

	2006 £m	2005 £m
Expiring in one year or less	200	-
Expiring in more than one year, but not more than two years	150	200
Expiring in more than two years	1,284	1,434
Total	1,634	1,634

The undrawn amounts comprise multiple loan facilities amounting to £1,634m. £860m of the committed facilities had been utilised at 26 March 2006. The DTI loans to Royal Mail Group plc are secured by way of a fixed and floating charge on various assets of the Group.

Royal Mail Group plc has received a waiver from the DTI, in its capacity as lender, for an insolvency default arising on adoption of IFRS, to record the Group's pension deficit as a balance sheet liability. As a condition of this waiver, the lender shall only be obliged to make an advance to Royal Mail Group plc if the Board resolves that without such an advance Royal Mail Group plc will be unlikely to meet its liabilities as they fall due.

The HM Treasury loans to Post Office Limited, which are secured by way of a floating charge on various assets of the Group and a negative pledge over cash and near cash items are short dated on a programme of liquidity management drawn down on the facility that expires in 2010.

The following securities apply to the Group's committed facilities:

	Amount £m	Security
DTI drawn down loan	500	Investment in GLS and floating charge over non regulated assets
DTI further facility	844	Floating charge over all assets and cash deposits with National Loans Fund
HM Treasury loan	1,150	Cash in the Post Office Limited network

The HM Treasury loan provides a total facility of £1,150m, but is restricted to funding the cash and near cash items held within the Post Office Limited network. As at 26 March 2006, the balance of this cash was £782m as shown in note 19.

23. Provisions for liabilities and charges

	Current provisions £m	Non-current provisions £m	Total £m	and Parcels £m	Counter Services £m	Total £m
At 28 March 2005	124	48	172	160	12	172
Charged in the year	82	4	86	71	15	86
Reclassification to current provisions	(3)	3	-	-	-	-
Utilised non-cash	(48)	-	(48)	(39)	(9)	(48)
Utilised cash	(97)	(2)	(99)	(83)	(16)	(99)
At 26 March 2006	58	53	111	109	2	111

	Current provisions £m	Non-current provisions £m	Total £m	Mails and Parcels £m	Counter Services £m	Total £m
At 29 March 2004	408	71	479	429	50	479
Charged in the year	35	12	47	47	-	47
Reclassifications to current provisions	26	(26)	-	-	-	-
Utilised non-cash	(130)	-	(130)	(116)	(14)	(130)
Utilised cash	(215)	(9)	(224)	(200)	(24)	(224)
At 27 March 2005	124	48	172	160	12	172

The cash utilisation of £99m includes £96m of spend relating to exceptional rationalisation and £3m relating to other operating costs. Total cash spend in the year relating to exceptional rationalisation is shown in the cash flow statement. Included within provisions is £51m (2005 £67m) relating to onerous property contracts and £13m (2005 £13m) of decommissioning costs.

The Mails and Parcels provision includes amounts relating to redundancy and other non-redundancy items (onerous property contracts and decommissioning costs), which relate to restructuring programmes. During the year £60m (2005 £36m) was charged to exceptional items and £11m (2005 £11m) to other operating costs. £39m was transferred to creditors due within one year mainly relating to amounts due to the pension scheme for redundancies with early retirement. £58m of this provision is expected to be utilised in 2006-07 and the remainder over the following two to three years, except for £12m relating to decommissioning costs and £31m relating to onerous property contracts, which are expected to be utilised over a longer period. The timing of cash flows for these provisions are by their nature uncertain and dependent upon the outcome of related events. The best estimates of the amounts are shown in the table above.

Counter Services provisions include amounts relating to the continuing headcount reduction programme. During the year £15m was charged to exceptional items and £9m was transferred to creditors due within one year mainly relating to amounts due to the pension scheme for redundancies with early retirement. The balance is expected to be utilised in 2006-07.

The change in the carrying value of the discounted element of the provision due to the passage of time is not material.

24. Current trade and other payables

	2006 £m	2005 £m
Obligations under finance leases and hire purchase agreements (note 22)	1	1
Client services balances	248	323
Trade payables and accruals	1,345	1,628
Advance customer payments	255	224
Other taxation and social security	104	102
Deferred consideration (note 22)	3	16
Annual leave entitlement creditor	39	42
Lease incentives	1	1
Other payables	18	15
Total	2,014	2,352

The Group, through its Post Office Limited subsidiary, receives and disburses cash on behalf of Government agencies and other clients to customers through its Post Office® branch network. Amounts owed to these parties are separately shown as client service balances (above). The level of cash held and the related creditors can vary significantly at each balance sheet date.

Details of related party transactions can be found in note 27.

25. Non-current trade and other payables

	2006 £m	2005 £m
Obligations under finance leases and hire purchase agreements (note 22)	1	2
Lease incentives	8	6
Deferred consideration (note 22)	-	8
Other long-term payables	23	32
Total	32	48

Other long-term payables represent £18m (2005 £20m) in respect of deferred income and £5m (2005 £12m) for the 'home computer' initiative.

26. Commitments and contingencies

Operating lease commitments

The Group is committed to the following future minimum lease payments under non-cancellable operating leases as at 26 March 2006:

	Land and buildings		Vehicles and equipment		IT equipment	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Within one year	124	128	49	52	46	46
Between one and five years	419	434	76	63	169	175
Beyond five years	755	850	2	2	77	117
Total	1,298	1,412	127	117	292	338

Existing property leases have an average term of 17 years and any new leases entered into generally have a 15-year term with a 10-year break clause. Vehicle leases generally have a term of between 3 and 7 years, depending on the asset class, with the average term being 4 years. The existing leases will mature between 2006 and 2011. The IT contract has a term of 10 years with 7 years remaining at the balance sheet date.

Capital commitments

At 26 March 2006, the Group has commitments of £59m (2005 £146m), which are contracted for but not provided in the accounts.

26. Commitments and contingencies (continued)

Guarantees

The Group has the following contingent liabilities at 26 March 2006:

Royal Mail Group plc, a subsidiary of the Company, has guaranteed the performance of a third party in relation to lease payments payable over the 15-year term of a lease entered into on 21 December 2000, and has given certain tax indemnities to the US lessors. In the opinion of the Directors, no loss will result to the Group as a result of these guarantees.

As required by the Notes Sorting Facility rules, notes in transit to cash handling centres and those processed overnight, for which the Group has received credit, are secured by gilts deposited with the Bank of England. On default, the estimated maximum liability would be £104m.

Royal Mail Group plc has given a guarantee to the Secretary of State for Work and Pensions, the Department for Social Development (Northern Ireland) and the Commissioners of Inland Revenue, to underwrite the performance of Post Office Limited of its obligations under the Universal Banking Contract (Post Office Card Account).

Royal Mail Group plc has also given a guarantee to Electronic Data Systems Limited to underwrite Post Office Limited's performance of its obligations under the Universal Banking Contract (Post Office Card Account).

27. Related party transactions

The ultimate parent

Royal Mail Holdings plc is the ultimate parent company of the Group. There were no transactions between Royal Mail Holdings plc and its subsidiary undertakings during the year (2005 £nil).

Principal subsidiaries

The consolidated financial statements include the financial statements of Royal Mail Holdings plc and the principal subsidiaries listed in the following table:

Name	Country of incorporation	% equity interest 2006	2005
Royal Mail Group plc	United Kingdom	100%	100%
Post Office Limited	United Kingdom	100%	100%
Royal Mail Investments Limited	United Kingdom	100%	100%
General Logistics Systems B.V.	Netherlands	100%	100%
Romec Limited	United Kingdom	51%	51%
NDC 2000 Limited	United Kingdom	51%	51%

Joint venture

The Group has a 50% interest in First Rate Exchange Services Holdings Limited (previously known as First Rate Travel Services Limited until its name change on 23 February 2006), a company registered in the United Kingdom.

Associate

The following companies are associated undertakings of the Group:

Company	Country of incorporation	2006	2005
Quadrant Catering Limited	United Kingdom	51%	51%
Camelot Group plc	United Kingdom	20%	20%
Camelot International Services Limited	United Kingdom	20%	20%
G3 Worldwide Mail N.V. (Spring)	Netherlands	24.5%	24.5%
Midasgrange Limited	United Kingdom	50%	50%

The majority of the Board and voting power in Quadrant Catering Limited is held by the Group's partner, hence it is not a subsidiary.

Related party transactions

During the year the Group entered into transactions with related parties. The transactions were in the ordinary course of business and included administration and investment services recharged to the Group's pension plan by Royal Mail Pensions Trustees Limited, a 100% subsidiary. The transactions entered into and the balances outstanding at 26 March 2006 were as follows:

	Sales to related party		Purchases from related party		Amounts owed from related party including outstanding loans		Amounts owed to related party including outstanding loans	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Royal Mail Pension Trustees Limited	9	8	-	-	-	1	-	-
Quadrant Catering Limited	-	-	42	43	-	-	6	15
Camelot Group plc	49	11	-	-	1	1	-	-
G3 Worldwide Mail N.V.	1	2	13	17	11	12	2	2
First Rate Exchange Services Holdings Limited Group	26	24	-	-	-	-	-	1
Midasgrange Limited	6	1	-	-	-	-	-	-
Romec Limited (subsidiary from December 2004)	n/a	3	n/a	127	n/a	3	n/a	18

Companies listed above are joint ventures and associates of the Group with the exception of Royal Mail Pensions Trustees Limited and Romec Limited.

Terms and conditions of transactions with related parties

The sales to and purchases from related parties are made at normal market prices. Outstanding balances at the year end are unsecured, interest free and settlement is made by cash.

27. Related party transactions (continued)

Key management compensation

	2006 £000	2005 £000
Short-term employee benefits	2,818	3,385
Post-employment benefits	688	344
Termination benefits	865	720
Other long-term benefits	463	3,832
Total compensation paid to key personnel	4,834	8,281

Key management comprise Executive and Non Executive Directors on the Royal Mail Holdings plc Board.

HM Government is the Company's sole shareholder and accordingly the Directors have no interest in the shares of the Company.

Transactions with other related parties

Bob Wigley, a Non Executive Director, is Chairman of Merrill Lynch's Europe, Middle East and Africa Business. The Trustees of the Royal Mail Pension Plan, not the Company, had a commercial relationship with Merrill Lynch Investment Management, for two UK equity portfolio mandates to the value of £950m (2005 £1.1bn) during the year. Bob Wigley is not a Trustee of the Royal Mail Pension Plan.

John Neill, a Non Executive Director, is Group Chief Executive and Deputy Chairman of the Unipart Group, which has a contract for the supply of operational support services and expertise with Royal Mail for improvements to mail centres. The total value of the contract is £1.7m (2005 £1.5m) of which £0.5m (2005 £1.5m) was paid during the course of the year. In accordance with normal Board procedures, John Neill took no part in the Board's decision to appoint Unipart Group. The amount outstanding at 26 March 2006 was £1.2m (2005 £nil).

28. Financial risk management objectives and policies

The Group's principal financial instruments, other than derivatives, comprise short-term deposits, money market liquidity investments, Government gilt edged securities, loans, finance leases and hire purchase contracts and cash. 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 debtors and trade creditors, which arise directly from operations.

The Group also enters into derivative transactions, principally commodity swaps and forward currency contracts. The purpose is to manage the commodity and currency risks arising from the Group's operations.

It is, and has been throughout the year under review, the Group's policy that no speculative trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are interest rate risk, liquidity risk, foreign currency risk, commodity price and credit risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

Interest rate risk

The Group's exposure to market risk for changes in interest rates relates to the Group's debt obligations and interest bearing financial assets. The DTI loans to Royal Mail Group plc (£500m as at March 2006) are at a fixed interest rate to maturity (average date 2023). The HM Treasury loans to Post Office Limited (£360m as at March 2006) are at short-dated fixed interest rates (average maturity 4 days as at March 2006). The total interest bearing financial assets of the group (£1,060m as at March 2006) are at short-dated fixed interest rates (average maturity 50 days as at March 2006). Both of these short-dated financial instruments are maturity managed to obtain the best value out of the interest yield curve.

The Group's policy is to manage its net interest expense using an appropriate mix of fixed and variable rate financial instruments. No external hedging of interest rate risk is undertaken.

28. Financial risk management objectives and policies (continued)

Foreign currency risk

The Group is exposed to foreign currency risk due to trading with overseas postal operators for carrying UK mail abroad and delivering foreign origin mail in the UK, and the balances held to operate the Bureau de Change services within Post Office Limited. These risks are mitigated by hedging programmes managed by Group Treasury. Where possible, exposures are netted internally and any remaining exposure is hedged using a combination of external spot and forward contracts. All other significant exposures are considered individually; hedging will not normally be considered for exposures of less than £1m; hedging is normally confined to 80% of the forecast exposure where forecast cash flows are highly probable.

The Group's obligation to settle with overseas postal operators is denominated in Special Drawing Rights (SDRs) – a basket currency comprising of US Dollar (USD), Japanese Yen (JPY), Sterling and euro. The Group has a policy of matching receipts and payments for individual currencies where possible and then hedging any material net exposure. The policy is that up to 80% of the forecast net exposure is hedged with agreement of the internal business unit. Group Treasury operates a rolling 18-month programme, which is subsequently reviewed on a quarterly basis. There has been no external hedge in place throughout the financial year 2005-06 due to there being no material net exposure.

Balances of major currency holdings along with minor currencies showing a closely correlated movement for the Bureau de Change business are hedged.

The Group's obligations to settle USD invoices on a specific capital project were hedged. This programme matured during the year.

Two further hedge programmes have been initiated during the year. The Group's obligations to settle conveyance charges in USD and euro has been hedged (as far forward as March 2007). Additionally the Group's obligation to settle euro invoices on a small capital project has been hedged.

The Group does not hedge the translation exposure created by the net assets of its overseas subsidiaries.

Commodity price risk

The Group is exposed to fuel price risk arising from operating one of the largest vehicle fleets in Europe, which consumes over 150 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 operates within the parameters set by the Board, which allow the use of over-the-counter derivative products (in both USD commodity price and USD/Sterling exchange rate) 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 rate price contracts with suppliers.

Credit risk

Royal Mail operate a Credit Policy, which provides a fair and equitable platform for all its customers to do business with. The level of credit granted is based on the customer's risk profile. The Credit Policy is applied rigidly within the regulated products area so as to ensure that Royal Mail is not in breach of compliance legislation. Assessment of credit for the non-regulated products is based on commercial factors, which are commensurate with the Group's appetite for risk.

Royal Mail has a dedicated credit management team, which set the credit limits, monitor credit limits exceeded on a regular basis and take corrective action as and when appropriate. Despite all the controls in place Royal Mail does suffer from bad debts, but the level of bad debts incurred is below 0.2% of turnover.

With respect to credit risk arising from other financial assets of the Group, which comprise cash, cash equivalent investments, available for sale financial assets, held to maturity financial assets, held for trading financial assets, loans and receivables financial assets and certain derivative instruments, the Group's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

There are no significant concentrations of credit risk within the Group.

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. Typical short-term investments include money market funds, time deposits with approved counterparties, UK Government gilts and treasury bills. Borrowing facilities are regularly reviewed to ensure continuity of funding. Of the current facilities, £300m is uncommitted lines of credit, which are reviewed annually, £1.6bn expires within 5 years.

29. Financial instruments

In accordance with the exemption under IFRS 1, comparative information has been prepared under previous UK GAAP (FRS 13) and not IAS 32 and IAS 39. Comparatives for 2005 have been provided in full at the end of this note.

Set out below is a comparison by category of the carrying amounts and fair values of all the Group's financial instruments.

	Carrying amount and fair value 2006 £m
Financial assets	
Cash	829
Cash equivalent current asset investments	332
Sub-total cash and cash equivalent	**1,161**
Financial assets at fair value through the income statement	133
Held to maturity financial assets	549
Loans and receivables financial assets	12
Sub-total Financial assets - investments (current)	**694**
Financial assets - investments (non-current)	5
Derivative assets	3
Total	**1,863**
Financial liabilities	
Obligations under finance leases and hire purchase contracts (note 22)	1
Deferred consideration (note 23)	3
Sub-total included in current other payables	**4**
Obligations under finance leases and hire purchase contracts (note 22)	1
Deferred consideration (note 23)	-
Sub-total included in non-current other payables	**1**
Other loans:	
HM Treasury loans to Post Office Limited (note 22)	360
Short-term loan from associate (note 22)	-
Miscellaneous bank loans in overseas subsidiaries (note 22)	1
Sub-total financial liabilities – loans (current liabilities)	**361**
DTI loans to Royal Mail Group plc [1] (note 22)	500
Miscellaneous bank loans in overseas subsidiaries (note 22)	5
Sub-total financial liabilities – loans (non-current liabilities)	**505**
Derivative liabilities	3
Total	**874**

Trade debtors, creditors, prepayments, accruals and client services balances have been omitted from this analysis on the basis that carrying value is a reasonable approximation for fair value. Pension scheme assets and liabilities are excluded.

[1] The only financial instrument where the carrying amount is different to the fair value is the 'DTI loans to Royal Mail Group plc'. At the year end the respective fair value is £520m.

All the above financial assets and liabilities are recorded in the accounts at amortised cost with the exception of the following:

- Financial assets – investments (non-current) are valued at fair value with the movement taken to reserves;
- Financial assets at fair value through the income statement (all of which are classified as held for trading) are valued at fair value with the movement taken straight to the income statement; and
- Derivative assets and liabilities are valued at fair value. Effective changes in the fair value of derivatives, which are part of a designated hedge under IAS 39, are deferred into equity. All other changes in derivative fair value are taken straight to the income statement.

29. Financial instruments (continued)

Fair values have been calculated using current market prices (forward exchange rates/commodity prices) and discounted using appropriate discount rates.

Interest rate risk

The following table sets out the carrying amount by maturity of the Group's financial instruments that are exposed to interest rate risk:

Financial year ended 26 March 2006

Fixed rate	Average effective interest rate %	Within 1 year £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m	Total £m
Cash at bank	2.7	12	-	-	-	-	-	12
Cash equivalent current asset investments	4.4	332	-	-	-	-	-	332
Financial assets at fair value through income statement	4.4	133	-	-	-	-	-	133
Available for sale financial assets	4.5	-	3	2	-	-	-	5
Held to maturity financial assets	4.5	549	-	-	-	-	-	549
Loans and receivables financial assets	4.8	12	-	-	-	-	-	12
Obligations under finance leases and hire purchase contracts (note 22)	6.1	-	(1)	-	-	-	-	(1)
HM Treasury loans to Post Office Limited	4.8	(360)	-	-	-	-	-	(360)
DTI loans to Royal Mail Group plc	5.8	-	-	-	-	-	(500)	(500)
Miscellaneous bank loans in overseas subsidiaries	6.1	(1)	(1)	-	(1)	-	(1)	(4)
Total		677	1	2	(1)	-	(501)	178

Floating rate	Average effective interest rate %	Within 1 year £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m	Total £m
Cash at bank	2.0	17	-	-	-	-	-	17
Obligations under finance leases and hire purchase contracts (note 22)	6.4	(1)	-	-	-	-	-	(1)
Short-term loan from associate	n/a	-	-	-	-	-	-	-
Miscellaneous bank loans in overseas subsidiaries	3.1	-	-	(1)	-	-	(1)	(2)
Total		16	-	(1)	-	-	(1)	14

Non-interest bearing	Within 1 year £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m	Total £m
Cash in hand or in Post Office Limited network	800	-	-	-	-	-	800
Deferred consideration	(3)	-	-	-	-	-	(3)
Derivative assets	3	-	-	-	-	-	3
Derivative liabilities	(3)	-	-	-	-	-	(3)
Total	797	-	-	-	-	-	797

Interest on financial instruments classified as floating is repriced at intervals of less than one year. Interest on financial instruments classified as fixed rate is fixed until the maturity of the instrument.

A one-percentage increase in interest rates throughout the period would have increased profit before tax by £6m. Calculated as the increase in interest income less expense on floating rate financial instruments and fixed rate financial instruments that matured during the year plus the profit/loss impact on fixed rate financial instruments that are carried at fair value.

29. Financial instruments (continued)

The following table sets out the carrying amount of the currency of the Group's financial instruments.

Financial assets	Sterling £m	USD £m	euro £m	Other £m	2006 Total £m
Cash at bank, in hand or in Post Office Limited network	715	13	79	22	829
Cash equivalent current asset investments	332	-	-	-	332
Financial assets at fair value through the income statement	133	-	-	-	133
Held to maturity financial assets	549	-	-	-	549
Loans and receivables financial assets	12	-	-	-	12
Financial assets/investments (non-current)	5	-	-	-	5
Derivative assets	-	3	-	-	3
	1,746	16	79	22	1,863

Financial liabilities	Sterling £m	USD £m	euro £m	Other £m	Total £m
DTI loans to Royal Mail Group plc	500	-	-	-	500
HM Treasury loans to Post Office Limited	360	-	-	-	360
Short-term loan from associate	-	-	-	-	-
Miscellaneous bank loans in overseas subsidiaries	-	-	6	-	6
Obligations under finance leases and hire purchase contracts (note 22)	-	-	2	-	2
Deferred consideration	-	-	3	-	3
Derivative liabilities	-	3	-	-	3
	860	3	11	-	874

29. Financial instruments (continued)

Hedging Activities

Cashflow hedges

The Group had four designated cash flow hedge programmes during the year:

i) The diesel fuel hedge programmes uses forward commodity price swaps and forward currency purchase contracts to hedge the exposure arising from commodity price and US$/£ exchange rates for forecast diesel fuel purchases.

ii) The air conveyance hedge programme uses US$ and euro forward currency purchase contracts to hedge the exposure arising from US$/GBP and GBP/euro exchange rates for forecast air conveyance purchases.

iii) The euro capital programme uses euro forward currency purchase contracts to hedge the exposure arising from GBP/euro exchange rates for contracted capital expenditure.

iv) The US$ capital programme used US$ forward currency purchase contracts to hedge the exposure arising from US$/GBP exchange rates for contracted capital expenditure. This programme matured during the year.

The following tables show the derivatives outstanding at the year end for each of these hedge programmes:

	Currency	Nominal amount	Maturity date	Average contracted exchange rate	Derivative asset fair value 26 March 2006 £m	Derivative liability fair value 26 March 2006 £m
Diesel fuel	US$	$81m	Apr 06-Jul 07	US$/£1.77	1	(1)
Air conveyance	US$	$24m	Apr 06-Apr 07	US$/£1.74	-	-
Air conveyance	Euro	€4m	Apr 06-Apr 07	£/euro0.69	-	-
Capital programme	Euro	€4m	Apr 06-Nov 06	£/euro0.69	-	-
Capital programme	US$	n/a	n/a	n/a	-	-

Hedge programme	Commodity	Nominal amount	Maturity date	Average contracted commodity price	Derivative asset fair value £m	Derivative liability fair value £m
Diesel fuel	Diesel fuel	131k tonnes	Apr 06-July 07	US$/tonnes 618	2	(2)

The following table shows the movements (net of deferred tax) on the hedging reserve for each of these hedge programmes:

	Gain deferred into equity during year £m	Gain released from equity to profit during year £m	Gain released from equity to initial carrying value of fixed asset during year £m
Diesel Fuel	3	10	-
Air Conveyance	-	-	-
Capital Programme - euro	-	-	-
Capital Programme - US$	-	-	1

For all the above cash flow hedge programmes, the underlying cash flows being hedged are expected to occur at the same dates as the hedge instruments (derivatives) mature. For the non-capital programmes (Diesel and Air Conveyance), the profit or loss will be taken on maturity. For capital programmes, the impact on the income statement will be the depreciation charge over the life of the asset being hedged.

In addition to the above hedge programmes, the Group hedges other foreign exchange and commodity price exposures, which are not designated as hedges under IAS 39 (including the hedge of currency holdings as part of the Bureau de Change services within Post Office Limited). The total fair value of the derivatives in these hedge programmes as at 26 March 2006 were £nil assets, and £nil liabilities.

29. Financial instruments (continued)

The Group had outstanding forward transactions to hedge foreign currency and fuel purchases as follows:

	In currency (millions)	Sterling equivalents (millions)
	2006	2006
Maturing within one year		
Euro	103	71
US Dollars	140	80
Australian Dollars	7	3
Fuel (US Dollars)	94	53
Maturing after one year		
US Dollars	15	9
Fuel (US Dollars)	12	7

Note - the fuel hedge (which fixes the GBP cost of purchasing fuel) consists of two elements:

- a commodity forward transaction fixing the cost in US Dollars of purchasing fuel; and
- a currency forward transaction fixing the GBP cost of these US Dollars.

The table above contains both of these transactions for the fuel hedge. The commodity forward transactions are shown under the heading Fuel (US Dollars) - $94m maturing within one year and $12m maturing after one year. The related currency forward transactions are contained within the total of US Dollars - $140m maturing within one year and $15m maturing after one year.

Comparative information

IAS 32 and IAS 39 were adopted for the financial year ending 26 March 2006 in line with the transitional arrangements for IFRS. The following disclosure provides comparative information for the year ending 27 March 2005 based on UK GAAP. This is replicated from the accounts for the year to 27 March 2005.

An explanation of the Group's treasury policy and controls is included in the Operating and Financial Review, as well as the role of financial instruments in creating or changing the risks the Group faces in its activities.

Financial assets and liabilities are a subset of the overall assets and liabilities of the Group and include balances which generally have interest rate and/or foreign currency risks attached. FRS 13, permits exclusion of items such as trade debtors, trade creditors, prepayments and accruals. The assets and liabilities, which fall under the definition, along with their fair values, are highlighted in (i) below:

(i) Fair value of financial assets/(liabilities)

Fair value is defined as the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties and is calculated by reference to market rates discounted to current value. Where market rates are not available, fair values have been calculated by discounting cash flows at prevailing rates transacted at year end exchange rates.

				2005
	Gross asset £m	Gross liability £m	Net book value £m	Fair value £m
Cash	890	-	890	890
Current asset investments	1,141	-	1,141	1,141
Other investments (Government gilt-edged securities)	7	-	7	7
Borrowings	-	(908)	(908)	(898)
Client services balances	-	(323)	(323)	(323)
Total	2,038	(1,231)	807	817

Fair values for borrowings and deposits have been calculated by discounting at an appropriate rate.

The carrying value of gilts is £141m, of which £134m is included in current asset investments above and £7m in the other investments figures. The Group portfolio of gilt holdings showed a loss of £4m during the financial year when revalued.

29. Financial instruments (continued)

(ii) Maturity profile of the Group's financial liabilities

The maturity profile of the Group's financial liabilities at 27 March 2005 is set out below:

	2005		
	Borrowings £m	Client balances £m	Total £m
One year or less or on demand	392	323	715
More than one year but not more than two years	10	-	10
More than two years but not more than five years	3	-	3
More than five years	503	-	503
Total	908	323	1,231

(iii) Maturity profile of the Group's undrawn committed borrowing facilities

Details of the Group's borrowings and undrawn committed borrowing facilities can be found in note 22.

(iv) Interest rate profile and foreign currency analysis:

	2005 Financial liabilities				2005 Financial assets					
	Sterling £m	euro £m	Other £m	Gross total £m	Sterling £m	USD £m	euro £m	Other £m	Gross total £m	Net total £m
Fixed rate	(860)	(7)	-	(867)	1,148	-	-	-	1,148	281
Floating rate	(14)	(3)	-	(17)	13	-	15	6	34	17
Non-interest bearing	(323)	(6)	(18)	(347)	785	16	48	7	856	509
Total	(1,197)	(16)	(18)	(1,231)	1,946	16	63	13	2,038	807

The fixed rate sterling financial liabilities of £860m have a weighted average interest rate of 5.5% and an average time to maturity of 11 years. The fixed rate sterling financial assets of £1,148m have a weighted average interest rate of 4.73% and an average time to maturity of 46 days.

The floating rate sterling financial assets have a weighted average interest rate of bank rate minus 1% and an average time to maturity of one day.

The fixed rate euro financial liabilities have a weighted average interest rate of 6.1% and average time to maturity of four years.

The floating rate euro financial liabilities have a weighted average interest rate of euro LIBOR plus 2% and an average time to maturity of three years. The floating rate euro financial assets have a weighted average interest rate of bank rate minus 1% and an average time to maturity of one day.

Of the £347m of non-interest bearing financial liabilities, £323m is payable on demand and £24m has an average maturity date of one year. All the non-interest bearing financial assets are receivable on demand.

A one-percentage increase in interest rates throughout the period would have increased profit before tax by £11m.

(v) Derivative financial instruments held to manage currency and commodity price fluctuations:

	2005 Fair value £m
Foreign currency transactions	138
Fuel derivatives	28

At the balance sheet date, the Group held contracts to purchase foreign currency for £138m and £28m for fuel contracts. No carrying amounts are shown as all these items are held off balance sheet. The difference between the contracted forward rate and mark to market rate was £nil for currency contracts and a gain of £8m for fuel contracts.

29. Financial instruments (continued)

(vi) Forward transactions

The Group had outstanding forward transactions to hedge foreign currencies and fuel purchases as follows:

	In currency (millions)	Sterling equivalents (millions)
	2005	2005
Maturing within one year		
Euro	86	60
Japanese Yen	-	-
US Dollars	138	74
Australian Dollars	3	1
Fuel (US Dollars)	46	25
Maturing after one year		
US Dollars	6	3
Fuel (US Dollars)	5	3

(vii) Gains and losses on transactional exposures

The Group's currency transactional exposures give rise to net currency gains and losses recognised in the profit and loss account. These liabilities arise from the net payments due to overseas postal administrations for delivery of mail, and are denominated in Special Drawing Rights (SDRs). This is a basket of currencies comprising US Dollar, euro, Japanese Yen and Sterling. Such exposures comprise the monetary liabilities of the Group that are not denominated in the functional currency of the operating unit involved.

For 2005 there was no material unhedged SDR exposure.

At 27 March 2005, the Group also held various open forward contracts that were taken out to hedge expected future foreign currency payments (as shown in note (vi) above).

(viii) Gains and losses on hedges

Foreign exchange exposures are hedged using currency deposits, currency borrowings, forward currency contracts and currency options. Gains and losses on these instruments are not recognised until the hedged exposure itself is recognised. Unrecognised gains and losses on these instruments used for hedging are not material.

Commodity price exposures are hedged using commodity swaps and options. Gains and losses on these instruments are not recognised until the hedged exposure itself is recognised. Unrecognised gains at the start of the financial year totalled £1m and were all realised in the current financial year. Unrecognised gains at the end of the financial year totalled £8m and are all expected to be realised in the next financial year. There are no gains/losses carried forward in the balance sheet.

30. Events after the balance sheet date

There are no events that warrant disclosure.

31. Transition to IFRSs

The Royal Mail Holdings plc (Royal Mail) financial year ends on the last Sunday in March.

In previous years, the accounts have been prepared under UK Generally Accepted Accounting Principles (UK GAAP). From this accounting year Royal Mail will produce its consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU).

This note explains how the Group's previously reported financial performance and position are reported under IFRS. The note includes the following financial statements restated on an IFRSs basis:

- The Group's consolidated balance sheet at 29 March 2004, the Group's date of transition;
- The Group's income statement, statement of recognised income and expense (SORIE) and cash flow statement for the year ended 27 March 2005, and balance sheet at 27 March 2005; and
- The Group's balance sheet at 28 March 2005 reflecting the adoption of IAS 32 and IAS 39 for the 2005-06 financial year.

Basis of preparation

The restated financial statements of the Group have been prepared in accordance with IFRS's that had been issued and adopted by the EU at 26 March 2006 and use the historic cost convention with the exception of derivative financial instruments that have been measured at fair value.

The rules for first time adoption of IFRS are set out in IFRS 1 'First Time Adoption of International Financial Reporting Standards'. IFRS 1 requires an entity to comply with each IFRS effective at the reporting date for its first full set of IFRS financial statements. As a general principle IFRS 1 requires the standards effective at the reporting date to be applied retrospectively. However, retrospective application is prohibited in some areas, particularly where retrospective application would require judgements by management after the outcome of the particular transaction is already known. In addition a number of limited optional exemptions from full retrospective application of IFRS are granted where the cost of compliance is deemed to exceed the benefits to users of the financial statements. Where applicable, the options selected by management are set out in the notes to the accounts and below.

The significant changes as a result of the adoption of IFRSs are detailed below:

Balance sheet reclassifications

To aid comparability the UK GAAP format has been reconfigured into the IFRSs format as far as possible from the available, previously published information. The balance sheet reclassifications required by IFRS are as follows:

i) IAS 1 'Presentation of Financial Statements' requires intangible assets to be separated from goodwill on the balance sheet. At March 2004 £107m was reclassified from intangible assets to goodwill (March 2005 £129m);

ii) At March 2004 long-term debtors previously included within trade and other receivables in current assets under UK GAAP of £14m are included within non-current assets under IFRSs (March 2005 £14m);

iii) A deferred tax asset of £nil at March 2004 (March 2005 £16m) was also included within trade and other receivables in current assets under UK GAAP and is now disclosed separately within non-current assets under IFRSs;

iv) At March 2004 trade and other payables under UK GAAP include £10m (March 2005 £nil) and £53m (March 2005 £375m) for income tax payable and bank loans respectively. These figures are disclosed separately as current liabilities under IFRSs;

v) IFRS requires provisions expected to be settled within one year of the balance sheet date to be shown within current liabilities. This has resulted in a reclassification of £408m at March 2004 (March 2005 £124m) from non-current liabilities;

vi) Deferred income tax liabilities at March 2004 are also included in provisions under UK GAAP and £96m (March 2005 £94m) is shown separately as a non-current liability under IFRSs;

vii) Interest bearing loans under UK GAAP are included in "other payables" at March 2004. These are disclosed separately under IFRSs and £507m (March 2005 £506m) has been reclassified within non-current liabilities; and

viii) IFRSs requires that foreign currency translation within reserves is separately identified on the face of the balance sheet. There is no reclassification required at March 2004 as the Group has elected not to apply IAS 21 retrospectively. The effect at March 2005 is £8m.

IAS 19 Employee benefits

IAS 19 requires separate recognition of the operating and financing costs of defined benefit pension schemes, together with other employee benefits, in the income statement. The standard permits a number of options for the recognition of actuarial gains and losses. Royal Mail has adopted the IFRS 1 transitional exemption and recognised the full actuarial pension deficit at the date of transition. The business will then recognise any actuarial gains and losses immediately in the SORIE. The option to account for actuarial gains and losses in this way is part of an amendment to IAS 19 'Actuarial Gains and Losses, Group Plans and Disclosures'. This amendment is effective from 1 January 2006 with earlier adoption allowed.

The impact of the standard on the balance sheet at the date of transition is to recognise a pension liability of some £4.4bn at 29 March 2004 and a liability of £4.0bn at 27 March 2005. Additionally, pension prepayments of £770m (2005 £834m) have been derecognised.

31. Transition to IFRSs (continued)

The impact of the standard on operating profits before exceptional items for the year ended 27 March 2005 is a reduction of £98m with an increase to interest and other financial income of £59m.

Under UK GAAP, Royal Mail did not accrue for annual leave not taken either at the half year or year ends. Under IAS 19 Royal Mail is required to accrue for all short-term accumulating compensated absences such as holiday entitlement earned but not taken at the balance sheet date. The impact of IAS 19 on Royal Mail's transitional balance sheet is to recognise an annual leave accrual of £40m at 29 March 2004. There is also a charge of £2m to the March 2005 income statement reflecting the increase in the accrual at that year end.

IFRS 3 Business combinations, IAS 36 Impairment of assets and IAS 38 Intangible assets

IFRS 3 prohibits merger accounting and the amortisation of goodwill. The standard requires goodwill to be carried at cost with impairment reviews both annually and also when there are indications that the carrying value may not be recoverable.

As permitted in IFRS 1, Royal Mail has chosen to apply IFRS 3 prospectively from the date of transition and has chosen not to restate previous business combinations. Therefore, goodwill is stated in the transitional balance sheet at its UK GAAP carrying value of £107m with subsequent amortisation in the year to 27 March 2005 being reversed. The increase in operating profit from reversing goodwill amortisation is £11m for the year to 27 March 2005.

Under IFRS 3, the identification of assets and liabilities within acquired businesses includes intangible assets not previously recognised under UK GAAP. The principal intangible assets recognised separately from goodwill on an acquisition are listings. These intangible assets are valued for each acquisition after 29 March 2004 and are amortised over their estimated economic lives.

The principal acquisitions in 2004-05 were of franchisee businesses in GLS Italy and GLS Poland. The value of the customer listings for these businesses amounted to £6m, with economic lives of 2 to 4 years. In addition, Romec Limited, previously a joint venture, and NDC 2000 Limited, previously an associate, became subsidiaries of the Group. Neither the Romec Limited nor NDC 2000 Limited acquisitions resulted in the identification of any intangible assets.

IAS 12 Income taxes

IAS 12 requires entities to calculate deferred tax based on temporary differences, as opposed to timing differences under UK GAAP. Temporary differences are defined as the difference between the carrying value of assets and liabilities and their tax base. The standard requires deferred tax assets and liabilities to be disclosed separately on the Group balance sheet.

Whilst the adoption of IAS 12 does not itself result in any restatement of the Group's tax charge, the deferred tax has been reassessed taking into account other accounting adjustments arising from the transition to IFRSs. The deferred tax liability at the transition date in March 2004 was reduced from £96m to £1m due to derecognition of the pension prepayment and the recognition of a defined benefit pension liability. Similarly, in the balance sheet at March 2005 an additional £318m of deferred tax asset and a reduction in deferred tax liability of £89m is recognised.

IAS 7 Cash flow statements

Under UK GAAP the cash flow statement focuses on movements in cash with details of these movements under seven headings. Under IAS 7 the focus is widened to cash and cash equivalents and details are classified under three headings – operational, investing and financing. The transition does not alter the Group's cash flow but the presentation of information on the cash flow statement changes. £316m and £450m of investments in March 2004 and March 2005 respectively, are now classified as cash equivalents. These are now reconciled within the cash flow statement rather than being disclosed under the heading of 'management of liquid resources' under UK GAAP. The Group continues to produce its cash flow statement using the indirect method.

SIC 15 Operating leases – Incentives

This interpretation requires that all incentives for the agreement of a new or renewed operating lease should be recognised as an integral part of the net consideration agreed for the use of the lease, irrespective of the incentive's nature or form or the timing of the payments. Lessees must recognise the aggregate benefit of incentives as a reduction of rental expense over the lease term, on a straight-line basis.

The Group has recognised lease incentives of £8m at the date of transition at March 2004. This has been amortised by £1m during 2004-05 leaving a balance of £7m on the balance sheet at 27 March 2005.

IAS 32 and IAS 39 Financial instruments

The requirements of IFRSs are different to UK GAAP in a number of areas. The changes that impact Royal Mail relate to hedging instruments and investments. Royal Mail has taken advantage of the exemption not to adopt IAS 32 and IAS 39 until the 2005-06 financial year.

Hedging instruments

Under IAS 39, all financial assets and liabilities are recognised at fair value with the corresponding debit entry booked to the hedging reserve in equity for those instruments which meet the requirement for hedge accounting. Derivative instruments of £9m assets and £1m liabilities have been recognised at fair value at 28 March 2005.

31. Transition to IFRSs (continued)

Under UK GAAP, foreign exchange gains and losses on an unsettled hedge programme were carried in the balance sheet. On introducing IAS 32 and IAS 39 at 28 March 2005, losses amounting to £11m have been written off against retained earnings.

Investments

Under UK GAAP investments are held at cost less provision for any permanent impairment. Under IFRSs, investments are initially recognised at fair value. The impact at 28 March 2005 is to re-categorise the £691m investments on the balance sheet as £134m of 'Held for trading investments', and £549m of 'Held to maturity investments' and £8m 'Loans and receivables'.

Group balance sheet at 29 March 2004

	UK GAAP £m	Reclass £m	Pensions IAS 19 £m	Holiday pay IAS 19 £m	Cash equiv IAS 7 £m	Lease incentives SIC 15 £m	IFRS £m
Non-current assets							
Property, plant and equipment	1,550	-	-	-	-	-	1,550
Goodwill	-	107	-	-	-	-	107
Intangible assets	123	(107)	-	-	-	-	16
Financial assets - investments	7	-	-	-	-	-	7
Investments accounted for using the equity method	131	-	-	-	-	-	131
Other receivables	-	14	-	-	-	-	14
	1,811	14	-	-	-	-	1,825
Current assets							
Inventories	32	-	-	-	-	-	32
Trade and other receivables	1,955	(14)	(770)	-	-	-	1,171
Financial assets - investments	999	-	-	-	(316)	-	683
Cash and cash equivalents	1,049	-	-		316	-	1,365
	4,035	(14)	(770)	-	-	-	3,251
Non-current assets held for sale	-	-	-	-	-	-	
Total assets	5,846	-	(770)	-	-	-	5,076
Current liabilities							
Trade and other payables	(2,590)	63	-	(40)	-	(1)	(2,568)
Income tax payable	-	(10)	-	-	-	-	(10)
Bank overdrafts and loans	-	(53)	-	-	-	-	(53)
Provisions	-	(408)	-	-	-	-	(408)
	(2,590)	(408)	-	(40)	-	(1)	(3,039)
Non-current liabilities							
Financial liabilities - interest bearing loans and borrowings	-	(507)	-	-	-	-	(507)
Retirement benefit obligation	-	-	(4,394)	-	-	-	(4,394)
Provisions	(575)	504	-	-	-	-	(71)
Deferred tax liabilities	-	(96)	95	-	-	-	(1)
Other payables	(543)	507	-	-	-	(7)	(43)
	(1,118)	408	(4,299)	-	-	(7)	(5,016)
Total liabilities	(3,708)	-	(4,299)	(40)	-	(8)	(8,055)
Net assets/(liabilities)	2,138	-	(5,069)	(40)	-	(8)	(2,979)
Equity							
Retained earnings	999	-	(5,069)	(40)	-	(8)	(4,118)
Hedging reserve	-	-	-	-	-	-	-
Foreign currency translation	-	-	-	-	-	-	-
Other reserves*	1,139	-	-	-	-	-	1,139
Equity attributable to equity holders of parent company	2,138	-	(5,069)	(40)	-	(8)	(2,979)
Minority interest	-	-	-	-	-	-	-
Total equity	2,138	-	(5,069)	(40)	-	(8)	(2,979)

*The other reserves comprise Mails reserve £765m, Rural Network reserve £311m and Other £63m.

Group income statement for the year ended 27 March 2005

	UK GAAP £m	Pensions IAS 19 £m	Goodwill IFRS 3 £m	Associates/JV's IFRS 3/ IAS 28/31 £m	Holiday pay IAS 19 £m	Lease incentives SIC 15 £m	IFRS £m
Revenue	8,956	-	-	-	-	-	8,956
People costs	(5,739)	(98)	-	-	(2)	-	(5,839)
Wages and salaries	(4,328)	-	-	-	(2)	-	(4,330)
Pensions	(391)	(98)	-	-	-	-	(489)
Social security	(319)	-	-	-	-	-	(319)
Subpostmasters	(544)	-	-	-	-	-	(544)
Temporary resource	(157)	-	-	-	-	-	(157)
Distribution and delivery costs	(1,183)	-	-	-	-	-	(1,183)
Other operating costs	(1,669)	-	8	-	-	1	(1,660)
Share of profit from associates and joint ventures	34	-	3	(9)	-	-	28
Operating profit before exceptional items	399	(98)	11	(9)	(2)	1	302
Operating exceptional items	(277)	-	-	-	-	-	(277)
Operating profit	122	(98)	11	(9)	(2)	1	25
Loss on disposal of subsidiary undertaking	(3)	-	-	-	-	-	(3)
Profit on disposal of property, plant and equipment	70	-	-	-	-	-	70
Profit before financing and taxation	189	(98)	11	(9)	(2)	1	92
Finance costs	(42)		-	-	-	-	(42)
Finance income – net pensions interest	-	59	-	-	-	-	59
– other	60	-	-	(2)	-	-	58
Profit before taxation	207	(39)	11	(11)	(2)	1	167
Taxation credit/(charge)	28	(55)	-	11	-	-	(16)
Profit for the financial year from continuing operations	235	(94)	11	-	(2)	1	151
Profit attributable to:							
Equity holders of the parent company	235	(94)	11	-	(2)	1	151
Minority interest	-	-	-	-	-	-	-

Group statement of recognised income and expense for the year ended 27 March 2005

	Previously reported under UK GAAP £m	Pensions IAS 19 £m	Goodwill IAS 38 £m	Holiday pay IAS 19 £m	Lease incentives SIC 15 £m	Restated under IFRS £m
Profit for the period	235	(94)	11	(2)	1	151
Translation differences on foreign currency net investments	8	-	-	-	-	8
Actuarial gains and losses		411	-	-	-	411
Taxation on items taken directly to equity		367	-	-	-	367
Total recognised income and expense for the period	243	684	11	(2)	1	937
Attributable to:						
Equity holder of the parent company						933
Minority interest						4

Group balance sheet at 27 March 2005

	UK GAAP £m	Reclass £m	Pensions IAS 19 £m	Goodwill IFRS 3 £m	Intangible assets IAS 38 £m	Holiday pay IAS 19 £m	Cash equiv IAS 7 £m	Lease incentives SIC 15 £m	IFRS £m
Non-current assets									
Property, plant and equipment	1,591	-	-	-	-	-	-	-	1,591
Goodwill	-	129	-	8	(6)	-	-	-	131
Intangible assets	144	(129)	-	-	6	-	-	-	21
Financial assets - investments	135	(131)	-	3	-	-	-	-	7
Investments accounted for using the equity method	-	131	-	-	-	-	-	-	131
Other receivables	-	14	-	-	-	-	-	-	14
Deferred tax assets	-	16	318	-	-	-	-	-	334
	1,870	30	318	11	-	-	-	-	2,229
Current assets									
Inventories	27	-	-	-	-	-	-	-	27
Trade and other receivables	1,955	(30)	(834)	-	-	-	-	-	1,091
Financial assets - investments	1,141	-	-	-	-	-	(450)	-	691
Cash and cash equivalents	890	-	-	-	-	-	450	-	1,340
	4,013	(30)	(834)	-	-	-	-	-	3,149
Non-current assets held for sale	-	-	-	-	-	-	-	-	-
Total assets	5,883	-	(516)	11	-	-	-	-	5,378
Current liabilities									
Trade and other payables	(2,684)	375	-	-	-	(42)	-	(1)	(2,352)
Income tax payable	-	-	-	-	-	-	-	-	-
Bank overdrafts and loans	-	(375)	-	-	-	-	-	-	(375)
Provisions	-	(124)	-	-	-	-	-	-	(124)
	(2,684)	(124)	-	-	-	(42)	-	(1)	(2,851)
Non-current liabilities									
Financial liabilities - interest bearing loans and borrowings	-	(506)	-	-	-	-	-	-	(506)
Retirement benefit obligation	-	-	(3,958)	-	-	-	-	-	(3,958)
Provisions	(266)	218	-	-	-	-	-	-	(48)
Deferred tax liabilities	-	(94)	89	-	-	-	-	-	(5)
Other payables	(548)	506	-	-	-	-	-	(6)	(48)
	(814)	124	(3,869)	-	-	-	-	(6)	(4,565)
Total liabilities	(3,498)	-	(3,869)	-	-	(42)	-	(7)	(7,416)
Net assets/(liabilities)	2,385	-	(4,385)	11	-	(42)	-	(7)	(2,038)
Equity									
Retained earnings	1,346	(8)	(4,385)	11	-	(42)	-	(7)	(3,085)
Hedging reserve	-	-	-	-	-	-	-	-	-
Foreign currency translation	-	8	-	-	-	-	-	-	8
Other reserves*	1,035	-	-	-	-	-	-	-	1,035
Equity attributable to equity holders of parent company	2,381	-	(4,385)	11	-	(42)	-	(7)	(2,042)
Minority interest	4	-	-	-	-	-	-	-	4
Total equity	2,385	-	(4,385)	11	-	(42)	-	(7)	(2,038)

*The other reserves comprise Mails reserve £801m, Rural Network reserve £171m and Other £63m.

Group cash flow statement for the year ended 27 March 2005

	UK GAAP £m	Cash flow statements IAS 7 £m	Pensions IAS 19 £m	Goodwill IFRS 3 £m	Associates /JVs IAS 28/31 £m	Holiday pay IAS 19 £m	Lease incentives SIC 15 £m	IFRS restated £m
Cash flow from operating activities								
Operating profit before exceptional items*	399	-	(98)	11	(9)	(2)	1	302
Depreciation and amortisation	156	-	-	(8)	-	-	-	148
Other non-cash movements (profits from associates and joint ventures)	(34)	-	-	(3)	9	-	-	(28)
	521	-	(98)	-	-	(2)	1	422
Changes in working capital	(486)	-	98	-	-	2	(1)	(387)
Cash payments in respect of exceptional items	(255)	-	-	-	-	-	-	(255)
Cash utilised in operations	(220)	-	-	-	-	-	-	(220)
Income tax recovered	13	-						13
Net cash outflow from operating activities	(207)	-	-	-	-	-	-	(207)
Cash flows from investing activities								
Proceeds from sale of property, plant and equipment	95	-	-	-	-	-	-	95
Dividends received from associates and joint ventures	19	-	-	-	-	-	-	19
Investment income (interest) received	52	-	-	-	-	-	-	52
Purchase of property, plant and equipment	(219)	-	-	-	-	-	-	(219)
Payment of deferred consideration in respect of prior years' acquisitions	(2)	-	-	-	-	-	-	(2)
Disposal of subsidiary undertaking	-	-	-	-	-	-	-	-
Purchase of other financial assets	(142)	134	-	-	-	-	-	(8)
Net cash outflow from investing activities	(197)	134	-	-	-	-	-	(63)
Net cash outflow before financing activities	(404)	134	-	-	-	-	-	(270)
Cash flows from financing activities								
Payment of finance lease liabilities	(34)	-	-	-	-	-	-	(34)
Repayment of borrowings	(4)	-	-	-	-	-	-	(4)
Finance costs (interest) paid	(42)	-	-	-	-	-	-	(42)
New loans	325	-	-	-	-	-	-	325
Net cash inflow from financing activities	245	-	-	-	-	-	-	245
Net decrease in cash and cash equivalents	(159)	134	-	-	-	-	-	(25)
Cash and cash equivalents at the beginning of the period**	1,049	316	-	-	-	-	-	1,365
Cash and cash equivalents at the end of the period	890	450	-	-	-	-	-	1,340

*The operating profit before exceptional items of £399m is after taking account of £34m profits from associates and joint ventures. This compares to a published Group operating profit before exceptional items of £365m under UK GAAP, which was before taking account of the £34m profits from associates and joint ventures.

**The cash and cash equivalents under UK GAAP are defined as cash whereas, under IFRS, cash and cash equivalents includes investments with a maturity date of less than three months at the date of acquisition and money market funds in line with the revised accounting policy. The adjustment of £450m reflects the reclassification of the appropriate short-term investments as cash equivalents.

Group balance sheet at 28 March 2005

	IFRS £m	IAS 32 & IAS 39 £m	Opening balance sheet £m
Non-current assets			
Property, plant and equipment	1,591	-	1,591
Goodwill	131	-	131
Intangible assets	21	-	21
Financial assets - investments	7	-	7
Investments accounted for using equity method	131	-	131
Other receivables	14	-	14
Deferred tax assets	334	-	334
	2,229	-	2,229
Current assets			
Inventories	27	-	27
Trade and other receivables	1,091	(11)	1,080
Financial assets - investments	691	(691)	-
Held for trading investments	-	134	134
Held to maturity investment	-	557	557
Cash and cash equivalents	1,340	-	1,340
Derivatives	-	9	9
	3,149	(2)	3,147
Non-current assets held for sale	-	-	
Total assets	5,378	(2)	5,376
Current liabilities			
Trade and other payables	(2,352)	-	(2,352)
Bank overdrafts and loans	(375)	-	(375)
Provisions	(124)	-	(124)
Derivatives	-	(1)	(1)
	(2,851)	(1)	(2,852)
Non-current liabilities			
Financial liabilities - interest bearing loans and borrowings	(506)	-	(506)
Retirement benefit obligation	(3,958)	-	(3,958)
Provisions	(48)	-	(48)
Deferred tax liabilities	(5)	-	(5)
Other payables	(48)	-	(48)
	(4,565)	-	(4,565)
Total liabilities	(7,416)	(1)	(7,417)
Net liabilities	(2,038)	(3)	(2,041)
Equity			
Retained earnings	(3,085)	(11)	(3,096)
Hedging reserve	-	8	8
Foreign exchange reserve	8	-	8
Other reserves*	1,035	-	1,035
Equity attributable to equity holders of parent company	(2,042)	(3)	(2,045)
Minority interest	4	-	4
Total equity	(2,038)	(3)	(2,041)

*The other reserves comprise Mails reserve £801m, Rural Network reserve £171m and Other £63m.

Group five-year summary

	Prepared under UK GAAP			Prepared or restated under IFRS	
Income statement	2002[1] £m	2003 £m	2004 £m	2005 £m	**2006 £m**
Revenue	8,408	8,299	8,633	8,956	**9,056**
(Loss)/profit from operations	(318)	(197)	220	-	**-**
Add pensions benefit/(charge) in respect of pensions surplus/(deficit) under SSAP 24	250	246	(132)	-	**-**
Operating (loss)/profit before exceptional items	(68)	49	88	302	**355**
Operating exceptional items	(1,126)	(721)	(64)	(277)	**(210)**
Operating (loss)/profit	(1,194)	(672)	24	25	**145**
Non-operating exceptional items	14	26	64	67	**67**
(Loss)/profit before interest	(1,180)	(646)	88	92	**212**
Finance income and costs	56	35	17	75	**100**
(Loss)/profit before tax	(1,124)	(611)	105	167	**312**
Taxation	179	52	(98)	(16)	**83**
(Loss)/profit after tax	(945)	(559)	7	151	**395**

Balance sheet	2002 £m	2003 £m	2004 £m	2005 £m	**2006 £m**
Goodwill and intangible assets	146	156	123	152	**174**
Property, plant and equipment	1,783	1,648	1,550	1,591	**1,594**
Fixed asset investments and other non-current assets	94	83	138	486	**528**
Net current assets	1,987	1,785	1,445	298	**534**
Non-current liabilities	(1,405)	(1,584)	(1,118)	(4,565)	**(6,169)**
Net assets/(liabilities)	2,605	2,088	2,138	(2,038)	**(3,339)**

Cash flow	2002 £m	2003 £m	2004 £m	2005 £m	**2006 £m**
Net cash outflow before use of liquid resources and financing	(100)	(486)	(222)	(304)	**(163)**

Note

[1] 53 week year. All the other years are 52 week years.

Paragraph 37 of International Financial Reporting Standard 1 – First time adoption of IFRS, requires that information prepared under a previous GAAP is clearly labeled. Disclosure is also required of the nature of the main adjustments that would be necessary to comply with IFRS. Quantification of those adjustments is not required. The main adjustments to the Group accounts on the adoption of IFRS are:

- the inclusion of a retirement benefit obligation on the face of the balance sheet;
- trade and other receivables no longer include an element of pension prepayment;
- deferred tax charges to reflect the introduction of the retirement benefit obligation;
- a holiday pay accrual is included in trade and other payables;
- the income statement reflects a number of minor changes which are mainly presentational but changes to the pension charge and related taxation are the major amendments; and
- the cash flow statement is now produced in IFRS format showing operating, financing and investing activities.

Parent Company accounts

Statement of Directors' responsibilities in respect of the parent Company accounts

Company law requires the Directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the Company.

In preparing those accounts Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

Directors are responsible for ensuring that proper accounting records are kept which disclose with reasonable accuracy, at any time, the financial position of the Company, and which enable them to ensure that the accounts comply with the Companies Act 1985. Directors are also responsible for ensuring that the assets of the Company are safeguarded and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent Auditors' report to the members of the Company, Royal Mail Holdings plc

We have audited the parent company financial statements of Royal Mail Holdings plc for the year ended 26 March 2006 which comprise the Balance Sheet and the related notes 1 to 6. These parent Company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the Group financial statements of Royal Mail Holdings plc for the year ended 26 March 2006.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The Directors are responsible for preparing the Annual Report, the Directors' Remuneration Report and the parent Company financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) as set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent Company financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent Company financial statements give a true and fair view, and whether the parent Company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

We also report to you if, in our opinion, the Directors' Report is not consistent with the parent Company financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent Company financial statements. The other information comprises only the Chairman's Statement, the Chief Executive's Statement, the Annual Review, the Operating and Financial Review, the Directors' Report, the Corporate Governance statement, the Internal Control statement, the unaudited part of the Directors' Remuneration Report and the Statement of Directors' responsibilities. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent Company financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the parent Company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent Company financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent Company financial statements and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion:

- the parent Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 26 March 2006; and
- the parent Company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP
Registered auditor
London
17 May 2006

Parent Company balance sheet

at 26 March 2006 and 27 March 2005

	Notes	2006 £m	2005 as restated £m
Fixed assets			
Investments	4	3,784	3,784
Total net assets		3,784	3,784
Capital and reserves			
Called up share capital	6	-	-
Profit and loss account	5	3,784	3,784
Shareholders' funds		3,784	3,784

The accounts on pages 105 to 106 were approved by the Board of Directors on 17 May 2006 and signed on its behalf by:

Allan Leighton

Adam Crozier

Notes to the parent Company accounts

1. Parent Company accounting policies

The following accounting policies apply:

Financial year

The financial year ends on the last Sunday in March and accordingly, these accounts are made up to the 52 weeks ended 26 March 2006 (52 weeks ended 27 March 2005).

Basis of preparation

The accounts on pages 105 to 106 have been prepared in accordance with applicable accounting standards in the United Kingdom, under the historic cost accounting convention and the requirements of the Companies Act 1985.

Royal Mail Holdings plc (the Company) has not presented its own profit and loss account, as permitted by the Companies Act s230 (3). However, the results of the Company for the year are disclosed in note 5 to the accounts.

No new Financial Reporting Standards, which affect the presentation of these accounts, have been issued by the Accounting Standards Board.

Fixed asset investments

Investments in subsidiaries, joint ventures and associates within the Company's accounts are stated at cost less any accumulated impairment losses. The Company has a single investment: Royal Mail Group plc, a 100% subsidiary.

Change in accounting policy

A change in accounting policy for fixed asset investments has been adopted giving rise to a prior period adjustment (see notes 4 and 5). Previously, investments in internally formed companies were recognised at the net asset value of the internally formed company. The current accounting policy, as disclosed above, is believed to be more appropriate, providing more relevant and reliable presentation in the accounts. Application of the current accounting policy in 2005 would have reduced the reported profit for the year from £184m to £nil.

2. Directors emoluments

The Directors of the Company are not paid fees by the Company for their services as Directors of the Company. The Directors of the Company are paid fees by other companies of the Group. These emoluments are disclosed in the Group accounts.

3. Auditors remuneration

The Auditors of the Company are not paid fees by the Company. The Auditors of the Company are paid fees by the other companies of the Group. This remuneration is disclosed in the Group accounts.

4. Fixed asset investments

	£m
As reported at 27 March 2005	2,330
Prior period adjustment (see note 1)	1,454
As restated at 27 March 2005	3,784
Movement	-
At 26 March 2006	3,784

5. Profit and loss account

	£m
As reported at 27 March 2005	2,330
Prior period adjustment (see note 1)	1,454
As restated at 27 March 2005	3,784
Profit/(loss) for the year	-
At 26 March 2006	3,784

The profit/(loss) dealt with in the accounts of the parent company was £nil (2005 restated £nil). The Company is a non-trading company and any profit/(loss) for the financial year arises as a result of the accounting policy on fixed asset investments. This states that investments are stated at cost less any accumulated impairment losses. Accordingly, the Company's profit for the financial year is eliminated in the Group accounts and does not therefore form part of the Group results.

6. Share capital

Details of the share capital are disclosed in the Group accounts on page 77.

Forward Looking Statements

This document contains statements concerning the Group's business, financial condition, results of operations and certain of the Group's plans, objectives, assumptions, projections, expectations or beliefs with respect to these items.

The Company cautions that any forward looking statements in this document may and often do vary from actual results and the differences between these statements and actual results can be material. Accordingly, readers are cautioned not to place undue reliance on forward looking statements. The Company undertakes no obligation to release publicly the result of any revisions to these forward looking statements that may be made to reflect events or circumstances after the date of this document, including, without limitation, changes in the Group's strategy, or to reflect the occurrence of unanticipated events.

By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. Such forward looking statements should, therefore, be considered in light of various important factors that could cause actual results and developments to differ materially by those expressed or implied by these forward looking statements. These factors include, among other things: the impact of competitive products and pricing; the occurrence of major operational problems; the loss of major customers; limitations imposed by the Group's indebtedness; undertakings and guarantees relating to pension funds; contingent liabilities; risks of litigation and risks associated with the Group's overseas operations.

Corporate Information

Registered Office and Group Head Office

Royal Mail Holdings plc
148 Old Street
LONDON
EC1V 9HQ
020 7250 2888
Registered No: 4074919

Corporate website

Additional corporate and other information can be accessed on the following website (www.royalmailgroup.com). Information made available on the website is not intended to be, and should not be regarded as being, part of the accounts.

The maintenance and integrity of the Group's websites is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

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