

FIRST ANNUAL REPORT TO PARLIAMENT ON THE PROGRESS OF THE REFORMS SET OUT IN THE WHITE PAPER ON POST OFFICE REFORM

Introduction

On 8 July 1999, the Government published its White Paper "Post Office Reform: A World Class Service for the 21st Century"¹. The White Paper detailed the way in which the Government would set the agenda for a modern UK Post Office operating in global markets and providing high quality services to every user in the country. It also described the way in which the Government would ensure that the postal services of the UK developed in such a way that all business and individuals could be confident of having the communications services needed in the 21st century.

The Government gave an undertaking to report annually to Parliament on the progress of the reforms set out in the White Paper, and particularly on the functioning of the new arm's length relationship between the Government (as shareholder) and the Post Office Board. This is the first such report.

The Government started implementing appropriate elements of the reform package as quickly as possible following publication of the White Paper, through a mix of administrative action and secondary legislation. The following measures were put in place following the White Paper:

- Establishment of an arm's length relationship between the Government and the Post Office, including the preparation by the Post Office of a rolling annual 5 year Strategic Plan which has been approved by the Secretary of State. This gives the Board greater freedom to run the business.
- Allowing the Post Office to retain more of its post-tax profits (50% in 1999 and 60% thereafter, compared to around 10-20% previously) for investment in its existing business.
- The Post Office has the freedom to borrow from the National Loans Fund for growth investments:
 - up to £75m per year without Government approval; and
 - for larger growth investments above £75m, there will be a fast track approval system.
- The Universal Service Obligation (setting out the minimum criteria for deliveries and collection by the Post Office) was set out in law for the first time in the UK when the Government implemented the European Postal Services Directive in September 1999.

¹ Command Paper 4340, The Stationery Office, July 1999 (ISBN 0-10-143402-2)

The Government has now completed the framework of the reform package with the passage through Parliament of the Postal Services Bill which received Royal Assent on 28 July 2000.

The Reform Package

The objectives set out in the White Paper were intended to achieve the Government's twin goals of:

- enhanced postal services which satisfy developing business and individual customer needs at affordable prices, and
- a Post Office which is able to succeed in an increasingly demanding national and international market place.

The reform package would allow the Post Office's customers to be given greater choice in postal services by allowing more competition, strengthening the Post Office Users' National Council (POUNC) to ensure that customers' interest are taken fully into account, and establishing a Regulator to ensure fair competition in the UK postal market. And the Post Office would be able to invest more in its future in order to help it become a thriving business, able to adapt to changing markets, providing high quality services and efficiently serving the needs of its customers.

Improving postal services for business and domestic customers through greater choice, better quality and falling prices

The Government's aim is to improve postal services for business and domestic customers through greater choice, better quality and falling prices. Experience with the utilities has shown that, in the right framework, greater competition can lead to improved services and falling real prices for domestic and business customers. As well as extending competition in the postal market, there should be robust regulation to ensure fair competition and to provide a surrogate for market pressures where competition continues to be limited in order to protect the universal postal service. An independent postal Regulator (to be known as the Postal Services Commission) has been established to achieve this objective.

The Regulatory Framework

The Postal Services Regulations 1999² made both the Secretary of State and the Postal Services Commission the national regulatory authorities for postal matters under the Postal Services Directive. The Commission took up its duties on 1 April 2000, initially with just the Chairman and Chief Executive as members. Five other members of the Commission took up office on 1 June

² S.I. 1999/2107

2000 completing its membership and putting in place the collegiate regulator envisaged in the White Paper. Their role is to advise the Secretary of State in carrying out his functions under existing Post Office legislation. They are supported by an office of some twenty staff.

The Postal Services Act abolishes the existing Commission and replaces it with a statutory body of the same name. Existing Commissioners and staff are expected to transfer to the new body. The first duty of the new Commission is to ensure the continued provision of the universal postal service. Subject to that it must also further the interests of users of postal services, wherever appropriate by promoting effective competition between postal operators.

The creation of the new regulator is complemented by the creation of a new Consumer Council for Postal Services (which will replace the existing Post Office Users' National Council) to represent the interest of consumers, working with the Commission, but from a position of independence, to raise the quality of postal services in the UK.

Establishing Greater Competition

The Postal Services Act provides a framework for greater competition in the postal market. Firstly it replaces the Post Office's monopoly with a reserved area in which any person who wishes to operate will require a licence to do so, including the new Post Office company. Subject to ensuring the continuation of the universal postal service at a uniform tariff, the Commission may promote competition within this reserved area by issuing licences to more than one postal operator. The Act sets the reserved area at letters costing less than £1 and weighing less than 350 grams.

In addition, the Commission is considering the scope for reducing the reserved area, promoting greater competition through liberalisation of the market.

The Postal Services Directive (97/67/EC) requires that a reserved area should be no larger than is required to fund the universal postal service. It is anticipated that the Commission will report during 2001 to the Secretary of State on the scope for reducing the reserved area. The Commission must, of course, ensure that any recommendation to reduce the reserved area is consistent with its duty to ensure the continuation of the universal service. If such a proposal is made, an order must be approved by a resolution of each House of Parliament before the reserved area can be changed. The Commission is also due to report in 2001 on its proposals for a price control mechanism to be incorporated in the licence regime.

Maintaining a universal service of postal delivery throughout the UK and the uniform tariff.

The Government is committed to the continuation of the universal service of postal delivery throughout the UK, and to a uniform tariff. Under the universal service, all customers, wherever they live or work in the UK, can currently send and receive letters, registered post and postal packets up to 20 kilograms at a uniform tariff, regardless of distance. In order to safeguard this vital service in the future, whatever other services the Post Office company (and any other designated universal service provider) wishes to provide and whatever its ambitions to expand, the Regulator will need to be assured that its universal service obligations can be met in full. The Government will also be looking for the Post Office company to maintain and improve its quality of service which will in future be laid down by the Regulator.

The universal service obligation was first enacted in UK legislation by the Postal Services Regulations 1999. The Postal Services Act re-enacts those universal service provisions (in section 4). One or more postal operators will be required by their licence to operate within the new reserved area, to provide a universal postal service or part of such a service. Quality of service targets and other requirements on universal service providers are expected to be the subject of licence conditions. Breach of licence conditions will be subject to enforcement action by the Commission, and where necessary fines. It is anticipated that the new licence regime will commence in Spring 2001.

Establishing clear and accountable relationships between the Government, the Post Office, the Regulator and POUNC.

The boundaries between the responsibilities of the Government and the Post Office have become blurred over the course of time with the Government previously acting as both owner and regulator with no clarity as to how it balanced its interests. Under the reform programme, clear boundaries and a genuine arm's length relationship are being established between the Government (as owner/shareholder) and the Post Office Board (as commercial/postal operator). For the Post Office, this will mean clarity about which decisions and objectives fall to the Board, rather than to the Government, and for which the Board should take responsibility. For the Government, this means greater transparency and accountability. The intention is that the Government will agree the strategic direction of the Post Office; the Board will be responsible for proposing and executing that strategy. The Postal Regulator will undertake economic regulation and promote competition. The new Consumer Council for Postal Services (currently the Post Office Users' National Council) will promote and advocate the views of consumers.

Establishing clear boundaries and a genuine arm's length relationship between Government and the Post Office and approving the Post Office's strategic objectives

The Post Office's annual five-year Strategic Plan is central to the establishment of the new arm's length relationship between Government and the Post Office. The Plan should set out the high level strategic approach by which the Board will secure the commercial success of the Post Office. Endorsement of the Plan by the Secretary of State will define the strategic envelope within which the Post Office is free to manage commercially, and will set the framework within which the Government will approve borrowing in excess of £75 million for major commercial investments, including acquisitions.

The Post Office's first Strategic Plan covering 1999-2004 was approved by the Government in November 1999. Both 1999 and 2000 are seen as transitional years in the move towards establishing the arm's length relationship and detailed discussions with the Post Office were necessary for the first Strategic Plan in order to develop an understanding of the general direction in which the Board was seeking to move forward. The Post Office are pursuing and developing their strategy of becoming a complete distribution company with global reach and this is reflected in the Strategic Plan for 2000-05 [which was approved by the Government on xy August]. Further detailed discussions have taken place to further the Government's understanding of the Post Office's developing strategy. In advance of the approval of the Strategic Plan for 1999-2004, the Post Office gave a presentation on the Strategic Plan to the Minister for Competitiveness and officials from both DTI and Treasury. This allowed an opportunity for questions from the Government side to be discussed prior to final consideration of the Plan. A similar presentation was made by The Post Office's Chief Executive to the Minister for Competitiveness prior to the recent approval of the Plan for 2000-05.

The key features of the Strategic Plan are commercially confidential and as such will not be published. However it is used as the basis for Government setting the Post Office's financial targets which are discussed in more detail below.

Some discussion has taken place with the Post Office about the frequency and form of shareholder meetings with the company to discuss progress against the Strategic Plan. To date one such meeting has taken place with senior officials from the DTI and the Treasury meeting the Chief Executive of the Post Office. It is expected that such meetings are likely to happen quarterly with preparatory discussions about the issues to be raised taking place between DTI, Treasury and Post Office officials.

In order to make the arm's length relationship between the Government and the Post Office fully transparent, the Government is currently discussing with the Post Office how best to enshrine the rights it intends to reserve to itself, as set out in the White Paper, within the Post Office company's Articles of Association when this is established. The Memorandum & Articles of

Association of the Post Office company will be publicly available in due course at Companies House.

Although the past year has seen the establishment of the arm's length relationship between the Government and the Post Office in respect of the new strategic approach towards the business of the Post Office, regular dialogue between both parties has continued during the year in respect of a number of issues. The Department of Trade and Industry remains the sponsoring department in Whitehall for the Post Office which entails regular contact about a range of issues. Whilst the Post Office remains a statutory corporation, the Department also retains responsibility for a number of matters under the current legislation governing the Post Office, such as the appointment of the Post Office's directors and auditors. As a public sector body, the Post Office remains subject to the Government's planning and control regime for public expenditure which requires dialogue with both the DTI and HM Treasury. The extent of the arm's length relationship will develop further once the Post Office becomes a plc and the Department moves into its role of shareholder of a wholly owned public limited company.

Government progress in setting strategic social objectives

The Government remains responsible, in the national interest, for setting the legal and regulatory framework for postal services in the UK and for the social and environmental obligations under which the Post Office, or any future licence holder, must operate.

The Government published draft Social and Environmental Guidelines at the time of introduction of the Postal Services Bill to Parliament on 11 February 2000. Further consultation will take place once the relevant sections of the Postal Services Act are commenced (probably in the Autumn).

Government progress in giving the Regulator and POUNC duties, powers and resources to promote consumer interests

Consumer interests are at the heart of the reform package and run throughout the Postal Services Act which creates a strong, independent regulator, the Postal Services Commission, and a new national consumer council, the Consumer Council for Postal Services. The Commission's core duties are focussed clearly on the interests of consumers.

The Council's sole purpose is to represent and further the interests of users of postal services. It is given a central role alongside the Commission in the new regulatory framework where it can be a more effective champion of consumers interests and investigator of complaints. The powers of the Commission and the Council are in line with those of other similar bodies in the utilities and elsewhere.

The Act gives the Council a function to provide advice and information and to represent the views of users of relevant postal services and make proposals to the Secretary of State and other specified bodies. The Act also allows the Council to make available to users such information as it considers expedient to give to users.

The Act also gives the Council a function to deal with complaints about relevant postal services that have not been dealt with by the operator concerned. Where it considers that a licence condition may have been breached it may refer the matters to the Commission. The Act also allows the Council to investigate any matter which it considers to be a matter relating to the interests of users of relevant postal services.

The Act requires the Commission and the Council created by the Bill to make reports annually to the Secretary of State on their activities as soon as possible after the end of each financial year. The Secretary of State is required to lay such reports before each House of Parliament and to publish the report in such manner as he considers appropriate.

Equipping the Post Office to meet the challenges of the changing postal market

The Government's intention is that the Post Office will be driven by market and regulatory disciplines which it will need to respond to by improving efficiency and seeking out commercial opportunities. But to make this work, the relationship between the Government and the Post Office had to change (as already discussed) and the previous financial regime had to be reformed.

Progress on implementing the new financial regime between Government and the Post Office, including the restructuring of the balance sheet and allowing the Post Office greater pay flexibility

The Government has already implemented by administrative action the new financial regime set out in the White Paper. Its key features are:

- the Government will set a profit target for the whole of the Post Office business on the basis of the agreed Strategic Plan;
- allowing the Post Office to retain more of its earnings for investment. The Post Office will be expected to invest an equivalent of a commercial dividend each year. This was set at 50% of the Post Office's expected post-tax profits in 1999/2000 and from 2000/01 reduces to 40% of post-tax profits each year. This will in effect mean more than halving the rate at which profits are removed from the business. The retained earnings will be expected to finance capital expenditure required to maintain and enhance its existing business;

- allowing the Post Office to borrow for growth investments including acquisitions and joint ventures, and subject to an approval process for larger investments;
- by 1 April 2002, the Post Office's balance sheet will be restructured.

Financial targets for 1999/2000

The Government announced the financial targets for the Post Office for 1999/2000 last November at the same time as announcing approval of the first Strategic Plan. On the basis of the Plan, a post-tax profit target of £350 million was set for the 1999/2000 financial year. This figure excluded any exceptional provisions made for the Horizon automation project. The equivalent of a "commercial dividend" to Government was set at 50% of the post-tax profits for 1999/2000, ie at £175 million. In the unlikely event of the Post Office falling short of the profit target, a "dividend floor" was also set of £140 million. The Post Office is not able to pay dividends until it becomes a plc, but in the meantime it is setting aside the relevant amount in its reserves.

The results of the Post Office for 1999/2000 were published on 19 June and showed a post-tax loss of £264 million for the group. The post-tax profit target of £350 million was not therefore achieved. However, excluding exceptional items - the write down of £571 million for the Horizon capital costs, write down of £50 million in respect of Parcelforce's legacy assets (following the commissioning of the Coventry hubs) and restructuring costs of £35 million - the outturn was £302 million. The Post Office has set aside £151 million for the payment of a future dividend, in accordance with the new financial regime. The Post Office will not pay dividends until it becomes a plc.

The write down of the full £571 million for the Horizon project's capital costs and the £50 million costs in respect of Parcelforce's Coventry hub was a prudent accounting measure in compliance with the latest Financial Reporting Standards, but it has given rise to a "paper" loss in the Post Office's group accounts. The profit target set for the group last November related to the expected trading results for the year and reflected its underlying profitability which the latest accounts confirm. It is normal commercial practice for businesses with sound underlying profitability to maintain payment of dividends whilst making provision for exceptional items.

Financial targets for 2000/01

In May 2000 the Government set the Post Office a return on capital employed target of 13% for 2000/01 which translates into an operational pre-tax profit target of £392 million. This target excluded the network of post offices, where the PIU report was awaited, and the non-operational interest arising from past surpluses held on the Post Office's balance sheet. The target will be

subsumed within the overall post-tax profit target for the Post Office as a whole, as described in the White Paper.

As already announced, the dividend that the Government effectively take out of the Post Office is set at 40% of the post-tax profits of the business as a whole from 2000/01 onwards. This is subject to a dividend floor payment which for 2000/01 will be raised from 80% to 90% of the dividend that would be paid if the Post Office meets its overall profit target.

In order to help the Post Office to plan for the medium term, the Government has also set an indicative financial target for 2002/03 of 13% return on capital employed (ROCE) in the Post Office's operational business, excluding the network of post offices and any non-operational interest arising from past surpluses. Return on capital employed is defined as profit before interest payable and tax, but after operating interest receivable, divided by operating capital employed.

The Post Office's financial target and dividend floor for 2000/01, and the indicative financial target for 2002/03, have been set in the light of external benchmarking, the likely regulatory environment, market expectations, the Post Office's approved Strategic Plan for 1999-2004, and other projections from the Post Office.

Borrowing for growth investments during 1999/2000

Under the new financial regime set out in the White Paper, the Post Office may borrow for growth investments where these cannot be funded from retained earnings, and subject to an approval process for larger investments. The Post Office may borrow up to an annual limit of £75 million for individual growth investments, but specific Government approval is required for borrowing for major strategic investments over £75million. Investments might include acquisitions, joint ventures and strategic alliances in new markets, both in the UK and overseas. Each proposal for a large acquisition by the Post Office will be considered by the Government on its own merits and on its strategic importance to the Post Office business as a whole. The Government will approve Post Office borrowing for large investments which are consistent with the Strategic Plan, commercially robust and pose no undue risk to the taxpayer.

Since granting the Post Office greater commercial freedom to borrow for growth investments at commercial rates, it has now invested over £600 million in strategic acquisitions. It has made a series of acquisitions in the European parcel sector, including Austria, Denmark, France, Germany, Hungary, Ireland, Netherlands and Slovenia. It has also purchased express companies in Germany, France and the United States. Recently it increased its involvement in the Swedish letters market by increasing its shareholding in Sweden's CityMail and in March 2000 it announced a joint venture agreement

with TNT Post and Singapore Post to create the world's biggest international mailing partnership.

During 1999/2000 the Post Office made the following acquisitions:

Der Kurier group	April 1999	£10m
Delacher etc	April 1999	£10m
Williames group	December 1999	£10m
Citipost group	January 2000	£25m
Crie group	January 2000	£6m
Pakke Trans group	March 2000	£20m
Nederlandse Paket Dienst	March 2000	£68m

Borrowing for growth investments will be at commercial rates from the National Loans Fund (NLF). Whilst the mechanics of NLF borrowing are being put in place, the Post Office has been allowed to draw down the necessary funds from its reserves. Appropriate readjustments will be made in due course, including the replacement of any reserves used in lieu of borrowing.

A table summarising the key financial information covered in this section can be found at **Annex A**.

Restructuring the Post Office's balance sheet

In order to place the Post Office on a more commercial footing, and one where it can be better benchmarked against its competitors, the balance sheet will be restructured by 1 April 2002. At present the Post Office holds on its balance sheet government gilts and deposits with the National Loans Fund (NLF) which in effect are accumulated dividends which could not be paid over to the Exchequer since the relevant legislation did not enable the Post Office to do so. The Post Office will cease to hold, and to have access to the interest from, the present level of these accumulated reserves.

Preliminary discussions have taken place with our professional advisers about the issues involved with the restructuring and we have agreed a preliminary workplan. But no decisions have been taken at this early stage as we intend to consider all the issues thoroughly and to hold discussions with the Post Office before reaching any final decisions. We will also need to consider how the development of the Post Office's business between now and the deadline for restructuring of 1 April 2002 might affect the final decisions about the shape of the balance sheet. But it remains our objective to give the Post Office both the incentive to perform and the financial scope to enhance its business.

Greater pay flexibility

The Government has discussed and agreed a pay framework with the Post Office following the contribution of discussion papers on pay reform from both the CWU and the CMA. The objective was to agree a general framework of parameters for overall pay settlements within which the Post Office have the flexibility to negotiate the detail of annual pay agreements. The framework seeks to achieve the policy set out in the White Paper of increasing the links between pay, productivity and performance, whilst moving away from the old requirement for the Post Office to put forward each settlement for the approval of Government.

Postal Services Act

The Postal Services Bill was published on 28 January and received Royal Assent on 28 July.

The aim of the Postal Services Act 2000³ is to complete the package of reforms set out in the White Paper on Post Office Reform published in July 1999.

The Post Office was established as a statutory corporation under the Post Office Act 1969. That Act and the British Telecommunications Act 1981 set out the responsibilities of Government towards postal services and give the Post Office its current powers and duties. Since the 1969 Act became law the postal services market has developed significantly and the Postal Services Act redefines the roles of the Government and the Post Office to reflect those changes. The Act will enable the Post Office to be transformed into a public limited company formed and registered under the Companies Act 1985 and subject to normal company law. Once the Post Office company becomes operational, the scope of its permitted range of activities will be defined by its Memorandum of Association which can be changed in accordance with the provisions of the Companies Act 1985 allowing the company the flexibility to develop its business in order to keep well abreast of market changes. All the shares in the new company will be owned by the Crown. There can be no disposal of shares without further primary legislation, except in the case of a share sale or swap between the Post Office company and a partner to cement a commercial alliance, which will require approval from both Houses of Parliament. Similar restrictions apply to the disposal of shares in any subsidiary company directly engaged in providing the universal postal service.

At present, an area of the postal services market is reserved largely as a monopoly for the Post Office. This is called the reserved (or licensed) area. Decisions relating to the Post Office monopoly are currently undertaken by the Secretary of State for Trade and Industry under provisions in the British Telecommunications Act 1981. The Postal Services Regulations 1999, tabled on 26 July 1999, designated the Postal Services Commission as the new independent regulator for postal services. Provisions in the Postal Services

³ Postal Services Act 2000, The Stationery Office (ISBN 0-10-542600-8)

Act will replace this advisory body with a new fully independent regulatory body, along the lines of those in the privatised utility industries, by giving the Commission powers to issue licences, to regulate prices, to enforce the monopoly, to introduce greater competition and to maintain a universal service at a uniform tariff.

The Post Office currently has the exclusive privilege of delivering mail costing less than £1 within the UK, subject to only a handful of exceptions provided through niche and class licences. The Act will require anyone operating in the reserved area, including the Post Office company, to be licensed by the Postal Services Commission. The Commission will be responsible for recommending the level of the reserved area in future and judging how far to open up the market to further competition from licensed competition within the reserved area. It will also be given powers of investigation and enforcement, including the power to impose monetary penalties for breach of licence conditions.

The Act provides for a new system of licensing and regulation for postal services operators/providers operating in the market currently reserved largely as a monopoly for the Post Office. It gives the independent regulator, the new Postal Services Commission, new duties and powers to protect the interests of users of postal services. In particular, it enshrines the universal service obligation in primary legislation and makes it the duty of the Commission to ensure the delivery of this universal service at a uniform tariff. Subject to this duty, the Commission is required to further the interests of users, wherever appropriate by the promotion of greater competition in postal markets. The Commission will also have responsibility for setting quality standards and regulating prices.

Consumers are given greater protection through replacing the Post Office Users' National Council with the Consumer Council for Postal Services (CCPS). The creation of this body brings consumer representation in the postal services market into line with the provision for other utilities. The CCPS will have a central role in the new regulatory framework, monitoring service standards that users can expect and acting as a focus for consumer issues and complaints. Its powers are strengthened and it is given wider access to relevant information from the Post Office company and other licence holders.

The Postal Services Act also seeks to consolidate the postal services provisions in the main pieces of legislation which currently govern the Post Office - the Post Office Acts 1953 and 1969 and the British Telecommunications Act 1981 - by repealing or redrafting relevant sections in order to provide a more simple and modern legal framework in which the Post Office company and other licensed persons can operate.

It is anticipated that the new licensing regime under the Act will commence in Spring 2001 and the transformation of the Post Office into a public limited company will take place at the same time.

The network of post offices

The Government remains firmly committed to a viable network of post offices across the country. The sub-post office plays a valuable role in local communities, particularly for the less mobile, but the Post Office cannot sustain a network if it is not sufficiently well used, and nor can the Government. The future of the Post Office counters' network lies above all in its continued attractiveness to clients and customers as a channel for accessing products and services and to sub-postmasters as a business proposition. The network has to offer products people want and automation is vital to this since it will provide the opportunity to offer a wide range of products as more traditional business falls away.

Given its important social role, issues around the network will form an important element of the Social and Environmental Guidelines (see page 6). The Performance and Innovation Unit of the Cabinet Office has now published its report on "Modernising the Post Office Network". The Government is committed to implementing its recommendations.

Horizon project

In July 1999, following a review of the Horizon post office automation project, the Government, the Post Office and ICL reached agreement on the continuation of the project, but in a simplified form without the original Benefit Payment Card. By Spring 2001 some 40,000 counter positions at more than 18,000 post offices will be equipped with a modern, on-line computer system to enable the Post Office to modernise and improve services to existing customers, and to win new business. The project is proceeding as planned with over [10,000] post offices automated to date.

The Government fully recognises the valuable role played by post offices in the communities which they serve, and in particular the importance of small rural post offices which can act as a focal point for village life, providing access to cash, postal services and other day to day items. In view of this, the Government decided to make a substantial contribution (£480m) towards the capital costs of the revised Horizon counters automation project. This represents a major investment, and commitment to, the future of the post office network, including small rural post offices.

Reconfiguration of the Horizon project to simplify its scope was necessary in view of the significant delays being experienced in the project which was running three years late. The fact that increasing numbers of benefit recipients are choosing payment by automated credit transfer (ACT) had also substantially reduced the role that the Benefit Payment card could be

expected to play. The current approach has enabled the Post Office to concentrate on automating the post office network by Spring 2001. All benefit recipients who wish to do so will be able to continue to access their benefits in cash at post offices after the move to ACT, and other bank customers will benefit from the wider availability of banking facilities.

The Post Office's write off of the full £571m capital costs in its 1999-2000 accounts was a prudent accounting measure in compliance with the latest Financial Reporting Standards, but it has given rise to a "paper" loss in the accounts. However underlying profitability of the group remains sound.

Setting criteria for access to post office counters' services

While it is essential that the Post Office places the network on the strongest possible commercial footing, it is also essential that everyone in Britain continues to enjoy convenient access to a post office.

The Performance and Innovation Unit (PIU) of the Cabinet Office has now published its report on "Modernising the Post Office Network". One of the Government's objectives for the network contained in the report is convenient access for all to post offices. The post office network should offer people in all parts of the country convenient access to the services available in post offices.

The White Paper on Post Office Reform published last year suggested that the Government might set numerical access criteria, expressed in terms of a percentage of the population within a certain distance of their nearest post office. The PIU team analysed carefully whether such access criteria would help to deliver the Government's aims in relation to the rural network where post offices play a particularly crucial role in sustaining rural communities. However they concluded that numerical access criteria could well undermine the Government's policy rather than strengthen it. For example, 99% of people in rural areas currently live within three miles of a post office. Setting access criteria which sought to maintain this level of provision would allow the Post Office to close down two-thirds of rural post offices.

The Government has accepted the recommendation of the PIU report that it should place a formal requirement on the Post Office to maintain the rural network and prevent any avoidable closures of rural post offices. This commitment on access will apply until 2006 and will then be reviewed so that the changing needs, circumstances and priorities of local communities can be taken into account. The six-year commitment should provide significant reassurance for sub-postmasters and their customers and allow time for the Post Office to maximise the potential of the network.

The Government has also accepted that the Postal Services Commission, informed by the new Consumer Council for Postal Services, should report annually to the Secretary of State on the shape of the rural network and any

developments which affect it. In particular, the report should assess whether the range of services across the network remain relevant and meets the needs of rural communities and any relevant regional disparities.

For urban areas, the Government has accepted the recommendation that the Post Office should embark on a programme of modernisation of the urban network in partnership with sub-postmasters and other stakeholders. The PIU report concluded that such a programme would place the urban network on a sound footing for the future, whilst ensuring continued convenient access for all in urban areas to post offices.

As for the rural network, the Postal Services Commission, informed by the Consumer Council for Postal Services, will report annually to the Secretary of State on the urban network, and in particular, will report on post office provision and access in deprived areas.

The Postal Services Commission, informed by the Consumer Council for Postal Services, will also work with key post office network stakeholders, including the National Federation of Sub-postmasters, over the next five years to develop a shared understanding of the role that post offices should play in the longer term. The PSC will advise the Government on the main options for the policy framework after 2006 on convenient access for all to post offices.

The Performance and Innovation Unit Report

In October 1999, the Prime Minister asked the Performance and Innovation Unit in the Cabinet Office to draw up a strategy for the future of the post office network. This was a response to the acknowledged challenges the Post Office faces and the need for its traditional work to respond the changing requirements of customers, to changes in society and to the opportunities arising from new technology.

The PIU Report on the future of the post office network⁴ was published in June 2000 and set out 24 proposals and measures to modernise the network, to protect the rural network in particular and to maintain convenient access and improve the quality of urban post offices.

In accepting all of the Report's 24 conclusions and recommendations, the Government has clearly demonstrated its continuing commitment to maintaining a nationwide network of post offices.

Among the key elements in this are:

- a formal requirement will be placed by the Government on the Post Office to maintain the rural network and to prevent any avoidable closures of rural

⁴ "Counter Revolution – Modernising the Post Office Network" published by the Performance and Innovation Unit of the Cabinet Office on 28 June 2000 (Ref: CABI 00-5902/0006/D96)

offices for a period of 6 years in the first instance. This will help to protect nearly 10,000 post offices in all communities of less than 10,000 inhabitants;

- in urban areas, the Post Office should embark on a programme of modernisation of the network to improve the quality of post offices and the Government will aim to provide a mechanism to ensure people in urban deprived areas continue to enjoy convenient access;
- subject to evaluation of detailed business cases, financial support will be available for a range of measures. As the first stage of modernising the post office network, ring-fenced funding for new investment of £270 million over the next 3 years to start the implementation of the PIU recommendations was announced in the Spending Review in July.

The Government has said that it is prepared to consider adding to this investment over the next few years through support for the development of the Universal Bank and the extension of the Government General Practitioner and Internet Learning and Access Points, following satisfactory evaluation of the pilot trials and development of business plans. The case for new financial support will be considered once viable proposals have been drawn up and approved.

These measures will help to develop the particular new business opportunities identified by PIU: Universal Bank; facilitation of e-commerce services; access to Government General Practitioner (GGP) and Internet learning and access services (ILAP). But the Post Office too will be seeking to develop other new commercial opportunities.

These new and improved services will utilise and build on the Horizon automation platform being installed in every post office.

Funding for PIU recommendations

Ring-fenced funding has been set aside in the Spending Review for new investment of £270 million over the next three years to start the implementation of the PIU report recommendations. Subject to validation by robust business cases which the Post Office is working on as matter of urgency, financial assistance is envisaged:

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| i) | to modernise and maintain the rural network, preventing avoidable closures of offices; |
| ii) | to support some modernisation of the urban network; |
| iii) | to improve support to local post offices in deprived urban areas; |
| iv) | to support the establishment and operations of the Universal Bank and |

- v) to support pilot trials for the development of Government General Practitioner and Internet access and learning point facilities.

Timescales for taking forward PIU proposals

The proposals will be taken forward in conjunction with the Post Office and other parties as a matter of priority in line with the timescales set in the PIU Report. These timescales are:

- Requirement on PO to maintain the rural network and avoid preventable closures – **Autumn 2000.**
- Completion of work to establish size and operational details of fund to sustain and improve post offices and associated retail facilities in deprived urban areas – **Autumn 2000.**
- Revision of code of practice for closure and relocation of post offices in deprived urban areas – **Autumn 2000.**
- Completion of business case and pilot trial specifications for GGP and ILAP by **early September 2000.** Pilot trials in place **during 2001.**
- Completion of the development by the Post Office and the banks of the Universal Bank concept and assessment of the appropriate level of public sector contribution which may be required – **by 31 December 2000.**

Annex A

SUMMARY OF KEY FINANCIAL INFORMATION

Financial Targets		Outturn
<u>1999/2000</u>		
Group post-tax profit target	£350m	£302m ¹
Dividend target – 50% of post-tax profits	£175m	£151m
Dividend floor – 80% of dividend target	£140m	
<u>2000/01</u>		
Operational pre-tax profit target	£392m ²	
Dividend target	40% ³	
Dividend floor	90% ⁴	

Borrowing for growth investments in 1999/2000 ⁵		
		£
Der Kurier group	April 1999	10m
Delacher etc	April 1999	10m
Williames group	December 1999	10m
Citipost group	January 2000	25m
Crie group	January 2000	6m
Pakke Trans group	March 2000	20m
Nederlandse Paket Dienst	March 2000	68m
		Total cost £149m ⁶

Outturn External Financing Requirement (EFR) ⁷ for 1999/2000	
Gilts purchased	[awaiting figures from the Post Office]
New NLF deposits	[awaiting figures from the Post Office]
(New borrowings)	[awaiting figures from the Post Office]
Outturn EFR 1999/2000	[]

¹ excluding exceptional items for the Horizon and Parcelforce write downs and restructuring costs.

² excludes the network of post offices and the non-operational interest arising from past surpluses held on the Post Office's balance sheet. The target will be subsumed within the overall post-tax profit target for the Post Office as a whole, as described in the White Paper.

³ as announced in the White Paper, the dividend payment to Government is set at 40% of post-tax profits of the business as a whole from 2000/01 onwards.

⁴ the dividend floor payment for 2000/01 will be raised from the level of 80% set for 1999/2000 to 90% of the dividend that would be paid if the Post Office meets its overall profit target.

⁵ in respect of acquisitions agreed by the Post Office during 1999/2000.

⁶ the mechanics of borrowing from the National Loans Fund are currently being put in place and appropriate readjustments will be made in due course, including the replacement of any reserves used in lieu of borrowing.

⁷ EFR equals the sum of the gilts purchased plus new NLF deposits, less new borrowings.