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Department for
Business, Energy
& Industrial Strategy

Date: XX December 2018

Director General: Mark Russell

Lead Official: Alex Cole / Tom Cooper

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Recipient	To Note / Comment	To Approve / Decide
BEIS Finance		X
Gavin Lambert	X	

OFFICIAL SENSITIVE POST OFFICE INVESTMENT FUNDING FOR Q3 2018/19

Summary

1. This submission recommends the release of £59.5m of funding to Post Office Limited ("POL") for Q3 2018/19 to support its investment spending.
2. POL conducted a reforecast of planned investment spending in advance of the request for Q3 funding. This showed that they were forecast to spend £84.3m more than the £459.3m in the 3-year Strategic Plan. UKGI requested that POL initiate the following to provide us with sufficient comfort to release funding for Q3:
 - Deep-dive of excess spending in Q2, including rationale for management overlay on the Q2 forecast
 - An outline of how and when its reprioritisation process would take place
 - Internal audit to be tasked with providing assurance regarding POL's controls over its capital expenditure spend monitoring and forecasts
 - Improvement in change spend reporting
3. UKGI is satisfied that these conditions are being fulfilled although much of the work has yet to be produced. In the meantime, UKGI recommends the release of £59.5m of investment funding for Q3. This will leave £23.5m for Q4.

Timing

4. Early December 2018. POL have stressed the importance of receiving the funding before the Christmas period, when cashflow comes under the largest pressure.

Recommendation

5. That you **approve** POL's drawdown of £59.5m from BEIS for investment funding for Q3 2018/19.

Background

6. POL secured a £370m funding agreement with BEIS in December 2017 (£210m investment funding, £160m network subsidy), covering the period 1 April 2018 to 31 March 2021. Of the £210m investment funding, up to £168m is available in 2018/19 and the remaining £42m in 2019/20, with flexibility to defer funding from 2018/19 to 2019/20 if necessary and subject to need.



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7. The funding agreement requires POL to produce a quarterly report on its investment spending to act as a stocktake on current projects and estimate the funding that it will require from BEIS in subsequent quarters.
8. POL's Q3 report states the intention to draw £59.5m for investment funding, to add to the £35m and £50m provided by BEIS in Q1 and Q2 respectively - more detail can be found in Annex B. A drawdown of £59.5m in Q3 would take POL's total drawdowns for the year to date to £144.5m, out of the maximum £168m available in 2018/19.
9. POL has spent £122.5m in 2018/19 to date. Overall this is in-line with the total forecast £122.6m spending for Q1 (£65m) and Q2 (£57.6m), but there are discrepancies within each quarter between these forecasts and actual spend (£42.7m in Q1 and £79.8m in Q2). This was due to delays in projects beginning in Q1 and then a certain level of catch-up in Q2. It raises questions about the forecasting at POL and UKGI is therefore working with POL on a number of measures to improve this – see paragraphs 20-22.
10. One project – Back Office Transformation – is currently projected to cost approximately £17.3m more than originally forecast over its lifetime. This is a critical project to modernise POL's internal IT and accounting systems and UKGI advises against withholding additional resources on this basis.
11. POL's revised 6+6 forecast for 2018/19 operating profit is £51m which would represent a significant £16m (46%) growth on 2017/18's £35m. POL is £7.9m ahead of budget after P7 and on track to achieve that £51m for the full year. To deliver this and to undertake critical infrastructure upgrades (mostly in IT), POL forecast that it will invest £255m in 2018/19. This is in line with the 3-year strategy approved by BEIS and UKGI in December 2017.

Q2 Investment Summary:

12. POL took a Q2 drawdown of £50m of BEIS funding in October 2018 to spend on projects agreed in the 3-year strategy. This was added to a £7.6m of surplus from Q1 to form its total projected investment spend for Q2 of £57.6m which was to be incurred on the following project categories:
 - Simplify the retailer proposition (£24.9m)
 - Build innovative, flexible and secure IT (£14.1m)
 - Modernise products and services (£8.0m)
 - Digitise and optimise the business (£2.1m)
 - Modernise skills, culture, HR policies and processes (£3.7m)
 - Regulatory and group litigation (£4.0m)
 - Other small projects (£0.9m)
13. However, POL actually incurred £79.8m of capital expenditure in Q2, as a number of projects caught up on Q1 delays, particularly in IT. We have subsequently discovered that overall spending was in line with the sum of forecasts from individual projects. However, the forecast was deliberately reduced as 'managerial overlay' by c.£23m by the CFOO due to historic over-estimation in forecasts. UKGI has been clear that (i) forecasting should be reviewed/improved; (ii) in future, any deviations from forecast should be transparent and justified. UKGI has been shown the supporting files behind the forecasting process from the POL team during a deep-dive and has been assured that this will improve in future. A further breakdown of actual Q2 spend is in Annex A.



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Planned Q2 spend	£57.6m
Actual Q2 spend (see Annex A)	£79.8m
Variance	£22.2m

14. Correspondence with POL shows that this £22.2m overspend is primarily due to £9.2m more than planned on IT projects, such as cloud enablement and branch technology refreshers, as well as £3.4m extra on litigation and £2.6m on back office transformation within Q2.

Benefits Realised:

15. POL budgeted for expected benefits of £40.2m in 2018/19 to be derived from its investment projects. At the end of Q2, the realised benefits year to date (YTD) amounted to £16.9m compared to a budgeted £15.7m.
16. However, POL is now less confident that budgeted benefits will be fully captured in 2018/19 and have therefore reduced the forecast to £38.9m. This is primarily due to a £1.7m decrease in Post Office Insurance projects, a decrease of £0.9m in the expected benefits from the Solar Full project, a decrease of £0.9m in Cloud Enablement and a decrease in £0.6m from the Travel App. These are all as a result of delays in the projects. These are partly offset by a £2.0m expected gain compared to budget for Project Galaxy (Homephone and Broadband changes) as fewer customers are taking up the free broadband offer.

Project Category	YTD Actual Benefits	2018/19 Expected Benefits
Simplifying the retailer proposition	£6.5m	£12.0m
Build innovative, flexible and secure IT	£1.2m	£6.1m
Modernise products and services	£7.5m	£16.9m
Digitise and optimise the business	£1.8m	£3.5m
Modernise skills, culture, HR policies and processes	£0.0m	£0.4m
Total Actual Benefits	£16.9m	£38.9m
Forecast at the start of 2018/19	£15.7m	£40.2m
Variance	£1.2m	(£1.3m)

Investment Plan for Q3:

17. UKGI has reviewed the planned investments for Q3 (i.e. between October and December 2018), forecast by POL to be £59.5m. This is expected to be distributed as follows:
- Simplify the retailer proposition - £14.0m
 - Build innovative, flexible and secure IT - £11.6m
 - Modernise products and services - £16.0m
 - Digitise and optimise the business - £7.2m
 - Modernise skills, culture, HR policies and processes - £6.0m
 - Regulatory and group litigation - £4.7m



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18. The key projects to be delivered as part of Q3 spending are:

- The continuation of the DMB franchising programme, which has been increased from 177 branches to 227;
- Project Everest (cloud enablement);
- Travel App upgrades;
- The last phase of back office IT transformation; and
- Insurance system migration.

19. Across the whole of 2018/19, POL now expects to spend £273.8m on projects compared to £255m in the strategic plan. Over the 3-year period, POL expects to spend £543.6m, compared to £459.3m in the strategic plan. The £18.8m difference in 2018/19 and £84.3m over the 3-year plan are classified between the following categories:

- Overspend
- Scope change
- New projects - £11.4m

20. The £84.3m will be “reprioritised” – i.e. some projects will be cancelled, some projects will be scaled back and the spending on some projects will be pushed out to later years. This process is taking place at the Investment Committee level which involves a number of members of senior management. We expect this process to be completed by the Q4 funding request to be received in January 2019. UKGI has been working closely with POL to ensure that this is done effectively.

21. UKGI has given POL a number of conditions that need to be in place in order to receive the funding for Q3. The first of these is the progress on the reprioritisation outlined in paragraph 20. Secondly, POL were asked to engage in a deep-dive on forecasting with UKGI, mentioned in paragraph 13. Thirdly, UKGI has agreed a scope of work with POL’s internal audit function which will deliver a report on the change spend procedures in place. This will include monitoring of spend so far and future forecasting and aims to provide recommendations that allow POL to better track the spend and timing on its investment projects to avoid repeats of the reprioritisation process. This report is expected to be presented to the January 2019 Audit and Risk Committee. Finally, UKGI and POL have begun working together on the long-term reporting procedure as we move deeper into the 3-year plan.

22. UKGI will continue to work closely with POL to monitor the ongoing delivery of the projects and to challenge them to improve their financial management processes. With this in mind, UKGI recommends that the £59.5m funding request for Q3 is approved.

Media Handling

23. UKGI does not consider there to be a need for specific communications action regarding this funding drawdown. The funding that this relates to was announced in December 2017.

Contributors

24. This note contains financial considerations, as agreed with Richard Beckett of BEIS Finance.



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25. This note is not considered to raise legal issues and Legal has not been consulted.

26. This advice does not have parliamentary handling implications.

Annexes

A. Q2 project level spend analysis (£m)

B. Summary Table of Investment Plans and Funding Drawdown



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Annex A – Q2 project level spend analysis (£m)

£m	Q2 Plan	Q2 Actual	Variance UKGI Funded
Further franchising DMBs incl. old Crown project	17.0	16.9	(0.1)
Network Expansion	3.4	3.4	0.1
Solar Full (HNGT)	1.9	1.9	0.0
Self Service Kiosk Rollout	0.3	1.1	0.8
Agents / Postmasters Portal	0.5	0.1	(0.4)
Other Smaller Projects	0.1	0.9	0.8
Simplifying the retailer proposition	23.0	24.3	1.3
Mails Projects	-	0.1	0.1
PO Insurance Investments	3.3	5.0	1.7
Identity Services Investments	1.7	0.4	(1.3)
Project Galaxy	0.0	(0.1)	(0.1)
Falcon - Travel Hub	1.0	2.8	1.7
Telephony Routers	0.3	0.6	0.4
Project Panther (integration costs only)	-	0.8	0.8
Falcon - Peregrine negotiations and implementation	0.6	0.6	(0.1)
Digital Developments	0.3	0.7	0.4
Eagle	0.0	0.5	0.5
Other Smaller Projects	(0.0)	0.5	0.5
Modernise our products and services	7.2	11.9	4.7
Project Everest - Cloud Enablement	0.4	3.7	3.3
Risk and Resilience	1.4	4.0	2.6
EUC Branch Deployment	3.9	7.3	3.3
End-of-Life Replacements	2.0	1.9	(0.1)
Branch Printer Replacement	2.0	2.0	0.1
Project Nelson	1.0	0.9	(0.1)
CDP re-procurement	1.2	1.4	0.3
Project Trafalgar	0.4	0.8	0.5
Other Smaller Projects	-	(0.5)	(0.5)
Build Innovative IT	12.2	21.4	9.2
Enabling supply chain and back office improvement	0.0	0.1	0.1
Property	1.2	1.0	(0.2)
Project Arrow (Data warehouse/BI)	0.3	0.4	0.1
Success Factors	1.4	0.5	(0.9)
Other Smaller Projects	0.6	1.6	0.9
Digitise and optimise the business	3.6	3.6	0.0
Back Office Systems Transformation	3.7	6.3	2.6
Modernise our skills, policies and processes	3.7	6.3	2.6
GDPR	1.6	1.0	(0.6)
Group Litigation	2.3	5.7	3.4
Other Smaller Projects	0.2	0.4	0.2
Regulatory	4.1	7.1	2.9
TOTAL UKGI Funded	53.9	74.6	20.7
Non-UKGI Funded (i.e. carry forward)	3.7	5.2	1.5
TOTAL Change Spend	57.6	79.8	22.2



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Annex B – Summary Table of Investment Plans and Funding Drawdown

Investment Category	YTD Actual	Q3 Forecast	Q4 Forecast	Total 2018/19	2019/20 and 2020/21	TOTAL
<i>Simplify the Retailer Proposition</i>	£35.3m	£10.4m	£35.6m	£81.3m	£157.4m	£238.7m
<i>Build Innovative, flexible and secure IT</i>	£27.2m	£16.0m	£12.0m	£55.2m	£52.7m	£107.9m
<i>Modernise our Products and Services</i>	£18.4m	£13.7m	£18.3m	£50.4m	£64.6m	£115.0m
<i>Digitise and optimise the business</i>	£4.8m	£7.2m	£11.2m	£23.2m	£17.7m	£40.9m
<i>Back office system transformation</i>	£7.2m	£6.0m	£6.0m	£19.2m	£0.8m	£20.0m
<i>Other</i>	£9.1m	£4.7m	£4.6m	£18.3m	£2.8m	£21.1m
<i>Carry forward spend*</i>	£20.6m	£3.6m	£2.1m	£26.2m	£0.0m	£26.2m
<i>Prioritisation review**</i>	N/A	N/A	£(18.9)m	£(18.9)m	£(65.4)m	£(84.3)m
Total Spend	£122.5m	£61.6m	£70.9m	£255.0m	£230.6m	£485.6m
BEIS Funding Drawdown	£85m	£59.5m	£23.5m	£168m	£42m	£210m
Cumulative Funding	£85m	£144.5m	£168m	£168m	£42m	£210m

* Carry forward of £26.2m into 2018/19 from prior year (i.e. delayed spend from 2017/18)

** No detail provided by POL yet – UKGI to discuss as part of wider review into the future years (2019/20 and 2020/21) forecasts