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Select Committee on Trade and Industry Eleventh Report

ELEVENTH REPORT

The Trade and Industry Committee has agreed to the following Report:—

THE HORIZON PROJECT FOR AUTOMATED PAYMENT OF BENEFITS THROUGH POST OFFICES

Project Horizon

1. In the mid-1990s, the previous Government embarked on an ambitious project, christened Horizon[1], to computerise the Post Office network and automate the payment of benefits, financed under the Private Finance Initiative (PFI). It was designed to give all benefit claimants a magnetic strip benefit payment card, for presentation at a specified post office, where it would be swiped by a clerk and cash paid out. The system was intended to produce substantial savings over the current system of payment books, and be substantially less open to fraud, as well as providing the Benefits Agency (BA) with the means to account fully for their vast programme of expenditure.[2] The contract was awarded to ICL in May 1996, with the intention that systems would be installed by the end of 1998 and that all benefit recipients would be in receipt of cards by mid-1999.

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1 The terms "Horizon", "Pathway" and "BA-POCL" (Benefits Agency-Post Office Counters Limited) have all been applied at different times to all or specific parts of the programme Back
2 Ev, p 34, para 5 Back

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Progress and problems

2. In the course of 1997, there were reports in the press of difficulties with the programme, and expressions of concern from interested parties. When we raised the matter with the Post Office and the Minister in the course of oral evidence in November 1997, however, both seemed confident that it was progressing to plan. We concluded in January 1998 —

"There have however been recent reports that the programme is running two years behind schedule. It is crucial for the future of the national network of sub - post offices that the ICL Pathway automation project be taken through to a successful conclusion: we seek a detailed account of progress and problems in the Government's response to this Report."[3]

In its response of April 1998, the DTI told us —

"... the Government is committed both to the maintenance of a nationwide network of post offices and to providing a secure, convenient and cost effective means of paying benefits to customers. That is what the Horizon automation programme is designed to do. Post Office Counters Ltd and the Benefits Agency are continuing to work closely with ICL Pathway to progress the Horizon programme and the Government is monitoring developments closely. A small pilot trial of paying child benefit by payment card at 10 post offices began in October 1996, followed in May 1997 by trials at 200 post offices of order book control service with bar-coded order books. These trials were extended in scope by a further software release in November 1997. Post Office Counters Ltd and the Benefits Agency are now working with ICL Pathway to finalise plans for the next stages of the delivery of the programme, with a working assumption that a live trial of all services at some 300 post offices would begin in January 1999. Subject to successful completion of this trial, national roll-out to all post offices would start in April 1999 and be completed before the end of 2000."[4]

3. In November 1998, aware of concerns being expressed at what was happening to the programme, we raised it in oral evidence with the then Secretary of State, Mr Mandelson. He told us -

"There have been delays but the Benefits Agency and the Post Office continue to work closely with ICL and the Government is closely monitoring progress. You are right to suggest that under the leadership of the Treasury there have been ministerial discussions about the progress that is being made and when it can be completed. The current plans provide for Post Offices to be automated by the end of the year 2000 and in that context the Government is committed to the maintenance of a nationwide network of post offices. I think people need to be assured of that. I feel confident that the project will be properly completed and that it will provide a very important platform, computer based platform, springboard, for the Post Office to introduce and develop quite a diversity of services which are very important indeed if the business prospects of the Post Office are to be secured ......There is a constant monitoring of the performance and attainability of this project by the

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Government. Obviously it is very, very important to the Post Office and its customers. It is very important to the Government's wider plans. *We remain confident on the basis of the information that we have at the moment that it will reach completion ..... .*"[5]

A month later, on 9 December 1998, we heard oral evidence from Ian McCartney MP, the Minister of State at the Department of Trade and Industry, on the outlines of the review of the Post Office announced on 7 December 1998 by the then Secretary of State. He told us -

"We are still committed to the creation of an information technology network in 18,000 post offices. As a Government we are working both as a Department with the Post Office and the Post Office partners which include of course the Benefit Agency one of the biggest customers, and that work is progressing to try and ensure we get in place such a network. It is critically important to the future of the Post Office that it does." [6]

4. While still awaiting the outcome of the review announced in April 1998 by the then Secretary of State Mrs Beckett, which was to have concluded in the autumn of 1998, we had reason to assume from successive Ministerial assurances that the Horizon programme was proceeding, despite delays and difficulties, and that Mr Mandelson's confidence expressed to us in November 1998 that the project would be "properly completed" was well-founded. On 24 May 1999, however, the Secretary of State for Trade and Industry announced in a Press Release, and in a Written Answer, changes to the Horizon project which in broad terms meant scrapping of the magnetic strip benefit payment card, and a rejigged fixed price computerisation contract between the Post Office and ICL, designed to lead eventually to a much broader smart card service. The Benefits Agency is no longer a party to the programme, save for paying as an interim measure for the bar-coding of order books, and is now committed to moving from 2003 to payment of benefits by automated credit transfer (ACT). The Secretary of State's statement explained that -

"The changes to the Horizon project are aimed to put it on a sustainable footing for the future and allow the Post Office to move as quickly as possible to the computerisation of post office counter services."[7]

5. It has been suggested that, over the past two years, Ministers have been less than candid in their responses to the House and to this Committee on the problems confronting the Horizon project. The Secretary of State for Social Security, in 1997 the Chief Secretary at the Treasury, confirmed in evidence to us that Ministers outside the DSS — primarily the Treasury and DTI — had been focussing on the programme since August 1997: it had been clear from then, if not sooner, that "there were major difficulties".[8] We appreciate that in such issues, involving large sums of money and, as the Permanent Secretary at the DSS told the Social Security Committee in July 1998, the prospect on termination of "a long, nasty negotiation which would probably in the end result in some sort of out-of-court settlement",[9] some discretion was necessary. Ministers were indeed intent over many months — perhaps too many months — on rescuing the project, until their cumulative loss of confidence at the turn of 1998-99. **Having reviewed the evidence given to us, we do however consider that a fuller reflection of the process of review which was underway, and of the serious problems with the programme, could and should have been presented to Parliament and to this Committee.**

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3 HC380 of 1997-98, para 40: Qq 159-60 & 220 Back
4 Fifth Special Report from the Trade and Industry Committee, HC 684, p vi, para 26 Back
5 HC 1138, Minutes of Evidence of 4 November 1998, Qq 102ff: *italics added Back*
6 First Special Report from the Trade and Industry Committee, HC 113 of Session 1998-99, Q177 Back
7 HC Deb, 24 May 1999, col 21w Back
8 Qq137, 157, 167 Back
9 HC 614 of Session 1998-99, Q377 Back

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Evidence

6. In view of the size and prominence of the programme, not only the largest PFI programme within the responsibility of the DTI, but one of the largest in existence, and of the significance of the decision to scrap the Benefit Payment Card for the survival of the national post office network and to the ability of benefit claimants to collect benefits in cash from post offices, we decided to inquire into the events which led up to the May 1999 announcement and into future prospects. We heard oral evidence on 14 June 1999 from the National Federation of Sub-Postmasters (NFSP); the Communication Workers Union (CWU) and Communication Managers' Association (CMA); ICL and the Post Office: and on 14 July 1999 from the Rt Hon Stephen Byers MP, Secretary of State for Trade and Industry; the Rt Hon Alistair Darling MP, Secretary of State for Social Security and the Rt Hon Alan Milburn MP, Chief Secretary to the Treasury. Following the latter session, we sought copies of the 3 principal reports on the programme, which had been referred to in evidence to us: the PA Consulting Group Report of October 1997, the report of July 1998 by an expert panel chaired by Adrian Montague (the Montague Report) and the report of October 1998 from the independent troubleshooter, Graham Corbett. Copies were made available on a provisional basis in early September. On 13 September the DTI confirmed that they were to be regarded as provided in confidence "in order to assist the Committee's understanding of the background to the project and to the decision which Ministers collectively reached". **We have therefore reluctantly agreed not to quote extensively from the three documents, nor reported them to the House; we have however drawn on their contents to inform our conclusions.**

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History

Origins

7. In late 1992, DSS trialled three new social security benefit entitlement claim forms only one of which "contained a direct reference to payment in cash at a post office".[10] Following a vigorous campaign by the NFSP, Ministers set up a joint study by the Benefits Agency (BA) and Post Office Counters Ltd (POCL) to undertake a review and come up with a way forward.[11] After what ICL described as "a lengthy competitive bid", and "following a procurement process in line with Government and European regulations",[12] ICL Pathway was selected in May 1996 to design, build, finance and operate an automatic benefit payment system as a Private Finance Initiative project, under which the private sector contractor carries the development risk, with the reward in the form of transaction fees. ICL had experience of establishing and running a broadly similar scheme for the Post Office (An Post) in the Republic of Ireland, as well as running a 1994-95 programme of barcoding of order books for use at post offices within the M25 area.[13]

8. The 1993 report of the joint feasibility study conducted by BA and POCL into a solution to the problems of paper based methods of payment examined three principal options — barcodes, a swipe card and a smartcard. It concluded that "a magnetic swipe card offered the most effective (as well as cost effective) way forward. This approach was endorsed by Ministers".[14] The Post Office had always intended to migrate its customers onto a "Post Office smartcard", covering many other functions, so that it naturally wanted any new technology to be compatible in future with smartcards.[15] The Benefits Agency saw the swipe card as "an interim measure", to ease the transition to ACT,[16] and may have been unwilling to tie themselves in for the longer-term to a Post Office smartcard. ICL told us that "ICL's original proposal was to issue a smartcard, but the customers maintained their preference for a "mag stripe" Payment Card."[17] In response to our subsequent inquiry, ICL told us that they had submitted a proposal in February 1996 during "proposal evaluation and pre-contract discussions", which noted that the German social security programme already used smartcards. The approach was rejected, possibly on the grounds of cost - an increment of around 80p a card - as well as technical risk.[18] The Chief Executive of the Post Office agreed with the benefit of hindsight that it might have been better to have moved straight to the smartcard, but noted that there had been "social and technical reasons" for the decision to select a magnetic stripe card.[19] **We question Ministers' characterisation of the magnetic swipe card system as "an out-dated concept" and a redundant technology; although the selection of a magnetic card rather than a smartcard in 1996 may with hindsight have proved unfortunate, it was always intended to move to a smartcard in due course.**

PA Review

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9. Under the original timetable, contract details, including a detailed schedule of service specifications, were to be completed by the end of 1996; a live Operational Trial would run from April to July 1997, and full roll-out to be completed by the end of 1998.[20] **There were however delays from the beginning.** The Post Office told us that the process of agreeing the Schedule of Service specifications "took eight months rather than the three originally allowed."[21] A revised timetable agreed by all parties in February 1997 delayed the beginning of roll-out from July 1997 to November 1997.[22] In the course of 1997 further difficulties emerged. In August 1997 DSS Ministers alerted Treasury Ministers to record that "they were extremely concerned by what they discovered."[23] In September 1997, as a result of consistent and chronic slippage in delivery dates, all parties commissioned a strategic review by PA Consulting Group. The review's broad conclusions were set out in evidence from the Post Office — "the programme was technically feasible, that it would take longer and cost more to deliver, was of a complexity underestimated by ICL and that there was no sensible way of descoping/radically altering the plan. Overall it was better to continue than to terminate."[24] The review noted that the target for national roll-out had slipped by 13 months in the 8 months between the November 1996 version 2 of the master plan and the July 1997 forecast, ending up further away than before. As a result of the review's recommendations, POCL took over line management of the programme in April 1998 from the Joint Programme Delivery Authority.[25]

Montague Report

10. Matters only improved in part over the next 9 months. In November 1997 a formal note of default letter was sent to ICL Pathway, who rejected it.[26] There were further delays to the programme and ICL requested a change in contractual terms, either by an extension of the contract or increased charges.[27] . In March 1998, following what ICL regarded as "excessive interference and bureaucracy", and against what the Post Office referred to as "a background of concern about delay to the project and its ability to deliver its objectives", Ministers established an interdepartmental working group, which in turn established an independent panel of experts, chaired by Adrian Montague.[28] The findings of the Panel's July 1998 report were "broadly in line with previous reviews" according to the Post Office, and "confirmed the technical viability of the project" according to ICL.[29] The Government's account to us of the Panel's findings was that the project could deliver the functions expected of it, but not before the end of 2001 and not without improved management and uncertain cost.[30] Annex A to the Montague Report set out a number of options and offered a detailed assessment of the two which it deemed to be the only practicable ones: Option 2, "partial restructuring" — that eventually adopted by the Government — which was seen as having the disadvantages of the perpetuation of a high cost paper-based method of payment: POCL's infrastructure being too highly specified for its needs: and the strong possibility of "long, acrimonious and costly legal disputes" but as presenting a lower risk; and Option 1, "full restructuring", by extension of the contracts, followed by a rapid move to ACT payments. The Government told us that the working group concluded that if the project were to continue it should be on the basis of "no increase in the level of payments to ICL: improved management: and the appointment of a troubleshooter."[31] We have not seen the detailed conclusions of the working group, which evidently constituted a gloss on the Panel's Report: their reported opposition to additional payments to ICL, whether by an extension of the period of transaction payments or an alteration in their level, boded ill for the programme's survival, since ICL were seeking at least to cover their expenditure to date and avoid a loss.

Corbett Report

11. In September 1998 Graham Corbett, Deputy Chairman of the MMC, was appointed by the Treasury as the troubleshooter recommended in the Montague Report to "facilitate discussions between the three parties [ICL, BA, POCL] on an acceptable way forward". We were told by the Government and ICL that he proposed extension of the contracts and an ICL/PO Public/Private Partnership.[32] Mr Corbett's written report to the Chief Secretary of 20 October 1998 records offers of extensions of the contracts made by the two public sector sponsors, BA and POCL, and the difficulty presented by ICL's unwillingness to give up its desire for a modest positive return over the project, and its reluctance to draw a line under the problems of the past two years. By December 1998, however, ICL and the Post Office had agreed terms, which would have led to ICL accepting a loss on their business case and to the Post Office taking on some of the financial burden "by picking up increased prices to ensure continuation of the programme and the BPC .... . This deal would have provided POCL with a more certain route to Network banking ....".[33] ICL submitted its final proposals in December 1998, based on these negotiations. We were shown in confidence by ICL and the Post Office the outlines of these proposals which seemed to them to represent an acceptable way forward. As the Post Office Chief Executive put it — "We thought we had it tied down by Christmas, but obviously we had not ....".[34] The Government state that these proposals "would have required both a large increase in the charges paid by the public sector parties, and also an extension of the contract", thus running aginst the working group's July 1998 conclusions.[35]

Outcome

12. Meanwhile, the October 1998 milestone for a live trial had come and gone.[36] ICL told us that it "emerged" in January 1999 that "the BA did not wish to proceed with the magnetic swipe card", although not until May 1999 was it clear that Ministers had decided to dispense with the Benefit Card.[37] Between January and May 1999 a number of options for retrieving something from the project were examined.[38]A senior Treasury official was tasked with devising an alternative solution, which was that announced in May 1999.

Basis for May 1999 decision

13. **It is evident that a combination of factors — repeated delays and failures to reach important milestones: the demands of ICL to recoup their expenditure by either a higher transaction charge or an extension of the period during which such charges would be payable: doubts about the resilience and relative obsolescence of the technology — led Ministers to a collective loss of faith in the programme.** The Chief Secretary told us "We were anxious if at all possible to try and resurrect what looked like a project which was beyond resurrection":[39] and "in the light of all the evidence what did we do? Try and resuscitate it? Try and resurrect it, when we were being told it would (a) cost us more money and (b) we could not be sure it would actually operate?"[40] The Secretary of State for Trade and Industry admitted that it " probably would have been easier to let the contract run on and not to have taken the decision that we have now taken".[41] **It is however our impression that the principal factor in deciding to ditch the Benefits Payment Card was neither the cumulative delays nor technical doubts on feasibility, but the increasingly unpalatable prospect facing the Benefits Agency of paying high transaction costs for an extended period, rather than moving as rapidly as possible to ACT transactions.** The evidence given in July 1998 by the DSS Permanent Secretary to the Social Security Committee puts it plainly —

"...as the project slips, our costs mount because we are having to carry on with our end of the project. The savings we shall get from it, which are administrative savings are balanced by the administrative costs, though there are big savings in fraud savings. But of course as the length of the project shortens, because it is supposed to end in 2005, we get less and less of those .... . From our point of view, the best answer would actually be payments into bank accounts and if we want to use post offices, the post offices could actually have some kind of banking facility where people can just put their card in at the post office and get their money out. So that is how it looks from our point of view. As the project got delayed and delayed the Benefits Agency who are accountable for it, were really beginning to say, "This can't go on" .....ACT is in pence and all other methods of payment are far more expensive than that so the more uncomfortable for us it feels."[42]

Already in the autumn of 1997 the PA Report recorded the reservations felt by the BA about the economic viability of supporting the automation of benefit payment at *all* Post Offices. Nine months later the Montague Report noted uncertainty about both sponsors long term intentions and that BA's commitment to the programme would be hardest to achieve while the lower unit cost of payment by ACT was so attractive. In the Annex setting out the Panel's views on a way forward, it records BA's concern at the implications of use of a benefit payment card for only a short while until 100% ACT became effective. While it is understandable that the BA should have had doubts about the prospect of *either* an ever briefer and potentially more costly interlude of a benefit payment card squeezed between an order book regime and ACT *or* delays to the introduction of ACT putting off the anticipated saving for two or more years, it remains unclear what timetable for migration to ACT was envisaged at the formative stage of the programme in 1994 to 1996. It is however clear that BA and ICL had radically different perceptions from the very outset, without the benefit of discussion on this crucial matter. **Everything we have heard and read confirms us in the view that the programme was blighted from the outset by the desire, justifiable or not, of the Benefits Agency to move as soon as permitted to compulsory Automated Credit Transfer: and that it finally foundered because of the reluctance of either the Treasury or ICL's parent company Fujitsu to find the additional funds required once the business case of all those involved deteriorated in**

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the face of delays. We do not fault Ministers for taking the decision they did in May 1999 in these circumstances. We have not regarded it as part of our task to come to a judgement on decisions taken prior to May 1997; it may be that the inquiry by the Comptroller and Auditor General will cast light on such decisions.

Costs

14. The Chief Secretary set out for us the costs to the public purse of the programme:[43]

	Sunk costs specific to Benefit Payment Card	Costs attributable to Horizon
	£m	**£m**
DSS	130	140
PO	10	30
Total	140	170

Furthermore, the Secretary of State for Social Security estimated fraud savings foregone as around £320 million.[44] The £140 million expenditure by DSS on Horizon is expenditure on the CAPS computerisation programme, which is necessary in any event.[45] We were relieved to hear that a number of relevant lessons had been drawn from the project and are being reflected in revised Treasury guidance.[46] **It has been an expensive lesson: we hope that it proves a salutary one.**

Major problems

15. We have sought to establish in outline terms only the reasons for the delays and difficulties in the programme. The PA Report identified three root problems, which are born out by our analysis and that of the other reports -

- **marginal business cases**: each slippage exposed further the vulnerability of the programme: as the financial return from the programme deteriorated significantly for all parties there was erosion of the sponsors' business cases, putting strain on relationships between sponsors and between the sponsors and Pathway.
- **agendas in conflict**: all the reports noted an adversarial approach between some of those involved and substantial tension, suspicion and distrust between the sponsor organisations at most levels.
- **PFI structural problems**: the PFI contract implied a transfer of risk which was not sustainable in practice, since the public sector sponsors could not afford failure of the system.

16. We add the following observations based on evidence and a reading of the Reports —

- It is agreed that the **management of the programme by the customers** — BA and POCL — was imperfect. In May 1996 a Programme Delivery Authority (PDA) was established, intended to provide a single customer base.[47] It grew in size to almost 150 people. ICL complained that "the PDA maintained it had a right to require ICL Pathway to behave as if this was a conventional government procurement programme. This led to a huge amount of senior management time being devoted to solving the issues which were constantly being raised by the PDA".[48] The PA Report identified in excess of 25 forums that met on a regular basis with numerous additional ad hoc meetings: found that certain change requests had taken more than six months to be resolved: and suggested that the PDA was far too large and should be reduced to around a quarter of its existing size. The Government's memorandum emphasised that the "new way forward" - management by POCL - was simpler both in terms of its management structure and focus, drawing on the lessons learned from large IT projects of this sort.[49]
- POCL and BA do indeed seem to have been pursuing **different and sometimes competing agendas** from the outset. The BA continued at a policy level to hanker after an accelerated move to ACT, meaning that, in the tactful phrase of the Managing Director of ICL Pathway, "the business drivers were out of sync with the technical drivers".[50] The Government candidly stated that the swipe card "had always been seen by DSS/BA as an interim measure, designed to ease the transition from paper-based methods of payment to payment by ACT".[51] POCL were looking towards an eventual migration to a smart card. As a result, the PDA had difficulty "in speaking with a decisive voice on the decisions which needed to be made .....when it had to

make decisions [it] had to really go back and try and broker decisions back with two sponsors so they did not have executive authority."[52] The Chief Executive of the Post Office attributed the delay primarily to the absence of a clear line of accountability between one customer and one supplier.[53]

- The **complexity** of the project seems to have been underestimated from the outset. The Government memorandum described the project as "highly complex, both in terms of scale and technology, and commercially" and affirmed that the process of agreeing detailed specifications "revealed a complexity not previously properly understood".[54] ICL seem to have assumed that the principal task was one of integration rather than new development and design, leading to additional work, and an unexpected degree of dependency on a relatively small privately owned North American software company — Escher — and Riposte messaging software. The Managing Director of ICL Pathway told us - "The complexity was greater than people anticipated ..... Complexity has to be managed. You have to bring it down to a scale. I think what has driven the complexity on this programme is not the individual activity across a post office, it is when you multiply that by 20,000... ."[55] The Chief Executive of the Post Office suggested that "in the early period there was maybe some under estimate of the complexity of this whole programme by the supplier."[56]
- ICL alleged that one major **technical obstacle** to progress was that the integrated database to be provided by September 1996 by the Benefits Agency — the Customer Accounting and Payment Strategy (CAPS) database — was not available as promised.[57] ICL told us that "it subsequently emerged that it would be available only on a phased basis and would be delayed by three years ...."[58] The Secretary of State however assured us that, while there were difficulties with CAPS in the early days, the "system is up and running, some 15 million customers have their records on it and it is used by 75,000 staff every day ..... CAPS actually works".[59] Reviews by consultants in 1997 led to a necessary strengthening in the CAPS programme management team, and it is evident that there were seen to be risks associated with the clean-up and migration of data from existing benefits processing systems to the new CAPS systems. Whether or not delays in CAPS releases arose from Pathway release problems rather than the other way round, CAPS releases were eventually "de-coupled". DSS told us that — "None of ICL Pathway's software delivery dates were delayed by CAPS. Throughout the project, DSS systems were ready as and when ICL Pathway's were and this would have continued to be the case ..... CAPS software "went live" over a series of releases from September 1996 up to May 1999. This included whatever CAPS software was required to enable flows of information to be provided to ICL Pathway on time ie for their initial release in September 1996, for full integration testing and again for their release in October 1997 (CAPS was ready in June 1997). Whenever ICL Pathway have required an interface or data from CAPS it has been provided in accordance with dates and plans agreed by all parties .... in relation to payments for benefits other than Child Benefit, the necessary CAPS software was in place in March 1998 but there was no associated ICL Pathway software to support this. The ICL Pathway release which was live in 204 Post Offices was not capable of supporting more than one benefit."[60]
- There seems to have been a constant procession of **changes to requirements**. ICL told us in response to our written queries that 323 formal requests for change had been received, against the original 366 contractual requirements, as well as "numerous informal changes and "clarifications" to requirements. These included the introduction of a temporary bar-coded paper payment card, with its own usage rules: the issue as late as February 1999 of 131 rules governing the encashment of benefit payments by other than the beneficiary: and ever-changing security procedures, described by ICL as "far in excess of typical financial industry norms".[61]

17. Whether or not the project and its outcome to date has been "the largest IT disaster ever for the Government"[62] — and there is no shortage of competition [63]— it has become apparent to us that a proper inquest is required, demanding detailed exploration of complex issues of management and finance beyond our capabilities. **Given the particular interest shown by the National Audit Office in PFI projects, and in the growing catalogue of Government IT failures, we are strongly of the view that an inquiry by the National Audit Office into the Horizon Project, using their powers to see departmental papers, would be of much assistance to Parliament: and we are confident that ICL and their principal sub-contractors would see it as in the national interest to co-operate as fully as possible. We wrote to the Comptroller and Auditor General in July to propose such an inquiry; we are pleased to record his agreement as conveyed to us in a letter of 7th September that the National Audit Office should carry out an inquiry into the**

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lessons learned from this project, focussing on risk management.

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10 Ev,p1, para 3 Back
11 *ibid,* p27, paras 8-10 Back
12 Ev, p17,para 2; p27,para 11 Back
13 Ev, p16,paras 1-2: p27, paras11-12 Back
14 Ev, p27, paras 9-10 Back
15 Ev, 27, para 6: p11, para 7: Qq15, 49 Back
16 Ev, p 35, para 14 Back
17 Ev, p17, para 5: Q76 Back
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21 Ev,p27, para 13: also p34, para 6 Back
22 *ibid,* para 15:p34, para 6 & Qq 139, 159 Back
23 Q157 Back
24 Ev,p28, para 17 Back
25 *ibid*, para 19 & Q127: p17, para 10 & Q75 Back
26 Ev, p28 , para 16: p17, para 11 Back
27 Ev, p34, para 7 Back
28 *ibid,*p17, para 12:p28, para 20 Back
29 *ibid Back*
30 Ev,p34, paras 8-9: Qq144 Back
31 *Ibid*,p34, para 10 Back
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33 *ibid,* p28,para 23 Back
34 Q114 Back
35 Ev, p34, para 11: Q146, 161, 167-8 Back
36 Qq146: 158: 170 Back
37 Ev,p34, para 13 Back
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39 Q 168 Back
40 Q 166 Back
41 Q 158 Back
42 HC 614, Qq 369-370: also Q382: and Q154, 166 Back
43 Q153 Back
44 Q154 Back
45 Q155 Back
46 Q140 Back
47 Ev, p17, para 6: p27, para 12 Back
48 Ev, p17, para 10 Back
49 Ev, p34, para 13 Back
50 Q102: also Qq 63-74 Back
51 Ev, p35, para 14 Back
52 Q75 Back
53 Q127 Back
54 Ev, pp33-4,paras 2 & 6: Q 140 etc Back
55 Qq 71, 90 Back
56 Q127 Back
57 Qq63, 73-4 Back
58 Ev, p17, para 8: Qq 66ff Back
59 Q154, 163, 165-6 Back
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61 Ev, pp25-6, A2 Back

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62 *Government Computing*, June 1999 Back
63 For list of successful PFI IT projects see Ev,p57 Back

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Revised contract

18. The May 1999 agreement provides for automation of Post Office Counter Services "as quickly as possible", by a "more realistic" target date of the end of 2001. The Secretary of State described the project in the Press Notice as delivering "the long overdue computerisation of the Post Office network in partnership with ICL".[64] The Post Office told us that following a Ministerial decision to abandon the Benefit Card, in early 1999 "negotiations then took place between Government and ICL on the cost of the new contract and in the light of these the Post Office signed heads of agreement on the basis of which we are now attempting to negotiate a full agreement by the end of July."[65] The Post Office and ICL agreed terms and signed a revised contract on 28 July 1999.[66] In oral evidence, the Chief Executive told us that this *new* contract would cost "somewhere in the region of £800-900 million" between now and 2005.[67] ICL referred in their evidence to a *revision* of the original contract, with the replacement of transaction payments by a fixed price contract to March 2005, and the removal of the Benefits Agency from the contract. The programme of automation and installation of the network is due for completion by April 2001.[68] It would seem that the POCL/ICL contract for rolling out the infrastructure is being presented as a revision of the original contract rather than a new contract for legal reasons, presumably to avoid the need for public tender: the Chief Secretary told us that the Government was confident that it was indeed a revision.[69] The Post Office Group Accounts for 1998-99 record in a "Post balance sheet event" that POCL" is required to pay ICL Pathway a total of £548m plus VAT (subject to certain retentions) and further annual payments by way of operating charges until 31 March 2005".[70] **While it makes evident sense for ICL to continue with the work it has already begun, the impression remains of an essentially political deal to ensure that ICL has a substantial contract with the Post Office, at a price which seems to have been largely determined in advance of contractual renegotiations, as a means, however inadequate, of making up some of the £180 million written off by ICL in their 1998-99 accounts.**

19. **The principal concern in this new or revised contract is how it is to be financed: a matter on which the Government statements were curiously silent.** The Chief Executive of the Post Office told us in oral evidence that half of the sum would come from "surplus funds from previous investments in the Post Office currently shown on our balance sheet".[71] The Post Office Accounts show that "£480 million of fixed asset investments can be utilised to fund the initial payments to ICL Pathway by way of a contribution."[72] The Secretary of State told us that the Treasury had agreed to make such a contribution, and that "the difference will be met then by Post Office Counters from charges for people using the services .....".[73] The Post Office had always planned to spend around £400 million over the 1999-2005 period, but had also expected "a fairly steady period of income from DSS through the payment of benefits": the prospect of a move to ACT in and after 2003 puts that income flow in some doubt for the last 2 years.[74] In order to pay for automation the Post Office now faces the possibility of making an annual loss on the POCL profit and loss account of around £100 million per annum rather than the expected annual profit of around £30/40 million, subject to how the up-front expenditure is accounted for.[75] Representatives of the workforce suggested that the expenditure required could have a "profound effect" on Post Office finances and on the range of other investments it is able to make, at the

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very time that it has been given greater freedom to pursue the joint ventures and acquisitions it deems essential. They warned that "It really blows a great hole in future Post Office finances ....".[76] **The Post Office is in effect being obliged to use its resources to pay half the price of the automation deemed necessary for preservation of the national network of sub-post offices, with a real risk that it may find it difficult to recover the costs by generating new business. The Government must recognise that in setting its annual minimum dividend, particularly in the years 2003-2005. We would also welcome confirmation that the automated infrastructure procured by the Post Office will not be too highly specified for its needs, and will be capable of handling branch banking business on-line.**

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64 DTI Press Notice P/99/439 Back
65 Ev, p28, para 25 Back
66 HC94, Ev, p38 Back
67 Q 126 Back
68 Ev, p18, paras 17 & 19: Q79 Back
69 Qq 175-8 Back
70 Group Accounts, p33, Note 28 Back
71 Q 126 Back
72 Group Accounts, p33 Back
73 Qq 181-2: 202 Back
74 Qq 126, 131 Back
75 Qq 130-1 Back
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Roll-out of automation

20. Delays apart, it is generally agreed that the system as installed works well and is popular with claimants and operators alike. The General Secretary of the NFSP told us "There was absolutely no resistance from sub-postmasters and very little from customers. It was warmly received by the customers .....", an impression confirmed by the NFSP's National President, a sub-postmistress in one of the trial areas in the North-East.[77] The General Secretary of the CWU told us "The experience that we have had during the trials was that the benefit card was popular with the public and it was popular with the staff working the trials".[78] ICL told us that "The technology was acknowledged as working successfully and was well received by sub-postmasters, their staff and claimants alike".[79] Equipment has been successfully installed in very diverse post office premises, some large, some small and antiquated.[80] Programmes of staff training and assistance are in place and have been assessed.[81] The Chief Executive of the Post Office emphasised that "The original project for the last 12 months was actually delivering what it should have done and it was hitting the milestones that it should have hit".[82] The Chief Secretary was confident that the 2001 deadline would be met:[83] the Secretary of State for Trade and Industry emphasised the relative familiarity of smartcard technology.[84] In evidence submitted to us on 27 August 1999, however, the Post Office told us that the first key milestone, of acceptance of the system had not been achieved by the due date of 16 August and that it was now hoped to achieve it by the end of September, with formal acceptance due by 15 November.[85] **While those concerned expressed general confidence that the roll-out of automation would proceed smoothly, and that the apparently ambitious target of converting 300 post offices a week in 2000 was achievable, the failure to meet the first milestone cannot but cause concern in a project with such a chequered history. We look to Ministers to inform us in response to this Report of the progress being made with the revised contract.**

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77 Q35: Ev, p2 Back
78 Q48 Back
79 Ev, p17,para 11 Back
80 Qq88-9 Back
81 Qq54ff, 89 Back
82 Q128 Back
83 Qq 148-9 Back

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Smartcard platform

21. Beyond the roll-out of the programme of automation of the network, a new and separate programme is envisaged for using this platform through the introduction of smartcards, and agreements with a range of Government, local authority and commercial agencies. The ICL Press Notice of 24 May stated

"ICL is also selected as the Post Office's preferred supplier for Modernising Government Services and Network Banking .... . We have opened up the prospect of an exciting partnership with the Post Office in developing its strategy for Modernising Government and Network Banking services."

In its evidence to us ICL stated —

"ICL and the Post Office will continue discussions on a Public/Private Partnership for the development of Network Banking and Modernising Government services which may be built upon the Pathway platform."

The Secretary of State told us that "this smartcard technology is something that we are negotiating at the moment and will come on after we have automated the system because it is a whole different set of proposals that we do need to put in place."[86] Although POCL hope and expect that cash payment of benefits by ACT either directly into the Post Office's banking partners or via other banks may form part of this future, it extends far wider. The Post Office evidence emphasised their vision of the Horizon project as a "cornerstone" of their future as the obvious local access point for a range of government and commercial transactions, connected to commercial networks.[87] As designed, the equipment which has been installed in trial areas and which will be nationally installed is "smart-enabled" and indeed already uses smartcard technology to be accessed by Counters staff.[88] It is also "web-enabled": as ICL put it —

"There is no reason at all in our view why the Post Office cannot reach their customers either through the Internet from their home TV, through digital TV or through kiosks .....".[89]

The Secretary of State underlined his commitment to opening up the "whole range of new opportunities" which smartcards presented, giving as an example the possibility of arranging for debits to pay utilities bills:[90] a commitment evidently shared by postmasters and postal services employees.

22. The introduction of smartcard technology is crucial to the future of Counters.[91] It would indeed seem to be the only way to make up for the loss of the exclusivity which would have been conferred by the Benefit Payment Card. The crucial benefit to the sub-post office network of

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the card was indeed its exclusivity: that claimants without bank accounts or choosing not to use them for this purpose and wishing to draw benefits in cash would only have been able to do so using the Post Office network. As the NFSP warned, "Without exclusivity, [POCL's] ability to provide the service on a commercially sustainable basis was not possible .....".[92] Under the May 1999 agreements, post offices will be only one of a multiple of alternative delivery channels, alongside automatic telling machines (ATMs or "holes in the wall"), supermarkets and others.[93] POCL will therefore need to make commercial deals with all or most of the banks and building societies which hold claimants' accounts.[94] While Counters will have to compete with other outlets for some of the potential business they do so from a strong geographic position and with a high public reputation for trustworthiness. The Secretary of State told us that without the automation programme now foreseen post offices would have been unable to compete.[95] As the General Secretary of the CWU put it, "The smart card technology can move you into all sorts of areas .....".[96] Evidently, POCL will have to have a close relationship with the Benefits Agency, to establish a robust regime for those claimants with bank accounts who nonetheless wish to draw benefits in cash, and those who are unable or unwilling to have a conventional bank account through which benefits are paid: and to come to agreements with a range of banks and building societies. **While there are obviously some difficult times ahead, and some hard bargains to be struck with a number of other commercial organisations, we are hopeful that Post Office Counters will be able to ensure the future of the network, given equitable treatment by the Benefits Agency, and other Government agencies.**

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86 Q 191 Back
87 Ev, p27, paras 2ff Back
88 Ev, p27, para 5: p18, para 16 & Q76 Back
89 Q107 Back
90 Qq 185, 191 Back
91 Q115 Back
92 Ev, p 2 Back
93 *ibid*: Q2 Back
94 Also Q17 Back
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96 Q49: Ev,p11, para 9 Back

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Compulsory ACT

23. The statement in May 1999, that the new arrangement for paying benefits through the Post Office, building on banking technology would be introduced in 2003 has caused understandable concern. In oral evidence, the Chief Executive emphasised that the Post Office's principal concern was the speed of migration to ACT from 2003.[97] The Secretary of State for Social Security told us that "we are not taking active steps to switch customers on to ACT before 2003" and that from then "we will start the process of enabling our customers to get the money paid into a bank, into a building society, other financial institutions or the post office ....for the next three years we are not going actively to pursue the transfer of our customers to ACT".[98] Thereafter, the speed of proposed migration remains unclear. The onus is on the Post Office to have in place agreements with all concerned to enable those who so wish — and indeed to encourage all — to use the local post office as a banking facility. The DSS is evidently in discussion with private sector competitors of the Post Office, and from 2003 is unlikely to show any favours to the Post Office. **We welcome the undertaking of the Secretary of State for Social Security not to take any active steps to encourage claimants to opt for ACT before 2003; we also look to him to ensure that the general benefit afforded by the national network of post offices is fully reflected in decisions by the Benefits Agency during and after the process of introduction of compulsory ACT from 2003 onwards, and that this process takes account of the needs of all claimants.**

24. The Post Office told us -

"Benefit recipients like to be able to collect benefits from post offices".[99]

It is estimated that around 80 or 85 per cent of benefit claimants have a bank account.[100] 70 per cent of those claimants nevertheless prefer cash payment to a bank transfer. A memorandum from the DSS drawing on recent research by the DSS and others sets out some of the reasons why claimants choose not to have ACT for their benefits.[101] The Managing Director of POCL told us that

"for some people it is the only way they trust themselves to actually budget through a week ... they know that is what they have to spend and live on and that is their choice".[102]

There is resistance to compulsory ACT, as was demonstrated in 1992. The General Secretary of the NFSP told us

"There are people who are not able or are very unwilling to have bank accounts ... the last time there was significant resistance to being forced to have bank accounts, forced to remember PIN numbers or write them down on the back of your purse, forced to queue at automatic telling machines ....".[103]

Witnesses from the Post Office put emphasis on the "human face" of withdrawing cash from a Post Office:

"People are fairly reluctant to go and do business with a machine ... at the end of the day there has to be a human face attached to that automation .... one of our greatest strengths is the personal service that we can give in virtually every community in the country ...".[104]

It is also asserted that the banks and other financial institutions may be less than enthusiastic at the prospect of a huge additional number of small personal accounts, although research suggests that few applicants for an account are refused. The CWU suggested " .... all our evidence shows that the banks do not really want these small bank accounts".[105] The Chief Executive of the Post Office told us that from the experience of discussions with banks "I have to say that at senior levels when I raised this there is something less than enthusiasm ....".[106] The Government is promoting as a matter of policy the spread of bank accounts especially among the more socially disadvantaged:[107] but it remains to be seen how far financial institutions will respond to this policy.

25. **The Government has emphasised the shift towards ACT in recent years.** The Post Office White Paper referred to over 30 per cent of child benefit recipients having opted for ACT and stated "over 50 per cent of new pensioners are making a similar choice."[108] The Government's memorandum referred to "the escalating trend of benefit recipients to opt voluntarily for payment by ACT — no less than 54% of new child benefit recipients choose ACT, as do 47% of new pensioners."[109] The Secretary of State for Social Security told us - "The vast majority of new entrants into the system .... are opting to go to ACT"[110]: that

"of the new entrants on to the system, 55 per cent of child benefit people are opting for ACT, 47 per cent of pensioners, 40 per cent of incapacity benefit people, and I think the group you will have most concerns about are those on income support where quite clearly their need is far greater but we will address that problem."[111]

We sought the latest figures on ACT for new benefit claimants.[112] **The image presented of a flood of new entrants opting for ACT is exaggerated.** Most new pensioners are in fact *not* opting for ACT. Fewer than one in 10 income support recipients elect for ACT. **Fewer than 1 in 3 of new benefit recipients opt for ACT.** Quite apart from the problems of dealing with what the Secretary of State estimated as the 5 per cent of claimants — maybe 1 million people — who will not be able to operate a bank account,[113] and the question of the frequency of payments, **the fact remains that, for a variety of reasons, most new benefit recipients still opt for cash in hand from a post office: and that this choice must be respected in action as well as on paper.**

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97 Q120: also Ev,p2: Q 51: Post Office White Paper, para 7.19 Back
98 Qq 192ff, 198 Back
99 Ev, p27, para 7 Back
100 Qq 160, 183 Back
101 Ev, pp 53-5 Back
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Other agencies

26. In addition to seeking new business with Government and other agencies, following the agendas set out in the *Modernising Government* White Paper and referred to in our recent Report on electronic commerce,[114] it is vital for POCL's future that they retain as much as possible of the current range of Counters contracts with Government agencies as operations move to electronic payment and authorisation. A 3-year contract has recently been signed with DVLA.[115] A consortium including the Post Office won the new contract for television licensing. There are however natural concerns as a wide range of agencies, none responsible on their own for a large proportion of Counters business, but taken together representing an important part, naturally seek to use other means of delivering their services. The Post Office White Paper states that —

"One element of the Government's help to sustain the nationwide network of post offices is to influence the rate of any migration of existing Government business so that it does not run too far ahead of POCL's ability to develop new sources of revenue to replace it"

and that

"The unique reach of the counters' network, coupled with the Horizon platform, should mean that POCL is well placed to offer a major channel to deliver the Government's ambitions to interface with citizens in a modern, convenient, efficient and coherent manner through the increasing use of IT".[116]

The Secretary of State for Trade and Industry told us —

"The real challenge actually for myself as Secretary of State for Trade and Industry and for the Post Office is to make sure we can capitalise on the Modernising Government agenda."[117]

We welcome the Government's recognition of the importance of retention by Post Office Counters of Government business, as expressed in the recent White Paper. We would however also welcome recognition by Ministers that their role is not restricted to that of interested spectators, and that Government agencies have obligations and duties beyond those of purely commercial organisations. We recommend that the Government set out in their response to this Report a table showing for each Government agency contracted to the Post Office for service delivery the current position and a clear indication of Ministerial policy on future contracts: and showing progress in introducing the Electronic Government agenda as it relates to delivery of services through post offices.

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114 Tenth Report, HC 648 of 1998-99, part V Back
115 Eg Cm 4340, page 64, para 19 Back
116 Cm 4340, page 61, para 10 and page 63, para 18 Back
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Post Office improvement

27. Post Office management, postmasters and Counters staff recognise that there are steps which they could take to make it more likely that benefit claimants and other customers would maintain their preference for using the Post Office for a range of services. The CWU told us that it had recently reached an agreement with POCL on a "major review of service and efficiency across all Crown Office counters .... both sides are committed to doing that ...".[118] It is accepted that there is need for greater flexibility on opening hours, although in evidence to us NFSP witnesses questioned the level of demand for Counters services outside the current hours, including Saturday afternoons.[119] In broad terms the NFSP told us —

"We want to go out to every sub postmaster and advise them that their customer is very important. ..... We are going to — to use a modern term — massage the customer so the customer knows that he or she is being looked after. We are going to look at the opening hours. We are going to look at how post offices present themselves ...".[120]

There are for example only around 20 post offices with automated cash machines: while in many areas there may not be sufficient demand to make them profitable, talks are progressing. The Secretary of State for Trade and Industry emphasised his view of the importance of such services in encouraging people to use their local post office.[121] **All concerned in Post Office Counters can and must now consider more imaginatively what they can do to make the network more attractive to actual and potential customers.**

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SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Overall conclusion

(a) **It is evident that a combination of factors — repeated delays and failures to reach important milestones: the demands of ICL to recoup their expenditure by either a higher transaction charge or an extension of the period during which such charges would be payable: doubts about the resilience and relative obsolescence of the technology — led Ministers to a collective loss of faith in the programme. It is however our impression that the principal factor in deciding to ditch the Benefits Payment Card was neither the cumulative delays nor technical doubts on feasibility, but the increasingly unpalatable prospect facing the Benefits Agency of paying high transaction costs for an extended period, rather than moving as rapidly as possible to ACT transactions. Everything we have heard and read confirms us in the view that the programme was blighted from the outset by the desire, justifiable or not, of the Benefits Agency to move as soon as permitted to compulsory Automated Credit Transfer: and that it finally foundered because of the reluctance of the Treasury and ICL's parent company Fujitsu to find the additional funds required once the business case of all those involved deteriorated in the face of delays. We do not fault Ministers for taking the decision they did in May 1999 in these circumstances. We have not regarded it as part of our task to come to a judgement on decisions taken**

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prior to May 1997; it may be that the inquiry by the Comptroller and Auditor General will cast light on such decisions (paragraph 13).

Reporting of problems

(b) **Having reviewed the evidence given to us, we consider that a fuller reflection of the process of review which was underway, and of the serious problems with the programme, could and should have been presented to Parliament and to this Committee (paragraph 5).**

Choice of technology

(c) **We question Ministers' characterisation of the magnetic swipe card system as "an out-dated concept" and a redundant technology; although the selection of a magnetic card rather than a smartcard in 1996 may with hindsight have proved unfortunate, it was always intended to move to a smartcard in due course (paragraph 8).**

National Audit Office

(d) **It has been an expensive lesson: we hope that it proves a salutary one. Given the particular interest shown by the National Audit Office in PFI projects, and in the growing catalogue of Government IT failures, we are strongly of the view that an inquiry by the National Audit Office into the Horizon Project, using their powers to see departmental papers, would be of much assistance to Parliament: and we are confident that ICL and their principal sub-contractors would see it as in the national interest to co-operate as fully as possible. We wrote to the Comptroller and Auditor General in July to propose such an inquiry; we are pleased to record his agreement as conveyed to us in a letter of 7th September that the National Audit Office should carry out an inquiry into the lessons learned from this project focussing on risk management (paragraphs 14 and 17).**

Revised Post Office-ICL contract

(e) **While it makes evident sense for ICL to continue with the work it has already begun, the impression remains of an essentially political deal to ensure that ICL has a substantial contract with the Post Office, at a price which seems to have been largely determined in advance of contractual renegotiations, as a means, however inadequate, of making up some of the £180 million written off by ICL in their 1998-99 accounts. The principal concern in this new or revised contract is how it is to be financed: a matter on which the Government statements were curiously silent. The Post Office is in effect being obliged to use its resources to pay half the price of the automation deemed necessary for preservation of the national network of sub-post offices, with a real risk that it may find it difficult to recover the costs by generating new business. The Government must recognise that in setting its annual minimum dividend, particularly in the years 2003-2005 (paragraphs 18 and 19).**

(f) **We would welcome confirmation that the automated infrastructure procured by the Post Office will not be too highly specified for its needs, and will be capable of handling branch banking business on-line (paragraph 19).**

(g) **While those concerned expressed general confidence that the roll-out of automation would proceed smoothly, and that the apparently ambitious target of converting 300 post offices a week in the year 2000 was achievable, the failure to meet the first milestone cannot but cause concern in a project with such a chequered history. We look to Ministers to inform us in response to this Report of the progress being made with the revised contract (paragraph 20).**

Future of Counters network

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(h) **While there are obviously some difficult times ahead, and some hard bargains to be struck with a number of other commercial organisations, we are hopeful that Post Office Counters will be able to ensure the future of the network, given equitable treatment by the Benefits Agency, and other Government agencies (paragraph 22).**

Move to ACT

(i) **We welcome the undertaking of the Secretary of State for Social Security not to take any active steps to encourage claimants to opt for ACT before 2003; we also look to him to ensure that the general benefit afforded by the national network of post offices is fully reflected in decisions by the Benefits Agency during and after the process of introduction of compulsory ACT from 2003 onwards, and that this process takes account of the needs of all claimants (paragraph 23).**

(j) **The Government has emphasised the shift towards ACT in recent years. The image presented of a flood of new entrants opting for ACT is exaggerated. Fewer than 1 in 3 of new benefit recipients opt for ACT. The fact remains that, for a variety of reasons, most new benefit recipients still opt for cash in hand from a post office: and that this choice must be respected in action as well as on paper (paragraph 25).**

Public sector agencies

(k) **We welcome the Government's recognition of the importance of retention by Post Office Counters of Government business, as expressed in the recent White Paper. We would however also welcome recognition by Ministers that their role is not restricted to that of interested spectators, and that Government agencies have obligations and duties beyond those of purely commercial organisations. We recommend that the Government set out in their response to this Report a table showing for each Government agency contracted to the Post Office for service delivery the current position and a clear indication of Ministerial policy on future contracts: and showing progress in introducing the Electronic Government agenda as it relates to delivery of services through post offices (paragraph 26).**

Post Office improvement

(l) **All concerned in Post Office Counters can and must now consider more imaginatively what they can do to make the network more attractive to actual and potential customers (paragraph 27).**

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