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Session 2001-02
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Public Accounts - Third Report

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Committee of Public Accounts

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The Committee has power to require the submission of written evidence and documents, to examine witnesses, and to make Reports to the House.[†] The Committee may not arrange to meet at any time when the House is adjourned, prorogued or dissolved. It has power to meet at any place in the United Kingdom and may also travel abroad.

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† In the footnotes to this Report, references to oral evidence are indicated by 'Q' followed by the question number; references to the written evidence are indicated by 'Evidence' or 'Evidence, Appendix ......', followed by a page number.

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THIRD REPORT

The Committee of Public Accounts has agreed to the following Report:—

THE CANCELLATION OF THE BENEFITS PAYMENT CARD PROJECT

INTRODUCTION AND SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

1. In May 1996, the Department of Social Security (the Department) and Post Office Counters Ltd jointly awarded a contract to Pathway, a subsidiary of the ICL computer services group, for delivery of the Benefits Payment Card. The project was intended to replace by 1999 the existing paper-based methods of paying social security benefits with a magnetic stripe payment card, and to automate the national network of post offices through which most benefits are paid across Great Britain and Northern Ireland. The project was vast in its scale and complexity, and estimated to cost some £1 billion in payments to Pathway. It was also one of the first information technology contracts awarded under the Private Finance Initiative (PFI). Figure 1 outlines the key statistics of the project.[1]

Figure 1: Key statistics of the Benefits Payment Card project

Estimated contract value, (Payments by Department and Post Office):	£1 billion, net present value over 7 years
Number of post offices to be equipped:	Up to 20,000, with 40,000 counter points in Great Britain and Northern Ireland
Number of post office staff to be trained in use of the system:	67,000 staff, serving 28 million customers per week
Number of social security benefit recipients to be issued with Payment Cards:	17 million, claiming some 24 different benefits
Number and value of benefit transactions:	In 1999/2000 some 760 million payments worth £56 billion were made through post offices

2. The project suffered delays and in May 1999 the government decided that removing the payment card from the project was preferable to continuation, and offered better value for money than complete cancellation which would prejudice the early automation of the Post Office. The Comptroller and Auditor General

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reported that cancellation of the benefit payment card had cost the parties and the taxpayer upwards of £1 billion in abortive costs, the write down of assets and delayed reductions in benefits fraud.[2] We therefore examined the lessons to be learned from the Benefits Payment Card project, and the alternative arrangements now being developed for paying benefits. We took into account the report of this Committee's predecessor, in January 2000, on the lessons to be learned from the implementation of more than 25 IT systems, and the Government's response.[3]

3. In the light of our examination, we draw three overall conclusions:

- Successful delivery of innovative and complex projects involves risks that need to be identified and managed. This project had special features that added to its risks; notably its status as a pioneering PFI project and the need to join up the systems of two purchasers with differing business objectives. While various parties identified many of the risks at various stages, they underestimated the difficulty of attempting to tackle a huge and complex project, at the heart of improving benefit delivery and Post Office automation, in one exercise using relatively untried PFI arrangements. There were also many basic project management failures, which mirror those referred to in our report in January 2000.

- The improved arrangements developed by the Treasury, the Central IT Unit and the Office of Government Commerce for managing PFI and IT Projects should go a long way to preventing similar failures in future. For example, similar projects would in future be broken down into more manageable modules and would be subject to independent reviews at key stages. Success is crucial, especially for the Department, which has embarked on a fundamental, challenging and innovative programme of investment in new information technology to modernise the delivery of benefit. In view of the Department's track record on IT, we remain sceptical about their ability to deliver. The Committee will consider further their progress as systems come on stream.

- When projects go wrong, management should face up to the prospect of failure and take prompt decisions to avoid abortive costs. Decisions in this case were complex, involving a number of Departments, Post Office automation and its future business streams, and ICL's proposed flotation. It took 18 months from the point where the Department took steps to preserve its right to cancel the project, to take the decision to do so. Meanwhile abortive costs were rising and development of alternative arrangements was stalled.

4. Our more specific conclusions and recommendations are as follows:

On lessons to be learned for future major information technology projects

(i) All the parties seriously underestimated the complexity of the project and the risk of attempting to tackle such a challenge in one go using relatively untried PFI arrangements. They failed to achieve a shared understanding of what was to be delivered and how, and the barriers to innovation contained in benefit rules.

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The other major factors included inadequate contracting and project management skills, and lack of clear ownership of project delivery and risk management. These mirror many of the failings referred to in our predecessor's January 2000 report on lessons to be drawn from IT projects (paragraph 22);

(ii) Pathway was selected because they were willing to take on a level of risk for preventing benefit fraud which the other two bidders would not accept, even though Pathway came third on 8 out of 11 technical and management criteria. At the time, there was a mistaken view that PFI bidders should compete on the level of risk they were prepared to take on, rather than achieving an optimum allocation of risk (Paragraph 23);

(iii) The various parties identified many of the risks at various stages, but did not always share this information. Risks were "cleared" without justification, and "cleared" risks were not well monitored and so re-emerged (paragraph 24);

(iv) Joined-up projects involving more than one purchaser carry extra risks, and steps need to be taken to establish clear leadership in purchasing and project management, and transparency of information between the various stakeholders. The Department and the Post Office took some steps in this direction during the project, by revising the project management arrangements. The McCartney report recommends one single responsible owner for each major project in future; but the Benefits Payment Card also demonstrates the delays and extra costs that can emerge when decisions on the future of a project involve many stakeholders with conflicting objectives, in this case, for example the Department, the Department of Trade and Industry, the Treasury and the Post Office. (paragraph 25).

On the outcome of the Benefits Payment Card project

(v) Cancellation of the Benefits Payment Card, at a cost of over £1 billion in lost fraud savings, nugatory expenditure and write-down of assets and costs, must rank as one of the biggest IT failures in the public sector (paragraph 31);

(vi) Both the Department (through its linked project to computerise its Customer Accounting and Payments System) and the Post Office (through its automation project, now nearing completion) claimed to have obtained some value out of the Benefits Payment Card project. But the Customer Accounting and Payments system was a separate, though linked, project, and £127 million of its cost may be wasted. In addition, some £571 million of the Post Office's investment in automation has already been written off (paragraph 32).

On developing new arrangements for paying benefits

(vii) In principle, the arrangements for payment of benefits through Automated Credit Transfer from 2003 should provide a more modern, efficient and secure method of paying benefits and deliver significant administrative and fraud savings. It is important, though, that these arrangements are developed with the customer in mind, in terms of access to their benefits through post offices, and continued access to cash payments if claimants so desire. The Department

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will need to communicate the new arrangements to claimants clearly and effectively (paragraph 39);

(viii) Arrangements are in hand to create a Universal Banking service, to provide claimants with a post office card account, basic bank accounts, and better access to current accounts at post offices. These arrangements are likely to require public money, government guarantees, or both, and to cover benefit payments of many billions a year. The Department, along with the Department of Trade and Industry, will need to secure proper arrangements for public accountability for these payments and guarantees, and for the quality of services delivered by post offices to benefit recipients. We expect the departments to enter into discussions with the Comptroller and Auditor General on access to the Post Office for this purpose, and to submit a note to the Committee on their proposals to secure accountability before the arrangements are finalised (paragraph 40).

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1 C&AG's report (HC 857, Session 1999-2000), paras 1-2 and 14 Back

2 ibid, paras 6-9, and 1.31-1.36 Back

3 First Report from the Committee of Public Accounts 1999-2000 (HC 65 (1999-2000)), Cm 4656, and Successful IT: Modernising Government in Action-Review of Major Government IT Projects, May 2000 Back

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LESSONS TO BE LEARNED FOR FUTURE MAJOR INFORMATION TECHNOLOGY PROJECTS

5. In his report, the Comptroller and Auditor General identified various factors that contributed to the cancellation of the Benefits Payment Card. In his view, the important reasons were insufficient time for specifying the requirement and piloting; the lack of a shared, open approach to risk management; and divided control.[4]

6. The Comptroller and Auditor General reported that, as a groundbreaking PFI project in the information technology sector, there was little by way of precedent to provide guidance. There was limited experience at the time as to the appetite and ability of the purchasers or potential suppliers to accept important risks, such as the liability for failing to prevent fraud. There was also a perception that, because responsibility for delivery could be transferred to suppliers, purchasers should be less concerned with validating the supplier's internal arrangements and had less need to know the detail of the supplier's solution.[5]

7. While Pathway had submitted narrowly the cheapest bid, they ranked third of three bidders on eight of eleven technical and management criteria. A decisive factor in their selection was their greater acceptance of risk, making their bid the only one that was PFI compliant. Pathway took on the liability to pay up to £200 million for losses if their system failed to operate or prevent fraud, at a cost of £20 million in their bid. The other bidders priced this potential liability pound for pound. The choice the purchasers felt they had was therefore either to accept the Pathway bid or not proceed with the project at all. In the event, Pathway lost £180 million in development costs through cancellation, but the Department and the taxpayer bore the impact of continued losses through benefit fraud.[6]

8. The Comptroller and Auditor General drew six key lessons from the project about the procurement of complex information technology projects (Figure 2).[7]

Figure 2: The procurement of complex IT systems

1	There is often understandable pressure on purchasers and potential suppliers to conclude a deal and to seize as soon as possible the benefits of the project. But it is never acceptable to sign a contract with fundamental "agreements to agree" the detail of the service in the future, even if as in this case, they are intended to be resolved quickly. Allowing realistic timescales for early planning and detailed specification will pay dividends in terms of overall project delivery and cost.
2	Departments undertaking IT procurement projects should fully understand the quality and quantity of resources available which actually will be committed by the supplier to deliver the agreed services. This is particularly important where new software development is required. It should be agreed during the competitive process how resource requirements can be achieved and measured, and the agreement should be drafted into the contract
3	For major, mission-critical, tailored and bespoke projects, there should be proper piloting of

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	technical solutions to address the full service requirement, rather than reliance on part-functional demonstrations. Departments may have to consider part-funding such pilots and should also consider awarding separate contracts for the design and development of systems before contracting with the developer for full implementation of the successful pilot. This approach also allows keener pricing of the later service implementation and operation stages by suppliers because the risks to them are reduced.
4	There must be agreement between purchasers and suppliers at the outset of information technology projects on the extent to which new systems will either replicate the purchasers' existing systems, or re-engineer and simplify them.
5	After examining the scope to simplify their business processes, and given certainty as to the detailed requirement, Departments should examine with potential suppliers the scope to use generic and widely used system components where available. This process may in turn suggest modifying the initially proposed solution. A major risk of the Benefits Payment Card elements of the project turned out to be their "bespoke" nature. Building bespoke systems adds to the development costs and the risks of any solution.
6	Where there are major project developments which involve more than one system being developed in parallel, as was the case here with the Benefit card, the Department's Customer and Accounting Payment System and new Post Office systems, it is sensible to plan and monitor these jointly.

9. The Department and the Post Office saw the use of PFI, and the way it was perceived at the time, as a major factor in the problems experienced on the project. This was one of the first PFI contracts. Everyone in Government and the trade was trying to find new ways of getting investment into projects. The philosophy then was for purchasers to design their business requirements at a high level, and to allow the contractor to create the solution, to innovate, without constraining them with detail. The expectation was that the risk would then be passed to the supplier. It was only after the contract had been placed, and there was a fixed price and delivery date, that the project team and the contractor worked through the detailed business requirements and the technical design. It was at that point that the difficulties began to emerge.[8]

10. The Department acknowledged that, with hindsight, the timetable for the project had been very over-optimistic. The people involved at the time had seriously underestimated the scale and complexity of the job. Everyone had been under pressure to move the project along as fast as possible. The Department had wanted the fraud savings; the Post Office had wanted automation; and ICL had commercial reasons.[9]

11. ICL added that people had been looking for quick results, and a lot of assumptions had been made by all three parties as to what they were going to get out of the deal. For their part, they had accepted an aggressive timescale on the assumption that there was a mood for compromise on some of the 289 requirements that had not been agreed at the contract stage. They had been encouraged to think about innovation and enterprise, and expected room for manoeuvre. The Department had attempted to simplify the benefit payment process in order to ease implementation, for example by streamlining

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arrangements for agents to collect benefit on claimant's behalf. But ICL and the Department found many things that were fixed, enshrined in various regulations.[10]

12. The Comptroller and Auditor General noted that, at various stages of the project, each of the parties produced registers of the key risks that needed to be managed, but these registers did not always assess probability, allocate risks to owners, or propose options for managing risks. Some risks were not addressed sufficiently, for example the risks and costs of slippage. Others were downgraded, because risk was seen to rest with the supplier, even though the impact would be on the Department, for example project slippage would delay delivery of anticipated fraud savings. In addition, a shared, open approach to risk management across the whole programme was not achieved. The Comptroller and Auditor General drew out 6 key lessons to be learned from this project about risk management (Figure 3).[11]

Figure 3: Lessons On Risk Management

1	For all projects, purchasers should maintain from the start of the procurement stage an assessment of the inherent risk of late delivery, and analyse before signing contracts the sensitivity of their business cases to major slippage and cost overrun.
2	Risks identified should be registered, assessed for impact and probability, assigned to a risk manager and used as a basis for subsequent management and contingency planning. Closed risks should be retained in a closed risk register and reviewed at regular intervals for "re-incarnation". Risk identification must be an ongoing activity, as new risks will occur throughout projects
3	Departments should appoint a permanent "risk scrutineer", independent of the project team and ad hoc input from consultants, to monitor how the project is handling risks and to report to senior management at regular intervals. This is a feature of the PRINCE 2 project management system widely used in government and in the private sector.
4	Contracts with suppliers, including Private Finance contracts, require detail and clarity about the reporting obligations of suppliers to support risk management and contingency planning by the purchaser. Contractual obligations must be underpinned by a recognition on all sides of the need for openness, extending beyond oral reporting to sharing their risk management documentation.
5	The project illustrates the importance of being able to clarify, quantify and allocate responsibility for risk very clearly if the Private Finance approach is to be a suitable contractual model. In the case of IT development projects in the public sector, this is particularly difficult. Ministers and officials cannot transfer responsibility for the overall service for which they are legally responsible and accountable to Parliament. Some risks, such as the delivery of benefits payments, on which many people depend, are too great for private sector suppliers to absorb and departments therefore must retain a direct interest and involvement in how the service is to be delivered.
6	It is vital that all bidders, and if necessary their parent companies, are clear about the extent of risk transfer proposed by the purchasers at the start of procurement rather than towards the end. Purchasers must ensure that the extent of risk transfer they propose is viable, and must evaluate

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	the extent of risk that they retain. Difficulties in this area can result in the loss of otherwise valid bids.

13. The Department accepted that, because the parties had not fully appreciated the real scale and complexity of the project, and because there had been a misunderstanding about how a PFI contract would work, some issues had not been identified as major risks early on. But following procurement, and as the scale of the project became apparent, their risk management methodology started to spot these significant risks. It was also in the nature of risk management that risks could arise at any stage, could increase during a project, and could be taken off the risk register and re-emerge later on, and its was part of their methodology that they kept all risks under review. For example, at the procurement stage they had identified the need to provide adequate security as a risk. They had accepted Pathway's high level proposal and had downgraded the risk to medium; but as they started to develop the detail, the difficulties became clear and the risk was increased to high. ICL confirmed that the devil was in the detail.[12]

14. As regards the sharing of data on risks, the Department noted that risks were regularly discussed at project boards and steering committees. However, they had not shared information in risk registers as well as they should have. Again, they noted that the view taken of PFI, about transferring risk to the people best able to manage them, had been very much about leaving the contractor to manage the risks from then on. The way PFI was being interpreted at that time got in the way of collaborative work.[13]

15. The Comptroller and Auditor General concluded that another important factor in the difficulties experienced on the project, was that the Department and the Post Office each had different aims, and different primary drivers. He drew 2 key lessons for future procurement by more than one purchaser (Figure 4).[14]

Figure 4: Procurement by more than one purchaser

1	Joint procurement is always difficult, especially where purchasers have divergent objectives. It is better to let one purchaser take the lead with proper arrangements for information flow and reporting to the other. This requires a clear agreement, embodied in the contractual arrangements as well as in a memorandum of understanding, as to roles and responsibilities.
2	Incentives to deliver should pull the same way for both parties to a project: for example, financial and timetable incentives should be mutually supportive: and the parties should agree common objectives and "must-haves" at the outset, as these will influence future behaviour.

16. The Department confirmed that they were interested in a fraud-free means of payment, which put an emphasis on controls to ensure the secure handling of benefit payments by post offices. On the other hand, the Post Office wanted to press ahead with developing their services and secure throughput of customers

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in local post offices, which would best be achieved by the speedier handling of claimants. Together they had put together a programme development authority to try to minimise conflicts of interest as far as they could. However, the Department accepted that when things were going well, those differences perhaps did not matter, but when things started to go wrong, and there were difficult choices to be made, those different priorities created difficulties.[15]

17. Since then, many lessons had been learned about handling PFI for IT projects, and in early 2000 the Treasury had issued guidance which drew on the lessons outlined in the Comptroller and Auditor General's report. In addition to this, and the report by Mr Ian McCartney, Minister of State at the Cabinet Office on Major Government IT Projects, there was now additional expertise available within the Treasury, and the Office of Government Commerce to help Departments.[16]

18. The Department thought it inconceivable that nowadays such a project would be tackled in one big bang. It would be broken down into more manageable chunks. They would adopt a phased acceptance programme. Under the new arrangements introduced following the McCartney report, projects would now be subject to independent reviews at key stages (the *Gateway* process). In future that would ensure for example that sufficient effort went into developing the technical design of the system before contract for implementation. The Department also recognised that for future projects of this nature there had to be a more collaborative, partnership approach to solve problems as they arose, and they would have a much more shared and open approach to risk. They had taken a different approach to PFI in their new modernisation projects, such as Child Support reform.[17]

19. ICL confirmed that the new guidelines very much reflected their experience. There needed to be much greater clarity at the outset about requirements, particularly where there are two purchasers and complex legacy systems which are vital to the smooth running of society. They supported the notion of an initial phase of defining requirements and solutions, before going forward to PFI delivery. They also preferred a more joined-up approach, rather than operating in separate silos and dealing at the boundary which did not work with such complex end-to-end systems.[18]

20. The Comptroller and Auditor General noted that the contract was placed in May 1996 for delivery by 1999. Despite a re-plan of the project in February 1997, the timetable for delivery slipped continually, the benefits were delayed, and in late 1997 Pathway requested improved terms. In November 1997, the Department took steps to preserve their legal rights to cancel the project. In March 1998, Ministers set up an interdepartmental working group to assess whether the project was technically viable, if so how quickly it could be completed and at what cost to the government; as well as the costs of cancellation and of any alternative available to deliver the project's objectives. Because no decision had yet been reached, the Secretary of State twice gave the Accounting Officer of the Benefits Agency formal instructions not to terminate the contract. The Government formally announced cancellation of the Benefits Payment Card element of the project on 24th May 1999.[19]

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21. The Department said that the length of time it had taken from November 1997 to May 1999, to devise a way forward reflected the importance of the issues at stake. Cancellation would affect every post office and 22 million potential benefit claimants, as well as the future of the Post Office and its automation and measures to reduce fraud. In addition, these issues involved the Department for Trade and Industry, as sponsor of the Post Office, and the Treasury. And there were commercial issues for ICL, which was coming up to flotation. There had been a long process of different kinds of review, inter-departmental groups, and a long period of negotiation trying to find a way forward. There had also been various changes of Ministers along the way. In the Department's view these factors justified such a lengthy decision making period.[20]

Conclusions

22. All the parties seriously underestimated the complexity of the project and the risk of attempting to tackle such a challenge in one go using relatively untried PFI arrangements. They failed to achieve a shared understanding of what was to be delivered and how, and the barriers to innovation contained in benefit rules. The other major factors included inadequate contracting and project management skills, and lack of clear ownership of project delivery and risk management. These mirror many of the failings referred to in our predecessor's January 2000 report on lessons to be drawn from IT projects.

23. Pathway was selected because they were willing to take on a level of risk for preventing benefit fraud which the other two bidders would not accept, even though Pathway came third on 8 out of 11 technical and management criteria. At the time, there was a mistaken view that PFI bidders should compete on the level of risk they were prepared to take on, rather than achieving an optimum allocation of risk.

24. The various parties identified many of the risks at various stages, but did not always share this information. Risks were "cleared" without justification, and "cleared" risks were not well monitored and so re-emerged.

25. Joined-up projects involving more than one purchaser carry extra risks, and steps need to be taken to establish clear leadership in purchasing and project management, and transparency of information between the various stakeholders. The Department and the Post Office took some steps in this direction during the project, by revising the project management arrangements. The McCartney report recommends one single responsible owner for each major project in future; but the Benefits Payment Card also demonstrates the delays and extra costs that can emerge when decisions on the future of a project involve many stakeholders with conflicting objectives, in this case, for example the Department, the Department of Trade and Industry, the Treasury and the Post Office.

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4 C&AG's report (HC 857, Session 1999-2000), para 29 Back

5 ibid, para 15 Back

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6 Qs 141-144 and C&AG's report (HC 857, Session 1999-2000), paras 25-26, 1.36 and 3.46 and pp 14-15 Back

7 C&AG's report (HC 857, Session 1999-2000) pp 14-15 Back

8 Qs 1, 20-23, 26-30, 60, 116-123 Back

9 Qs 1, 18-19, 24-25, 135-136 Back

10 Qs 22, 26, 107-116 and Evidence, Appendix 2, p22 Back

11 C&AG's report (HC 857, Session 1999-2000), paras 18-20, 27-29 and pp 13-14 Back

12 Qs 1, 19-25, 31-32, 43-51 Back

13 Qs 52-55, 124, 151-154 Back

14 C&AG's report (HC 857, Session 1999-2000) paras 16-17 and p15 Back

15 Qs 3, 81-85 Back

16 Qs 1, 5-7 and Successful IT: Modernising Government in Action-Review of Major Government IT Projects, May 2000 Back

17 Qs 1, 56-57, 122-124, 170-172 Back

18 Qs 7, 55 Back

19 C&AG's report (HC 857, Session 1999-2000) paras 1 and 1.11-1.29 Back

20 Q2, 33-36, 42, 168-169 Back

THE OUTCOME OF THE BENEFITS PAYMENT CARD PROJECT

26. The Comptroller and Auditor General reported that cancellation of the project had had serious financial consequences for each of the parties involved. The

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Department had not secured their planned fraud and administrative savings of over £500 million. In addition, up to £127 million of their investment in a linked computerised Customer Accounting and Payments system might be wasted. Post Office Counters Ltd had written down their investment in automation, by £571 million, because the case for automation had depended so much on the Card and there were doubts whether they would now get sufficient income from automation to recoup the cost. ICL wrote off project development costs of £180 million.[21]

27. The Department accepted that, as a result of slippage and cancellation, they had not achieved planned fraud savings. But the impact had been offset by reductions in fraud achieved through interim measures, including their order book control system, which had saved £68 million in 1999-2000; and, although some of the £270 million cost of the Customer Accounting and Payment package had been wasted, they regarded the major restructuring of these systems as a success. It was a very important basis for improving customer service and improved accounting. It had enabled wider roll-out of bar coding of order books and would be the platform for implementation of Automated Credit Transfer.[22]

28. The Post Office too thought they had got value from the project. They would complete implementation of counter automation across the network by June 2001 at the latest, although they had financed the cost - around £1 billion - partially out of reserves, with Treasury agreement, rather than through charges to the Department for handling benefits using the Benefits Payment Card. This investment would help them maintain the network of post offices at the current size and build a technological future.[23]

29. ICL on the other hand had found the project a bruising experience. In addition to the financial loss, their reputation had suffered.[24]

30. The Department accepted that in such a project the business risk remained with them, and noted that there had been no interruption or inconvenience to any of their customers as a result of delay and cancellation. However, the financial risk had been shared between the parties, and the transfer of part of this risk to the private sector was demonstrated by the loss to ICL.[25]

Conclusions

31. Cancellation of the Benefits Payment Card, at a cost of over £1 billion in lost fraud savings, nugatory expenditure and write-down of assets and costs, must rank as one of the biggest IT failures in the public sector.

32. Both the Department (through its linked project to computerise its Customer Accounting and Payments System) and the Post Office (through its automation project, now nearing completion) claimed to have obtained some value out of the Benefits Payment Card project. But the Customer Accounting and Payments system was a separate, though linked, project, and £127 million of its cost may be wasted. In addition, some £571 million of the Post Office's investment in automation has already been written off.

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21 C&AG's report (HC 857, Session 1999-2000) paras 1.9 and 1.30-1.36 Back

22 Qs 62-64, 74-78, 121, 131-132, 157-163 Back

23 Qs 65-72, 129-130, 145-149 Back

24 Qs 66, 79, 164-165 Back

25 Qs 65-66, 79, 102-103 Back

PROGRESS IN DEVELOPING NEW ARRANGEMENTS FOR PAYING BENEFITS

33. In advance of the hearing, the Department of Social Security gave the Committee a report of the progress made with the Post Office and the banks in

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developing suitable bank account arrangements for benefit claimants - the so called Universal Banking service.[26]

34. The Department advised that Automated Credit Transfer would become the normal method of paying benefits from 2003, and they now had a Public Service Agreement target that by 2005, 85 per cent of their customers would have their benefits paid into bank accounts. Automated Credit Transfer will provide a more modern, efficient and secure method of paying benefits, and deliver administrative savings of some £500 million a year and fraud savings of over £100 million a year. Their plans were on schedule.[27]

35. All high street banks had agreed to introduce basic no-fee accounts in line with the recommendations from the Social Exclusion Unit's Policy Action Team on Financial Exclusion (PAT 14). In addition, banks had agreed to allow free cash withdrawals at post offices. The Post Office had announced its plan to offer Universal Banking services. Six high street banks had agreed in principle to provide a financial contribution to the cost. The Department had commissioned research to help design the new service in a way that would take account of different people's needs and preferences. Amongst other things, this would inform an educational programme to ensure that customers had all the information and advice they need.[28]

36. The Department confirmed that the Government were committed to providing for people to continue to collect their payments in cash from post offices if they so wished. Their research suggested that the numbers involved would be thousands not millions, but the method of doing this was still under discussion. The Post Office was close to signing a memorandum of agreement with the banks, which would be the key underpinning for putting in place the Universal Banking service. Their objective was to have it fully up and running well in advance of the changeover in 2003. The main components would be a Post Office card account, basic bank accounts, and enlarged arrangements for availability of current accounts at post offices. These would all provide channels through which cash could be obtained at post offices. In addition, the Department were in discussion with the banking industry about possible arrangements for urgent payments, such as Social Fund crisis loans.[29]

37. The Committee noted that the Universal Banking Service would require public money, Government guarantees, or both, and asked for an assurance that there would be proper arrangements for public accountability, particularly by ensuring access rights for the Comptroller and Auditor General. The Department of Trade and Industry confirmed this was their intention, as far as the public financing aspects were concerned.[30]

38. We took note that, in undertaking their study of the Benefits Payment Card, the National Audit Office had access to certain Post Office documents held by other parties, but the Post Office had not provided them with access to Post Office records. The Post Office assured us that they had co-operated with everything they were asked to do; but they considered that the issue of access was a matter for the Government and successive administrations had decided that that was not what they wanted. The Treasury confirmed that the Government was considering its response to the Sharman Report, which dealt

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with that kind of issue. The report had emphasised the importance of auditors having rights of access to obtain sufficient appropriate evidence in order to provide Parliament with independent assurance.[31]

Conclusions

39. In principle, the arrangements for payment of benefits through Automated Credit Transfer from 2003 should provide a more modern, efficient and secure method of paying benefits and deliver significant administrative and fraud savings. It is important, though, that these arrangements are developed with the customer in mind, in terms of access to their benefits through post offices, and continued access to cash payments if claimants so desire. The Department will need to communicate the new arrangements to claimants clearly and effectively.

40. Arrangements are in hand to create a Universal Banking service, to provide claimants with a post office card account, basic bank accounts, and better access to current accounts at post offices. These arrangements are likely to require public money, government guarantees, or both, and to cover benefit payments of many billions a year. The Department, along with the Department of Trade and Industry, will need to secure proper arrangements for public accountability for these payments and guarantees, and for the quality of services delivered by post offices to benefit recipients. We expect the departments to enter into discussions with the Comptroller and Auditor General on access to the Post Office for this purpose, and to submit a note to the Committee on their proposals to secure accountability before the arrangements are finalised.

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26 Evidence, pp 1-2 Back

27 ibid Back

28 Q132 and Evidence, pp 1-2 Back

29 Qs 4, 8-9, 94-100, 155-156, 175-176 and Evidence, Appendix 2, p22 Back

30 Qs 10-13 Back

31 Qs 14-17 and 73 and Holding to Account-The Review of Audit and Accountability for Central Government, by Lord Sharman of Redlynch, February 2001 Back

PROCEEDINGS OF THE COMMITTEE

RELATING TO THE REPORT
SESSION 2000-2001
MONDAY 26 FEBRUARY 2001

WITN03770103

Members present:
Mr David Davis in the Chair

Mr Simon Burns
Mr Alan Campbell
Mr Ian Davidson
Mr Nigel Griffiths
Mr Edward Leigh
Mr David Rendel
Mr Gerry Steinberg
Mr Alan Williams

Sir John Bourn, KCB, Comptroller and Auditor General, was further examined.

The Committee deliberated.

Mr Glenn Hull, Second Treasury Officer of Accounts, was further examined.

* * * * *

The Comptroller and Auditor General's report on the Cancellation of the Benefits Payment Card Project (HC 857) was considered.

Ms Rachel Lomax, Permanent Secretary, and Mr George McCorkell, Director of Information Systems and Commercial Management, the Department of Social Security; Mr Derek Davies, Director of Consumer Goods, Business and Postal Services, the Department of Trade and Industry; Mr Tony Oppenheim, Director, Commercial and Finance, ICL Pathway; Mr John Roberts, CBE, Chief Executive, the Post Office; and Mr Paul Schofield, HM Treasury, were examined (HC 282-i).

* * * * *

[Adjourned until Wednesday 28 February at half past Four o'clock.

* * * * *

PROCEEDINGS OF THE COMMITTEE
RELATING TO THE REPORT
SESSION 2001-2002
MONDAY 12 NOVEMBER 2001
Members present:
Mr Edward Leigh in the Chair

Mr Richard Bacon
Mr Ian Davidson
Mr Brian Jenkins
Mr David Rendel
Mr Gerry Steinberg
Mr Jon Trickett

* * * * *

Draft Report (The Cancellation of the Benefits Payment Card Project), proposed by the Chairman, brought up and read.

Ordered, that the draft report be read a second time, paragraph by paragraph.

Paragraphs 1 to 3 read and agreed to.

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Paragraph 4 postponed.

Paragraphs 5 to 40 read and agreed to.

Postponed paragraph 4 read and agreed to.

Resolved, That the Report be the Third Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

* * * * *

[Adjourned until Wednesday 14 November at Four o'clock.

Public Accounts - Minutes of Evidence

Here you can browse the Minutes of Evidence which were ordered by the House of Commons to be printed 26 February 2001.

WITN03770103

MINUTES OF EVIDENCE
TAKEN BEFORE THE COMMITTEE OF PUBLIC ACCOUNTS
MONDAY 26 FEBRUARY 2001

Members present:

Mr David Davis, in the Chair

Mr Simon Burns	Mr Edward Leigh
Mr Alan Campbell	Mr David Rendel
Mr Ian Davidson	Mr Gerry Steinberg
Mr Nigel Griffiths	Mr Alan Williams

SIR JOHN BOURN, KCB, Comptroller and Auditor General, National Audit Office, further examined.

MR GLENN HULL, Second Treasury Officer of Accounts, and MR PETER SCHOFIELD, Head of Team Public Enterprise Partnership, HM Treasury, further examined.

REPORT BY THE NATIONAL AUDIT OFFICE:
THE CANCELLATION OF THE BENEFITS PAYMENT CARD PROJECT (HC 857) (Session 1999-2000)

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Examination of Witnesses

MS RACHEL LOMAX, Permanent Secretary, and MR GEORGE MCCORKELL, Director of Information Systems and Commercial Management, Department of Social Security; MR DEREK DAVIS, Director of Consumer Goods, Business and Postal Services, Department of Trade and Industry; MR TONY OPPENHEIM, Director, Commercial and Finance, ICL Pathway; and MR JOHN ROBERTS CBE, Chief Executive, The Post Office, examined.

Question Number

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Examination of Witnesses (Questions 1 - 19)

MONDAY 26 FEBRUARY 2001

MS RACHEL LOMAX, MR GEORGE MCCORKELL, MR DEREK DAVIS, MR TONY OPPENHEIM AND MR JOHN ROBERTS CBE

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Chairman

1. This afternoon the Committee is considering the Comptroller and Auditor General's Report on the Cancellation of the Benefits Payment Card project. We have as witnesses Rachel Lomax, the Permanent Secretary at the Department of Social Security, Mr Derek Davis, the Director of Consumer Goods, Business and Postal Services at the DTI, Mr Tony Oppenheim, Director of Commercial and Finance at ICL Pathway and Mr John Roberts, the Chief Executive of the Post Office. Welcome everybody. For those of you who are not used to our proceedings, I will try to give some indication before each question as to which part of the report I am referring to so that you can at least be able to pick up on that. Ms Lomax, you are familiar with the procedure so I will start with you if I may. Welcome. The first question relates to paragraph 31 and Appendix 5, or perhaps a little wider than that in truth. This Committee has investigated many IT project failures in recent years, it is about 40 now, but this is probably the largest and one of the most costly that we have seen. How would the new guidance from the Cabinet Office have ensured that you succeeded in this project rather than the outcome we see before us?

(*Ms Lomax*) In lots of different ways I think, Chairman. First of all, I think that the project was vast in scale. It involved automating the Post Office for the first time ever. It involved restructuring the DSS's back end computer systems and then there was the Benefits Payment Card itself. I think it inconceivable that nowadays such a project would not have been broken down into more manageable chunks, that is the first thing. Secondly, I think that if it was not a PFI project we would have approached it rather differently. I think that more time would have gone into developing any technical design together with the supplier before we went to try to build the project. There would certainly have been an independent review through the gateway process, the McCartney review, before we got to contract, which would have insisted that we did that. Thirdly, we would have had a much more shared and open approach to risk taking throughout the life of the project. I think we would have approached it much more in a partnership spirit. This was one of the very early PFI projects and there was very much more an emphasis of allocating risks and arms' length dealing between suppliers. I think this project has been one of the ones which has emphasised the need for a collaborative approach to solve problems as they come up. Then, finally, I am sure there are lots of other things as well, I draw attention to the acceptance process. I think that we would avoid a sort of big bang acceptance where you either have to say "yes, this system is ready for national roll-out" or "we must progress more", we would have a phased acceptance process. I think those are the big things that I would highlight.

2. You have pretty much answered my next question which is what you would do to improve the process. From what you have said you have picked up most, from memory, of the suggestions that we would have made from our own report of January of last year into the IT project and the C&AG's report that went with it. I will move on, others may want to pick that up. My next reference is paragraphs 1.18 to 1.28, quite a long group, that tells us that even under the old arrangements it took 18 months to devise a new way forward, and in all that time abortive work and costs were increasing. They must have been quite spectacular costs that were slipping out of the door. Why did it take so long and how would you try to reach the joined-up Government decisions more quickly in future because over 18 months it must have been very expensive in all sorts of

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ways?

(*Ms Lomax*) I think the length of time does reflect the importance of the issues at stake as well as their complexity. You are talking about every post office in the country and 28 million[1] potential benefits claimants, huge sums of money and a project which was seen as cementing the way forward for the Post Office as well as producing a fraud free system of payment for the DSS. The big issues at stake involved a number of Government departments: DTI as the sponsor of the Post Office and the Treasury and No.10 got involved as well as the DSS. We all had quite legitimately different approaches to all of this. Also, the commercial issues for ICL, which was coming up to flotation, were also very big and very significant and needed to be taken seriously. We went through a long process of different kinds of review, inter-departmental groups, a long period of negotiation trying to find a way forward. I can take you through each stage of it but, I think you are right, 18 months was a long time considering the issues at stake and the difficulty of finding a way forward even from now on was what the subject deserved.

3. Did it not also reflect the fact that a number of parties involved really had a different view of the problems and even different aims?

(*Ms Lomax*) I think that there were legitimately different interests at stake here. All the parties to the project signed up to the same objectives, the same four objectives, of what the Benefits Payment Card was about. We all had different primary drivers. The DSS was interested in a fraud free means of payment, the Post Office wanted to secure our custom and was interested in securing footfall in local post offices. When things are going well these differences in what is your main driver perhaps do not matter, but when things start to go wrong and there are difficult choices to be made these things need work.

4. I am sure others will pick that up. You mentioned the future. When cancelling the Card project, the Government said that people who wished to continue to collect their cash at post offices would be able to do so, paragraph 1.29. What arrangements are planned to ensure that all your customers, especially those in rural areas, will be able to claim their cash without excessive travelling and inconvenience? What assurances can you give the Committee on this?

(*Ms Lomax*) The Prime Minister has given the assurance that people who want to collect their payments in cash from post offices will be able to do so and I cannot improve on that. The actual means by which this assurance is going to be delivered is still under development and under discussion. The Universal Banking Service, which the Post Office is going to offer, is the primary vehicle and, as presently conceived, this consists of two separate elements, a basic banking service where the post office will be acting as agent for other banks, and a basic card account. I think that the second part of your question is about the network of post offices through which people will be able to access their benefits and that is a broader question really than I can deal with so I would like to hand it over to Derek Davis, if you do not mind.

5. I will come to Mr Davis in a minute because I will raise with him this question of the Universal Bank and perhaps he can pick it up when we get to that point. If that is as much as you can tell us today I may well be asking for a note on this issue at the end because we expect rather more certainty on this

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issue than we have so far. Can I turn for a second to the TOA. We see in paragraphs 25 and 26 that the Department and Post Office Counters selected ICL to supply the system even though they had greater confidence that the other two bidders could deliver it. They did this because only ICL's bid complied with the PFI that the Treasury laid down. What lessons have the Treasury drawn from this about how PFI should be applied?

(*Mr Schofield*) I think the key points are set out in the guidance that the Treasury put out in early 2000 which addressed the whole issue of how we go about PFI for IT projects, many of which are set out in the lessons learned in the NAO Report and in the annex.

6. That does not surprise me because the Department took on board what was in the NAO draft report.

(*Mr Schofield*) I think in that sense the Treasury has learned and is applying those lessons in that way. In terms of the way in which PFI has developed over the period since this contract was entered into there are a number of very key points. First of all, there is that guidance. Second, the guidance that was put out by CITU in May 2000. Third, I think the gateway procedure that Ms Lomax has already referred to. Fourth, the additional expertise which is now available, for example within the OGC, as a result of various changes made since May 1997.

7. Okay, again others may ask more about that. My next question is for Mr Oppenheim. Good afternoon. It relates to paragraph 3.14 which tells us that the Department and independent reviewers both suggest that Pathway underestimated the extent of new software to be developed, and ran short of resources to develop it. Can you tell us what lessons you have learned from this project about fully understanding the requirement?

(*Mr Oppenheim*) Yes indeed. The guidelines which have been produced are, in fact, very much in line with our own discovery from this experience which really is that we have got to be very clear at the beginning as to the requirements and not enter into fixed price contracts and in particular fixed timescales before those requirements are very clearly expressed, particularly when there are two parties and they are of such considerable complexity. We were dealing here with legacy systems, with processes which are vital to the smooth running of society, and unless they are very well specified then one is going to run into problems. We fully support the notion, as Ms Lomax said, of having an initial phase of defining requirements, and we would very much like to be involved in that, and solutions, before as it were, firing the gun and going forward on the PFI delivery.

8. Thank you. Mr Oppenheim, I think you could take your evidence just there and frame it and give it to every software supplier in the country, it would be quite functional. Thank you very much. We will move on to Mr Davis, the DTI. Paragraph 1.40 is the one I am referring to. The Department's note to the Committee outlines the progress made with the Post Office and the banks in developing suitable bank account arrangements for benefit claimants. What further steps are now needed to agree the terms on which benefit customers will be given bank accounts?

(*Mr Davis*) This is the Universal Banking Services you are asking about?

9. What I asked you was what further steps are now needed to agree the terms on which benefit customers will be given bank accounts? You can roll in the Universal Bank if you want.

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(*Mr Davis*) We have made quite a lot of progress towards getting the Universal Banking Services in place. We reached an agreement in principle last December with six of the major banks and we are now very close to signing a memorandum of understanding which will be the key underpinning for putting in place the Universal Bank. We will then have to carry out the detailed work on the operational systems that it will involve. The object is to have it fully up and running well in advance of the change over in 2003. The main components envisaged for the UBS are, first, a post office card account and, secondly, basic bank accounts, or PAT 14 accounts as they are known, and, thirdly, the Post Office already has, and will be seeking to enlarge, arrangements for availability of current accounts at post offices. So all these will provide channels through which cash can be obtained at post offices when we have the system fully up and running.

10. Your answer tells me that this depends entirely on the success of the Universal Bank, which is mentioned in paragraph 1.43. That bank will require public money, government guarantees, or both. Will you be making proper arrangements for public accountability to Parliament for this new entity, particularly by ensuring access rights for the National Audit Office, the Comptroller and Auditor General?
(*Mr Davis*) That will certainly be our intention as far as the public financing aspects of the UBS are concerned.

11. I almost enjoyed your answer until you said "as far as". What does that mean?
(*Mr Davis*) What it means is that when we come to putting the arrangements in place there are likely to be elements of public contribution into the Universal Banking Services and that the Departments involved in those contributions will be fully accountable in the normal way.

12. Are you happy with that, Comptroller and Auditor General?
(*Sir John Bourn*) I think it would be helpful, Chairman, if as this develops we could discuss with the Department what it actually means. It is encouraging and I note what the witness has said about the intention to seek proper access.

13. My concern is not just about the money, my concern is about the provision of a public service.
(*Sir John Bourn*) Yes, that too.

14. On that issue, could I just come back to Mr Roberts on the Post Office. I understand that while the NAO had access to certain documents on the Post Office's involvement in the project which were held by other parties, you did not provide them with access to your own records and declined to give them information, even in meetings. Why was that?
(*Mr Roberts*) Chairman, we discussed this two weeks ago. The National Audit Office does not have—

15. Who is "we" in this context?
(*Mr Roberts*) You and me and the rest of the Committee when we were here two weeks ago in the context of the last Audit Report. The National Audit Office does not have access to us. I think we provided answers to every question that

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was put to us via the DTI as our representative in Government. We arranged for them to see the terminals in operation. I would not want you to think that "lack of access" meant lack of co-operation because I think we co-operated with everything that we were asked to do. In fact, I think in one of the letters the NAO said thank you for the co-operation they had had so far. As we go from there, I think it is back then to the point that you were raising with Mr Davis which was around what does Government want to do. If the Government wants the NAO to have full access to the Post Office then I think that is a matter for Government to decide. Successive administrations have decided that that is not what they want. If that is to change then obviously the Post Office will respond to it but at the moment, in the same way as I would not allow any other company's auditors access to the Post Office, I have taken that line with the NAO.

16. On the basis of?
(*Mr Roberts*) We are not part of Government, we are a separate corporation. We have independent external auditors. We have accountability to DTI. We have accountability to the Government in terms of financial targets. We are going to have accountability to the regulator from the end of this month. We have accountability to the Select Committee for Trade and Industry. There are a vast number of ways in which the Post Office is held accountable and all of those have been approved by Government over the years and the NAO, in terms of access, has not been one of those.

17. Accountability is only as good as the information provided and you are here responsible for providing a public service.
(*Mr Roberts*) Yes.

Chairman: Okay. I think we will be coming back to that issue at some length. Let us widen it out. We will start with Mr Gerry Steinberg.

Mr Steinberg

18. On page 81, Ms Lomax, there is a chronology of the events that led up to the eventual contract. It obviously had been going on since about 1988 but, in fact, by May 1994 the then Secretary of State announced to the National Federation of Sub-Postmasters the intention to move towards a new automated system for paying benefit. Then in October 1995 the Secretary of State made the announcement that the Benefits Payment Card would be introduced in 1996. In May 1996 Pathway were given the contract which stated that the trial would be finished by June 1997 and the roll-out was to be completed by 1999. Then the Secretary of State announced again in May 1996 that it was going ahead. If we look at page 46, paragraph 2.14, and read the first three lines, it was all pie in the sky, was it not?
(*Ms Lomax*) I think that it was clear by what—

19. It was never on the cards, was it?
(*Ms Lomax*) I do not think that was what people thought at the time. I think that with the benefit of hindsight they did seriously underestimate the scale and the complexity of the job.

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Examination of Witnesses (Questions 20 - 39)

MONDAY 26 FEBRUARY 2001

MS RACHEL LOMAX, MR GEORGE MCCORKELL, MR DEREK DAVIS, MR TONY OPPENHEIM AND MR JOHN ROBERTS CBE

20. Underestimate might be a slight exaggeration, I would have thought, because the Department signed the contract and they had no idea of the risks that they were taking. It says: "The Department took only limited steps to evaluate this risk before signing the contract. Their May 1996 business case included no analysis to assess its sensitivity to major slippage in the project..." In other words, the contract was signed and it was all pie in the sky.
(*Ms Lomax*) I think at the beginning when I said that I thought more work ought to have been done, I was talking about the work between procurement and the building of the system. The work that was done up to procurement, I think the NAO says elsewhere in this report, was competently done, the risks were identified at that stage, it is just that it should have been followed through for a fixed price contract with much more detailed work. I think the work that was done was inadequate for the purposes of the PFI, then a very novel way of doing a contract of course.

21. So it was a very clear contract?
(*Ms Lomax*) This must have been one of the very first Private Finance contracts in the world.

22. With great respect, it is irrelevant whether it was the first PFI contract or not. The fact of the matter was you were going into a business contract with the Post Office and Pathway, as it turned out to be, and clearly the contract was totally unclear. If you turn to page 52, paragraph 3.7, and read perhaps the first four or five lines, and I do not want to repeat them, you can see clearly 289 agreements to agree, 124 with Post Office Counters, 127 with both clients jointly. You were going into a contract with three of you and you had not got a clue what you were going into. No wonder it failed.
(*Ms Lomax*) No, I do not think I can accept that and I do not think that the NAO Report supports that interpretation either.

23. The end result proves it though, does it not?
(*Ms Lomax*) With great respect, the fact that it was an early PFI did make a difference. This was a fixed price contract and the risks involved for the contractor were much greater. You do need more pre-contract work for a PFI than you would for a conventional procurement.

24. It does not matter whether it was a fixed price contract or whatever it was, at the end of the day the Secretary of State announced in 1996 that by 1999 the system would be up and going but it was never anywhere near up and going.
(*Ms Lomax*) I think it is clear to say that all sides acknowledged that they had seriously underestimated the scale and the complexity of the task and that was why the whole thing was fundamentally re-planned in February 1997.

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25. I want to come on to that.
(*Ms Lomax*) To that extent what you are saying has got some substance. I do not think it is true to say, therefore, that the procurement was incompetently done and no-one took any notice of risks because it says in the NAO Report that they did, it just was not adequate for the scale of the task.

26. That admission to me clearly is pathetic, to be quite honest, because at the end of the day a huge project that you were going into was never, ever delivered, not even a small part of it. Can I ask the three organisations why they went into a contract that was unclear. Why did you, as the contractors, go into a contract that was totally unclear?
(*Mr Oppenheim*) Let me try to answer that. It was not totally unclear. There was a great mass of definition but some vital elements were missing. As we have all stated before, we would now look to get that definition phase done at the beginning. There was a kind of honeymoon period around the PFIs at that time, for want of a better description, where people were looking for quick results and there were a lot of assumptions made, probably by all three parties, as to what they were going to get out of it. For our part, why did we go into such an aggressive timescale? We assumed that there was a mood for compromise on some of these yet to be agreed requirements. We believed that we were given comfort in those assumptions because of the time of the essence timescales which were impressed upon us. I am sorry if I am taking time. The consequence of that was that we expected there to be room for manoeuvre, we were encouraged to think innovation and enterprise and those kinds of things but what we actually found was that there were a lot of things that were fixed that we could not move for a variety of reasons that we did not really understand at the time.

27. Okay. So you went into a contract that, frankly, you were unclear about. Why did the Department go into a contract when I cannot find anywhere in the report where it clearly states that the contractor was given any assurance of delivery? I cannot see anything in the report which states that Pathway, or whatever they were called, were actually going to deliver, there were no assurances.
(*Mr McCorkell*) At the stage the Department entered the contract it was based on an extensive procurement process where something like 400 business requirements were defined. They were defined at a high level and the PFI philosophy at the time was precisely design your business requirements at a high level, allow the contractor to create the solution, do not constrain them with the detail. This is the major lesson we have all learned about PFI, that that just does not work.

28. You keep blaming the PFI, but at the end of the day whether it was a PFI, whether it was in the private sector solely or whether it was in the public sector solely you want a successful conclusion to the project. It does not matter who is delivering it, that is what you want, and there were never any indications that was going to be the case. Why did the Post Office get involved when there were no assurances at all?
(*Mr Roberts*) I think in any contract like this what you are committing to, and what ICL Pathway were committing to, is to produce a system by a particular time. I think when we started the intention was that the system would be rolled

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out by the end of December 1999. The contract within the terms of PFI, and I agree with what else has been said about PFI—

29. You would.
(*Mr Roberts*) I think that was quite clear. It was clear in the sense that we knew what we were signing. PFI at that stage was very much about the transfer of risk. If one looks to the guidelines that were being turned out at that stage on PFI, they were all stressing that this risk was passed over to the supplier. We were not quite specifically allowed to—

30. As long as the risk gets passed over it does not matter whether the scheme fails or not?
(*Mr Roberts*) No. The whole point of passing over the risk is obviously one is making an assessment of what risk you are passing over. Do remember, we were being asked specifically not to design the answer and that was very unusual. In any contract prior to that that I had been involved with, the first thing that you do is you try with the contractor, with the supplier, to sit down and define as closely as you can what you expect to get out of it. That was not the intention of PFI at the time through the instructions, it was very much around "you must have a high level view of what you are trying to do", which we did, we wanted to automate the post offices, we wanted to automate the benefits payments. The methods that were then used to do that under the PFI instructions were down to the supplier to come back with suggestions for doing it. That was the way, I think, at the time that it was supposed to encourage innovation from the supplier.
(*Ms Lomax*) It is still the case that PFI is about specifying what you want from the service, not how it is going to be delivered. We know that to have an arms' length black box approach to that does not work, you need to work together on the how in order to get the what right.

31. Your Department wanted a scheme which was going to combat fraud and this was not even written into the contract.
(*Ms Lomax*) I am sorry?
(*Mr Oppenheim*) Excuse me, it was.
(*Ms Lomax*) It was.

32. Not according to the report, it was not. As I saw it in the report, the purchaser wanted a particular scheme to combat benefit fraud and yet this was not agreed in the contract.
(*Mr Oppenheim*) A lot of it was specified in the contract but there were fine details and the devil turned out to be in the detail. The notion of an extended verification procedure in order to target specific verification, via authentication methods was written into the contract. The detail of how that was going to be done, how it was going to be targeted, the processes, were not, and resolution turned out to be quite difficult between the three parties because of the tensions. There were significant sums of money obviously and it was very difficult to fix after the contract was actually signed.

33. That sums it up, frankly. Thank you very much for that. Once that is written down on the record that sums up the whole idea. Can I move on. By November 1997 it seems to me if you read the report that it was pretty clear

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that Pathway were not going to deliver the scheme because there had been trials in the North East of England, there had been trials in the South West of England and all they had come up with was a Card scheme which dealt with Child Benefit payments, so it was not very, very successful. Why did the new Government that had come in in May 1997 not scrap the scheme straight away? Were they giving the scheme a chance to succeed or what? It was so clear it was going to fail, why did they not just scrap it?
(*Ms Lomax*) They had a review because very large issues were at stake, such as the future automation of the Post Office.

34. It was a doomed project, was it not?
(*Ms Lomax*) I do not think it was that clear to new Ministers and they, therefore, I think rightly, had a proper review to see whether it was capable of succeeding. If you look at July 1998 the Head of the Treasury Task Force, Adrian Montagu, concluded that the project was deliverable although it would take an extra two years.

35. The new Government was told that, in fact, it was deliverable?
(*Ms Lomax*) Yes.

36. By the Department?
(*Ms Lomax*) Yes.

37. Yet you came into the Department and within a month of coming into the Department the scheme was dropped. Was that a coincidence?
(*Ms Lomax*) It was, yes, actually. The discussions were very well advanced by the time I arrived.

38. So you are not taking any credit for it?
(*Ms Lomax*) I cannot take any credit for it, no.

39. You should have done.
(*Ms Lomax*) There we are. That was my mere presence.

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WITN03770103

Examination of Witnesses (Questions 40 - 59)

MONDAY 26 FEBRUARY 2001

MS RACHEL LOMAX, MR GEORGE MCCORKELL, MR DEREK DAVIS,
MR TONY OPPENHEIM AND MR JOHN ROBERTS CBE

40. From the report it is quite difficult to work out who was most incompetent: Pathway, who were unable to deliver, who were never going to be able to deliver, the Department who were signing up to a contract that in my view had more holes than a sieve, and that has clearly shown how—I do not like the word "incompetent", I should use another word—problems have arisen. If you look at page 58, paragraph 3.19, for a start, the CAPS programme was going along with the scheme and it was very important that the CAPS scheme worked but that had failed already. This had actually failed by 1997 as well and yet nobody had picked it up.
(*Ms Lomax*) The CAPS scheme involved making changes which went right across the benefits system and that turned out to be more complicated than people had appreciated to start off with. After the February 1997 replan CAPS delivered again to all its timescales and it has actually been a great success, it is not a failure.

41. It had been a failure up until then because it clearly states in the report at 3.19: "It is clear that the risks of late delivery of CAPS were not well managed prior to the replan of the whole CAPS and Payment Card programme..." etc., and people were not being informed, Pathway were not being informed, the Post Office were not being informed, so they were going on their merry way with this doomed project and about this CAPS, which was so important to the project itself, nobody was actually telling them.
(*Mr McCorkell*) I think leading up to 1996 the CAPS programme was running behind schedule to deliver to the then contracted timetable. That was identified and a major review took place and major actions were taken, which I think are mentioned in the report, to put the CAPS programme back on line. So CAPS, as well as the other two parties, in 1996 recognised that we could not meet the original timescale defined. We then undertook very significant action to bring that back on line, and hence agreed the replan for February 1997.

42. I am not wanting to be political or anything like that, I try not to be, but one has got to see the chronology of all this. Did the Government that came in at the time have the unenviable task of basically clearing up what was a shambles?
(*Ms Lomax*) I think they inherited a very difficult project and it took a long time to get it on track.

Mr Steinberg: The Post Office have got away with murder because I wanted to get on to them next but I have not got the time.

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Mr Williams

43. Permanent Secretary, we have been told a partial explanation of why we are where we are, that it was a pioneering project, which I assume you would agree with?
(*Ms Lomax*) Yes.

44. It was a large project with up to one billion pounds worth of payments that Pathway had identified, that is agreed. It was a complex project, that is also agreed. In that case, when the risk analysis was being carried out, why was it that the risk of inadequate project management methods, the risk of inadequate planning and the risk of inadequate risk management were not even identified as risks? They were not identified in 1995 and they were not identified in March 1996. Now we find in April 1998 that they were high probability risks with high impact expectations. How on earth could whoever drew up the risk register not have taken that into account, the fact that dealing with something so large, so complex, meant that management itself was a risk?
(*Ms Lomax*) I am surprised at what you say and I am wondering what it is based on.

45. If you look at page 90, Appendix 7, item 15 at the bottom of the page, there is a description of risk and there was no entry in September 1995 and in march 1996 it says "not identified" and then if you move to the final column it had been recognised by April 1997 and in 1997-98 it was regarded as high risk under both headings.
(*Ms Lomax*) These are the purchasers' risk assessment of Pathway's proposals and Pathway's own risk registers did not mention inadequate project management methods, planning and risk management. I do not know.

46. Who drew up this list? How was it devised? Who was responsible for that? Was it the Department? Would they be the people solely responsible?
(*Ms Lomax*) This was the joint procurement authority presumably that drew up the list.

47. So who is putting hands up and saying "we were party to this"?
(*Ms Lomax*) The DSS and the Post Office. This was a joint procurement, part of which—

48. And neither of you recognised the possibility that management and risk management could possibly be worth listing as risk factors? I find that astonishing.
(*Mr McCorkell*) What we are looking at here, and the point you are making, is the stage before the procurement and the difference in the stage up to the procurement. During the procurement these would have been identified as risks but may not have been identified as major risks given at that time the appreciation of the real scale and complexity of what we were trying to do and the difficulties that we were facing under the PFI methods of development were not recognised. What is shown here is that following procurement, when we tried to deliver this, the risk management methodology immediately started to spot these as significant risks because we now realised the scale of what we were attempting and realised the restrictions under the contract under which we had to develop it. So they became highlighted risks. I think this is showing that risk

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management after procurement picked up these issues. Before the procurement, part of the misunderstanding of how a PFI contract would work did not highlight these as major risks.

49. Looking at this table it is a devastating indictment. Just look down the column for March 1996 for all the items there "cleared, cleared, cleared, cleared, cleared, cleared, not identified". The security requirements were seen as a medium risk in 1996 and yet by April 1998 had become a very high risk. Surely you should have started off with that as being one of the highest risk problems, should you not?
(*Mr McCorkell*) I think it is the nature of risk management that risks (a) can arise later in the process, (b) increase later in the process, and (c) some risks which you may take off your register, in fact it is part of our methodology that we keep reviewing them, may well come back on the register. Again, we are looking here at a procurement phase and development and implementation phase.

50. You are managers, you are not low level managers, you are top level managers, you are being paid high salaries, and one would have thought when it comes to identifying risk you would want to ensure that you have some sort of consensus on what both parties were contracting for. Pathway have a legitimate complaint to my mind because you asked them to share the risks but you did not tell them what you thought the risks were.
(*Mr McCorkell*) If I can try to explain just a little bit further. The security risk is—

51. That is just one of them, I am talking about all of them.
(*Mr McCorkell*) The security risk was identified as a risk during the procurement process. There was a proposal to meet that risk. There was high level definition of the extended verification process. That was acceptable to the procurement process, we believed that would work and, therefore, that was down to medium risk. When we started to develop the detail, as Mr Oppenheim pointed out earlier, that became much more difficult because of the interaction between the three parties and, therefore, because it was absolutely vital to our system it went straight back up the risk register and became a high risk and would remain a high risk until it was fully developed and delivered.

52. I just cannot understand, rather than try to work on the basis of collective wisdom and collective experience, something that is pioneering, and, therefore, pooling your knowledge and pooling your thoughts, the Post Office or the purchasers made, according to Pathway, top of the final two columns that neither of these risks registered were shared or discussed formally with them. Surely that is crazy, it is lunatic? Did anyone resign?
(*Mr Roberts*) That was at the time exactly the way PFI was expected to operate and we were being—

53. When you say, "was expected to operate", if it is intended to be a pioneering method a pioneering project, you have to pioneer the method of operation. On something of £1 billion it would seem to me that pooling ideas on risk was sheer common sense, not postdated common sense.

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(*Mr Roberts*) I would absolutely agree with you. Q: Then why did you not do it? Roberts: Because it was not what we were told to do at the time.

54. Do you not have any initiative? What are you paid for?
(*Ms Lomax*) Can I introduce some things in here? The point that Mr Roberts is making is that the PFI was all about transferring risks to the people who were best designed to manage them, and in the thinking about PFI it was very much, "You do your thing; we will do our thing". Nevertheless, informally, there was a great deal of discussion about risks during this project, a great deal of discussion. Risks were regularly discussed at project boards and steering committees, and all the rest of it. The difference from our approach to risk at the moment is that sharing of risks registered now would be formally written into the contract. We would have a much more open process mandated under the contract.

55. That sounds much more rational, but it is not what you signed up to. You signed up to this Report. The heading says, "Pathway told the NAO that neither of these registers were shared nor discussed formally with them". You are just trying to give the idea that there was a meaningful interchange. Let us ask Pathway, do you feel that there was a meaningful exchange at an informal level?
(*Mr Oppenheim*) We would have preferred a more joined-up approach, which is certainly what will happen now. The problem was one of silos as I think you are alluding to. The notion was that we could operate in our respective silos and deal at the boundary. In actual fact, with such a complex end-to-end system, which involves processes right through from one end to the other and back again, that does not work.

56. It is small wonder that IBM dropped out and the other company. You cannot blame them. You were very lucky to get anyone who was daft enough to enter into an agreement with you on the basis that you will not tell them what is at risk when you, the Department, and you, the Post Office, are the people who know what is needed and what the operational risks are. How crazy.
(*Ms Lomax*) People have doubts about PFI as the framework for doing development work for IT.

57. You have doubts about it still?
(*Ms Lomax*) We have needed to reinterpret what PFI means as applied to IT projects quite substantially. That is what all of these reviews and reports you have been doing, the new guidance is about. What we are doing for our current modernisation projects, such as Child Support reform, is a very difficult subject.

58. As you did not share risk, let us share blame. How much of the responsibility for the mess we find here rests with the Department and how much with the Post Office? Then you can each tell me who resigned in each as a result of it. Let us start with the Department. What is your view of this situation?
(*Ms Lomax*) Speaking as somebody who was not in the Department when this went on, I have looked at it very thoroughly in preparation for this hearing, as well as earlier, and I think the Department actually tried very hard to manage a very difficult contract, and manage an over-ambitious project within a very difficult contractual framework really quite well. Far from sacking people

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involved, many of the people involved are our most experienced programme and project managers, on whom we would depend to deliver projects in the future.

59. You managed it quite well, but when the contract was signed it was intended to have a trial within ten months of the full system, and three years later no such trial had ever taken place. That does not look well-managed. Let us hear your view of why your organisation did so well?
(*Mr Roberts*) I have a very similar reaction to Rachel Lomax.

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Examination of Witnesses (Questions 60 - 79)

MONDAY 26 FEBRUARY 2001

MS RACHEL LOMAX, MR GEORGE MCCORKELL, MR DEREK DAVIS, MR TONY OPPENHEIM AND MR JOHN ROBERTS CBE

60. Do you not think anyone is to blame?
(*Mr Roberts*) We are all to blame in the sense that the project obviously did not meet the objectives that were set for it and, to that extent, in any sense we failed to deliver what we should deliver. May I just finish please—I think the key issue is you are set a particular framework in which you try and operate. I think we all now know—the NAO Report has made it clear—that that framework was something that if we were presented with it today, knowing what we know now, nobody, as you quite rightly say, would have signed up for it, but at the time five years ago this was something that was completely different. I think everyone in Government and the trade was trying to find a new way of getting investment into the projects. It was the first time I had ever seen a project like this where you allowed the supplier so much freedom, and that is probably the same for ICL Pathway, and it did not work.

61. You say you are all to blame, but at the end of it what I am gathering, since nobody is volunteering the information, no-one was shown the door as a result of getting it wrong. That is about right, is it not?
(*Ms Lomax*) Nobody has been shown the door—

62. That is the answer I want. Let us see what it has cost us. The Post Office is a cherished, national organisation. The Department operates on taxpayers' money. I understand it was envisaged in the business case that there would be net savings of £667 million. That is correct, is it not?
(*Ms Lomax*) Initially.

63. Initially, that is right. That was then reduced to £148 million.
(*Ms Lomax*) Yes.

64. So you were only £519 million wrong in your estimate. Now, was it the Department that was £519 million wrong or was it the Post Office that was £519 million wrong?
(*Ms Lomax*) That was the consequence of slippage because we did not get fraud savings, which were the basis for the business case. The Department did get something of value from this project, as has the Post Office. We got a major restructuring of our customer account payment systems, which will be the platform for going forward to ACT. We also got from Post Office automation the ability to roll out order book control systems, which are enabling us to save £68 million in administrative payment fraud at the moment.

65. Let me tell what you what you did not get. Let us go now to Post Office Counters, you recorded in your accounts an exceptional charge, I assume that means a write-off or something of that sort, an exceptional write-off of £571 million. I would expect to see somebody hanging from a lamp post for £571

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million of getting it wrong, but we understand that no-one has. On the other hand, ICL wrote off project development costs of £180 million. In terms of risk transfer, I recognise that is a very significant loss for a private organisation, and I am not criticising them in that respect, but what emerges is that in a project that was intended to transfer risk from the public second to the private sector, the public sector loses £571 million and the private sector loses £180 million. It seems to me on simple arithmetic that the public sector bore more than three times the cost that the private sector bore, so the fundamental objective of passing the risk does not seem to have been achieved with any distinction whatsoever, does it?
(*Mr Lomax*) I do not think I agree with that. The question is what did you get for that money? What happened was that Post Office automation has gone ahead, but it has been financed by the Treasury not by the DSS.

66. Yes.
(*Ms Lomax*) That is what the £571 million is. That is not a dead loss, that is buying something of value. The people who have really suffered here are ICL.

67. You have written off £571 million, ICL has written off £180 million, so there is £751 million, three-quarters of a billion that has been written off. Are there any other costs that we do not know about?
(*Ms Lomax*) I do I not agree that the £571 million represents a loss to the public sector.

68. What happened to the money?
(*Ms Lomax*) The money is a way of financing Post Office automation other than through the high charges made by the DSS.

69. Have they still got the money?
(*Ms Lomax*) The taxpayer has paid for Post Office automation.

70. Somebody has paid. Who has paid?
(*Ms Lomax*) The taxpayer has paid, but what you have got is an automated Post Office system.
(*Mr Roberts*) When Ministers decided to cancel the Benefit Payment Card they also decided that they wanted counter automation to continue, as we did. The costs of automating 18,000 counters was round £1 billion. That has now been virtually completed and will be completed within the next three months. That cost was borne partially out of the reserves of the Post Office, which the Treasury allowed us to use to pay ICL for the development costs, and that had gone on to produce all of the activities they had so far, minus the Benefit Card. There is a continuing payment which will go on for about another two years, which is the remaining expenditure which will complete all of the activity and, as a result of that, we will then have a complete network of automated Post Offices.

71. If you had not lost the £571 million might you have been able to keep open some of the Post Offices that you closed?
(*Mr Roberts*) We did not lose it, Mr Williams.

72. Someone did.
(*Mr Roberts*) It came out of reserves of the Post Office, which are past profits

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of the Post Office. It was used to pay ICL because we changed the contract. Up until that point ICL were having to fund all of the expenses themselves, that was the nature of the PFI contract. When the contract was changed it was changed to what I would call a much more ordinary supplier contract and, as a result, we then paid for the development costs and we paid for the installation and the completion of counter automation. In one sense in Post Office terms, although we would not have preferred to do it this way, we basically paid £1 billion to automate the nationwide network of post offices, out of that we have the assets of the terminals on the counter, the technological infrastructure, the ability to do the things that we do which I believe will, to meet your last point, enable us to maintain that network of post offices at the kind of size that it is at the moment.

73. On the basis of what you have just told me I can well understand why it was that you wanted to keep the NAO out, I understand very well—we might have found out about this a lot earlier. On the basis of what you have just told me, can I then come back to the Department again, and I finish on this question. We are now about to launch into another black hole of public money in the form of the Universal Bank. I say, a "black hole" because at this stage nobody can tell us what it might cost. That is correct, is it not? I gather negotiations are still going on about the public sector input. In view of what happened in this case, does the Department intend that the National Audit Office shall have the access, that it thinks it will need, to the new Universal Bank, or does Treasury? I do not care which of you answers; I just want an answer from one or other of you.
(*Ms Lomax*) It is a matter for either the Treasury or the DTI.
(*Mr Hull*) Mr Williams, as you know, the Government is considering its response to the Sharman Report, and the question you have asked is very much to be taken in that context. I cannot pre-empt what the Minister will say.

Mr Williams: I said that was the final question, I have a final observation, as someone who was on the Sharman Committee, as was the Chairman and David, if anything justifies the claim this Committee made in the procedures of the Resource Accounting Bill, and that the NAO has made, for more access to public funds, this case is a glaring example of where money might have been saved if there had been involvement at an earlier stage. Thank you, Chairman.

Chairman: Before I call the next member of the Committee, may I remind the witnesses that the Report that this Committee wrote, both on PFI projects and on IT projects, was drawing on a large amount of experience which the Committee believed Whitehall should have learned from before this project was even started. Much of this was outwith or nothing to do with the regulations that the Committee made. It is simply common sense. I just remind you of that before we move on. Mr David Rendel.

Mr Rendel

74. I want to carry on a similar line to Mr Williams, to start with, at least. Mr Roberts has told us that the £571 million written off by the Post Office was not wasted but was used to purchase the automation of the Post Office Services. You had not expected to have to pay for that; is that right?
(*Mr Roberts*) We had expected, Mr Rendel, that it would be dealt with in the way that Ms Lomax has described under the original contract.

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75. It was an extra cost which was unexpected as a result of the failure of the Benefits Card System.
(*Mr Roberts*) Yes.

76. We have heard there was about £519 million worth of fraud which was not prevented, which you had expected to prevent as a result of the Benefits Card System. Had it gone ahead you would have prevented £519 million of fraud. Can you tell us how much money was spend on the Benefits Card System itself and on those parts of CAPS which are no longer going to be able to be used?
(*Ms Lomax*) The total spent on CAPS was £410 million[2], of which there was about £127 million, which may or may not turn out to be nugatory. I will not know how much will, in effect, until we finish the technical design work for ACT. It is quite possible that some parts of that system will be reusable, but I cannot tell you how much at the moment. £127 million is the top limit on the amount of development cost through CAPS which may turn out to be nugatory.

77. Can you say how much you spent on the card system itself which has gone to waste?
(*Ms Lomax*) That is the only bit. The rest of it is reusable, it is part of the architecture of our system that we need to go forward for ACT, we need to improve our customer view and our internal financial accounting.

78. You have not paid anything to ICL for the card system itself, which is no longer going to be of any value.
(*Mr McCorkell*) During the trials in the 200 offices we paid for the transaction charges, but it was a very small amount of money.
(*Ms Lomax*) The loss to the Department is £127 million, the upper limit of that. On the fraud front, we have put interim measures in place to reduce instrument of payment fraud, including the order book control system, which the automation of the Post Office has facilitated. We made savings last year of £68 million. Some of that £571[3] we will recoup through other means.

79. The point, I guess, that Mr Williams was trying to make and I am trying to make in my own way, is it does seem for a PFI scheme, whose intention was to transfer the risk to the contractor, the contractor seems to have spent a great deal less than has both the Department and the Post Office as compared to what the Department and the Post Office were expected to spend at the time the contract was signed. That, it seems to me, to be an absolutely clear failure to transfer the risk. I understand about the difficulties of PFI and the changes you have made since that time, but it does seem to me there is a need to accept that in this case risk was not transferred.
(*Ms Lomax*) I am not sure I fully accept that. The write-off that ICL took was just a loss to them. Both the Department and the Post Office have had value for most of the money they expended.

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2 *Note by Witness:* The estimated spend in the business case was £410 million until 2004. £270 million was spent on CAPS. Back

3 *Note by Witness:* The sum was, in fact, £127 million, not £571 million. Back

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Examination of Witnesses (Questions 80 - 99)

MONDAY 26 FEBRUARY 2001

MS RACHEL LOMAX, MR GEORGE MCCORKELL, MR DEREK DAVIS, MR TONY OPPENHEIM AND MR JOHN ROBERTS CBE

80. They expended money they were not expecting to expend. Had the thing gone head and worked that money would not have been expended. That is what Mr Roberts has just told us, on his side at least.
(*Mr Roberts*) It would have been expended later because the original contract meant that ICL Pathway would have taken all of the up front development costs and paid for those. What was going to happen downstream, once it worked, is that we would have paid a per transaction cost back to ICL and that was the way in which ICL would have gained their revenue and got their return on their original investment.

81. Can I move on to talk about the question of a split project. Ms Lomax, you said earlier, "When things go wrong there are always difficult choices to be made". Either you or Mr Roberts said that.
(*Ms Lomax*) I certainly said that, yes.

82. Surely it is always going to be true of a project which is split between the public sector, your Department, and an independent body—and Mr Roberts has emphasised very strongly that his body is an entirely independent body from the public sector—I do not see how you are ever going to be able to make the decision sensibly when part of the money is having to come from the public sector and part is coming from, apparently, a private organisation?
(*Ms Lomax*) What made it particularly difficult was that the Post Office is a very important supplier. We have a very sensitive commercial relationship, a rather peculiar commercial relationship between the DSS and the Post Office, and that made the relationship very special. The fact that it was at arm's length body, I am not sure whether that really makes that much difference, I do not know.

83. It seems to me that the Post Office is organising itself as, in effect a private sector body—in which case the fact of the matter is you do not any longer have the same aim in terms of public sector money—if that is the case you are always going to have a conflict when any difficult decision has to be taken, whether the project is working well or not.
(*Ms Lomax*) It is important that the two parties to a project like this have shared objectives, the extent to which they genuinely have shared objectives makes a big difference to how they cope with difficulties when they arise.

84. You are never going to have shared objectives in terms of the financing of the project if one is private sector and one is public sector.
(*Mr Roberts*) I think the point you are making is that one set will be coming from a government vote, whereas ours will have come through the Department and the Post Office. Those differences are absolutely there. The only point I was going to make was, we did put a lot of effort into the memorandum of understanding, which was produced before the tendering exercise went ahead,

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which was really to define the key aims of the project, which we both subscribed to, and this was around automating the Post Office, automating transactions and getting fraud out of the system.

85. Was it not obvious from the very start that if anything ever did go wrong, if any further decisions had to be made there was going to be a clear conflict of interest between your organisation, which set itself up as a private and separate organisation, and the Department, which was clearly a public organisation?
(*Mr Roberts*) If it was about returns on money and those kind of commercial activities, then, yes, I accept that. I think on a lot of the activities which were around automating the Benefit Card, many of those things were quite split. Anything to do with the card and the security arrangements was quite clearly a matter for the DSS and anything to do with the running of the Post Office network was ours. By putting together the programme development authority, as we did, we were trying to minimise that as far as we could. As the NAO report makes clear there were difficulties and what we were trying to do was build a sufficient system to resolve those as quickly as we could.

86. We have taken you far enough through what went wrong. Let me turn to the future, Mr Roberts, what is the current rate of closure of small rural post offices?
(*Mr Roberts*) In the network this year, Mr Rendel, 424 post offices have closed. That is a snapshot number. Not all of those will remain closed. That is at about a month ago.

87. Over what period?
(*Mr Roberts*) Over our financial year, which started last April, about ten months.

88. That is out of how many?
(*Mr Roberts*) 18,000.

89. One in 36, three per cent closed in one year.
(*Mr Roberts*) Yes.

90. In a rural area how far would you expect the average resident to travel to the nearest post office?
(*Mr Roberts*) I am not sure we have an average figure, it would depend on the kind of rural area you have. If you are in the middle of Scotland it is probably quite some distance. If are you Southern England—

91. I represent a constituency in Berkshire, let us start with Berkshire.
(*Mr Roberts*) I really would not want to hazard a guess, two or three miles maybe. It does depend on terrain and all sorts of other things. I would not want to mislead the Committee, we do not have an average figure.

92. Ms Lomax, what analysis you have done of whether there will be any excessive travelling and inconvenient distances to be travelled as a result of this new system coming in?
(*Ms Lomax*) A considerable amount of research is going on into attitude towards payment through the Post Office, and things like that, in preparation of

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payment modernisation. I am not aware of the answer to that particular question.

93. My actual question was, what analysis have you done?
(*Ms Lomax*) I do not know. We are doing a lot of research but I do not know if we researched that particular aspect.

94. Quite a number of people are paid by post at present when they are living out in rural areas. That, presumably, is going to be impossible, are they going to have go in before they can get anything.
(*Ms Lomax*) A huge amount of our business is conducted over the telephone and through the post.

95. They will still be able to claim by post?
(*Ms Lomax*) Yes, indeed.

96. Once the Universal Bank has been set up, how many of your benefit recipients do you expect will not have any bank account?
(*Ms Lomax*) About three and a half million I think is our best estimate at the moment.

97. After the Universal Bank has been set up.
(*Ms Lomax*) After, I do not know, a small number. There will be some absolute exceptions of people who just do not want bank accounts at any price or are not capable of having one.

98. You do not know how many that small number is.
(*Ms Lomax*) I think we have an estimate of a small number, 5 per cent[4]. I would be misleading you if I gave you a precise figure. It is a small core.

99. I have to say I am horrified to hear you do not know what the precise figure is. Given the difficulties these people are going to have, how are they going to get their money?
(*Ms Lomax*) We have to make some special arrangements for them, we have not yet done that.

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4 *Note by Witness:* The figure is, in fact, under 5 per cent, not 5 per cent. Back

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Examination of Witnesses (Questions 100 - 119)

MONDAY 26 FEBRUARY 2001

MS RACHEL LOMAX, MR GEORGE MCCORKELL, MR DEREK DAVIS, MR TONY OPPENHEIM AND MR JOHN ROBERTS CBE

100. You do not know how many are involved and you do not know what the special arrangements are?
(*Ms Lomax*) No. We have a great deal more work to do. We have two years before we get to the point at which we start to move to ACT, and that is rolling out over two years beyond that. A great deal of research and work needs to go into this.

101. You hope that the use of bank accounts is going to reduce some of the risks of fraud, and I accept that it almost certainly will, what increased risk of fraud will there be following the use of bank accounts?
(*Ms Lomax*) The research we have done does not suggest that people who are paid by ACT at the moment are particularly different in their capacity to commit fraud. The risk that we do need to take very seriously is less interaction with the customer and the possibility of payment being paid into inactive or the wrong bank accounts. We have quite a lot of money earmarked to research that too.

102. Let me ask one final question, I think it was Mr Oppenheim who said, "This was a project which was vital to the smooth functioning of society", I may not have your exact words, it was something of that sort, and the Chairman complimented you on your evidence in saying so. Ms Lomax, if that is correct, and I believe it to be correct, does that not mean this sort of project is one which is never going to be suitable for PFI, because you cannot transfer to the private sector, at the risk of something going wrong, something which is so fundamental to the functioning of society?
(*Ms Lomax*) The Department has always got to retain responsibility for the smooth running of the business.

103. Therefore you cannot transfer the risk.
(*Ms Lomax*) Some risks can be transferred. What you cannot do is completely transfer everything. The business risk remains with the Department. In this particular case, I note, although the NAO report did note there was no interruption or any inconvenience to any of our customers, the Department did successfully discharge that responsibility.

Mr Griffiths

104. Good evening, Mr Oppenheim this is difficult for you. You are a company that has, I think, multi-million if not billion pound contracts with the Government; is that right?
(*Mr Oppenheim*) Yes, it is.

105. You have to maintain your relations with government departments on a civilised basis in order to win further contracts.
(*Mr Oppenheim*) Yes.

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106. Before a Committee like this, which is trying to tease out who is to blame, you would not want to point the finger too much at people who you may depend on for future business?
(*Mr Oppenheim*) You are right. It is a difficult question, if you are inviting me to say, were it not the case, I would say something different, then no.

107. I will not have the Chairman remind you of your responsibilities here, because I am sure you know them. You did say in answer to him earlier something which, I think, members of the Committee found fairly astonishing, that was, the requirements that were placed on you in this contract and how it was structured were not clearly expressed by the DSS, the DTI and others[5].

(*Mr Oppenheim*) Yes. I think that has been identified quite clearly in the NAO report. There were a large number of agreements to agree, some of those were quite crucial in the design system.

108. That must have hamstrung you?
(*Mr Oppenheim*) Yes.

109. Are you saying that the DSS did not know what it wanted?
(*Ms Lomax*) There was a lot of clarification needed right across the piece.

110. Give me an example of that?
(*Mr Oppenheim*) The determination of the rules for benefit encashment would be one.

111. That is how somebody is claiming social security.
(*Mr Oppenheim*) Let me explain, not claiming Social Security, this is all to do with encashment. There are some very complex rules as to precedents and limits of the amount that can be paid in one go. There are limits to how many so-called foreign transactions you can make at post offices other than your post office, your nominated post office. There are complex rules about proxies and other kinds of agents.

112. These were paper rules previously, were they?
(*Mr Oppenheim*) Yes, they were. As we now understand it a lot of those are enshrined in various regulations which, it turns out, the Department need to adhere to.

113. Your phraseology there says a lot, were you not given an indication that here was a manual that the Department had to adhere to and you would be required to do it as well? (*Mr Oppenheim*) There was no manual.

114. There was no manual provided to you, why would that be?
(*Mr McCorkell*) The situation we are talking about here is one where the difficulty is that when you are going to an entirely new system the contractor, the supplier, in this case ICL Pathway, would wish to make a set of assumptions on the business rules that will apply and that will simplify the overall system.

115. I do not think you have grasped the point. I think if Parliament and/or the Department has got manuals, and I have seen them, and these are not

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handed over to the contractor who is designing the software you are heading for a disaster?

(*Mr McCorkell*) Those manuals, if they were to help the process, could have been handed over. During the process of doing the detailed development of the requirement the precise rules were handed over.

116. My question was, was that an example of what did not help the process? We have established that did not help the process.

(*Mr McCorkell*) I am trying to explain what it is that did not help the process. We started with a set of rules which could have been handed over and the contract would have to design something which met that set of rules based on paper methods of payment when we were going to an electronic method of payment. What we wanted was an electronic method of payment and a set of rules that would fit the electronic method of payment. What we found when we got to the detail was that there was certain things that were enshrined in legislation and hence we could not change it, even though it might have been simpler to change it, or where there were customer service aspects we felt we could not accept. That was part of the process of attempting to simplify the system. Again, it was PFI philosophy, he has the right to make assumptions if this can be made much simpler. When you get to the detail you find we cannot make it that simple.

117. This is nothing to do with PFI. This is to do with the fact that when the minister made a statement in 1994—who was the minister then?

(*Ms Lomax*) Peter Lilley.

118. When Peter Lilley made the statement in 1994, months, if not years, went by with the DSS not, apparently, knowing what was legally required by Parliament of them, and handing that over to the contractor, but saying, "The contractor might come up with a better system". If the contractor spends £180 million he had to write off developing a better system we could have come along and said to them, "We did not bother checking before". That is what you just told us.

(*Mr McCorkell*) What I am trying to tell you is that the process that was agreed was we would work on the basis of a high level business requirement, work that down through the detail and then find out the problems we were getting at a detailed level. You are quite right, the Department has lots of sets of rules, manuals and manuals and manuals of them. I think to give those over to the contractor, and to go through a process that goes through every single one of those and check it would stretch the procurement process, bearing in mind this is costing the Department and the contractor lots of money, and it would delay the eventual implementation of the project and would take forever. Look at what you need to change. Some of the things you would like to change you find you could not change, and that causes difficulties.

119. You would have known from day one what you could change and could not change. The contractor was not told that.

(*Mr McCorkell*) We would not have known from day one what we could and could not change throughout a massive set of rules and regulations.

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Examination of Witnesses (Questions 120 - 139)

MONDAY 26 FEBRUARY 2001

MS RACHEL LOMAX, MR GEORGE MCCORKELL, MR DEREK DAVIS, MR TONY OPPENHEIM AND MR JOHN ROBERTS CBE

120. At the stage, since the statement made by Peter Lilley in 1994, did you anticipate that changes that the minister should have been advising the Secretary of State, that these changes to the law, were hamstringing your contractors, and might, given the period of time over which this was being developed, be presented to Parliament as unnecessary?
(*Mr McCorkell*) I believe, and I cannot remember specific examples, I am sure we can let you have a note, we did put through some changes in order to simplify the system[6].

121. A bit of too little too late. You said, Permanent Secretary, that you seriously underestimated the scale and the complexity of the task. I think we have one example of that. We know from paragraph 134, which you touched on, the maximum cost to the Department of this failure. We know it already cost the Post Office some hundreds of millions and £180 million to Pathway and several, it could be £170 up to £270 million, to the Department. What is savable from this new system?
(*Ms Lomax*) It is not £270 million, I said £127 million maximum. What is savable is the bulk of the CAPS system, which is a major redevelopment of our underlying customer accounting and payment computer systems. It is a very important basis for improving customer service, for improving our accounting and for protecting my position as accounting officer and really putting us on a much better footing for ACT. The CAPS work has been a major step forward for the Department. Also, the other thing that is savable to the Department or, you know, a major improvement is the fact that the Post Office is now automated and we have been able to put in place the bar coding of order books, which enables us to save money there.

122. Convince me of one thing has PFI made much difference to this? It seems to me that under any system if you brought a private contractor in to use solely the taxpayers' money and then after some months, or it could possibly be years, you are negotiating with them and handed them a manual and said, "We would like to change that, but we need Parliament's permission and we do not have time". That has nothing to do with PFI, does it?
(*Ms Lomax*) The point about PFI is that it puts the onus on the contractor to work out the "how". What you contract for is the "what". What service do you want. The contractor can try different ways of working out how to do it and, you know, it just enables him to figure it out in an immensely complicated system like the benefits system. You know it is not surprising it turned out to be enormously complicated without very close working with the Department.
(*Mr McCorkell*) The fundamental thing about PFI is not what PFI should be, it is how PFI was perceived when this contract was let, where it was perceived you have a very high level of requirement and you allow the contractor to go and develop it. We now know, and we have learned the lesson, as others have

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learned the lessons, that particularly with IT projects, what does not work and cannot work, which is why there is a whole range of guidance now that advises you not to do that, which is why we no longer do it. We still let PFI IT contracts, but we start with the contractor working with us on the business requirement, that leads through to a technical design study, which provides a detailed design for the system and a detailed development plan, at which point you can let that PFI contract.

123. There was obviously a project team involved in this. They had, presumably, flowcharts and a myriad of items that had to be ticked and incorporated. One of them was not checking which legislation had to be changed. That is a problem. Why did nobody in this project team sit and say, "Look, if new technology gives us a new way of detecting fraud, countering fraud that we spend a lot of time chasing paper tails on that they should get on with that and in the meantime should be briefing the minister and preparing for legislation to go through Parliament". As far as I can see, no bid was put in to change legislation.
(*Mr McCorkell*) Precisely the process you are describing was carried out, but it was carried out after the contract was signed and after we were committed to a fixed price and a fixed timetable for delivery. At present we would be working with the supplier in defining the business requirements and doing the technical design study before we got to a fixed price PFI timetable. The process was carried out, but it was after we were already committed to a fixed price.
(*Ms Lomax*) ICL hoped that it would be possible to make more changes when it came to the point than the Department was willing or able to make. When that turned out to be the case you were then forced to develop a more complicated system than you would need to do. It was that sort of circle, that is why a bit more pre contract work would have driven out the complexity that was involved in trying to do this within the constraints of the existing benefit system.

124. With all due respect, all that seems to have happened here is a catalogue of previous errors in ordering new technology was transferred to this one, with an added problem of PFI and transfer risk, or not a problem, as the case may be. There was failure to analyse the scale of the task that underestimated them. In 1994 we are well into the computer age, that is a time when many people in their homes have computers and that every Department and every business of just about any size is computerised. We are repeating errors in 1994, 1995 and 1996 by not getting to grips with the specification of what can and cannot be done and the need for Parliament to change legislation. That is at the root of this problem, is it not?
(*Ms Lomax*) I do not think it is. I think that this was one of the first ever PFI contracts for a large IT software development, anywhere in the world. I think it involved a different method of working, between the Department and the contractor, from anything that either of them had been used to doing in the past. With IT and software development projects you need collaborative work, particularly in an area as complicated and as sensitive as the benefit system. The way in which PFI was being interpreted at that time got in the way of that necessary collaboration, with the consequences we see.

125. I am a former welfare rights officer and I know how complicated it is and I know that the manuals do exist so that people like me can understand it, and claimants as well. I have a final question, were the new ministers in 1997 given

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a categorical assurance by your Department they could get this back on track?
(*Ms Lomax*) Were they given a categorical assurance?

126. That could get this project back on track?
(*Ms Lomax*) I have drawn attention—

127. I really wanted a yes or no answer to that.
(*Ms Lomax*) I do not think I can give you that.

128. In 1997 when new ministers came in and were briefed on this were they given a categorical assurance by your predecessors that this project, if it was off track could be got back on track?
(*Ms Lomax*) Chairman, you would not expect me to answer something which reflects advice given to ministers in a previous government.

Mr Campbell

129. Mr Roberts, can I ask you to clear up something which confused me. If we had not gone down the route of Benefit Payments Cards and we wanted to get to the point of automating Post Office Counters, how much would that have cost to get us to where we are today?
(*Mr Roberts*) It would probably cost, without the Benefit Card, roughly what it will cost now, which is roughly £1 million[7], because what we have is just that kind of system which we have now implemented and will finish implementing in the next three months.

130. Okay. The half billion, or so, which has been quoted earlier is racked up in that £1 billion, is it?
(*Mr Roberts*) Yes, it is.

131. It is not an additional amount of money on top of that. When we talk about the cost of the failure of the Benefit Payment Card, Ms Lomax, surely we should build into the equation the difference between the anti-fraud measures, which are now possible—one should not underestimate the £68 million saved in bar coding order books—how does that stack up with the savings that the Benefit Payment Card would have introduced?
(*Ms Lomax*) We were hoping that the Benefit Payment Card would virtually eliminate instruments of payment fraud, which at the time the business case estimated was something like £150 or £160 million a year. We think we now have the instrument of payment fraud down to something like £100 million through the order book bar coding and we hope to improve that over the next few years.

132. While there may have been some benefit in terms of infrastructure investment from the whole project we have not arrived at the destination that we would have hoped to have arrived at?
(*Ms Lomax*) We have not eliminated all instrument payment fraud, but we have computer systems within the DSS which are a value in their own right in terms of improving our accounting and our customer service and will provide a very good basis for the move to ACT, which is, of course, a very much cheaper means of payment for the DSS than the Benefit Payment Card would ever have been.

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133. ACT was not the chosen route announced in October 1995. Was Peter Lilley still the Secretary of State then?
(*Ms Lomax*) Yes.

134. Given, as you described earlier, the complexity of this project and given the fact there was £1 billion of investment here, and given the fact that this is a political mine field, to change the benefit system, not only does one raise the expectations of taxpayers, in terms of bearing down on fraud, but one also raises the potential questions of recipients of benefits as well. Was it wise, with the benefit of hindsight, to announce just three months short of 1996, that the Benefit Card would be introduced in 1996? Was it a little premature?
(*Ms Lomax*) Ministers often announce things which have not happened.

135. To announce in October of one year that something would be introduced in 1996, and five years later not only are we waiting for it, but it has not been announced, is that not over-ambitious, over-optimistic? I am searching for the right word here.
(*Ms Lomax*) It turned out that timetable was very over-optimistic.

136. What effect would that timetable have? Presumably clocks were set ticking here. We have heard a great deal about the nature of early PFIs and the Committee is not unfamiliar with those concerns, it does seem to me, from answers which were given earlier, that the Post Office and the Department had a view about early PFIs, which was about transferring risk to the supplier, about specifying what you want and how you want it and it is up the supplier to deliver on that. Yet, if I heard Mr Oppenheim correctly earlier, he said, "They did not really understand the complexities of what they were being asked to do". That is not just in the nature of PFI, is it, it is in some decisions that were made by people at the time?
(*Ms Lomax*) The point we are making about PFI, is that this was government policy at the time, this was the way the government wanted to conduct an investment at the time, and not something that was just sort of invented around this project. The point about the PFI is that it matters more within the context of a fixed price, fixed timetable contract if you have not thrashed these things out before you start. I think that the PFI context is absolutely pitiless if you rush into things, but it also gives people a tremendous incentive to race ahead. ICL was very anxious to move ahead to contract as well. All of the people who were bidding for this contract were spending money without remuneration. The private sector supplier does not get any money until the service is delivered. It was an enormous up-front commitment for them. They too want to move ahead as fast as they can. It was not a question of them asking for more detail and being frustrated by the Department. There was tremendous time pressure both on the Department and on ICL to move this thing along as fast as possible, ICL for commercial reasons and the Department because they wanted the fraud savings, and the Post Office because they wanted automation. Everyone was under a lot of time pressure.

137. Presumably at the end of the day somebody has to decide, somebody did decide, to call a halt to this when it became obvious it was not going to deliver what they hoped to deliver. Let me ask you a question about that, paragraph 1.11, the "Initial Go-Live" in October 1996 dealt with, as I understand it, only Child Benefit, it dealt with a limited volume of transactions and it also came up

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against difficulties about the collection of benefits only by nominated individuals. For anyone who knows much about general benefits, there are all sorts of other issues, it is also quite common for people to collect benefits on behalf of other people. Why did the Initial Go-Live take place and what purpose did it serve?

(*Mr Oppenheim*) I think it served as a marker. It was possible to put service into place very quickly, to give an impetus to delivery. Following the thrust of your question, it actually was a distraction from defining the eventual service and it probably put back the eventual service, to some extent. It was treated as an off line special project and ring-fenced so as not to do that to the maximum, but it was an additional delivery that needed attention.

138. Was it true that this was a distraction and it really had not served a useful purpose? Was that a decision which was reached quite quickly or a view which was taken quite quickly?

(*Mr Oppenheim*) It is a personal view I am expressing here, based on the amount of work of delivering something which did not lead anywhere because it was a special piece of software, it was an intercept of the eventual solution. The interim solution, 1C, which was released in 205 post offices doing, admittedly, just Child Benefit was dealing with foreign encashments and did deal with proxies, and so on. It did have those features. It did have the EVP security system, but it was hard wired as opposed to being flexible. It had all of the headline features, barring one or two support and security features that the DSS considered to be very important for the higher risk benefits, such as income support. That is why the DSS decided not to put income support through the system. Our system did not mind which benefit it was, it made no distinction whether it was Child Benefit or Income Support, because it all came from CAPS. It was part of the decision not to release any other benefits on us, but that is just a technical point.

139. We heard earlier, Ms Lomax used the phrase, "A proper review in September 1997", and then the decision by the new government not to go ahead with the Benefit Payment Card. There was an earlier opportunity, was there not, in February 1997, which was the replan. What is the difference between a review and a replan?

(*Mr Oppenheim*) The replan was something that we did between the three parties to break up this very large, single block of deliverables into three or four discrete elements of delivery. Progress was, indeed, made down that track and it also reset the timetable by mutual agreement. Progress was made down that track, but roundabout July further major problems were identified which caused a review. Those were essentially around, we would certainly argue, the agreements to agree territory of security and other very difficult areas. At that point we had largely the functionality, as perceived by the customer in place, but we did not have some of what we call the nonfunctional requirements.

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6 Note: See Evidence, Appendix 1, page 20 (PAC 2000-2001/158). Back

7 *Note by Witness:* The figure is, in fact, £1 billion, not £1 million. Back

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Examination of Witnesses (Questions 140 - 159)

MONDAY 26 FEBRUARY 2001

MS RACHEL LOMAX, MR GEORGE MCCORKELL, MR DEREK DAVIS, MR TONY OPPENHEIM AND MR JOHN ROBERTS CBE

140. Was the option to abandon the card considered in February 1997 as part of the replan?

(*Ms Lomax*) I do not think so.

(*Mr McCorkell*) No, I do not believe the option to abandon the card was considered at that stage. I believe we looked at our forward plans and realised we could not meet the date we were then contracted for. We went through a series of discussions and negotiations between the three parties and worked together on a new plan, which came up with a new date which we thought was still perfectly acceptable in terms of delivering the project and, therefore, the question of cancelling the project did not arise.

141. My final question, again, goes back to the issue about early PFIs and the difficulty with that. One thing which stood out in the report was out of the three bidders on eight out of 11 of the technical and management criteria, including security against fraud, Pathway was third, but was the cheapest bidder.

(*Ms Lomax*) It was the only one that was likely to be PFI compliant.

142. I suppose the question I am getting is, what weight is given to the fact that Pathway was the cheapest, yet bottom of the league, of three, on eight out of 11 counts?

(*Ms Lomax*) In terms of cost I do not think there was a great deal between Pathway and—

143. They were the cheapest?

(*Ms Lomax*) Just. There were two things which tipped the balance in Pathway's favour, one was that it was certainly PFI compliant, which the other two bids either clearly were not or were dubiously PFI compliant. At that time it made a big difference, because it was the difference between the project going ahead and not going ahead, it would not have gone ahead on a non-PFI basis. The second reason why the Pathway bid was successful was because people liked the distributed architecture they were proposing, which was thought to be quite resilient. It was based on a system which was in operation in Southern Ireland, whereas the other two proposals did not have that advantage.

144. Given the way which PFI has changed since then would Pathway get the contract now?

(*Ms Lomax*) That would be asking me to speculate, I have no idea.

Chairman: Thank you.

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Mr Davidson

145. I wonder if I can start off by asking a couple of points to Mr Roberts. I have been slightly confused by the way you have responded to some of the questions, I am not clear whether or not you believe this whole project has been a success?

(*Mr Roberts*) It has been a success in my terms, in the sense that we have got a product which is working extremely well, we have managed to automate, which was obviously one of our aims, the whole network of post offices, we will have done by the due date, which is June of this year at the latest, we will probably complete it by March/April rather than June. In a very limited sense we have an automation project, we have moved, as many other countries have done, the network of post offices, which is probably bigger than most other countries, into one which is now fully automated and on which we can build the kind of technological future that the performance innovation in the report wanted us to do. In that limited sense I think there is some success that we can look at from this project.

146. Some success. You are happy with where you have got to. You would not have come this way or paid this money if you had your time again?

(*Mr Roberts*) That has to be clear. The NAO report makes that very clear. I would not. We did not get to where we intended to be when we started. We have not got a Benefit Payment Card. We are now going to move towards ACT and a Universal Bank, in the way we have been discussing. We have not got to where we thought we would be.

147. I am not clear about how much you have lost. How much money that has been spent on this by the Post Office has been wasted? You seem to be suggesting that you have spent lots of money, you got stuff, equipment, and so on, you are happy to have. Some of that must be investment and some of that must be waste.

(*Mr Roberts*) If we go back to the original project, most of the costs that we were bearing at the time were people costs, the people on the Project Development Board and the internal staff, who were working on the system. Most of the heavy costs, the capital costs, the investment costs, the development costs was being borne by Pathway who, under the original contract, would have then got that money back over a number of years on a per transaction basis as we then used the equipment. That is the big difference. I reckon by the time the project was changed by ministers to the different process we have probably spent internally, on internal software developments, because we had to link this with other things internally, something around £40 million was our costs. We then spent, as we discussed earlier, the extra money to buy the equipment and to have the network automated. 40 million was sunk on the original project and we have now been involved in the £1 billion costs.

148. In terms of what could be generally considered by any normal person as being waste your waste is only 40 million.

(*Mr Roberts*) Yes, in that sense.

149. I am slightly confused, then, about the accounts with the exceptional charge of £517 million[8] here, it is described as requiring an asset which does not at this stage yield sufficient income to justify the cost. I once had a car like that. Why, in that case, in your accounts was it not presented that the £40

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million was a disaster and the rest of it was investment which had been done earlier than was previously considered?

(*Mr Roberts)* That was the advice we had from the accountants under the accounting standards, that the £571 million that we wrote off in those accounts was the money what was then going to Pathway for the development project. My understanding of the impairment rules, FRS11 accounting standards, is that because at that stage we were not able to say precisely where the revenue would come from to cover that asset, therefore, we had to write it down in the accounts in those terms. I gather that that was precisely in line with the accounting standards.

150. You can understand why normal people would not understand it.
(*Mr Roberts*) I am not an accountant, so I agree with you.

151. I wonder if I can turn to page 72, paragraph 3.56. This is about your relationship with the Department at a much later stage in this process, particularly the last sentence, which is quite an interesting one, "The Department actively sought, but did not obtain, an open, shared risk management process from the Post Office Horizon team, who maintained direct reporting arrangements between themselves and Pathway." That is not joined-up government, is it? It seems to me that since you are coconspirators in this there is something not quite right about all of this. Can you explain why you took this view?
(*Mr Roberts*) We have been talking this afternoon about the problems of joint control, after the PA Review in 1997 one of the things that we certainly at our end wanted not to repeat was some of the problems that did emerge from joint control that Rachel Lomax and I have been describing. Our view was that in terms of actually handling the Pathway contract, because the PA Review suggested that the Post Office should now do this on its own, the thing we should have was a very clear link between us and Pathway, as you would in a normal contract, with us managing the risks and with us managing the responsibility. Below the level of the top group there was almost daily contact between ourselves and the Department talking about what was going on and talking about risk. The project manager who was running this for us was then attending the CAPS board to report on a monthly basis what was going on. It was very clearly trying to separate this out, having learned, I hope, some of the lessons of the earlier part of the project, into something which was very clear between us and Pathway, but with us then keeping the Department involved.

152. Are you saying that I have picked up the wrong impression from this, or that this is misleadingly representing the position? I am quite clear what I take out of this, if this was such a wonderful arrangement, as you have described, which sounds fine to me, why were they not happy?
(*Mr Roberts*) I was not aware until I read this they were not happy. Certainly the intention was, it worked relatively well compared with what had gone before, that we were sharing quite openly.

153. I understand that. There is an issue here, I would have thought that normal procedure would be for you to see this before it is published and for you to agree it. Normally the people that are coming in front of us, as I understand it, have seen what is here and have agreed it, so we do not have disputations

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about fact. You are, in fact, saying this is misleading.
(*Mr Roberts*) I do not know where the comment came from. From my point of view it worked well and I was not aware at the time that there was concern.

154. I accept that from your point of view it worked well. The issue here is that from the Department's point of view it did not work well, they were not able to access information.
(*Mr McCorkell*) Perhaps I can help at this stage, Mr Roberts is absolutely right, the Horizon people reported to the CAPS Project Board on a monthly basis. In the Department we had an opportunity to monitor their performance on what they had to deliver to meet our interface. They came regularly, every month, and I think Pathway attended most times with them. That reporting progress worked very well. I think what this is referring to is the formalisation of the process of sharing risk registrars, which we did not do well enough with Pathway. What we are saying is we did not do well enough when we changed these arrangements. It was not a formalised process for sharing them. It is quite true to say that at a working level we meet with the Horizon Team on a very regular basis and then directly, at this stage of the process, with the ICL Pathway team.

155. I am not sure there is a great deal to be gained by going further into this. Can I clarify from the Post Office, you will soon be able to dispense cash for the benefit recipients, you will be able to participate in the Universal Bank, we will not be meeting in ten years from now trying to unpick all of that, will we? All of the lessons of this backlog have all been learned and there will now be no problems.
(*Mr Roberts*) I hope they will be learned.

156. I understand that, that is not quite what I am looking for.
(*Mr Roberts*) I cannot give you that assurance at the moment, because an awful lot of work is still going on to develop the Universal Bank, once we are clear as to what that will mean then, maybe, I will be in a better position to give you assurances. Certainly the intention is that anyone what wants to receive cash in the Post Office will still be able to do that, but the precise methods are still very much the centre of a lot of work between us and other government departments.

157. Ms Lomax, how much did your Department lose out of this—I am not clear how much has been wasted—from your point of view?
(*Ms Lomax*) I have given you an upper limit of £127 million, that will turn out to be an upper limit. Until we have done the technical design work for ACT I cannot tell you how much of that £127 million will be used.

158. £127 million wasted, how much do you reckon the savings foregone were?
(*Ms Lomax*) We are catching up with ourselves. The total amount of savings foregone as a result of slippage must be a few hundred million.

159. A few!
(*Ms Lomax*) I have not done the calculations precisely. The maximum we estimated we could have saved is a number like £150 million[9]. Each year we

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save some money as a result of measures we are putting in place at the moment. It requires a complicated sum. I acknowledge we have not made the savings on the scale that we hoped to. If the Benefit Payment Card had rolled out at the end of 1999—

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8 *Note by Witness:* The figure is, in fact, £571 million, not £517 million. Back

9 *Note by Witness:* Sentence should be amended to read as follows: "At the start, the maximum we estimated we could have saved from fraud is a number like £190 million (not £150 million) a year. Back

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Examination of Witnesses (Questions 160 - 176)

MONDAY 26 FEBRUARY 2001

MS RACHEL LOMAX, MR GEORGE MCCORKELL, MR DEREK DAVIS,
MR TONY OPPENHEIM AND MR JOHN ROBERTS CBE

160. Can I be clear about this, we have made some of them, but there are some that have gone forever. There are some here that you would expect to make in the first year, they are all gone; then in the second year they are all gone as well. There is a process, presumably, of catching up.
(*Ms Lomax*) This is estimates on estimates. We may do better by moving to ACT earlier as well, I do not know.
(*Mr McCorkell*) I think the significant saving, the only real saving was the reduction on instrument payment fraud, which was a saving in the card programme. Because we did not roll out cards to the original timetable we have not been making those savings. Having, instead, rolled out OBCS to the current Post Office automation we are now starting to make those savings.

161. What surprises me, having listened to both of you, is how much or how minimal the loss has been and why this enormously expensive project was being entered into. My feeling is that this has been a disaster. Why did you proceed with it, there must have been other things we would have to spend so much time and money on?
(*Ms Lomax*) I think it is wrong to think of this as an unmitigated disaster, it is not. What this was, was three bits of a vast project, three separate chunks you can identify, one was about automating the Post Office, that has gone ahead, perhaps two years later and financed in a different way from what was originally envisaged, then there is something about completely restructuring the DSS customer accounts and payment systems, which we needed to do anyhow, for a number of reasons, not least improving our internal accounting and providing a platform for the modernisation of our benefit systems. We are putting modern IT down the track. That has gone ahead. Most of that was at value, we put it in place, it went there a little bit later than we hoped, but by and large we have got that. The bit that has failed is the bit that connected up the CAPS programme with the—

162. The point of it.
(*Ms Lomax*) It was not the only point of it.

163. The main point of it is the bit that has not worked. The rest of it has not been a complete and utter disaster.
(*Ms Lomax*) I am not certain that is true. There were three big things we wanted to get out of this. The Post Office automation was always a large part of this. The business case for the Post Office automation would not have stacked up without the DSS involvement. It was about making sure that long-standing relationship continued.

164. I think I understand what you say, but I do not accept it. I wonder if I can turn to Mr Oppenheim and ask about the figure we have bandied about for

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the loses by yourselves. Can you clarify for me whether or not you have factored in the loss of reputation, and so on and so forth? If this was a normal commercial operation, how much have you lost out on all of this?
(*Mr Oppenheim*) There is nothing factored in for loss of reputation.

165. Do you think your reputation has suffered loss?
(*Mr Oppenheim*) It certainly did. I think we have managed to pull a little bit of it back. I appreciate the favourable comments today about the success of the Post Office roll-out and, indeed, OBCS, which was a piece of innovation that we put on the table as part of the original PFI. There are things to take some satisfaction from. It has been a very bruising experience for us, that is for sure. There was a time when ICL's name was mud as a result of this. £180 million was certainly a massive hit, as was observed earlier.

166. Can I finish on this point. The books of rules, which have turned out not to be books at all, but a combination of rules, which if they were gathered together would be a book, had you been given authority to streamline the whole lot? Could a lot of these difficulties been overcome? Ought your remit to have been wider to achieve the same objectives?
(*Mr Oppenheim*) I really do hesitate to answer this. All I can say is that we could see a way through this, otherwise we would not have taken it on in the first place. It would have required more compromise and more understanding, perhaps, than was available at that time and under the processes at that time. Technically we would have to live with this and we were on our way to delivering it, but it would have certainly taken more time.

Mr Leigh

167. I apologise for being delayed. I seem to remember when I was in the DTI that this debate was going on then, ten years ago, and the problem was that the DTI was mainly concerned about preserving the Post Office network, and the DSS was concerned about saving money. We have resolved our differences of approach nowadays, have we?
(*Ms Lomax*) I hope so.

168. Thank you. If you have answered this question already let me know, there was meant to be a live trial system within ten months of signing the contract. Nearly 36 months later there has only been a trial in ten post offices in Gloucester, and the contract was then terminated. It was almost two years after the deadline for the live trial to begin that it was decided that the Benefit Payment Card would be scrapped in May 1999. Why was there such a delay about making a decision about the future of the project?
(*Ms Lomax*) It took time for the scale of difficulties to become apparent. There was a major "no fault" replan in February 1997, people completely rescheduled this project. Then by July it was clear that there was slippage on the replan. Then there was the PA Review, which suggested there was some serious issue. Roundabout December of that year, I think, ICL came back and said that essentially there had to be a major renegotiation of the contract terms, this was going to cost 30 per cent more or it would take five years longer and cost five per cent more. We were immediately into major interdepartmental discussions about the way forward. It would either involve more money, or whatever, so the Treasury comes in at that stage. We then have, I have to say, various reshuffles going on in the background at various points. Some of the key political

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personalities changed, which delays things a bit. We had a change in chief secretaries along the way, the DTI Secretary of State, the Social Security Secretary of State. Not surprisingly when we get to a major interdepartmental issue like this, there is an interdepartmental group set up. Adrian Montague, Head of the Treasury Task Force, is brought in to give advice on whether this project is deliverable at all, and, if so, on what sort of time scale. Then roundabout mid-1998, after a lot of work looking into it, he says, "Yes, it is probably deliverable, but not on this time scale". There is a long period where people are trying to renegotiate the terms. Correct me if I am wrong, Mr Graham Corbett was brought in to try and broker a new deal, without, ultimately, success. The answer I gave to the Chairman when he essentially put the same point to me was, "What took you so long?" That these were very big issues, involving lots of different interests around the Government and big things about the future of the Post Office, which you will remember were intensely, politically sensitive. Also, the commercial future of ICL at various points. It took a long time. We went through many elaborate reviews in an attempt to get the right answer. Given the scale of the project and the issues at stake that was defensible.

169. Fair enough. It seems to be wise after the event, does it not?
(*Ms Lomax*) Indeed.

170. What lessons has the Department learned from the report of the Cabinet Office? Is there now a single, responsible owner of the above project? To what extent has the Department sought to ensure that the projected costs and time scale decided upon by the suppliers are realistic and achievable?
(*Ms Lomax*) I hope we have learned a lot, from our own experience, which we have fed into the Cabinet Office Review and the reviews we have done internally where we have fallen down. I think we accept all of the Cabinet Office recommendations and we are attempting to implement them. None of this is easy. Someone was saying earlier, can you give me an assurance that there will never be any mistakes again, but I could give you an assurance that we have done our best to learn the lessons of our past mistakes.

171. With PFI projects there is a pressure to accept bids from a company who are willing to contribute the necessary funding. How great an influence is that on choosing whether to accept an offer from a company? Surely this could lead to prioritising the costs over quality when deciding on targets for PFI projects? What is being done to ensure that long-term value is assessed rather than short-term costs and expedience?
(*Ms Lomax*) I think we learned the hard way, that cheap never is on big projects like this. What is being done is a serious attempt to assess the quality of the bid against a wide range of value-for-money criteria, the competence of the bidders. We have to look for value for money and not cheapness on these things. The review process which the Cabinet Office have put in place is a serious discipline on us.

172. You think you have overcome this pressure to accept bids from companies that are willing to contribute the necessary funding and it is not going to unduly influence your decision-making in the future?
(*Ms Lomax*) I did not say that. It is always tempting to save money if you are

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short of money, it is always tempting. That is why I say the external review process is quite helpful in keeping you honest.

Chairman

173. I have a couple of round up questions arising from matters that came up during the course of the Committee. Mrs Lomax, Mr Griffiths asked you at one point about whether new ministers in 1997 were told about the project being on track. You diverted your answer by saying you were not allowed to divulge advice given to former governments, he was asking about the current government.

(*Ms Lomax*) It does not make any difference. I did mis-speak there, that is quite right, however ought I to be giving you insights into advice given to ministers?

174. This goes directly to the operation of this project, were ministers made aware of the status of this?

(*Ms Lomax*) Ministers were certainly made aware of the status of this project and by July 1997 clearly made aware of where things were going. At that stage we were instituting the PA Consulting Review, they would certainly have been told about that. The question you asked, "Were they given an assurance this project would work?" I do not know what was said in 1997.

(*Mr McCorkell*) Certainly when they were advised in the middle of 1997 that we were experiencing further difficulty, they were not advised that the project would work, they were advised we were experiencing further difficulty and that the timetable was going back. They supported us in arranging the external review by PA at that time.

(*Ms Lomax*) I think one would never have given the Permanent Secretary one hundred per cent assurance that something will work. You would say there are some problems, I do not think I would ever say this is bound to work. That is just rash.

175. You are breaching the spirit of Sir Humphrey Appleby. Can I ask you a further question, in response to Mr Rendel you said that you did not know how many people, how many benefit recipients would not have bank accounts after the Universal Bank was set up. Given that, how on earth can you know what magnitude or capacity systems you require to deal with these people, given these will be some of your difficult customers, the illiterate, the disabled, the mentally problematic and so on? How are you going to make plans without that knowledge?

(*Ms Lomax*) I could have been more helpful than what I said to you. In terms of orders of magnitude we are thinking about thousands on the basis of the research we have done already. We are looking at people who received early payments, people with genuine emergencies, bankrupts, that is the sort of category of people we have in mind for whom bank accounts are not suitable. I cannot forecast the numbers, because we are talking three years down the track. We will be looking into it and doing more work. We will be thinking about ways in which they can be paid. This is something that might go out to tender, it would be perfectly possible. It may be able to access special payments at the Post Office. There are a number of possibilities. We have not got to the stage to say this is what we are going to do.

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176. It would be helpful if we had a note on that in terms of what is your best estimate and what research you are going to do[10]. This may relate to people who choose not to have bank accounts as well, which may be larger than thousands.

(*Ms Lomax*) There is going to have to be a big marketing effort here.

Chairman: We would be grateful for a note on that. It remains for me to thank you for coming. It is one of those difficult hearings, nevertheless a constructive one. Our particular thanks to Mr Oppenheim for the clearest piece of evidence we have had this year. Thank you.

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10 Note: See Evidence, Appendix 1, page 20 (PAC 200-2001/158). Back

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APPENDIX 1

Memorandum submitted by the Department of Social Security (PAC 00-01/158)

Q.120. Simplification of the benefit rules and Benefit Payment Card processes

Legislative constraints, customer service requirements and the need to minimise the risk of fraud meant that it was not possible to introduce the amount of simplification that ICL Pathway would have wished in certain areas. The Department did, however, where they could, try to find ways in which existing payment processes could be simplified. As a result, some significant changes were made (or planned) including:

— **A single nominated Post Office for each customer:** the Benefit Payment Card arrangements required customers to have a single nominated Post Office at which to collect all the benefits to which they were entitled. Previously, customers could nominate different Post Offices for each benefit to which they were entitled. Since the ICL Pathway solution relied heavily on being able to predict accurately where the vast majority of encashments were to take place, this was a significant simplification.

— **Agency arrangements:** Regulations introduced in April 1996 simplified the Agent arrangements for the Benefit Payment Card. Where a customer appointed an Agent to collect a benefit, that person became the Agent for all other bendfits received by that customer. Previously, it had been possible to appoint a different Agent to collect each of the benefits to which the customer was entitled.

— **Plans to change the arrangements for Signing Agents:** the Signing Agent facility is employed when the person appointed to collect benefit for a customer is effectively a "post" or "body" rather than an individual, eg, Local Authority Finance Director. ICL Pathway security procedures relied heavily on knowledge of personal details of the person making the encashment. It was recognised that the Signing Agent facility would make it very difficult for ICL to develop a solution. To simplify matters, the Department agreed to develop a simpler arrangement that could be readily incorporated within the Pathway solution.

Q.176. Numbers of people who will not have accounts when Universal Banking Services are in place

Over 80 per cent of benefit recipients already have a bank or buiding society account, which is suitable to receive benefit payment by Automated Credit Transfer (ACT).

One of the key objectives for the Government's plans to make all benefit payments via ACT into bank accounts, starting in 2003, is to encourage more of the 3.5 million people who currently do not have bank accounts—and the linked access to mainstream financial services—to open an account.

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Over the past 18 months, the Post Office have been working with the banks to secure arrangements which mean that everyone could have access to a bank account. The new universal banking services package which the Post Office are developing will provide access to newly designed basic bank accounts (sometimes referred to as PAT 14 accounts) and simple post office based accounts. Universal banking services are being designed to cater for the overwhelming majority of those benefit recipients who do not currently have access to an account suitable for payment by ACT.

At the same time, this Department has commissioned research and undertaken a programme of discussions with informed groups to establish what barriers there might be to universal access to accounts. This programme of work has included:

— discussions with experts in the financial services industry (eg, the Financial Services Authority and Building Societies Association), those with an interest in financial exclusion (eg, the social exclusion group at the British Bankers Association);
— detailed research by Elaine Kempson at the University of Bristol[11], buiding on research she has already undertaken for the BBA and which was made available to the Social Exclusions Unit's PAT 14 group, which reported on financial exclusion[12]; this research shows clearly that while there are certain vulnerable people who may need particular help in using a new account-based payment system, there are no clearly identifiable groups of people in the UK who could not be paid by ACT eg, because of disability, religious or other conscientious objections.

Under current plans for access to bank accounts, it would be possible in theory for everyone to be paid via ACT into a personal account. This is the situation already in countries such as Australia and Holland.

We have thought it prudent, however, to plan on the assumption that there will be some exceptions to payment by ACT. In particular, there will be a small number of individuals who are simply unable to operate a bank account, or who for other reasons making payments via ACT may not be suitable, eg, some drug addicts, people with learning difficulties, people with mental illness who have just come out of hospital. First, to ensure a suitable payment mechanism is in place, DSS intends to tender for a service provider to make payment to these individuals. Second, to develop with other service providers an effective way of delivering such payments, which might involve Post Office, Social Services Departments and other Agencies.

Although it is difficult to predict exact numbers at this stage, against the background of our policy objectives and current plans for Universal Banking Services, we are assuming thousands rather than millions for planning purposes.

There is a separate issue about the provision of urgent, payments, such as payment of Social Fund crisis loans. Together these amount to around one million payments per year. We are in discussion with the banking industry about possible arrangements they may be able to provide.

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Department of Social Security

13 March 2001

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11 Director of the Personal Finance Research Centre at the University of Bristol. Back

12 "Access to Financial Services" report of Policy Action Team 14 November 1999. Back

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APPENDIX 2

CANCELLATION OF THE BENEFIT PAYMENT CARD (PAC/00-01/105)
Supplementary memorandum by the Deputy of Social Security

SIMPLIFICATION OF THE BENEFIT RULES AND BENEFIT PAYMENT CARD PROCESSES. QUESTION NUMBER 120 (PAGE 38)

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NUMBERS OF PEOPLE WHO WILL NOT HAVE ACCOUNTS WHEN UNIVERSAL BANKING SERVICES ARE IN PLACE QUESTION NUMBER 176 (PAGE 59)

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1 Director of the Personal Finance Research Centre at the University of Bristol. Back

2 "Access to Financial Services" report of Policy Action Team 14 November 1999. Back