

RESTRICTED-POLICY AND COMMERCIAL

TO:

SIR MICHAEL SCHOLAR

cc PS/Mr Byers
PS/Mr Johnson
Mr Davis Hd/CGBPS
Mr Fraser IBB
Mrs Britton PORT
Mr Hosker FRM
Mr Hopkins CII
Mr Fincham FRM
Mr Francis CII
Mr Whitehead CGBPS
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Mr Smith SOLS
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FROM:

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14 July 2000

**DRAFT NAO REPORT ON CANCELLATION OF THE BENEFITS
PAYMENT CARD (BPC) PROJECT**

Issue

1. Sir John Bourn, Comptroller and Auditor General, has invited your comments on the final draft report of the National Audit Office on the cancellation of the Benefit Payment Card project.

Recommendation

2. That you should reply along the lines of the attached draft.

Timing

3. In his letter to you (at Annex A), Sir John asked for comments by 14 July, but this deadline has effectively been extended to 18 July to allow DSS more time to resolve their concerns (see below).

Background: the project

4. Contracts for the Horizon project were signed in May 1996. The contracting parties were DSS/BA and Post Office Counters Ltd (POCL) as joint purchasers, and

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ICL Pathway as supplier. The project was established as a major (£1 billion) public sector PFI. Its purpose was two-fold:

- to provide POCL and the network of post office counters with a modern, on-line IT platform needed to retain existing Government and private sector clients and attract new business opportunities, and to modernise POCL's internal processes; and
- using the Horizon platform, to replace the existing fraud-prone and paper-based methods of paying social security benefits at post offices by a magnetic strip plastic card, the Benefit Payment Card (BPC).

5. The project ran into difficulties from the outset, with escalating slippages and cost overruns. In late 1997 Ministers set up an inter-Departmental Review, led by HMT and including DTI, DSS and the Cabinet Office (primarily CITU), which in turn drew on the services of a panel of independent senior technical experts, an external facilitator (Graham Corbett) for the commercial renegotiations, and KPMG to assist with the evaluation of options. By the culmination of this work the project had slipped still further, with an estimated completion date some 3 years behind schedule. Ministers had by then lost confidence in the deliverability of the project in its existing form even within the extended timescale, and in May 1999 they announced a major restructuring of the contract. Under it the BPC was cancelled, and DSS/BA removed from the contractual loop. Instead, DSS/BA were granted their long-held wish to pay all social security benefits direct into recipients' bank accounts by automated credit transfer (ACT), but with migration to ACT not to start until 2003. That part of the project designed to equip all post offices with the Horizon infrastructure continued, but on the basis of a re-worked conventional procurement/service contract between POCL and ICL. This was subsequently put in place, and rollout of the system to some 36,000 counter positions at 18,000 post offices nationwide is currently on target for completion by late April/early May next year.

The enquiry

6. The NAO enquiry is technically into events culminating in the decision to cancel the BPC, but inevitably spills over into the Horizon project in its entirety. The study was initiated two years ago, but NAO largely suspended work on it until after Ministers' decision in May 1999 to cancel the BPC element of the project. They are now under pressure to publish before the summer recess, not least to meet the concerns of ICL about the impact of publication of the report on their planned flotation in November, as expressed in their recent letter to the Secretary of State (Annex B).. NAO's judgement is that if there is to be a PAC hearing – surely almost inevitable – it is likely to be December/January, ie after the ICL flotation has been completed.

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7. Neither DTI nor HMT had any significant involvement in the project (as opposed to the policy decisions which led to it) until the establishment of the inter-Departmental Review in late 1997. That part of the report which relates to the letting of the contract and the early problems with the project has therefore largely been left to DSS/BA and ICL to fight over. NAO had limited access to ICL under the terms of the contract, but ICL have chosen to cooperate voluntarily well beyond this. The third contracting party, POCL, have maintained a strict policy of no formal cooperation with NAO (as the Post Office have also done with the parallel NAO enquiry into the acquisition of German Parcel). We have however consulted POCL extensively and where appropriate have fed comments to NAO direct. We have also maintained contact with ICL throughout.

The report

8. The main conclusions of the report are perhaps best seen at paragraph 29 of the extract from the Executive Summary appended to this note. The tendering process and evaluation of the bids, and the early stages of the project are a sorry mess for which all parties take a share of the blame. The three-cornered contractual relationship is an object lesson in how not to take forward a project of this kind. The endless wrangle between DSS/BA and ICL on whether ICL was deliberately set up as the fall-guy to take the blame for project delays to disguise BA's failure to have the CAPS feeder systems ready in time is not definitively resolved.

9. The study focused on two key areas:

- The reasons why the BPC project failed to meet its objectives; and
- Whether there are useful lessons that should be learned from (for?) other projects particularly in terms of the approach taken towards management of risk.

10. The report is presented in four sections:

Executive Summary: incorporating a conclusion and section on lessons learned (pp.1-14).

Part 1: addresses the aims of the project, the severity of the slippage; the interdepartmental review of the project and decision to cancel the BPC element of the project; and the consequences of this for future benefit payment arrangements and for the post office network (pp.15-39).

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Part 2: focuses on the key risks to the DSS business interest in the project (ie delivering benefit payments) and how well these were managed (pp.40-48).

Part 3: examines the key risks of the project itself, covering the early arrangements for identifying risk and the procurement process; DSS' own CAPS programme; and how well risks were managed throughout the project history (pp.49-73).

Our objective

8. Given how badly wrong the project went almost from day one, the NAO report could hardly fail to make uncomfortable reading to a greater or lesser extent for each of the key players. Within this, however, our objective has been to secure a report which focuses in a positive way on the lessons to be learned from the project, and which without pulling punches at least avoids unnecessary criticism that could gratuitously damage the commercial prospects either of ICL (and through them our relations with their parent, Fujitsu) or of POCL. Beyond this, and within the same context, we have also sought to secure a report which wherever possible avoids reheating in full public view the three-cornered battles and bitterness that characterised much of the contractual relationships, and which could now damage the still-fragile but improving relationships between POCL and DSS/BA, and between POCL and ICL, both of which are essential if Ministers' ambitions for a smooth migration to payment of all benefits by ACT, and a new future for POCL, are to be realised.

9. Overall, and stressing again the constraints imposed by the reality of just how badly the project went off the rails, we believe that after 18 months of negotiation with NAO, working for the most part through DSS as the lead Department, we have achieved our objectives. Perhaps the best measure of this is that until the last minute changes made by the C&AG to the Executive Summary, ICL, DSS/BA, HMT, and (subject to the one proviso set out at paragraph X below, which we support) POCL, had all expressed themselves broadly content with the result.

DSS concerns

10. At a very late stage, and after Departments thought they had effectively reached an accord with the NAO team on the text of the report, the C&AG personally made a series of changes to the Executive Summary. These seriously upset DSS. They included a substantial shortening of the Summary (in itself no bad thing) and the addition of a number of paragraphs (29-31) drawing conclusions. Taken alone, this redraft risks leaving the reader with a strong impression that responsibility for the

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problems encountered by the project rests in very large measure with DSS/BA. This is both unfair and inconsistent with the main body of the report, which properly attributes blame more widely between the contracting parties.

11. We and HMT officials have supported DSS efforts to secure a more balanced presentation (see also Sir Andrew Turnbull's letter at Annex C) and urgent exchanges are continuing. But we have also made clear the need for rapid resolution to ensure that publication of the report is not delayed until the autumn. A revised text of the conclusions paragraphs that NAO officials have said they will suggest to Sir John Bourn is appended to this note, but is unlikely to be the last word. At Annex D is a draft of a letter which Rachel Lomax may send later this evening to Sir John, refusing to accept the report as drafted.

POCL's concern.

12. There is a suggestion at a number of points throughout the report (including for example at paragraph 17 of the Executive Summary) that POCL either had, or was perceived to have had, a lower financial incentive than did DSS/BA to move quickly from order books to the benefit payment card. Whilst this is self-evidently true on the narrow issue of the BPC itself, POCL had a very powerful incentive to want the earliest possible completion of the Horizon project as a whole in order both to retain existing Government and commercial clients and to exploit the commercial opportunities that without a modern on-line system were increasingly passing them by. Indeed, Ministers' final decision to continue with the project in a restructured form was very much predicated on POCL's need for such a system to be completed as quickly as possible. POCL's strong – and very well documented – preference was for the system with the BPC, rather than without it. This is an issue which DSS have previously raised with NAO on our behalf, but given POCL's strong feelings on the subject we have warned NAO officials that you may want to give it a further run with Sir John, and we are currently discussing with them possible compromise text.

13. A draft letter for you to send to Sir John Bourn is appended.

DAVID SIBBICK