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RESTRICTED - POLICY AND COMMERCIAL

Review of the Benefits Agency/Post Office Counters Automation Project

Note for Ministerial Meeting on 22 June

Introduction

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- This note provides a summary of progress on the review of the project; and background on the key issues.

- When you receive the Working Group Report at the end of June, you will need to take early decisions on the way forward[1];

- We suggest at this meeting you:

  1. note the background to the project and the consequences of cancellation (pages 3 to 9 below);

  2. note the Expert Panel's assessment on the viability of the project, timing and costs (executive summary attached);

  3. discuss key criteria for choosing between options (page 10);

  4. give any initial reactions to the emerging assessment of options (page 11);

  5. identify any areas and issues where you would like to see further work.

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[1] Apart from other considerations, ICL need an urgent response to their request for a variation in contract terms. There is a risk they may withdraw unilaterally and seek redress through the courts.

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Progress on the Review

- Harriet Harman sought urgent review of the project in March because it was running 2 years late, causing loss of projected savings of over £300m. ICL are in breach of the contract, having missed a key project milestone.

- Following a proposal from the Chief Secretary, a Working Group was set up with officials from HMT, DTI, DSS and Cabinet Office to look at:

  - whether the project is technically viable; and if so how quickly it can be completed and at what cost to Government;

  - the direct and indirect costs of cancellation and of any alternative means available to deliver the project's objectives.

- The Working Group set up an Expert Panel to provide a balanced and independent view of the technical viability of the project and its costs.

  - the Panel consists of Adrian Montague, head of the private finance taskforce (Chairman) with Alec Wylie and Bill Robins. PA Consultants were appointed to work with the Panel.

- The Panel is due to finalise its report on 22 June (subject to any extra work arising out of this meeting); a summary of its findings is attached to this paper.

- The Working Group is due to report by end June.

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Benefit payment

- 27 million claimants - receive 28 different benefits;
- 958 million transactions - value £79 billion a year (1997-98 data);
- methods of payment (GB only, excluding housing benefit):

		% of transactions	cost to BA (pence per transaction)
1	across post office counters;		
	on presentation of giro	7	78p
	orderbook;	80	47p
2	via ACT to claimants bank accounts	13	1.35p

- problems with current arrangements:
  - fraud - arising from means of payment - estimated at £190m a year ;
  - largely because orderbook payments are not currently reconciled, so no way of knowing who has received what;
  - cost to BA of administering the system £525m a year; £420m of this is payment to POCL.

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Post office counters

- Offers by far the largest retail network in the country - 19,000 outlets (as at May 1998)

	Urban	Rural
Crown offices	601	0
Other main offices (run by agents such as franchisees)	938	0
Sub post offices (run by self employed sub postmasters)		
Full time	8348	6964
Community/part time	41	2087

- Income from benefit payment is around 40% of total POCL turnover (1997-98 data)

POCL Income	£ million	%
BA/SSA	420	36
Royal Mail	251	21
Bill payment services	180	15
DVLA	56	5
National Savings	49	4
Other (lottery, OGDs, etc)	209	19
Total	**1165**	**100**

- Spending by benefit claimants in POs provides wider 'footfall' benefits:
  - £130m spent on PO services
  - £200-300m on non PO sales in PO premises

- Post Office currently handles £65-70 billion of cash per year, ¼ of all cash transactions; making 40 000 van deliveries of cash per week.

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The BA/POCL automation project

- Basic idea:
  - give claimants magnetic stripe card;
  - install networked computer terminals at all 40 000 PO counters to automate procedures to assist with delivery of products and administration;
  - link network to BA computer system (CAPS - Customer Accounting and Payment Strategy);
  - claimant goes to nominated PO; counter staff swipe card through terminal;
  - computer tells staff how much benefit to pay, and prompts staff to ask appropriate anti-fraud questions;
  - beneficiary collects all money due.

- Benefits
  - to BA: largely eliminates means of payment fraud (around £190m a year); provides audit information - but little reduction in admin costs;
  - to POCL: counter automation system which can improve supply of existing services, and provide platform for new services, such as banking, insurance, bureau de change;

- ICL Pathway won contract in 1996 to supply and operate system under PFI. Contract worth £1 billion.

  - ICLPathway is subsidiary of ICL which is UK subsidiary of Fujitsu

  - ICL Pathway have committed £250m to date and a further £250m to complete build phase much of which is subject to cancellation charges. Interest costs are additional.

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Timetable

- The project is now seriously behind schedule

	Original timetable	Best estimates from Panel
Pilot in 200 post offices	Apr 1997	Oct 1997
Roll out of full system to start	June 1997	Jan 2000[2]
Roll out of full system complete	Nov 1998	Sept 2001
End of BA's commitment to project	2005	2005

- Preliminary findings of the Expert Panel are that the project is technically viable though there may be a risk of up to 9 months further delay.

[2] Current plans are for Apr. '99 and Oct. '00. The Panel believes these are unlikely to be met.

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Consequences of cancellation

- serious blow to POCL
  - loses counters automation; damages commercial prospects; could take 2-3 years longer to get a substitute platform commissioned and installed;
  - threatens major loss of income to POCL in medium term; in extreme case with 100% of benefits paid through ACT, estimate 5000 to 13,000 post offices could close and annual subsidy of up to £280m would be needed (this could be mitigated if POCL can develop banking services) with associated job losses of up to 43 000;
  - could be liable for up to £245m in compensation to ICL (on worst case scenario).
- serious blow to ICL
  - has incurred over £500m in development costs so far; originally anticipated £125m profits. May seek to recover all or part through courts;
  - severe blow to commercial reputation; damaged ability to sell similar solutions abroad; some 270 jobs likely to be lost at Pathway, many others at their contractors; could affect Fujitsu's view of investment in UK.
- for Benefits Agency
  - short term costs: continues to suffer deficiencies of current system; and may face costs for compensation to ICL of up to £150m (DSS estimates) or £200-250m (Panel estimates).
  - loss of considerable investment in the project: £200m invested to date, 32 000 staff trained, 1375 people

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working on the project.

- for Government generally
  - blow to PFI;
  - potentially a set back to implementation of electronic government if it was decided to use the project technology to handle smartcards;
  - potentially a set back to social banking;
  - a second loss making business within the PO (POCL's underlying position is already very weak), with possible knock-on effects on the possibility of implementing options coming out of the Post Office review;
  - political fall-out of any adverse impact on post office network.

Against all these disadvantages is to be set the long term opportunity to make administrative savings of up to £500m a year from 100% switch over to ACT and realise longer term welfare reform objectives more quickly.

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Key criteria and questions

- the effect on the Post Office network. Could you envisage it shrinking significantly in the next 5 to 10 years?

- overall effect on public spending of each option - taking into account savings from DSS compared to a possibly explicit subsidy for POCL to keep the network going and possible compensation to ICL from project cancellation.

- the Government's objectives for welfare reform and social exclusion.

- the acceptability of making benefit payments receivable only through a bank account.

- could you envisage a large switch to payment through bank accounts 2-3 years after the benefit payment card was fully rolled out?

- should benefit payments be available over post office counters for the foreseeable future?

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Options for ways forward

1 Project continues; contract end date extended to allow ICL to earn return and POCL to prepare to offer banking and financial services using the Horizon platform; BA prepares for rapid growth of ACT after end of contract;.

- likely to be acceptable to POCL and ICL.

- unacceptable to DSS and BA given longer term/wider objectives for welfare reform since uncertainty about completion of roll out and extended commitment to benefit payment card;

- may expose BA (and possibly POCL) to risk of legal challenge from other suppliers and EC Commission for breach of EC procurement rules.

2 Project continues in modified form; benefit payment card element of project cancelled; BA develops ACT at rate compatible with POCL's introduction of banking services; ICL continue to develop Horizon system as automation platform for POCL with bolt on banking services provision.

- likely to be unacceptable to ICL unless large compensation was paid;

- possibly acceptable to POCL if they believed alternative applications of Horizon platform including banking services could provide adequate return to compensate for loss of BA business. Full ACT by 2005 likely to threaten stability of post office network.

- acceptable to BA provided post offices can offer basic banking services to benefit recipients in time for full switch to ACT.

3 Project cancelled; BA strengthens existing anti fraud measures; encourages voluntary take up of ACT or moves to full

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ACT including negotiations with banks to provide accounts for the unbanked; POCL seeks to develop banking services with partner and appropriate technology platform in time to provide banking service to benefit claimants in parallel to switch to ACT.

- eases blow for POCL if voluntary ACT route is chosen because loss of BA business would be more gradual; would be serious doubts whether POCL could afford fully automated platform if rapid loss of income from BA under full ACT route. In the medium term raises doubts over viability of current network if returns from banking activities are not as large as estimated;

- BA would not achieve full potential savings available through ACT under voluntary route; would mean continuing with paper-based systems for some time;

- quick switch to full ACT delivers large DSS admin savings over a shorter timescale but poses serious risk to stability of post office network;

- unacceptable to ICL, who would seek large compensation payments.