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**Horizon Working Group Members**

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Sarah Mullen HMT

From: Sarah Graham PFD Sp Proj

Date: 13 November 1998

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**BA/POCL AUTOMATION PROJECT: TOWARDS AN INTER-MINISTERIAL DECISION**

1. In preparation for the Inter-Ministerial meeting on Tuesday, and as agreed at the last Working Group meeting, it is important that we do not concentrate on an analysis of the ICL proposals at the expense of giving Ministers the opportunity to consider whether they still wish to continue with an option around the project "as is", or whether now is the time to pull the plug and open discussions with ICL either around an alternative option or a negotiated termination.

2. I attach a note of some of the main issues that I believe the Working Group should put to Ministers, which do not naturally fall out of the evaluation process we have been following.

3. Turning to the ICL proposals themselves, having had the benefit of attending the presentation they gave yesterday, I am quite clear that the proposals taken together do not present a sufficiently significant move on ICL's point to meet Ministers' original criterion for the discussions - to find a commercial "deal" acceptable to Government. The analysis that DTI/POCL has put to you completely ignores the transfer of risk that underlies the ICL proposals - Government/public sector parties being asked to underwrite not only the new loans but the ones that already exist; guaranteed payment to ICL, with scant regard to the level of performance; significant price increases; payment in advance; acceptance of the project before it is fully trialed in any systematic form: by any token this is a complete re-write of the contract which was originally let; certainly changes the original PFI concept of transferring some risk to the private sector; re-draws the project in terms of the contractual basis, the specification, the funding - now put at £600 million over the life of the project for ICL of which £480 million is to be underwritten by the public sector sponsors. In practical terms, to close the deal as David Sibbick says, Government needs to commit

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a further £120 million and more - for the privilege of allowing ICL to continue with the project, and possibly glean some future benefit from "the golden cloud" which hovers over the partnership agreements with POCL.

4. Against this backdrop, you should be aware that DSS/BA cannot see the case for Government continuing negotiations on Option 1. To do so, in effect, will tie us in until 11 December (see Jonathon Evans' paper - and I agree, if we are to embark on a further round, we will need something like his suggested timetable even to get so far as Heads of Agreement); we will, in effect, have authorised Government to spend another £40 million on the project since Ministers first aimed to make a decision on this in July; the further we go down this route, obviously the more difficult it is to pull out - we are committing more and more to the project - for example, in preparation for the introduction of the Card, DSS is now having to embark on a huge amount of preparatory work to organise the implementation (preparation of forms, operational arrangements etc) which may or may not be needed.

5. I think it is also worth pointing out that against this background, it is increasingly likely that we will, after all, need a substantive Accounting Officer Direction, should Ministers decide that the project should continue on anything resembling the terms proposed by ICL.

6. It may also be worth making clear to Ministers that a decision to proceed will depend on how much further funding POCL/DTI/HMT are willing to commit: as you know, DSS/BA have nothing further to throw into the pot, beyond what they have already offered under the Corbett proposals.

7. Finally, I am sending through to you some manuscript amendments to the draft you have just sent me: paras 1-12 so far; the rest to follow.

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**BA/POCL AUTOMATION PROJECT: TOWARDS AN INTER-MINISTERIAL DECISION**

**"Aide-memoire" of issues that may have escaped the formal evaluation process**

**1. The risks of continuing with the project:**

- **why should ICL performance improve dramatically in the future over the past?** Apart from the well documented and continuing delays, ICL have dragged their feet every step of the way, always looking to do less rather than more eg. constant arguments about the security requirements for the BPC have only recently been resolved, although these were central to the DSS business and policy objectives for undertaking the project at all. There is no evidence that ICL is making extra efforts to keep to committed milestones since they were placed in breach of contract by both parties last November eg. the October, 1998 milestone for the software required for delayed operational trial (11 months late) was not met. The whole tenor of the discussions around the negotiations with Graham Corbett was to make life much easier for ICL than under the current contract: easing requirements, cutting corners etc; and this is further reflected in spades in the latest (9 November) proposals from ICL. This cannot bode well for the future. Either the project is in the end going to cost much more than is envisaged, to get the quality and timely product we need; or, just as likely, it will not be delivered on time or in totality; or most likely of all, a mixture of both.

- **incomplete "roll-out" to Post Offices:** even if ICL meets its commitment to develop the system to an agreed timescale, it cannot - and has no confirmed plans - to meet certain isolated Post Offices which are too difficult and expensive to "wire-up" with existing solutions; it is arguable that these would be amongst those very offices that for "social" reasons the Government would wish to keep open, certainly for benefit delivery;

- **ICL commitment to the project is likely to be reduced for the following main reasons:**

  - in their latest proposals, ICL are claiming they will be accepting a loss of £100 million over the life of the project; certainly the project will not be earning much, if any, profit for the organisation over its remaining life, and is therefore unlikely realistically to command their best or possibly adequate resources;

  - it is now understood by ICL that the BPC element of the project has no life for Government after contract completion; neither does it have any life for ICL in terms of a wider product marketability; it is unreasonable to

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expect a high level of commitment to a product with no future;

- commitment of the public sector parties: the Independent Panel (which reported in July) quite rightly recognised the difficulties inherent in a project designed around different and often mutually conflicting objectives; continuing with the project merely cements these, and does not give an opportunity for the three parties to re-group and re-commit in any significant way; if anything, the different objectives of the two parties are now even more firmly cemented following this year long period of debate.

2. <u>What are we buying for the £5 billion that DSS will be spending on the contracts with POCL and Pathway until 2008?</u>

- the DSS return on this investment will be up to £850 million in fraud savings, provided the project is fully operational by 2002;
- all options (with improvement in the security of paper-based methods in the interim) can provide this same level of fraud savings;
- an earlier move to a fully operational ACT system would see additional administration savings of the order of £400 million a year being achieved;
- in effect, this could release around £2-3 billion over the next decade (assuming DSS plans to move to full ACT over 3 years from 2000) which Government could make available to spend on funding the Post Office and ICL developments;
- on this basis, a large number of Post Offices which might otherwise close - over and above the 6000 we understand are planned to close anyway under the Post Office Review assessment of the basis for a commercially viable network - could be kept open;
- in addition, a more transparent approach (eg. by giving social grants to certain Post Offices that meet given criteria) could mean the Government has some influence over which offices close, and which stay open.

3. <u>Will continuing with Option 1 really help the Post Office significantly more than other options?</u>

- the VFM of the options carried out by KPMG showed that none could give the Post Office a viable commercial future, which sustains its current 19 000 network;
- a viable Post Office network has to shrink, irrespective of whether Horizon goes ahead or not (as confirmed by the Post Office review);

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- all that option 1 does is put off the agony for a further 2-3 years compared with arrangements under the current DSS/BA contract with the Post Office;
- as shown above, there will be plenty of money from ACT administration savings (once fully implemented) to cushion any cliff-hanger effect for the Post Office, as it moves to a new commercial future;
- the only viable way forward for the Post Office to emerge so far, is to:
  - act as an agent of Government services, including but not dependent on benefit delivery, and adding in information and other services that Government may require;
  - provide financial and banking services; and
  - related, but probably marginal services, such as providing insurance etc;
- the Post Office under any option has a further two years at least of guaranteed paper-based levels of payment from the Benefits Agency and accompanied funding;
- it could use that time to use and plan more swiftly for simple banking initially followed by more sophisticated services in the longer term.

4. <u>What will continuing with the project really do for ICL?</u>

- if a solution acceptable to the Government and the taxpayer is found it will not give ICL what is normally understood to be a commercial rate of return, certainly over the life of the project (under their proposals of 9 November, they are accepting a loss of £100 million);
- provided the project is delivered (and that is questionable - see above) it could help ICL market itself as a successful deliverer of large business systems;

**BUT**

- there are better ways that ICL could do that eg. by delivering an adapted Horizon automation programme, with a banking facility instead of the "bespoke" BPC element: this should surely be attractive to ICL:
  - there must be significant savings to ICL in removing the BPC elements: it is relatively cheap to install (around £20 million) and there will be savings in the service requirements for Card operation (eg. provision of new Cards; Help Desk Services etc);

- is simpler and familiar to ICL - they have delivered similar systems successfully - eg. for First Direct; and
- is potentially, in itself, a marketable product globally - we understand that Post Office systems worldwide are moving to banking-based IT/business solutions;

- ICL could work much more overtly closely with Government in delivering its future programme, rather than the past programme of a previous administration.

5. **How will continuing with Option 1 further the Government agenda?**

- In practice it may put off the introduction of ACT for longer than is theoretically being planned: it may be difficult to change payment arrangements for the 15 million or so people currently paid by Order Books and Giros, and shortly after that expect them to move to an ACT-based/banked system; similarly we would be asking Post Office and their staff to undertake 2 major changes in their business in a relatively short period.
- Will not further the Government's agenda in terms of opening up "access to banking" for all - currently under discussion within the Social Exclusion Unit, from which it is evident that, without a major move to ACT, other measures are marginal - or worse, socially divisive involving "poor people's banking";
- The BPC in itself is potentially socially divisive, marking out often poorer beneficiaries from the rest of the population;
- Similarly it will prolong the situation recognised by the Chancellor and his plans for WFTC, that there is a distinct difference between the benefit economy - cash based - and the world of work associated with payment into bank account, with the access this brings to other financial services, payment by direct debit (and consequent savings in bills for utilities); and arguably losing the opportunities offered by moving to a banking-based system, to help support a sense of personal responsibility - a "hand-up" rather than a "hand-out" - that this Government is seeking to inculcate in its approach to welfare provision.

6. **How will the Government be judged for its handling of this project?**

- In five years' time - or earlier! - Government could easily be judged to have rewarded a failed PFI project (and in the shorter term it may find itself under attack from Andersen Consulting who have been given a very different package on NIRS 2);
- In the short term the PAC have commissioned an NAO VFM study which will start

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immediately Ministers' reach their decision on a route forward; this will certainly pore over all the detailed VFM analysis undertaken by the Working Group(s) and KPMG and however a decision to continue is justified in broader Government terms, will raise many difficult issues for Ministers about the BPC angle - which already presents such difficulties in VFM terms, that the Chief Executive of the Benefits Agency (CE/BA) has required a formal Direction from his Secretary of State to continue with the project while a decision is being taken;

- Ministers will need to give a very clear justification for continuing with the project, in order to avoid the need for a further substantive Direction to the CE/BA (DSS are drawing up an example of the sort of statement that would be required, for Ministers to consider at their meeting on 17 November); without such cover, the PAC probing of the issues will be even more difficult: they have a duty to explore all the background to the issue of a formal Ministerial Direction;

- There will be a complete lack of evidence of "joined-up" Government:

Government could be accused of a lack of clear of strategy around either the future of the Post Office network, or of benefit delivery - Government could easily be seen as the victim of ICL, as it fumbles for a strategic way forward on either front.

- What may seem the "safe" way forward now to continue with the project at all costs (quite literally!), will not look such a comfortable decision in five years time.

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13/11/98

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*DRAFT OUTLINE*

## *BA/POCL AUTOMATION: UPDATE REPORT*

### Background

The BA/POCL automation project (known as "Horizon") has been under review since the contractor, ICL Pathway, was placed formally in breach of contract after a key contractual milestone was missed. The project is now over two years late. An inter-departmental report to Ministers (July 1998) and an HMT/No. 10 Policy Unit report for the Chief Secretary (September 1998) considered the options for taking the objectives of the project forward. Following a Ministerial discussion, it was agreed that the parties to the contract would be given one month to establish whether a commercial basis for proceeding with the contract could be found. At the same time fall-back options were prepared to provide a basis for judging whether the outcome of the negotiations offered the best value for money for the public sector as a whole. A report was presented to Ministers on this work on 23 October.

acceptable to Government

2. Following receipt of this report the Chief Secretary wrote to ICL stating that he and his Ministerial colleagues were prepared to agree to their request for a period of two weeks for them to make progress in their discussions with the Post Office to develop a public/private partnership (letter to Keith Todd of 30 October). This was on condition that:

- non binding "Heads of Agreement" for the proposal, agreed with the Post Office, were received no later than Monday 9 November;
- the proposal was based on a realistic business case involving no explicit or implicit guarantees or commitments on the part of the public sector for future additional business;
- that ICL and the PO seriously considered the case for involving a third party with wider retail experience in the partnership - or otherwise demonstrated how the necessary skills would be acquired.

3. We have now received ICL/PO's proposal for the partnership, agreed with Post Office Counters. ICL have also provided 3 additional papers addressing commercial, contractual and financing issues. Ministers must now decide:

- whether the partnership proposal meets the criteria set out in the CST's letter of 30 October;
- whether ICL's proposal on this and the wider deal represents sufficient movement to be a constructive basis for further (time-limited) discussions with the public sector;
- whether further discussions are likely to deliver a deal which represents value

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for money when compared to the fallback options, taking into account the risks and rewards of each option.

4. However before providing an assessment of ICL's proposals it is worth briefly revisiting the reasons why a decision on a way forward is urgently required.

### Objectives of the Horizon project

5. Horizon was initiated in 1993 with the aim of:

- providing a more secure and efficient way of paying benefits;
- providing DSS/BA with the means to account fully for their programme expenditure;
- automating PO counters, to make current business more efficient and help them to win new business;
- helping to maintain the nationwide network by providing a secure revenue stream from POCL's biggest customer until ~~the middle of the next decade.~~ 2005

If you want to mention (X) / suggest saying: 6. The project also had the indirect effect of helping maintain etc - - -

Omit or

? was this an objective? (X)

I've never seen this given as an objective before.

6. Against the background of severe delays to the project (attributed to ICL Pathway) Ministers became very concerned that there was a serious risk that the Horizon project would fail to deliver its objectives - or would not do so in a timescale that would make it worthwhile to proceed.

7. These concerns have prompted a number of inter-departmental reviews of the project and possible alternative options. These reviews have provided an opportunity for Ministers to revisit and update the government's policy objectives for the Horizon project. The key goals are: ? might be: have Ministers agreed these?

- to pay social security benefits in a way that is as cheap, efficient, fraud free and convenient as possible, consistent with plans for welfare reform;
- to ~~maintain~~ help support a nationwide network of post offices in order to protect the accessibility of services provided across PO counters; ? Government services
- to improve delivery of existing and new government services and information, & more generally taking full advantage of new technology; to streamline Government's dealings with citizens;
- to improve access to basic financial services, including banking services, for poorer members of the community and the socially excluded;
- to maintain a thriving IT sector in the UK, in which ICL is a key player; while ensuring that risks transferred through PFI projects do not end up with the

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taxpayer;
~~(proposed)~~ against these objectives, to secure ~~improve~~ prudent use of taxpayers' money.

8. Decisions on whether to proceed with the contract or to move into an endgame on the basis of ICL's failure to deliver need to be set in the context of these objectives.

**Assessment of the ICL proposal**

9. Under cover of Keith Todd's letter to CST of 9 Nov, ICL submitted four papers. One meets the CST's request for non-binding heads of agreement on a public/private partnership with POCL for further joint exploitation of Horizon, and is also signed by POCL, subject to agreement with ICL on the wider commercial issues left outstanding. The other three are from ICL alone.

10. The partnership heads of agreement, while giving no guarantees or commitments about levels of future business, envisage:

- a joint marketing executive to seek out and develop new business to be transacted over Horizon;
- a single tender arrangement with ICL for certain specified areas of work, subject to value for money and procurement considerations; and
- the possibility of involving a further partner with financial retail experience.

The heads of agreement are, in the Post Office's view, but being in their infancy, [illegible] [illegible] a sensible way forward on which could be built a valuable partnership with ICL. [We have no estimates yet of how much value might be added for POCL.] [A preliminary estimate of the added value to POCL of the partnership is ...] Subject to HM Government consent and satisfying various legal, regulatory and contractual constraints, POCL and ICL would wish to work towards a binding agreement by the end of the year.

11. Taking the Heads of Agreement together with the other three papers, the proposal is an attempt by ICL to reduce its risk, making the project more secure and hence more attractive to sources of limited recourse finance. ICL ~~has accepted a~~ claims to be willing to accept a loss of £75-100m on reasonable central assumptions. It hopes, through the further exploitation of the system with POCL, to recover some or all of this loss (though we have no figures).

12. Key components of ICL's proposal are:

- increased prices, and inflation risk transferred back to sponsors
- greater guaranteed volumes across the system, ~~[illegible]~~ (funded by Government) said to
- a contingency fund ~~to~~ for incentivise the delivery of the project to timetable (but no [illegible])
- payments in advance, rather than in arrears
- a revised acceptance process ~~[in line with current practice]~~ which

no contribution to closing the funding gap between the public sector parties and ICL Pathway.

next page [illegible].