POL00027309

RESTRICTED

MEMORANDUM FOR: **The Board of Post Office Limited**

FROM: **Alisdair Cameron, CFO**
Lesley J Sewell, CIO & Operations Director

SUBJECT: **Fujitsu extension option**

DATE: **29th June 2015**

Recommendation

1. The Board is asked to approve an option to extend the existing Fujitsu Horizon contract as contingency against delays in the establishment of new Front Office services, protecting continuity of operational service for Post Office.

Background

2. The Front Office programme is due to complete at the end of March 2017. IBM, Computacenter and Verizon have been appointed as our key technology partners and the design phase is underway. However, the scale and complexity of the project is such that we cannot be confident today that we will finish on time. Our concerns are not just that third parties will let us down: we have to roll out the new equipment and software across all of our branches. Any suggestion that branch accounting was not right would, given the Sparrow sensitivities, cause us to slow down. Fujitsu's contract to support Horizon ends in March 2017, leaving no room for manoeuvre.

3. We have been in negotiation with Fujitsu for a contract extension for several months. In May, the Board did not approve a proposal for a one year extension at a maximum cost of £62m (£26m capital and £36m run costs), requesting that the CFO & CIO re-evaluate the options, setting out:
   - a view of the Fujitsu contingency;
   - the phased capital expenditure investment plan for Fujitsu;
   - the governance for releasing this spend;
   - clarification of the Fujitsu contract and the legal position;
   - possible further incentivisation of IBM to help minimise the Fujitsu costs; and
   - a timeline when decisions have to be made, taking into consideration the Telco contract negotiations.

Contingency and Phased Spend

4. In further negotiation with Fujitsu, the maximum potential spend has been reduced to £57m, £24m of capital, £33m of run costs. The minimum spend is £6.5m.

5. There has been an extensive joint review of the required capital investment. We have negotiated with Fujitsu a slower schedule of spend as set out below. This enables continuity of service in the Belfast datacentres to March 2018.

6. The actual spend will be determined by the date we decide we can terminate the option. For example, if we are sufficiently confident by June 2016 that we can exit on time, the cost would be £22.5m.

7. The maximum spend assumes a full year of running to March 2018. If even more time was needed, in theory a further limited extension could then be negotiated. However, the back-up datacentre is due to be demolished in September 2018.

Decision Point	Exit By	CAPEX	OPEX	Termination	Total
September 15	March 17	£1.5m	-	£5m	£6.5m
December 15	March 17	£5.5m	-	£5m	£10.5m
March 16	March 17	£9.5m	-	£5m	£14.5m
June 16	March 17	£17.5m	-	£5m	£22.5m
December 16	March 17	£23.2m	-	£5m	£28.2m
December 17	March 18	£24m	£33m	-	£57m

*N.B. All costs are **exclusive** of VAT.*

8. In the Three Year Plan, we have assumed that we will spend the full capital provision and six months of additional run costs, April 2017 - September 2017 – some £45m.

Governance

9. The exit team, overseen by the Front Office Steering Group, will continue to explore options to reduce the capital investment, with an aim to cancel the refresh and extension by June 2016. The Steering Group is therefore targeting a maximum spend of £22.5m.
10. Spend will be approved by the CFO and the CEO in 3 month stages.
11. A further update will be provided to the Board in October, following the completion of the Front Office design phase.

Legal

12. Post Office Legal has, with third party support, explored Fujitsu's exit obligations. Their key responsibilities are for an orderly and efficient transfer of responsibilities and services to the next supplier with the risk to or adverse effect on continuity or quality of services during transfer being minimised.
13. All parties are also required to act and negotiate reasonably in agreeing the contents of the exit strategy and plans and shall not unreasonably require the exclusion or inclusion of matters requested.
14. This is helpful and forms the basis of our interactions with Fujitsu. An exit manager has been working with them for some months and additional legal support is being provided to ensure Fujitsu fulfil their contractual obligations. However, this cannot make Fujitsu responsible for the failings of ourselves or others or require them to extend services beyond the contractual end date.

Incentivisation

15. We have sought to negotiate an incentive plan with Fujitsu. Their request is for an additional £17m, which would buy us nothing more than good intent. We believe that this is not value for money and cannot recommend this option to the Board.

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16. We will continue to explore incentivising early delivery with IBM. This may enable us to have greater confidence in an early exit – but it is too early to do so now. A firmer view on the delivery timeline will be available on completion of the design phase in September.

Timeline

17. The telephony extension is being presented to the Board on 15th July 2015.
18. The telephony extension is arguably more urgent. Fujitsu and POL have a shared need to replace Capita, a key provider of services under the contract. This can be done contractually now, because of the poor service provided by Capita but that situation may not remain and Fujitsu will not go through the replacement process without the longer contract period.
19. We are not clear whether Fujitsu would be inclined to provide the IT extension absent the opportunity provided by a new telephony contract. We could delay the contract extension to some future date but the capital improvement could become impossible and the price might rise substantially.

Risks

20. The Board should note that each risk retains 'Controlled' status and is within the Technology and Operations risk appetite of Adverse.
    a. Failure to fully transition to the new Front Office solution by March 2017 may result in a delay in benefits realisation and significant additional Fujitsu cost being incurred to maintain continuity of service. (Operational Risk / Financial risk – Controlled)
    b. Failure to deliver within the three-year transformation window may have significant ramifications to the wider business transformation, and require major funding outside the existing cost envelope. (Operational / Financial risk – Controlled)
    c. Operational continuity of service may be put at risk through adverse influence from failure in relations with Fujitsu, or behaviours of Fujitsu. (Operational risk – Controlled)
21. Agreement of the extension will reduce these risks. In addition, a more comprehensive update on further mitigation is provided in Appendix I.

Conclusion

22. We continue to believe that to proceed without a contract extension option would present an unacceptable level of risk. On the basis that the business will minimise the cost of that option and that any spend will be approved by the CEO and the CFO, the Board is asked to approve a one year option to extend the existing Fujitsu Horizon contract at a maximum investment of £57m: £33m of operating costs and £24m of capital.

Al Cameron, CFO
Lesley J Sewell, CIO & Operations Director

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Appendix I - Key Programme and Contract Risks

Further detail on how the key programme and contract risks are being controlled is set out in this appendix. All the identified risks are within the Technology & Operations risk appetite of adverse.

1. Failure to fully transition to the new Front Office solution by March 2017 may result in a delay in benefits realisation and significant additional Fujitsu cost being incurred to maintain continuity of service.

   (Operational Risk / Financial risk – Controlled)

   As highlighted in the main body of this paper, there is significant financial exposure should we need to extend Fujitsu beyond March 2017 and thereby invest in an infrastructure refresh for the Horizon estate. The IT OPEX benefits will only be realised once we achieve a steady state for the new IBM solution, and that is predicated on Fujitsu exit.

   Mitigating Actions:

   - The potential additional costs are included in the three-year plan.
   - The scale of the proposed benefits in Front Office are significant offering a much quicker pay back profile so delays to realising the benefits expected can be recovered.

2. Failure to deliver within the three-year transformation window may have significant ramifications to the wider business transformation, and require funding outside the existing cost envelope.

   (Operational / Financial Risk – Controlled)

   Delay to this programme will necessitate a longer window of constraint to change for products and services, and also delay process efficiency opportunities within the business. If the delay is caused by IBM our financial position is protected within the scope of that deal, though may not account for loss of market opportunity. If the delay is caused by Post Office, it is likely we will incur further costs in paying for exit services from incumbent suppliers over a longer timeframe.

   Mitigating Actions:

   - Senior transformational programme governance is in place to steer business and IT programmes effectively.
   - We are also seeking to establish formal external assurance and review of the plan.
   - Avoidance of unnecessary day one business requirements or scope creep.

3. Operational continuity of service may be put at risk through adverse influence from failure in relations with Fujitsu, or behaviours of Fujitsu.

   (Operational risk – Controlled)

   Fujitsu have clearly stated that the majority of the current IT infrastructure will be end of life by March 17. Without commitment to refresh critical elements of the estate Fujitsu will increasingly look to transfer risk to Post Office and reduce their risk profile. In addition, the perception is that Fujitsu are delaying full and proper engagement in transition planning until Post Office decides to take the contingency option or not.

   Mitigating Actions:

   - Fujitsu are represented in appropriate transformational programme governance and as such are being proactively managed to deliver exit services.
   - Increased contract & relationship management by use of dedicated exit manager.