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To Sean

KPMG

RESTRICTED - COMMERCIAL AND POLICY
WITHOUT PREJUDICE AND SUBJECT TO CONTRACT

HM Treasury

BA/POCL - Comparison of Options

28 May 1999

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WITHOUT PREJUDICE AND SUBJECT TO CONTRACT
RESTRICTED - COMMERCIAL AND POLICY

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1 Introduction

1.1 Background

1.1.1.1 In 1996 Benefits Agency (BA) and Post Office Counters Limited (POCL) signed a PFI contract with ICL Pathway. The objective of this programme, known as Horizon, was to develop and maintain an automated infrastructure for POCL to enable benefits to be paid to customers using a magnetic stripe card (the Benefit Payment Card or BPC) and to provide a platform for other POCL business.

1.1.1.2 In 1997, ICL was placed in breach of contract for failure to deliver a key contractual milestone and subsequently there were extensive negotiations between all parties. Earlier this year, an alternative approach, known as Option B, for the continuation of the project was proposed. The alternative approach involved migrating benefit recipients to Automated Credit Transfer (ACT) earlier than was originally planned, while enabling recipients to continue to receive their benefits in cash at post office counters.

1.1.1.3 Initially exploration of the alternative approach focused on variants B1 and B2, in both of which POCL would establish "benefit accounts" for benefits recipients into which benefits could be paid by ACT. This approach was seen as potentially facilitating ACT migration, creating a POCL-branded smartcard which could form a platform for the delivery of electronic government services, and furthering social inclusion.

1.1.1.4 Subsequently, a further variant of option B - referred to as B3 - was proposed and explored. This option involved proceeding with post office automation but with neither the BPC nor the benefit account. Migration to ACT would still take place earlier than planned, but would be deferred until POCL could put in place mechanisms which would allow benefit recipients to withdraw their benefits from bank accounts in cash at post offices.

1.1.1.5 From late March to mid-May 1999, KPMG worked with HM Treasury and the three parties to Horizon in assessing the value for money of the various options for taking forward the Horizon programme. This work was carried out in "real time", informing decisions and the evolution of thought as the Treasury review of the programme progressed. This report formally records the results of the work.

1.2 Approach

1.2.1.1 Initially, exploration of option B focused on two variants: option B1, in which benefit accounts would be operated by ICL, and option B2 in which they would be operated by a number of banks with whom POCL would contract. Having participated in the process of evolving the definitions of these options, we asked the parties to model both options under a common set of assumptions.

1.2.1.2 It was decided by HM Treasury and the three parties that option B2 should be set aside and option B1 pursued further. We worked with the three parties to refine the understanding of the costs associated with option B1 and to agree a core set of assumptions on which POCL and ICL could base proposed business cases. We asked the

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parties to model option B1 against these core assumptions and against key sensitivities. The results of this modelling were analysed and presented to HM Treasury.

1.2.1.3 Following presentation of this analysis, we were asked to consider the potential implications of contract termination (option C). An initial analysis of this option was carried out, where POCL provided their modelling and we estimated the impact on ICL (drawing heavily on previous work on termination conducted in October 1998) and on BA.

1.2.1.4 BA proposed a further option for the way forward, referred to as B3, where the Benefit Payment Card would be cancelled but the core Horizon infrastructure would continue (which is similar to option 2 in the October 1998 work). We were asked to model the impact of B3, in isolation from POCL and ICL. We also carried out further work on option C to ensure comparability with option B3. An analysis of the impact of options B3 and C, together with a discussion of the assumptions and associated risks, was provided to HM Treasury.

1.2.1.5 Subsequently, POCL was asked to model option B3. The results of this modelling have been taken into account in the analysis presented herein, adjusted as required to ensure comparability of assumptions between options.

1.2.1.6 Throughout, our main task was to ensure that common assumptions were being used by all parties in order to consolidate the results of each party to determine the overall impact on the public sector. We reviewed the work of each party for reasonableness and commented upon this but, except where specifically indicated, we have not imposed our judgements on the workings of the different parties.

1.3 Structure of this document

1.3.1.1 Section 2 presents the results of the value for money analysis of the various options for the way forward.

1.3.1.2 Section 3 describes the general methodology for assessing the impact on the public sector across all options.

1.3.1.3 Section 4 presents the financial projections for option A (current programme), together with modelling of the potential impact of a further 6-month delay.

1.3.1.4 Section 5 describes option B1 and its commercial, technical and operational implications. Projections for option B1 and the results of sensitivity analysis are presented, together with an interpretation of the results.

1.3.1.5 Section 6 describes option B2 which was included in the initial exploration of option B, but later set aside.

1.3.1.6 Section 7 describes option B3, which arose during the process of exploring option B1.

1.3.1.7 Section 8 presents the results of the modelling of option C.

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1.4 Qualifications

1.4.1.1 The projections presented herein have been derived in the compressed timescales allowed for the analysis of each option, and we have been heavily reliant on project costs and assumptions produced by the parties. At times we were required to estimate the impact of options - particularly for options B3 and C - in isolation of some of the parties, based on their modelling of other options. We have not audited the cashflow models used by the parties, but we have discussed the integrity of the models including internal control mechanisms.

1.4.1.2 We must emphasise that the realisation of the projections is dependent on the continuing validity of the assumptions on which they are based. This is particularly so as regards the amount and timing of the cash flows. The limited scope for interrogating the cash flow information produced by the parties, within the time available for the completion of each option, should be borne in mind when considering any decision based on these projections.

1.5 Acknowledgements

1.5.1.1 KPMG wishes to acknowledge the contribution made to this analysis by HM Treasury, POCL, BA, DSS, DTI and ICL. The willingness of staff in these organisations to provide information - sometimes at personal inconvenience - has been of considerable value.

1.5.1.2 In particular, we would like to acknowledge the contribution of:

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David Sibbick
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ICL
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Darryl Murphy (SG)

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2 Summary of results

Comparison of NPV's: Options A, B1, B2, B3, C and sensitivities

NPV of cashflows, as compared to the baseline, from 1999/00 to 2009/10 discounted at 6%

	Options								
	A	A delay	B1 core	B1 Sep01	B1 high	B3 mktg	B3 no mktg	C 2yr	Cx
	£ m	£ m	£ m	£ m	£ m	£ m	£ m	£ m	£ m
Individual entity NPV's									
BA	1,572	1,477	2,254	2,558	2,254	2,181	1,926	2,621	1,990
POCL	(484)	(452)	(1,630)	(1,904)	(2,069)	(1,145)	(1,052)	(1,886)	(1,447)
Change in ICL settlement	114	91	(289)	(245)	(165)	(190)	(166)	0	0
Public Sector Impact NPV	1,202	1,117	335	409	21	845	709	734	543

	Variances compared to A							
	A delay	B1 core	B1 Sep01	B1 high	B3 mktg	B3 no mktg	C 2yr	Cx
	£ m	£ m	£ m	£ m	£ m	£ m	£ m	£ m
Individual entity NPV's								
BA	(95)	682	985	682	608	354	1,048	418
POCL	33	(1,146)	(1,420)	(1,585)	(661)	(568)	(1,402)	(963)
Change in ICL settlement	(23)	(403)	(359)	(279)	(304)	(280)	(114)	(114)
Public Sector Impact NPV	(86)	(868)	(794)	(1,182)	(357)	(493)	(468)	(660)

The definitions of the options are summarised in the assumptions table in appendix 1; a more detailed description of each option can be found at the beginning of the sections on the options.

The value for money analysis summarised in the table assumed that for all options involving ICL, including B3, ICL would be prepared to accept a £126m NPV loss. Following the value for money analysis, the public sector parties entered into

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negotiations with ICL for the delivery of option B3. During the negotiations, KPMG staff supported HM Treasury in calculating the impact on cashflows of the pricing proposals made by both private and public sectors. For completeness, appendix 6 presents the cashflows relating to the latest offer which was modelled, and which we understand to have been the basis for the heads of agreement.

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3 General methodology

3.1 Overall approach to the value for money analysis

3.1.1 *NPV calculation*

3.1.1.1 The financial results in the value for money analysis are expressed as the net present value (NPV) of real cashflows, in 1998/99 prices, from 1999/00 to 2009/10. The NPV is calculated using a real discount rate of 6%, based on the standard discount rate used within Government. This is not necessarily the discount rate that the BA and POCL would use for their internal business cases.

3.1.2 *Baseline*

3.1.2.1 The financial projections for each option are presented as compared to the baseline, "business as usual". The cashflows in the baseline assume that there will need to be a settlement payment to ICL to exit from the current contract, paper-based methods of benefit payment will continue, and there will be no automation platform for POCL.

3.1.2.2 POCL's modelling of the baseline and all options is based on its automation business case, ie it does not include the POCL business as a whole.

3.1.2.3 The baselines originally modelled by BA and POCL have been adjusted, as follows:

- BA's CAPS costs and ITSA costs have been transferred from the options to the baseline, in consultation with BA, as the activities underlying these costs are required with paper-based mechanisms of payment;
- POCL's income from BA, has been amended to reflect BA's assumptions for payments to POCL, and associated variable costs have been amended proportionately.

3.1.2.4 As a result of applying consistency in the baseline payments from BA to POCL, we would expect that the intra-party payments in the options should approximately net to nil. This has not been the case. But as the net imbalance, taking into account the impact on POCL's variable costs as well as income, was not deemed significant in proportion to the total, and was consistent across options, no adjustment to the BA/POCL payments has been made in the options.

3.1.3 *Intra-public-sector adjustments*

3.1.3.1 We have made adjustments to the cashflows provided by BA and POCL to eliminate intra-public-sector costs where applicable. Specifically, we have deducted irrecoverable VAT and prefunding costs from POCL's modelling.

3.1.4 *Presentation of BA cashflows*

3.1.4.1 At a late stage, it was realised that BA cashflows had been presented based on 1997/8 prices rather than 1998/9 prices, which was the basis for the presentation of the other

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parties' cashflows. In consultation with HM Treasury, it was decided not to alter the presentation of the results due to the confusion that such a change would create at that late stage, given that the change would not signifcantly affect the comparison between options.

3.1.5 ***Impact of ICL projections on the public sector***

3.1.5.1 In assessing the overall public sector impact, we have assumed that the result of the commercial negotiations would be the net loss of £126m NPV for ICL, as they had previously proposed in December 1998. That is, we have assumed the "funding gap" between ICL's NPV position (including sunk costs) and the £126m NPV loss to be an additional cost for the public sector.

3.1.5.2 In all options ICL charging was based on the scorecard, with agreed assumptions on the charges for benefit account transactions. The modelling was thus independent of the parallel commercial discussions which were addressing mechanisms through which the funding gap might be bridged. At the request of HM Treasury, an up front payment of £180m proposed for option B1 has been included in the indicative phasing of the ICL funding gap for options B1, B2 and B3. This does not impact on the NPV calculations.

3.2 Assumptions applicable to all options

3.2.1 ***Payments from BA to POCL for paper-based transactions***

3.2.1.1 To ensure consistency in the modelling prepared by BA and POCL we asked them to assume that the floor payment ends at the start of compulsory ACT migration, except in option A where the assumption used in the Corbett negotiations was that the floor payment ends when ACT migration is completed. It is also assumed that even when the floor payment ends at the beginning of ACT migration, the fixed fee element of the BA payment continues through the ACT migration period.

3.2.2 ***Post office network size***

3.2.2.1 POCL has assumed that the network size is consistent across all options. There will be 200 rural closures each year and a total of 1000 urban closures over the period of the projections.

3.2.3 ***Network banking income***

3.2.3.1 The modelling of all options has assumed that network banking income to POCL from banks is equal to 30p per transaction - the assumption which was used during the Corbett negotiations. There is a risk that this is unduly conservative, our work in October 1998[1] having assumed an income of 50p per transaction. The effect of a higher

[1] Benefits Agency/Post Office Counters Limited Automation Project: Analysis of Fallback Recommendations, KPMG, 23 October 1998

transaction charge would be to amplify the differences between options caused by changes in network banking volumes.

3.2.3.2 As an indication of the effect of the assumption, an initial analysis of the impact of assuming a transaction income of 50p, suggests that the NPV **differences** relative to option A of the key options would vary as follows:

Option	**Approximate Change in NPV movement from option A (-ve means a more adverse movement as compared to option A)**
B1	(60)
B3 With Marketing	(30)
B3 No Marketing	(16)
C	(40)
Cx	(16)

3.2.3.3 POCL have assumed - and we have maintained this assumption in B3 in order to ensure comparability - that the availability of network banking services via POCL does not influence claimants' choice of bank. That is, benefit claimants opening accounts for the first time are not more likely to choose a bank which is a network bank; nor are claimants likely to switch from a bank which is not a network bank to one that is.

3.2.3.4 This conservative assumption is in line with the general thrust of the network banking strategy, whose attraction to banks is seen as being in supporting branch closures rather than offering a competitive advantage *per se*.

3.2.3.5 On the other hand, we would observe that all assumptions relating to network banking volumes are at risk, given the novel nature of the proposition and the fact that we are not aware of detailed discussions of the (electronic) network banking proposition having taken place with banks.

3.2.4 *Communications architecture*

3.2.4.1 In its costing of options A and B1, ICL has assumed that the ISDN-based communications architecture planned for the initial releases of Horizon would be retained, even when network banking is introduced.[2] This assumption is based on an analysis of current cash payment transactions which indicates that these are widely distributed.

3.2.4.2 In options B3 and C, online (ie network banking and interim cash payment) transaction volumes initially climb more rapidly than in A. However, the maximum number of transactions reached is lower. In order to ensure comparability between options, we have assumed that a network architecture comparable to that currently proposed is used for all options (other than B2 which would have entailed a significant increase in online traffic).

[2] Source: telephone conversation with Tony Oppenheim, ICL, 4 May 1999

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3.2.4.3 We would observe that there is a risk that this architecture would adversely affect transaction times due to the overhead of call setup, and that a greater proportion of online links might therefore be required. However, on the basis of the volumes modelled, we would expect the effect of such an increase to be broadly consistent across options.

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4 Option A

4.1 Definition of option A

4.1.1.1 Option A represents continuation of the Horizon programme on the basis of ICL's proposal of 18 December 1998.

4.2 Financial results

4.2.1 *Scenarios*

4.2.1.1 We asked each of the parties to model two scenarios for option A:

- **Option A Core -** This scenario assumes that latest programme dates (slightly revised since the Corbett negotiations last summer) are maintained.
- **Option A Delay** - BA has expressed a view that the current programme is likely to slip by at least 6 months due to the combination of a 2-month slip in Model Office Testing arising from unresolved flaws and the embargo on BA IT development around the year 2000. This scenario models the effect of this slip.

4.2.1.2 The modelling was based on latest forecasts of transaction volumes provided by BA, rather than the volumes used in the value for money analysis in October 1998.

4.2.1.3 Further detail of assumptions is provided in appendix 1.

4.2.2 *Financial results*

Option A

4.2.2.1 The table below summarises the financial results for option A. Descriptions of the line items are presented in appendix 2, and detailed cashflows are included in appendix 3.

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Option A	**£m NPV**
BA	
Payments to Pathway	(431)
ACT costs, including contingency	(232)
Cost of the "unbanked"	(70)
CAPS savings	881
POU savings	6
Payments to POCL saved	514
BA net administrative savings	667
BA programme savings	905
BA net administrative savings and programme savings	1,572
POCL	
Capital costs and non recurring revenue costs	(126)
BA & girocheque income	(714)
BA/SSA & girocheque related ABC costs	469
POCL bank costs: smart cards, opening accounts etc	-
Network banking income	456
Network banking ABC costs	(319)
Network banking systems charges	(111)
Cost of new banking technology	-
Other POCL contribution	172
Other systems charges	(367)
Loss in other POCL contribution - footfall impact	(36)
Other POCL net costs	91
Subsidy: retail impact subpostmasters	-
POCL net impact on profits	(484)
Sub total impact on the Public Sector	1,088
ICL funding gap (ie ICL's NPV excluding £126m)	(36)
Total cashflow impact on Public Sector	1,052
Less ICL termination payment in baseline	150
Total NPV impact on Public Sector	**1,202**

Option A Delay

4.2.2.2 The table below summarises the NPV movements from option A to option A delay. It can be seen that the principal effect is an adverse impact arising from the 6-month delay to BA administrative and programme savings.

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Option A delay, plus A delay compared to option A	**£m NPV** A delay	**£m NPV** v option A Fav/(adv)
BA		
Payments to Pathway	(420)	11
ACT costs, including contingency	(209)	23
Cost of the "unbanked"	(70)	-
CAPS savings	822	(59)
POU savings	6	-
Payments to POCL saved	504	(10)
BA net administrative savings	632	(35)
BA programme savings	845	(60)
BA net administrative savings and programme savings	1,477	(95)
POCL		
Capital costs and non recurring revenue costs	(126)	-
BA & girocheque income	(699)	15
BA/SSA & girocheque related ABC costs	451	(18)
POCL bank costs: smart cards, opening accounts etc	-	-
Network banking income	456	-
Network banking ABC costs	(319)	-
Network banking systems charges	(111)	-
Cost of new banking technology	-	-
Other POCL contribution	172	-
Other systems charges	(338)	29
Loss in other POCL contribution - footfall impact	(35)	1
Other POCL net costs	97	6
Subsidy: retail impact subpostmasters	-	-
POCL net impact on profits	(452)	33
Sub total impact on the Public Sector	1,026	(63)
ICL funding gap (ie ICL's NPV excluding £126m)	(59)	(23)
Total cashflow impact on Public Sector	967	(86)
Less ICL termination payment in baseline	150	-
Total NPV impact on Public Sector	**1,117**	**(86)**

Notes

4.2.2.3 The impact of a 6-month slip on BA has been estimated by KPMG in consultation with BA. Note that the derivation of the cashflows for all options is presented in appendix 5.

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5 Option B1

5.1 Description of B1[3]

5.1.1 *Principles*

5.1.1.1 The BPC element of Horizon would be cancelled. Development and implementation of the core Horizon infrastructure to support POCL automation would continue, as would the development and implementation of the Order Book Control System (OBCS).

5.1.1.2 POCL would provide simple "benefit accounts" into which benefits could be paid by Automated Credit Transfer (ACT) and withdrawn in cash at post office counters using a smartcard. If necessary, POCL would seek authorisation under the Banking Act to be a bank.

5.1.1.3 POCL would contract with ICL for the delivery and operation of a modified Horizon infrastructure supporting the benefit account, the management of the smartcard and the operation of the benefit accounts. It is likely that ICL would subcontract the operation of benefit accounts, possibly to Girobank.

5.1.1.4 Once benefit accounts were available, BA would begin migration to ACT as the only means of payment for orderbook and girocheque customers.

5.1.2 *Functionality and operation of the benefit account*

5.1.2.1 As currently defined, the benefit account would not offer the functionality of a conventional bank account. This is intentional to avoid banks perceiving this account to be in competition with their accounts offering fuller functionality. Services would be limited to:

- cash withdrawal at post office counters using a smart card;
- balance enquiries;
- mini-statements produced at post office counters.

5.1.2.2 There would be the potential to develop additional services in the future. These might include cash deposits and household budgeting. These services have not, however, been assumed in any of the modelling.

5.1.2.3 For customers transferring from paper-based methods of payment to ACT, the process of opening a benefit account would be largely automatic. It would, however, be necessary for the customer to sign a "mandate" form at the post office counter, agreeing to both the transfer of personal data from BA to POCL/ICL (to meet data protection requirements),

[3] Note that the variant of Option B1 which is described here and reflected in the financial projections is that known as B1.2. An alternative variant, known as B1.1, in which POCL acted as a paying agent rather than a bank, was rejected at an early stage.

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and the terms and conditions of the benefit account (eg the responsibility of the customer to safeguard his/her PIN).

5.1.2.4 New customers would also have the option of opening benefit accounts. It would be possible for this process to be automated in a fashion similar to that for customers migrating from paper-based methods of payment, with information being passed from BA to POCL/ICL. It should be noted, however, that BA would expect to charge POCL for this service and that the costs of the service have not been included in the financial models.[4] Alternatively, customers could open benefit accounts through personal application at post offices.

5.1.2.5 Account closure procedures would be analogous to those for conventional bank accounts.

5.1.3 *Timing*

5.1.3.1 The current position of ICL and POCL - reflected in their draft heads of agreement for option B1 - is that rollout of the benefit account capability would be complete by July 2002. There is a possibility that this assumption is somewhat conservative and we have therefore included additionally the modelling of the impact of an earlier implementation in our analysis.

5.1.3.2 Compulsory ACT migration would begin when the benefit account capability was rolled out and is assumed to take around two years.

5.2 Implications of B1

5.2.1 *Commercial implications for POCL*

Network banking

5.2.1.1 Network banking - the provision by POCL of teller services for banks on an agency basis - is a key element of POCL's future strategy. The following potential impacts of option B1 on the network banking strategy have been identified:

- There is a risk (over which POCL has expressed concern during the development of the option) that by establishing itself as a bank - albeit one offering limited services - POCL could be seen as posing a competitive threat to the banks, thus jeopardising its network banking strategy. However, POCL would be able to reduce this risk by being open about its strategic intent in discussions with the banks.
- The option would allow the capability of the Horizon infrastructure to handle online banking transactions to be proven in the field prior to the introduction of network banking. The resulting reduction in risk would tend to make the network banking proposition more attractive to banks.
- Through its operation of benefit accounts, POCL would acquire customer information which could potentially be an asset in its negotiations with banks. However, POCL would need to consider carefully whether or not to exploit such information - a deal

[4] Source: telephone conversation with Ken Davenport, BA on 15 April 1999

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which provided one bank with access to customer information (for customers other than its own) would be likely to prejudice negotiations with that bank's competitors.

- Benefit account customers might continue to use their benefit accounts even if they also held bank accounts for which network banking had become available. There is thus a risk that option B1 might reduce network banking revenues.

Electronic government

5.2.1.2 By providing for the development of a smartcard-based infrastructure and the creation of a sizeable population of holders of a POCL-branded smartcard, this option would appear to support POCL's electronic government strategy. However:

- In order to exploit the potential of the card, POCL would need to develop its electronic government services quickly, before benefit account holders migrate from the benefit account to ACT into normal bank accounts.
- The benefit recipient population contains high proportions of people in higher age groups and/or lower socio-economic groups. Research[5] suggests that these groups are among the least likely to be early adopters of electronic government due to such factors as fear of technology.

For the purpose of this value for money analysis, the impact of electronic government has been excluded from all options.

Conclusions

5.2.1.3 POCL faces a complex task in maximising benefit from option B1 while minimising cost. Prior to the availability of network banking, it will need to attract and retain benefit account customers, both to maintain footfall and to increase the future network banking transaction base. When network banking becomes available, it will need to encourage customers to move from benefit accounts to "network bank accounts", both to reduce benefit account costs and to increase network banking revenues.

5.2.1.4 Meanwhile, POCL must develop its electronic government services and successfully market them to benefit account holders (who may be reluctant adopters of electronic government) and to the non-benefit-recipient public. These services would need to be firmly established before the numbers of benefit account holders began to decline significantly.

5.2.1.5 Careful planning of the introduction and marketing of new POCL services will therefore be required. Factors to be considered in formulating the plans will include the following.

- There will be a need to maintain the attractiveness of the benefit account in comparison with bank accounts during the early years. During development of the option, there has been a focus on periodicity as a continuing source of competitive advantage for POCL. While BA has advised that, for planning purposes, no change in the periodicity of payments via POCL should be assumed, it has indicated that it is not in a position to guarantee that there will be no change. POCL and ICL view this as

[5] Source: The View from the Queue, Cabinet Office Central IT Unit, October 1998

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a risk. If option B1 is adopted, there will be a need both to explore the periodicity issue and to consider other means of rendering the benefit account an attractive proposition.

- There will be a need to consider carefully the relationship between POCL's electronic government and network banking strategies given that banks are potentially a major channel for electronic government services. For example, POCL might wish to explore collaborative arrangements with banks covering both network banking and electronic government.

5.2.2 *Technical and operational implications*

Horizon infrastructure

5.2.2.1 Option B1 has only a limited impact on the development, implementation and operation of the Horizon infrastructure. This is reflected in the build and operating cost estimates provided by ICL as input to the PA review.[6] The table below summarises these estimates and their derivation. We have assessed the potential variance where there are significant uncertainties relating to the costs.

5.2.2.2 Note that the table presents only the net effects of moving from option A to option B1 rather than the full cost savings from cancelling BPC and the full costs of implementing B1. For example, the table does not include costs for the staff who would no longer be required to support card management for the BPC (a saving from cancelling BPC) but would be required to support card management for the POCL bank card (an equivalent cost associated with B1).

Impact of B1 on ICL as compared to option A			
Item	**ICL Estimate (£m)**	**Discussion of Derivation**	**Estimated Variance £m**
DEVELOPMENT AND IMPLEMENTATION ONE-OFF COSTS			
Software development and test	25	Principally development of account management system and end-to-end testing. This has been derived by extrapolation from current programme costs. Given that the requirement has not been fully defined and that a project plan has not yet been prepared, the figure is subject to significant uncertainty. The variance shown represents ICL's own assessment of the uncertainty of its estimate.	-5 to +25
Training	15	This estimate assumes that a half-day training session will be required, covering the business rules associated with Universal Banking and Network Banking. This may be an underestimate.	up to +15
Magnetic stripe card costs excluded	(6)	Approximate cost of initial batch of cards, now replaced by smartcard cost included in POCL's modelling.	
Contingency	8	Calculated at 20%	
TOTAL	**£29m - £74m with best estimate of £42m one-off cost**		

[6] Report to HMT on Option B for BA/POCL Automation Project, PA Consulting, 9 April 1999

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Impact of B1 on ICL as compared to option A			
Item	**ICL Estimate (£m)**	**Discussion of Derivation**	**Estimated Variance £m**
STEADY STATE PER ANNUM OPERATING COST (Peak Universal Banking Population)			
Data centre operating costs	(1)	Saving from elimination of two-way overnight processing with CAPS.	
Reconciliation	(3)	Saving from elimination of three-way reconciliation with BA and POCL.	
Emergency payments	5	Cost of operating help desk to carry out authorisation checks (including fraud risk).	
Magnetic stripe card costs excluded	(3)	Approximate cost of new and replacement cards, now replaced by smartcard cost included in POCL's modelling.	
PIN reminders by post	2		
Contingency	1	Calculated at 20%	
Total	**£0-1m per annum**		

Bank account operation

5.2.2.3 There will be additional costs associated with the opening and operation of benefit accounts. POCL has estimated an administrative cost of £4.50 for each new benefit account, corresponding to an NPV cost of £45m. The cost is composed as follows.

Item	Cost per account (£)
Counter time associated with signing of mandate by new customer	2
Transmission and storage of completed mandates	2
Counter time associated with PIN selection on distribution of smartcard	0.50
TOTAL	**4.50**

5.2.2.4 ICL has estimated a further steady-state cost of £20m per annum (£121m NPV) for the administration of benefit accounts. The box below summarises the items included.

Administration of benefit accounts - items costed

- retrieval of signed account mandates;
- management of the closure of accounts, including on the death of the account holder or on the appointment of a legal representative for the account holder (eg in the event of the account holder having become mentally unstable);
- change of account holder personal details;
- (occasional) opening of accounts via help desk (as opposed to over the counter or via BA);
- handling of enquiries on account history;
- support for investigation of disputed account activities (eg alleged "phantom withdrawals");
- production of statements on demand (see note);
- handling of lost PIN incidents.

Note: The Banking Code requires statements to be despatched automatically at least quarterly. However, it has been assumed that an on-demand statement capability, coupled with the production of mini-statements at the counter as part of the receipt for each withdrawal, will be acceptable. If automatic quarterly full statements were required, costs would be significantly higher.

5.2.2.5 The £20m per annum estimate is an indicative figure. ICL[7] reports that an initial quote received from Girobank for providing such a service suggests that the costs may be up to 50% higher. We have, however, retained the £20m as a modelling assumption since we would anticipate that the subcontract would be subject to competition which might put a downward pressure on price.

5.2.3 *Encashment fraud*

5.2.3.1 Option B1 transfers a number of encashment fraud risks and associated costs (such as fraud investigation) from BA to POCL. The table below explores specific fraud risks. The table assumes that PINs would be employed as an authentication mechanism for B1, as proposed by ICL. POCL has reservations about the PIN mechanism and this issue is discussed later in this subsection.

Risk	How treated under Option A	How treated under Option B1
Lost/stolen card or PIN compromise - not reported	If EVP[8] is used, ICL bears the risk. If signature is used and investigation indicates that the signature was not properly checked, POCL is liable. Otherwise the risk is borne by BA.	The current understanding is that the risk would be borne by POCL. (However, there is an argument that ICL should bear some or all of the risk if it is controlling the customer authentication mechanism, ie recommending and implementing PINs.) POCL might seek to transfer some of the risk to the customer. However, under the Banking Code, the cardholder's liability should be limited to £50 unless he/she acted negligently. Even where the cardholder has acted negligently (eg by writing his/her PIN on the card), there may be a policy need to provide some compensation. Further work would be required to determine whether this would lead to any greater impact on the public sector than is currently caused by emergency payments following, for example, theft of order books.
Lost/stolen card or PIN compromise - reported	Borne by ICL.	As option A.
Counterfeit card	Borne by ICL. Assessed by ICL as being very low on the grounds that the BPC is an unattractive target compared with credit cards.	As option A. Would be reduced further since smartcard would be harder to counterfeit.
Insider attack	Borne by the organisation whose systems are attacked.	As option A.

[7] Source: telephone conversation with Tony Oppenheim 16 April 1999.
[8] The Extended Verification Process (EVP) is a mechanism for authenticating the identity of a claimant by asking the claimant questions relating to personal information held on the Horizon system. It is analogous to banks' practice of using knowledge of personal information (eg mother's maiden name) to authenticate telephone customers.

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Risk	How treated under Option A	How treated under Option B1
Card not delivered to intended recipient then used for fraudulent withdrawals	Borne by POCL or ICL depending on whether correct procedures were followed.	As option A.
Repudiated transactions	Initial investigation is carried out by BA. Further investigation may be required by BA, ICL and/or POCL. If fraud is identified, cost is borne as per discussion above.	Initial investigation is carried out by POCL. Further investigation may be required by ICL and/or POCL (but not BA). If fraud is identified, cost is borne as per discussion above.

5.2.3.2 In summary, the principal difference between options A and B1 is that, under B1, the costs associated with the initial investigation of repudiated transactions and the risks of fraudulent withdrawals made using an unreported lost/stolen/compromised card transfer from BA to POCL.

5.2.3.3 BA has estimated steady-state encashment fraud savings to be £15m pa greater than under option A, on the assumption that 100% of encashment fraud is eliminated when benefit recipients transfer to ACT. However, because paper-based methods of payment - with their associated fraud costs - are retained for longer than under option A, the NPV increase in fraud savings is only £13m.

5.2.3.4 POCL has estimated an additional cost of £20m per annum (£104m NPV). This is an indicative figure and may be an overestimate, but has been included in the modelling of costs.[9] In particular, we would not have expected a significant increase in overall fraud costs given the analysis above.

PINs

5.2.3.5 The modelling of option B1 has assumed the use of PINs as proposed by ICL. It is important to emphasise that option B1 is not fundamentally dependent on the use of PINs and that an alternative mechanism - most likely to be physical signature - could be used. The issues are summarised in the table below.

Aspect	Without PINs (signatures used)	With PINs
Vulnerabilities	Forgery, fraud/collusion/carelessness on the part of post office counter staff.	Compromise of PIN through negligence on the part of the customer (eg writing the PIN on the card). Unfamiliarity with PINs (eg on the part of older customers - who are less likely to have used ATMs - will increase this risk.
Risk transfer	ICL would be unlikely to accept any risk relating to fraudulent withdrawals other than on stopped cards.	It is more likely that fraud risk could be transferred, although no transfer has been assumed in the financial models.
Costs	There is no PIN pad cost. However, there would be a cost (currently included in	There is a cost associated with installing and operating PIN pads. The cost may be

[9] On B1 core volume assumptions, £104m NPV corresponds to an annual cost in excess of £3 per account. APACS figures (March 1999) suggest an average level of fraud for UK plastic cards of around £1.20 per card (although this does not include the costs of fraud investigation).

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Aspect	Without PINs (signatures used)	With PINs
	option A) associated with the storage and retrieval of paper receipts.	higher than under Corbett since a separate rollout may now be required. POCL's understanding is that the cost of PIN pads would be specific to the provision of benefit accounts since it assumes that signatures will be adequate for network banking.
Customer acceptability	No issue compared with BPC.	Unfamiliarity with technology may reduce customer acceptability, impacting the takeup of benefit accounts. Customers may refuse PINs (as they are entitled to do under the Banking Code) necessitating fallback to other methods.
Transaction times	No impact compared with BPC.	Transaction times may be increased , at least in the initial years, due to a lack of familiarity with technology on the part of customers.

5.2.3.6 In summary, the final decision on authentication mechanisms will require a trade-off to be made between risk, cost and customer acceptability. We would expect the final decision to be made following further detailed assessment of these aspects by POCL and ICL.

5.2.4 ***Impact on Benefits Agency costs and savings***

Delays to automation savings

5.2.4.1 Because the move to ACT under option B1 is later than the move to BPC under option A, savings from automation will be delayed. Steady state savings from automation are around £137m per annum, of which around £62m are from the elimination of physical production and postage and the remainder are from the elimination of manual processes.

Bringing forward of ACT costs

5.2.4.2 Because ACT migration occurs earlier and more quickly under option B1 than under option A, ACT costs are increased. The steady state cost of ACT is £78m per annum. The largest element of this (£50m) is to cover increased entitlement fraud prevention costs, as benefit recipients will no longer be required to sign a declaration of entitlement when they have migrated to ACT. The remainder of the steady state ACT cost comprises payments to BACS, the provision of an alternative mechanism for urgent payments, and contingency (£10m). There are further one-off costs associated with the initial migration to ACT, such as project costs, training and helpdesk operation.

5.2.4.3 From BA's perspective, the costs of ACT are offset by savings in payments to Pathway.

Savings in payments to POCL

5.2.4.4 By bringing forward ACT migration, option B1 reduces payments from BA to POCL. However, from an overall public sector perspective, this effect represents a transfer rather than a saving.

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5.2.5 ***Impact on ICL***

5.2.5.1 Option B1 has the following impacts on ICL's financial position:

- a small increase in net costs of the Horizon infrastructure to support benefit accounts, discussed at 5.2.2 above;
- subcontractor termination costs, amounting to approximately £30m;
- bank operation costs, also discussed at 5.2.2;
- net loss of revenue due to lower transaction volumes.

5.2.5.2 It has been assumed by the parties, during development of the option, that ICL's bank operation costs would be passed through to the public sector.

5.2.6 ***Impact on POCL***

Loss of BA income and associated costs

5.2.6.1 ACT migration is earlier and quicker than in option A, and the floor payment from BA ends at the beginning of ACT migration rather than at the end. This significantly reduces POCL's income, but is set against an equivalent saving for BA. POCL's activity-based costs associated with the paper based mechanism of benefit payment also fall, but not proportionately as only the variable costs are saved.

Cost of establishing POCL bank

5.2.6.2 The following costs are involved in establishing POCL bank:

- Smartcards are assumed and they are considerably more expensive than the magnetic stripe cards, which would be used for the BPC in option A (POCL has estimated the cost to be £65m NPV).
- Account setup costs will be borne by POCL directly.
- POCL will be paying Pathway for the Card Management System and for benefit account transactions. The unit costs of such transactions are similar to those of benefit payments in option A, but in option A these costs were paid by BA.
- New activity based costs will be incurred associated with the benefit account transactions, and these costs more than offset the activity based costs saved for benefit transactions in 5.2.6.1. It is assumed that the activity based cost of performing a banking transaction is equivalent to that of performing a paper-based benefit transaction.
- As discussed above, ICL's bank operating costs will be passed on to POCL.

5.3 Financial results

5.3.1 ***Scenarios***

5.3.1.1 We asked the parties to model three variants of option B1:

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- **Option B1 Core -** This scenario was based on availability of the benefit account from July 2002, as agreed between POCL and ICL in their draft Heads of Terms for option B1, and on POCL's assumptions on the rate of takeup of, and attrition from, the benefit account.
- **Option B1 Sep 01 -** This scenario assumed that the benefit account could be made available nine months earlier than in the core scenario: at the end of September 2001. The core assumptions on takeup and attrition were used.
- **Option B1 High -** There was a concern that the assumptions on takeup and attrition rates were conservative, and that higher takeup and lower attrition could be achieved if the benefit account were correctly positioned. This scenario assumed an availability date of July 2002 but with higher takeup and lower attrition than the core scenario, resulted in transaction volumes comparable to the BPC.

5.3.1.2 Further detail of the assumptions used is given in appendix 1.

5.3.2 ***Financial results***

Option B1 Core

5.3.2.1 The table below summarises the financial results for option B1 Core, and the NPV movements from option A to option B1 Core (favourable movements are shown as positive numbers and adverse movements as negative numbers). As before, detailed cashflows are presented in appendix 3.

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Option B1 Core, plus B1 Core as compared to option A	**£m NPV** B1 Core	**£m NPV** v option A Fav/(adv)
BA		
Payments to Pathway	(73)	358
ACT costs, including contingency	(456)	(224)
Cost of the "unbanked"	-	70
CAPS savings	606	(275)
POU savings	16	10
Payments to POCL saved	1,243	729
BA net administrative savings	1,337	669
BA programme savings	918	13
BA net administrative savings and programme savings	2,254	682
POCL		
Capital costs and non recurring revenue costs	(147)	(21)
BA & girocheque income	(1,410)	(696)
BA/SSA & girocheque related ABC costs	715	246
Cost of smartcards	(65)	(65)
Card Management Service (CMS)	(57)	(57)
Account setup	(43)	(43)
Systems charges for POCL banking	(124)	(124)
POCL banking ABC costs	(269)	(269)
POCL banking fraud costs	(104)	(104)
Network banking income	366	(90)
Network banking ABC costs	(256)	63
Network banking systems charges	(86)	25
Cost of new banking technology	-	-
Other POCL contribution	172	-
Other systems charges	(371)	(4)
Loss in other POCL contribution - footfall impact	(40)	(4)
Other POCL net costs	88	(3)
Subsidy: retail impact subpostmasters	-	-
POCL net impact on profits	(1,630)	(1,146)
Sub total impact on the Public Sector	624	(465)
ICL funding gap (ie ICL's NPV excluding £126m)	(439)	(403)
Total cashflow impact on Public Sector	185	(868)
Less ICL termination payment in baseline	150	-
Total NPV impact on Public Sector	**335**	**(868)**

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Notes

5.3.2.2 The ICL funding gap includes a cost of £121m NPV for banking operations. The majority of the remainder of the gap is attributable to loss of revenue, with less than £50m being attributable to increased costs for the B1 Core.

Options B1 Sep 01 and B1High

5.3.2.3 The table below shows the NPV movements of options B1 Sep 01 and B1 High relative to option A, and also includes option B1 core again to aid comparison.

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B1 scenarios relative to option A, fav/(adv)	**£m NPV** B1 Core v A	**£m NPV** B1 Sep01 v A	**£m NPV** B1 High v A
BA			
Payments to Pathway	358	372	358
ACT costs, including contingency	(224)	(303)	(224)
Cost of the "unbanked"	70	70	70
CAPS savings	(275)	(192)	(275)
POU savings	10	14	10
Payments to POCL saved	729	974	729
BA net administrative savings	669	936	669
BA programme savings	13	49	13
BA net administrative savings and programme savings	682	985	.682
POCL			
Capital costs and non recurring revenue costs	(21)	(21)	(21)
BA & girocheque income	(696)	(904)	(696)
BA/SSA & girocheque related ABC costs	246	255	246
Cost of smartcards	(65)	(72)	(110)
Card Management Service (CMS)	(57)	(63)	(97)
Account setup	(43)	(45)	(57)
Systems charges for POCL banking	(124)	(137)	(215)
POCL banking ABC costs	(269)	(294)	(480)
POCL banking fraud costs	(104)	(121)	(154)
Network banking income	(90)	(86)	(120)
Network banking ABC costs	63	62	84
Network banking systems charges	25	25	32
Cost of new banking technology	-	-	-
Other POCL contribution	-	-	-
Other systems charges	(4)	(3)	(4)
Loss in other POCL contribution - footfall impact	(4)	(3)	11
Other POCL net costs	(3)	(12)	(5)
Subsidy: retail impact subpostmasters	-	-	-
POCL net impact on profits	(1,146)	(1,420)	(1,585)
Sub total impact on the Public Sector	(465)	(435)	(903)
ICL funding gap (ie ICL's NPV excluding £126m)	(403)	(359)	(279)
Total cashflow impact on Public Sector	(868)	(794)	(1,182)
Less ICL termination payment in baseline	-	-	-
Total NPV impact on Public Sector	**(868)**	**(794)**	**(1,182)**

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5.3.3 ***Potential Additional Costs***

5.3.3.1 Subsequent to the modelling reported above, a number of additional costs were identified by BA. Further work would be required fully to validate these costs and they have therefore not been included in the modelling. However, a summary of their indicative NPV impact on the B1 core case is given in the table below.

Item	**Impact £m NPV on B1 Core**	**Comments**
BA Cost of migration	(12)	Cost to the BA of issuing letters to advise claimants of the change (estimated by BA at £1 per letter)
Cost of the "unbankables"	(137)	Cost to the BA of supporting those claimants who refuse to open a benefit account or a bank account and therefore cannot be paid by ACT
Quarterly statements	(52)	Estimate of the cost (40p per statement) which would be incurred if it were necessary to issue quarterly statements in accordance with the Banking Code (5.2.2.4 refers).

5.3.4 ***Interpretation of results***

5.3.4.1 The table below summarises the way in which different aspects of option B1 have contributed to the overall movement. A detailed discussion of each of the movements is presented in appendix 4.

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Summary of NPV movements from option A to option B1 Core, £m				
	BA	**POCL**	**ICL**	**Total**
Impact of cancelling BPC and accelerating ACT				
Payments to Pathway for BPC services	358		(358)	0
Payments from BA to POCL	729	(696)		33
ACT costs	(224)			(224)
Savings foregone through automation delay	(265)			(265)
Estimated variable costs saved from cancelling BPC			150	150
ABC costs for orderbooks and girocheques		246		246
Subtotal	599	(450)	(208)	(59)
Impact of POCL Bank				
Smart card		(65)		(65)
Card Management Services		(57)	57	0
Account setup		(43)		(43)
Payments to Pathway		(124)	124	0
POCL bank ABC costs		(269)		(269)
ICL bank operating costs			(121)	(121)
Additional ICL costs (based on net capex/opex 42m)			(192)	(192)
Cost of "unbanked" saved	70			70
Subtotal	70	(558)	(132)	(620)
Other effects				
ICL funding gap (excl effects above)			(62)	(62)
Net impact on fraud[10]	13	(104)		(92)
Misc		(34)		(34)
Subtotal	13	(139)	(62)	(188)
Total	682	(1,146)	(403)	(868)

5.3.4.2 Because ICL has a high fixed cost base, it is necessary to replace a significant proportion of the revenue lost from the cancellation of the BPC in order to return ICL to its former position of a £126m NPV loss. This more than offsets the savings to the public sector to be gained from the cancellation of BPC and the acceleration of ACT. In effect, the public sector is still paying for the BPC. In addition, the public sector is paying for the setting up and operation of the BPC's replacement: the benefit account. It can be seen from the table that the new costs associated with this are considerable.

[10] As discussed at 5.2.3, we would not expect a significant increase in fraud costs given that the principal effect of B1 is to transfer existing costs and risks from BA to POCL. The net impact on fraud may therefore be overstated, reflecting the indicative nature of the estimates of POCL bank fraud costs.

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5.3.4.3 The modelling of B1 Sep01 indicates that an acceleration of the option B1 development would only slightly improve the situation for the public sector. This is because the benefit to be gained by bringing forward BA administrative and programme savings is largely offset by the bringing forward of ACT and benefit account costs.

5.3.4.4 The modelling of B1 High indicates that the supporting of a large number of benefit accounts would represent a significant cost for the public sector. This reflects the fact that there would be no (modelled) cost savings or income offsetting the increase in variable costs. Note, however, that the model does not include Electronic Government income, which might be increased if the population of benefit account smartcard holders were greater.

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6 Option B2

6.1 Description of B2

6.1.1 *Principles*

6.1.1.1 In Option B2, the purpose and functionality of benefit accounts would be the same as in Option B1. However, rather than being operated by ICL, the accounts would be operated by a number of banks with whom POCL would contract.

6.1.1.2 The counter application used to handle benefit account transactions would continue to be hosted on Horizon. A high-capacity interface, known as the "banking hub" would be required to link Horizon to the systems of the banks operating the benefit accounts.

6.1.1.3 In discussions of Option B2, it was assumed that ICL would carry out management of the benefit account smartcard, as under B1. However, it would also be possible for card management to be carried out by the banks.

6.1.1.4 POCL's view is that of the order of five banks would be involved in operating benefit accounts. The principal drivers for this figure are the lack of presence of English banks in Scotland and Northern Ireland, and the extent of spare capacity in banks' IS/IT.

6.1.2 *Difference in commercial implications for POCL compared with B1*

Network banking

6.1.2.1 There is likely to be a strong linkage between the negotiations for benefit accounts and network banking. This is because:

- It has been assumed that POCL would pay banks to operate benefit accounts but that banks would pay POCL for network banking transactions. If the agreements with a particular bank reflected this assumption, the bank would be disincentivised from facilitating the migration of customers away from benefit accounts and into network bank accounts, thereby compromising the network banking strategy. This potential conflict of objectives could potentially be addressed by negotiating the two elements as a "package".
- Banks operating benefit accounts will potentially benefit from the customer information and sales opportunities which the account could offer. This may enable POCL to obtain lower charges for the operation of the benefit but may also prejudice future network banking opportunities (eg by requiring a measure of exclusivity).

6.1.2.2 As POCL and its partner banks will be well-positioned to migrate customers from the benefit account to a partner bank account, POCL may well be able to increase its network banking revenue.

6.1.2.3 However, due to the linkage between benefit accounts and network banking Option B2 may place negotiations on network banking on the critical path for the achievement of

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public sector savings from the automation of benefit payments. There is thus a risk that because of the consequent urgency of the negotiations, POCL might be pressured into entering into agreements which would be inappropriate in the longer term.

Electronic government

6.1.2.4 One of the objectives of option B1/B2 is to provide POCL with a competitive advantage in the emerging electronic government market. However, banks are potential competitors in this market. There is thus a possibility that the negotiations with banks might be extended to cover electronic government aspects (eg branding of the card, use of the card at banks for electronic government transactions). This could increase the complexity - and hence duration - of the negotiations.

6.1.2.5 Again, it should be noted that the impact of electronic government has been excluded from the modelling of all options.

6.1.3 ***Differences in technical and operational impact compared with option B1***

Horizon infrastructure

6.1.3.1 Option B2 has a more significant impact on the development, implementation and operation of the Horizon infrastructure than does option B1. The table below summarises the *difference* in costs between option B2 and option B1, as set out in the costing information prepared by ICL as input to the PA review[11]. As in the case of option B1, the table shows net effects and such aspects as redeployment of headcount are excluded from these estimates. We have assessed the potential variance where there are significant uncertainties relating to the costs.

Impact of B2 on ICL as compared to option A			
Item	**ICL Estimate (£m)**	**Discussion of Derivation**	**Estimated Variance (£m)**
DEVELOPMENT AND IMPLEMENTATION ONE-OFF COSTS			
Process definition	5	A new cost covering the agreement of operating processes with each of the five banks.	
Software development and test	(5)	Although it would not be necessary to develop an account system - hence the reduction in costs - it would be necessary to modify the card management system and carry out end-to-end testing with each of the banks. Given that the requirement has not been defined, a project plan has not been drafted, and the programme risk arising from the number of banking partners, this estimate is subject to significant uncertainty.	-5 to +30
Setup costs of online communications	14	It has been assumed that some post offices would require Frame Relay rather than ISDN because of increased transaction volumes.	

[11] Report to HMT on Option B for BA/POCL Automation Project, PA Consulting, 9 April 1999

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Impact of B2 on ICL as compared to option A			
Item	**ICL Estimate (£m)**	**Discussion of Derivation**	**Estimated Variance (£m)**
Banking Hub	30	This estimate has been based on a very limited analysis and is therefore subject to a wide margin of error. Note that this estimate from ICL was increased by £5m from that provided to PA, following further analysis by ICL.	-10 to + 10
Contingency	8	Additional contingency.	
TOTAL	**Increase over B1 = £29m to £92m with a best estimate of £52m one-off cost**		
STEADY STATE PER ANNUM OPERATING COST (Peak Universal Banking Population)			
Contractual boundary management	1	Management of the relationships with the five banks.	
Data centre operating costs	4	Operation of online processes interacting with other banks. This figure assumes online notification of lost/stolen card stops to banks' systems. Depending on design, this element of complexity may be eliminated.	down to -3
Reconciliation	5	Support for reconciliation with the five banks.	
Online communications	16	Frame Relay rental.	
Hub operating costs	5.5	Indicative estimate, subject to significant uncertainty.	-2 to +2
Contingency	6	Additional contingency.	
Total	**£32.5m to £39.5m per annum additional to B1**		

Bank account operation

6.1.3.2 We would expect the costs of account operation to be broadly comparable between options B1 and B2 and assume that POCL would seek to optimise the balance between economies of scale and exploitation of spare capacity in its selection of, and negotiations with, partner banks.

6.1.4 *Differences in timescale compared with option B1*

6.1.4.1 We would expect the development of option B2 to take longer than that of B1. This is for the following reasons:

- While negotiations for option B1 have already progressed to draft heads of agreement, option B2 would require identification of, and negotiation with, a number of partner banks. This would delay specification of the changes required to Horizon, particularly given the complexity of the negotiations discussed at 6.1.2.
- The development programme is more complex than that for option B1 because of the need to develop additional operating procedures and the systems to support them, to specify and develop the banking hub and to carry out end-to-end testing with all the partner banks.

6.1.5 *Financial impact compared with option B1*

6.1.5.1 Although some modelling of option B2 was carried out at an early stage by the parties, a decision was made by the parties to focus on option B1 and not carry B2 forward.

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Consequently, we do not have financial projections for B2 based on a common set of assumptions comparable with B1.

6.1.5.2 We would expect option B2 to have an adverse impact on the public sector as compared with option B1. Significant elements of the effect would include:

- BA savings would be impacted if the implementation of benefit accounts were delayed compared with option B1. As a guide to the impact, the nine-month delay in ACT migration between scenarios B1 and B1Sep 01 has an adverse impact on BA of approximately £300m NPV (of which around £240m represents payments to POCL not avoided, and is therefore a transfer within the public sector).
- The increase in Horizon costs would have a significant impact which previous ICL modelling suggests would be in the range £150m-200m NPV.

7 Option B3

7.1 Description of B3

7.1.1 *Principles*

7.1.1.1 In option B3, the BPC would be cancelled as in option B1. As in B1, development and implementation of the core Horizon infrastructure and OBCS would continue.

7.1.1.2 Rather than establishing benefit accounts, POCL would put in place mechanisms which would allow it to pay benefits in cash from ordinary bank accounts over post office counters.

7.1.1.3 Once a cash payment mechanism was available, BA would begin migration to ACT. Compulsory ACT migration would be over the two years 2003/4 and 2004/5, timed to complete before expiry of the BA contract with ICL for OBCS, in May 2005. Optionally, the compulsory migration period could be preceded by a period of voluntary migration, beginning around June 2001, during which ACT would be heavily promoted.

7.1.1.4 BA expects that there would remain a small proportion of claimants (assumed by BA to be 15%) for whom ACT was infeasible, at least initially. BA would contract a "New Service Provider" to provide a payment service for these claimants. It is possible that POCL/ICL might win the contract to be the New Service Provider.

7.1.1.5 There are no smartcards assumed in the modelling of option B3.

7.1.2 *Cash payment mechanism and implications for timing*

Network banking

7.1.2.1 In the longer term, POCL's network banking strategy offers a potential solution to the problem of paying benefits in cash from customers' bank accounts. However, there is a timing issue - will network banking be sufficiently firmly established before the migration to ACT needs to begin?

7.1.2.2 In our previous work on termination options, we estimated the following timescales for the development of network banking over the Horizon infrastructure:

- development: 6-9 months;
- testing and live trial: 6-12 months (with a further 6 months if a pilot were required);
- rollout: 15 months (could possibly be reduced to 12 months if no PIN pads required; other timescale drivers are staff training and the rate at which banks/LINK would accept connections).

7.1.2.3 To this total must be added the time required to establish the network banking requirement in consultation with banks and/or LINK. Our view is that 12 months should be allowed for this, giving a total timescale of 36-48 months.

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7.1.2.4 It is consequently unlikely that network banking could be made available over the Horizon infrastructure (other than perhaps for a pilot) until 2002/3.

7.1.2.5 These estimates of timing are closely aligned with POCL's forecasts of the growth of network banking used in the modelling of options A and B1. In 2001/2, POCL's forecast of network banking "market share" (the proportion of current accounts which can be accessed via network banking) is only 9% (representing a pilot project). This rises to around 25% by 2003/4 and around 45% by 2005/6.

7.1.2.6 There is a possibility that POCL might be able to accelerate the establishment of network banking, particularly since cancellation of the BPC would allow resources to be focused on the banking aspect of Horizon. However, other factors would impede such acceleration. For example, in the absence of the BPC, POCL's automation technology - which is critical to the acceptability of the network banking proposition to banks - will remain unproven.

7.1.2.7 In summary, it would be prudent to assume that if network banking as currently planned is to form the basis of benefit payments, ACT migration should be delayed until the start 2003/4 (if payment via post offices is required).

7.1.2.8 This is consistent with B3 provided that the compulsory migration period is not preceded by a period of heavily-promoted voluntary migration. However, if there is to be such a period, it is likely that an alternative cash payment mechanism would be required. A possible approach is outlined below.

Cash advance via Merchant Acquirer

7.1.2.9 The alternative approach involves POCL providing cash advances against debit cards (comparable to the "cashback" service offered by supermarkets) by means of EFTPOS. This would involve POCL establishing a relationship with a Merchant Acquirer. In contrast to the network banking proposition - which is novel - this option has the advantage that there are well-established standards for technical and procedural relationships.

7.1.2.10 However, a number of issues would need to be addressed. Firstly, a change to APACS rules would be required in order to allow cash advances against debit cards. (Current rules prevent the provision of "cashback" unless a purchase is made.)

7.1.2.11 Secondly, the commercial basis for cash advances against debit cards would need to be agreed. Retailers normally pay the Merchant Acquirer commission on each transaction, a portion of which is passed on to the Card Issuer by the Merchant Acquirer. A straightforward continuation of this paradigm would result in POCL paying its Merchant Acquirer a fee (possibly in the range 4.5p - 8p[12]) for each cash advance.

7.1.2.12 This would both represent an additional cost for POCL and, potentially, create a conflict of objectives between POCL and the banks which would impede the development of the network banking strategy - a move to network banking would change the commercial

[12] Source: informal discussions with a Merchant Acquirer during October 1998

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relationship from one in which banks were paid commission on cash advances to one in which they had to pay POCL.

7.1.2.13 It is, however, possible that the Merchant Acquirer would be able to negotiate the payment of commission by Card Issuers for cash advance transactions and that POCL would be able to negotiate a share of this commission. This possibility is suggested by the following precedents:

- The cash advance service is functionally equivalent to a "foreign" ATM transaction. It is established practice for the Card Issuer to pay commission of around 50p for such transactions.
- The proposed debit card cash advance would be analogous to a credit card cash advance. Card Issuers currently pay Merchant Acquirers a commission on credit card cash advances at the International Credit Card Reimbursement Rate (around 1% Of the transaction value).

7.1.2.14 For the purposes of modelling, we have prudently assumed that such a commission would not be negotiated and that POCL would therefore pay Merchant Acquirer fees.

Timescale for cash advance facilities

7.1.2.15 We have not discussed the timescales for EFTPOS to support cash advances with ICL. However, timescales are likely to be shorter than those for network banking, for the following reasons:

- negotiations with banks on technical requirements would not be required - development could proceed in parallel with commercial negotiations;
- development and testing are likely to be more rapid because only one bank (the Acquirer) is involved and the technical and procedural interfaces are well-understood;
- there may be fewer constraints on the rate at which offices can be brought on line, again because of the standard nature of the interface.

7.2 Implications of option B3

7.2.1 *Impact on POCL*

Impact on POCL strategy

7.2.1.1 As discussed above, there is a risk that the introduction of an interim cash payment service based on EFTPOS would impede the development of POCL's network banking strategy. It would be important to hold early discussions with banks, in particular potential Merchant Acquirer partners.

7.2.1.2 Option B3 may also impact the development of electronic government services. Although it would provide a technical infrastructure capable of supporting smartcards, it would provide neither a smartcard-carrying population nor the back-end operation required to support that population (help desks, card production and distribution, etc). As

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in other options, revenues from electronic government services have not been included. Smartcard costs have not been included in option B3.

7.2.1.3 We would observe that banks are moving towards the replacement of magnetic stripe cards with smartcards and that banks are viewed as potential channels for the delivery of electronic government services. POCL may wish to consider widening its network banking (and, if applicable, interim cash payment) negotiations to embrace the possibility of collaboration with banks in the delivery of electronic government services.

Network size and footfall

7.2.1.4 Although our modelling of option B3 was carried out in isolation from POCL, we have used assumptions for network size and impact of footfall loss broadly comparable with those used by POCL for the modelling of option C. These are discussed at 8.1.3.

7.2.2 *Impact on ICL*

Impact on ICL cost base

7.2.2.1 In our modelling, we have assumed a reduction in ICL's costs of £150m. This assumption is based on information provided by ICL, in the course of our October 1998 work on fallback options, on the impact of cancelling the BPC. The estimate is consistent with the change in ICL's revenue and our understanding of ICL's ratio of fixed to variable costs. However, since the estimate for the purposes of this work has been derived in isolation from ICL, it must be considered to bear a significant margin of error.

7.2.2.2 It should be noted that the modelling of ICL's costs assumes that there is not a major hiatus in the project such as might result from terminating the current agreement prior to opening negotiations over B3. It is likely that additional costs would be incurred in restarting the project following any such hiatus.

ICL's net NPV position

7.2.2.3 The modelling of option B3 assumed that ICL will still be prepared to absorb a loss of £126m NPV. However, it was recognised at the time of the modelling that this might not be acceptable to them under this option. In particular, because this option does not involve the creation of a smartcard-carrying population, ICL may perceive the potential of "Golden Cloud" to be lower.

7.2.2.4 Subsequent to the value for money analysis, KPMG staff assisted HM Treasury in calculating the impact on cashflows of the price elements of the offers discussed during negotiations with ICL over option B3. The last offer for which such calculations were performed is set out at appendix 6.

7.2.3 *Impact on BA*

7.2.3.1 As in the case of option B1, B3 has impacts on the timing of ACT costs and automation-related savings. The impact of B3 is adverse compared with B1 because ACT migration completes later.

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7.2.3.2 In addition, this option involves new costs for the New Service Provider. The costs associated with the New Service Provider have been modelled by BA and assume a payment of 60p per transaction for the 15% of benefit recipients who will not be able to take up ACT initially. (It is assumed that in future years most will indeed migrate to ACT.)

7.3 Financial results

7.3.1 *Scenarios*

7.3.1.1 The paragraphs below define the scenarios modelled and key assumptions employed. Further detail of assumptions is given at Appendix 1.

Scenario definitions

7.3.1.2 We defined the following scenarios:

- *With Marketing* - Voluntary ACT migration is heavily promoted in the period July 2001 to April 2003. Compulsory ACT migration takes place over the two years 2003/4 and 2004/5. This variant requires the deployment of an interim cash payment service based on EFTPOS. It is assumed that this would be delivered over the Horizon platform.
- *Without Marketing* - Compulsory ACT migration takes place over the two years 2003/4 and 2004/5 without prior marketing of voluntary ACT.

Interim cash payment service

7.3.1.3 In the With Marketing scenario, we have assumed the provision of an interim cash payment service based on EFTPOS, in line with the conclusion above that Network Banking would not be in place in time for the voluntary migration period.[13] It is assumed that POCL will have to pay the Merchant Acquirer for these transactions.

7.3.1.4 We have assumed that the interim cash payment service would be heavily promoted so as to maintain footfall in advance of network banking. Costings therefore assume that all migrated benefit claimants would continue using the post office for cash withdrawals via the interim service (which, being based on EFTPOS, would support all accounts with debit card facilities).

7.3.1.5 There is a risk that the volumes may be overstated as some customers may well change their behaviour as a result of ACT migration, moving to the use of cash withdrawal channels other than POCL. As a guide to the impact of this assumption, a reduction by 50% in interim cash withdrawal transactions would reduce banking costs by an amount of the order of £20m NPV (although this would be offset to some extent by an adverse impact on footfall).

[13] Notwithstanding the uncertainty surrounding the introduction of network banking prior to 2003/4, we have retained the non-benefit-payment-related network banking costs and revenues prior to 2003/4 which were included in other options to aid comparability. As an indication of the effect of this, the total net impact on POCL contribution of these is of the order of only £1m NPV.

7.3.1.6 Once network banking becomes established in 2003/4, we have assumed that POCL would actively encourage non-network-bank customers to stop using the service and to switch to network banking instead, eg by beginning to levy transaction charges for cash advances over EFTPOS.

New Service Provider

7.3.1.7 We conservatively have assumed that POCL would not win the BA tender for a "new service provider" for those claimants not migrating to ACT. If POCL were to win this tender, we estimate it would improve its NPV contribution by around £100m.

7.3.2 ***Derivation of models***

7.3.2.1 The B3 With Marketing scenario was modelled as follows:

- The impact on BA was modelled by BA.
- The impact on POCL was estimated by KPMG in isolation from POCL and was based on POCL's modelling of other options, taking into account the appropriate phasing of ACT.
- The impact on ICL was estimated in isolation from ICL, drawing heavily on an assessment, provided by ICL in October 1998, of the impact of cancelling the BPC element of Horizon.

7.3.2.2 Initially, the B3 No Marketing scenario was modelled in the same way as the With Marketing scenario. On reviewing the models, the public sector parties took the view that B3 No Marketing was preferable to B3 With Marketing. Consequently, further analysis and modelling were carried out by both POCL and BA. The model presented herein reflects the results of that analysis and was derived as follows:

- The impact on BA was re-modelled by BA. KPMG made a number of adjustments - in consultation with BA - to this modelling in order to ensure comparability of assumptions between options. These adjustments were as follows:
  - BA's model did not include ACT contingency costs for the years 2007/8 to 2009/10. KPMG added contingency cost to these years in line with that modelled by BA for previous years (£10m pa).
  - BA's model included ESNS[14] savings of £4m pa from 2001/2 to 2004/5. These savings were not assumed in the modelling of option Cx, which has the same ACT migration pattern. For prudence and comparability, we have excluded these savings.
  - BA's model assumed that the fixed fee element of payments to POCL did not continue during ACT migration, whereas in option Cx, it was assumed that the fixed fee element would continue. For comparability, KPMG assumed payments to POCL based on those modelled by BA for option Cx. However, the annual

[14] Electronic Stop Notice Service - an existing electronic system for controlling fraudulent use of lost and stolen order books. This is currently deployed within the London area only. The capability is to be deployed throughout mainland UK, either over the Horizon infrastructure or, were Horizon to be cancelled, over an alternative platform.

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payment to POCL avoided once ACT migration was complete was limited to £351m, this being the annual payment to POCL assumed in the baseline for the relevant years.

- The modelling of the impact on POCL was based on modelling carried out by POCL. KPMG adjusted the technology costs modelled by POCL; a discussion of the adjustments is provided below.
- The impact on ICL was estimated on the basis used for the model of B3 With Marketing.

POCL technology costs for option B3 No Marketing

7.3.2.3 ICL's proposal for option B3 covers only the period up to the end of 2004/5. POCL assumed in its modelling that, at the end of this period, it would contract for the development of a new service completely replacing Horizon. Consequently POCL had modelled the costs for the development of an entirely new service, using the costs assumed in option C and option Cx for such a development.

7.3.2.4 KPMG proposed an alternative "do minimum" assumption: that at the end of 2004/5, ICL would be contracted to continue to operate the Horizon infrastructure, carrying out the level of technology refreshment which would have been carried out under option A. Although there may be advantages to POCL in contracting for a new service, we would expect that an approach other than the "do minimum" would be required to yield additional benefits sufficient to offset its additional costs. The "do minimum" assumption could therefore be seen as representing a "worst case".

7.3.2.5 POCL raised two concerns relating to the use of the "do minimum" assumption:

- POCL would not wish it to be inferred that it was willing to enter into any agreement now with ICL for the period beyond 2004/5.
- POCL is concerned that it might not be in a position to contract another party to refresh and operate the Horizon system at a price comparable to that which it is assumed would be charged by ICL, and might therefore be unable to exercise competitive pressure on ICL. ICL might therefore seek to charge a price for refreshing and operating Horizon significantly in excess of that currently estimated. POCL's concerns in this area relate to issues such as IPR and software support.

7.3.2.6 Following discussion with HM Treasury, it was agreed that the "do minimum" assumption should be used for modelling purposes. Nonetheless, the concern expressed by POCL over its position to exercise competitive pressure on ICL at the end of the initial contract represents a real risk.

7.3.2.7 If the risk were to mature, and POCL were to contract for an entirely new infrastructure, the adverse impact, based on POCL's modelling, would be in the range £260m NPV (assuming an ISDN-based communication architecture as assumed across this value for money analysis) and £409m NPV (if a fully online network were employed, as assumed by POCL).

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7.3.2.8 We strongly recommend that, prior to any final agreement with ICL, POCL satisfy itself that it will be in a position to take over the Horizon infrastructure so that it can readily contract a third party to refresh and maintain it. Issues to be explored in the negotiation will include IPR, ownership of assets, and software and hardware support.

Modelling of the "do minimum" assumption

7.3.2.9 We took the following approach to the modelling of the "do minimum" assumption:

- The costs of technology refreshment and operation were estimated based on the high-level (published) ICL costs for other options.
- A 15% margin was added, as it was assumed that ICL would seek to negotiate any new contract on a profitable basis.

7.3.3 *Financial Results*

7.3.3.1 The table below shows the summarises the financial results for the two variants of option B3, with and without marketing of ACT prior to 2003/04.

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Option B3 with and without marketing	**£m NPV B3 mktg**	**£m NPV B3 no mktg**
BA		
Payments to Pathway	(66)	(84)
ACT costs, including contingency	(515)	(387)
Cost of the "unbanked"	(204)	(174)
CAPS savings	584	505
POU savings	16	13
Payments to POCL saved	1,433	1,179
BA net administrative savings	1,248	1,052
BA programme savings	933	874
BA net administrative savings and programme savings	2,181	1,926
POCL		
Capital costs and non recurring revenue costs	(148)	(148)
BA & girocheque income	(1,561)	(1.295)
BA/SSA & girocheque related ABC costs	821	627
POCL bank costs: smart cards, opening accounts etc	-	-
Network banking income	411	432
Network banking ABC costs	(288)	(301)
Network banking systems charges	(99)	(104)
Cost of new banking technology	(49)	-
Other POCL contribution	172	172
Other systems charges	(368)	(368)
Loss in other POCL contribution - footfall impact	(37)	(52)
Other POCL net costs	138	105
Subsidy: retail impact subpostmasters	(137)	(121)
POCL net impact on profits	(1,145)	(1,052)
Sub total impact on the Public Sector	1,035	875
ICL funding gap (ie ICL's NPV excluding £126m)	(340)	(316)
Total cashflow impact on Public Sector	695	559
Less ICL termination payment in baseline	150	150
Total NPV impact on Public Sector	**845**	**709**

7.3.4 ***Interpretation of results***

7.3.4.1 The table below summarises the way in which the different aspects of B3 have contributed to the overall movement of NPV as compared to option B1 core (NB not option A).

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Variance compared to B1 core	£m NPV B3 mktg	B3 no mktg
Impact of accelerating or delaying ACT		
BA payments to POCL	38	51
BA administrative savings	(81)	(36)
BA programme savings	15	(43)
Paper based ABC costs for POCL	105	(88)
Payments for OBCS (or equivalent from alternative supplier)	6	(11)
Sub total	84	(127)
New benefit payment mechanism		
Smart cards	65	65
Card Management Services (CMS)	57	57
Account setup	43	43
Account running costs	121	121
POCL bank systems charges	124	124
"New Service Provider"/cost of the unbanked	(204)	(174)
POCL banking ABC costs	269	269
POCL bank fraud costs	104	104
Subsidy: retail impact on subpostmasters	(137)	(121)
Sub total	442	488
Automation technology		
New banking technology (including interim solution)	(49)	-
Other systems charges saved	(10)	(13)
ICL funding gap (excl account running costs in B1)	(22)	-
Sub total	(81)	(13)
Other	65	26
Total	510	374

7.3.4.2 As illustrated above, the main reason that option B3 is significantly less expensive than option B1 is because the costs of establishing POCL bank as the mechanism for paying benefits are avoided.

7.3.4.3 The cost of the core infrastructure is largely unchanged. The cost of the interim solution in option B3 With Marketing is arguably attributable to the new benefit payment mechanism as it is required to enable benefit recipients to withdraw cash from Post Offices, but is has been included as a cost of the automation technology on the basis that it is a means to retain footfall prior to the availability of network banking.

7.3.4.4 Option B3 With Marketing benefits from ACT migration beginning one year earlier than in option B1. Similarly, B3 Without Marketing is adversely impacted by delayed ACT migration as compared to option B1. Note, however, that in both cases there is a (smaller) compensating footfall effect.

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8 Option C

8.1 Description of option C

8.1.1 *Introduction*

8.1.1.1 Under option C, the contract with ICL would be terminated. A date would be set for compulsory ACT migration. It would be necessary to:

- identify an alternative means of allowing benefit recipients to withdraw benefits in cash from post offices;
- procure an alternative automation infrastructure for POCL which would support the benefit payment mechanism and a platform for the development of other services.

8.1.2 *Benefit payment mechanism*

8.1.2.1 As in the case of option B3 (see 7.1.2), two benefit payment mechanisms have been identified: network banking and cash advance. The timescales for availability of the mechanisms, however, differ between options B3 and C.

Network banking

8.1.2.2 The procurement and development time for the replacement automation platform are likely to be the critical timescale driver for network banking in option C. Our work on the termination option in October 1998 estimated that 39 months would be required from award of contract to the rollout of a replacement automation platform. To this period, it is necessary to add the time required for requirements analysis and procurement, previously estimated at a minimum of 24 months.

8.1.2.3 Consequently, if the project to implement a new automation platform incorporating network banking were begun now, it is reasonable to assume that implementation would not complete until 2004/5.

8.1.2.4 It is possible that these timescales might be reduced by concentrating purely on the network banking requirement. However, this could delay the realisation of other automation benefits for POCL, and possibly place those benefits at risk (eg if a platform attuned to banking but poorly suited to other POCL requirements was procured in order to meet the accelerated timescales).

Cash advance via Merchant Acquirer

8.1.2.5 Two approaches could be adopted towards the EFTPOS functionality required.

8.1.2.6 Firstly, a dedicated infrastructure could be deployed solely to support EFTPOS. This would be based on standard off-the-shelf debit terminals. This was the approach envisaged in the original work carried out on fallback options in October 1998. That

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analysis suggests that, if the project were to start now, a debit terminal infrastructure could be made available during 2001/2.

8.1.2.7 Alternatively EFTPOS could be provided by a new automation platform supporting electronic point of sale and other POCL automation requirements. It is likely that an early release of the new automation platform, specifically focused on meeting the EFTPOS requirement, would be required.

8.1.2.8 As in the case of network banking, there is a risk that acceleration of this one component of the programme could jeopardise the realisation of other benefits. However, the overall risk associated with accelerating EFTPOS rather than network banking is likely to be lower since the former is a well-understood standard mechanism while the latter is an innovative proposition.

8.1.2.9 Even given such acceleration of the development, we believe it unlikely that the initial release could be made available in significantly less than two years from the award of a contract, ie during 2003/4, unless procurement could be accelerated. This is principally due to the time required for rollout.

8.1.3 *Impact on POCL strategy*

8.1.3.1 The implications of option C for POCL's network banking and electronic government strategies are similar to those of option B3. However, the extent of the impact is likely to be greater because the introduction of an automation infrastructure for POCL would be further delayed.

8.1.3.2 The approach taken to the modelling of other impacts on POCL is discussed at 8.2.2 below.

8.2 Financial results

8.2.1 *Scenarios*

8.2.1.1 Two variants of option C were modelled: C and Cx. The only difference between the two options was that option C assumed ACT migration beginning in 2001/02 whereas option Cx assumed ACT migration beginning in 2003/4. Both scenarios assumed that migration would take place over two years, evenly spread. It should be noted that option Cx is therefore directly comparable with option B3 with respect to ACT migration.

8.2.2 *Derivation of POCL projections*

8.2.2.1 The POCL projections were derived from new modelling by POCL. The paragraphs below present our comments on the modelling and describe the adjustments made by KPMG.

Benefit payment mechanism

8.2.2.2 In carrying out its modelling, POCL assumed:

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- that network banking would be employed as the cash payment mechanism;
- that network banking market share would be same as in option A. Consequently, in scenario C, only 9% of customers migrating to ACT in 2001/2 would have access to network banking facilities and therefore continue to withdraw cash at post offices.

8.2.2.3 However, based on the analysis at 8.1, we have assumed that both scenarios - and in particular scenario C - would initially require a cash payment mechanism based on cash advance rather than network banking. Scenario C would require the implementation of an interim solution (eg debit terminals) while scenario Cx could possibly be supported by an accelerated initial release of the new automation platform (were this more cost-effective than an interim solution).

8.2.2.4 In order to reflect this, the modelling of options C and Cx was adjusted to include the costs associated with interim cash payment from the start of ACT migration to 2004/5. Network banking and interim cash payment transaction volumes consistent with those used in the modelling of option B3 were employed.

Cost of new automation platform

8.2.2.5 The following adjustments were made to the POCL estimates of the cost of a new automation platform:

- POCL assumed a fully online network - a significant change of architecture from option A which provides all the functionality of the replacement including network banking. This led to an increase in communications costs of at least £300m NPV. In line with our general assumption on communications architecture (3.2.4 refers), we have not included this increase.
- POCL's estimates assumed that development of the replacement automation platform would begin immediately. We have adjusted the profile of costs to reflect an indicative 1-year period for procurement in advance of development. The resulting delay in development results in a cost reduction of approximately £100m NPV. This is intended as a conservative adjustment - as discussed above, the period required for procurement may be greater.

8.2.2.6 We would emphasise that the POCL estimates were presented as indicative estimates only, and that considerable further specification and planning work would be required to produce refined estimates. It should also be noted that the POCL estimates were based on an "in-house" development and that potential benefits from economies of scale which could be brought by the private sector have not been factored in.

Impact on network

8.2.2.7 POCL's modelling of the impact of options C and Cx does not reflect the risk of unmanaged closures which may flow from a loss of subpostmaster confidence following announcement of termination. POCL has assumed, consistently across all options, that the network size remains the same.

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Impact of loss of footfall on POCL's income

8.2.2.8 POCL has estimated the impact of loss of footfall on contribution from other POCL services arising from the reduction in benefit cash payment transaction volumes. We have not examined the calculation of this loss of contribution but it is broadly consistent with the cost of avoiding 6,000 post office closures assumed in the modelling of option 2 in October 1998.

Impact of Loss of footfall on sub-postmasters

8.2.2.9 We have assumed that a subsidy to sub-postmasters will be required, based on our work of October 1998. We have estimated this subsidy to amount to £30m pa, which would ensure that no sub-postmaster lost more than 10-15% of his/her income (which in some cases could be offset by reductions in variable costs).

8.2.3 ***ICL termination payment***

8.2.3.1 An estimate of the termination payment to ICL was included. Note that this is not a KPMG-derived estimate.

8.2.4 ***Derivation of BA projections***

8.2.4.1 The impact of options C and Cx on BA was modelled by BA.

8.2.5 ***Financial results***

8.2.5.1 The table below summarises the financial results for options C and Cx.

Options C and Cx	**£m NPV C**	**£m NPV Cx**
BA		
Payments to Pathway	(48)	(84)
ACT costs, including contingency	(515)	(383)
Cost of the "unbanked"	(163)	(114)
CAPS savings	716	505
POU savings	20	13
Payments to POCL saved	1,650	1,179
BA net administrative savings	1,660	1,116
BA programme savings	961	874
BA net administrative savings and programme savings	2,621	1,990
POCL		
Capital costs and non recurring revenue costs	(114)	(114)
BA & girocheque income	(1,797)	(1,319)
BA/SSA & girocheque related ABC costs	874	655
POCL bank costs: smart cards, opening accounts etc	-	-
Network banking income	397	433
Network banking ABC costs	(276)	(302)
Network banking systems charges	-	-
Cost of new banking technology	(980)	(898)
Other POCL contribution	172	172
Other systems charges	-	-
Loss in other POCL contribution - footfall impact	(76)	(54)
Other POCL net costs	70	90
Subsidy: retail impact subpostmasters	(157)	(111)
POCL net impact on profits	(1,886)	(1,447)
Sub total impact on the Public Sector	734	543
ICL funding gap (ie ICL's NPV excluding £126m)	-	-
Total cashflow impact on Public Sector	734	543
Less ICL termination payment in baseline	-	-
Total NPV impact on Public Sector	**734**	**543**

8.2.6 *Interpretation of results*

The table below summarises the way in which the different aspects of C have contributed to the overall movement of NPV as compared to option B1 Core.

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Variance compared to B1 Core	**£m NPV C**	**Cx**
Impact of accelerating or delaying ACT		
BA payments to POCL	20	27
BA administrative savings	54	(32)
BA programme savings	43	(43)
Paper based ABC costs for POCL	159	60
Payments for OBCS (or equivalent from alternative supplier)	24	(11)
Sub total	301	(120)
New benefit payment mechanism		
Smart cards	65	65
Card Management Services (CMS)	57	57
Account setup	43	43
Account running costs	121	121
POCL bank systems charges	124	124
"New Service Provider"/cost of the unbanked	(163)	(114)
POCL banking ABC costs	269	269
POCL bank fraud costs	104	104
Subsidy: retail impact subpostmasters	(157)	(111)
Sub total	464	559
Banking technology		
New banking technology	(980)	(898)
Other systems charges saved	457	457
ICL funding gap (excl account running costs in B1)	168	168
Sub total	(355)	(273)
Other	(10)	42
Total	400	208

8.2.6.1 A key saving in option C relative to option B1 is the cost avoided of establishing POCL bank. These savings are similar to those in option B3.

8.2.6.2 The cost of the core infrastructure in options C and Cx is considerably higher than in option B1. This is a result of:

- the termination payment to ICL assumed in option C and Cx of £150m NPV;
- the assumption that an alternative supplier of the technology infrastructure will not be prepared to take a loss of £126 NPV;
- the cost of interim cash payment, particularly in option C.

8.2.6.3 ACT migration in option C begins one year earlier than in option B1 which gives rise to significant savings; these savings are more pronounced than the savings in option B3 With Marketing where ACT migration took four years (two years voluntary plus two year compulsory). The adverse impact of delaying ACT migration in option Cx is

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comparable to that in option B3 Without Marketing as the ACT migration period is similar.

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A) Assumptions underlying modelling of the options

	A	**A - Delay**	**B1 core**	**B1 high**	**B1 Sep 01**	**B3 mktg**	**B3 no mktg**	**C**	**Cx**
Summary	Current programme*	Current programme; BPC slips 6 months	B1.2 with POCL bank in Jul 02 and POCL takeup assumptions	Higher takeup and lower attrition for POCL bank	POCL bank available Sep 01	BPC cancelled; Horizon rolled out; ACT promoted from Jun 01	BPC cancelled; Horizon rolled out; ACT not promoted	Horizon cancelled; ACT migration starts 2001/2	Horizon cancelled; ACT migration starts 2003/4
* Current programme assumes: New Release 2 begins rollout August 1999; the rate of rollout is as defined in the current programme plan (Firebreak); New Release 2+ September 2000									
Timescales									
Infrastructure rollout	As current programme	Slipped 6 months	As current programme			Not specified by POCL		Not specified by POCL	
POCL bank established	N/A		Start Jul 2002		End Sep 2001	N/A		N/A	
Electronic network banking	April 2002		April 2002			April 2002		April 2004	
ACT migration	2005/6 - 2007/8 20:40:40		2002/3 - 2004/5 36:56:7 ie 2 years migration from Jul 02		2001/2 - 2003/4 22:57:21	2001/2 - 2004/5 (voluntary first two years) c20:40:20:20	2003/4 - 2004/5 c50:50	2001/2 - 2002/3 50:50	2003/4 - 2004/5 50:50
Volumes									
BA transaction volumes	Up-to-date volumes provided by BA								
Number of people claiming benefit	24.5m of whom 15.5m currently paid via POCL. Churn = 5% per annum								

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	A	A - Delay	B1 core	B1 high	B1 Sep 01	B3 mktg	B3 no mktg	C	Cx
Summary of basis for POCL banking volumes	N/A		Takeup on transition 80%; attrition 12% climbing to 25%; takeup for new claimants 25% declining to 20%	Takeup on transition 100%; attrition 3% climbing to 6%; takeup for new claimants 43% declining to 32%	Takeup on transition 80%; attrition 12% climbing to 25%; takeup for new claimants 25% declining to 20%	N/A		N/A	
Summary of basis for network banking volumes	Core network banking assumptions based on McKinsey work. These are based on a "market share" profile. The market share represents the proportion of banking customers who can access their accounts via network banking. 20 transactions per customer per year are assumed.		Core network banking is as option A. However, customers moving out of POCL bank through attrition are treated differently. It is assumed that availability of network banking is a neutral factor in determining the bank to which such customers transfer. However, where a customer does transfer to a bank which is a "network bank" at the time of transfer, they are assumed to carry out an additional 20 network banking transactions per year so as to maintain their withdrawal pattern.			Core network banking is as option A. Benefit claimants are assumed to be supported by interim payment methods until the start of 2003/4 (for options B3) and until the start of 2004/5 (for options C). At that point, it is assumed that the proportion of benefit claimants with network bank accounts reflects the network banking market share. It is assumed that that proportion of claimants will continue using POCL as a channel for benefit payments and that, like "transfers from POCL bank" in option B1, they will carry out an additional 20 network banking transactions per year compared with other network banking users. It is assumed that those customers who are not network bank customers will cease using POCL as a channel (because they are assumed to be dissuaded, eg by charges) over the course of 1 year.			
PO network	Rural attrition (200 closures pa) and 1000 urban closures								
Commercial									

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	A	A - Delay	B1 core	B1 high	B1 Sep 01	B3 mktg	B3 no mktg	C	Cx
Basis for Pathway system charges (or cost of alternative technology)	Pathway scorecard		Pathway scorecard with POCL bank transactions at 46.8 servicepoints and card management at 70 servicepoints per card per month			Core system: based on Pathway scorecard. Interim solution (B3 mktg only): EFTPOS via Pathway at 9p per transaction (plus 6.25p per transaction paid to Merchant Acquirer)		POCL estimates for new technology adjusted for: consistency in comms costs assumptions; earliest implementation 2000/01. Interim solution based on cost of debit terminals per work in October 1998.	
Network banking income	30p per transaction								
Government direct	Excluded								
BA floor payment to POCL	Ends when ACT migration ends		Ends when ACT migration begins			Ends when ACT migration begins		Ends when ACT migration begins	
BA payment fixed fee element	Ends when ACT migration complete								
DSS programme savings	90% of savings accrue with BPC, then 100% with ACT		100% of savings accrue with ACT			100% of savings accrue with ACT		100% of savings accrue with ACT	
BA costs	Net administrative savings and programme savings in baseline and all options based on 1997/98 prices								
POCL costs	Exclude intra public sector costs, namely irrecoverable VAT and prefunding costs								
Subpostmaster compensation	N/A		N/A			£30m pa assumed per work in Oct 98		£30m pa assumed per work in Oct 98	

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B) Illustrative summary of timings of key assumptions

	99-00	00-01	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09	09-10
Option A											
BPC rolls out											
ACT migration											
Option A Delay											
BPC rolls out											
ACT migration											
Option B1 (Core)											
POCL banking development and rollout											
ACT migration											
Option B1 (Sep 01)											
POCL banking development and rollout											
ACT migration											
Option B3 (Marketing)											
Period when interim cash payment in use											
Promoted voluntary ACT migration											
Compulsory ACT migration											
Option B3 (No Marketing)											
Compulsory ACT migration											
Option C											
Period when interim cash payment in use											
ACT migration											
Option Cx											
Period when interim cash payment in use											
ACT migration											

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Appendix 2

Description of items in cashflows and NPV analyses

Heading	Description
BA	
CAPS costs	Staff and goods & services costs associated with the running of CAPS, largely constant across options (assumes PDCS, PACS and part of CPCS will continue).
ITSA costs	Outsourced IS/IT development and operation costs, largely constant across options
Payments to Pathway	CMS, BES/PAS and OBCS payments (including BES payments passed through POCL)
ACT costs, including contingency	The steady state cost of around £78m comprises measures to counter increased entitlement fraud risk (£50m), BACS payments and provision of an alternative mechanism for urgent payments. There are additional costs associated with initial migration.
Cost of the "unbanked"	The cost of incentivising banks to provide accounts for those currently unbanked.
CAPS savings	CAPS savings from the move from paper based payment methods to BPC or ACT. Steady state savings are around £137m of which around £62m are from the elimination of physical production and postage and the remainder are from elimination of manual processes.
POU savings	Costs related to physical storage of foils
Payments to POCL saved	Payments for order book and girocheque transactions, including the BA floor payment to POCL in option A
BA programme savings	Encashment fraud savings achieved through move from orderbooks to electronic means of payment (ACT or BPC)
POCL	
Capital costs and non recurring revenue costs	Principal elements are Horizon refresh costs, PIN pad costs and residual value of Horizon hardware
BA & girocheque income	Income from BA for orderbook and girocheque transactions
BA/SSA & girocheque related ABC costs	POCL's activity-based costs for orderbook and girocheque transactions
Cost of smartcards	The cost of using smartcards rather than magnetic stripe cards (ICL costs include magstripe savings)
Card Management Service (CMS)	Payments to ICL for management of POCL smartcards under option B1

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Description of items in cashflows and NPV analyses

Heading	**Description**
Account setup	Operations cost of setting up POCL bank accounts in option B1
Systems charges for POCL banking	Payments to ICL for POCL bank transactions in option B1
POCL banking ABC costs	POCL's activity-based costs for POCL bank transactions
POCL banking fraud costs	Costs of fraud risk plus fraud investigation in option B1
Network banking income	Payments from banks for network banking transactions, assumed to be 30p per transaction in line with Corbett assumptions. This is intended to be a conservative assumption; note that previous work on fallback options in October 1998 assumed income of 50p per transaction.
Network banking ABC costs	POCL's activity-based costs for network banking transactions
Network banking systems charges	POCL's payments to ICL for network bank transactions
Cost of new banking technology	Indicative costs of Horizon replacement technology under option C
Other systems charges	Payments to Pathway for services other than BPC, POCL banking and network banking, eg automated bill payment
Loss in other POCL contribution - footfall impact	Impact on other POCL services from lower footfall caused by reduction in benefits transactions handled at post offices
Other POCL net costs	These include income relating to services other than BPC, POCL banking and network banking supported by Horizon, eg automated bill payment
Subsidy: retail impact subpostmasters	Cost of compensating subpostmasters for loss of private retail income (assumption as per Oct 98)
ICL	
ICL funding gap	Additional payment to ICL required to result in NPV loss of £126M
ICL termination payment estimate	Estimate of £150m for option C, based on informal discussion with Bird and Bird. This is not a KPMG-derived estimate.

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Appendix 3
Annual cashflows for options

Baseline: "business as usual" - ie continue with paper-based methods of payment and terminate Horizon

BA: from BA's business case, adjusted to include CAPS and ITSA costs common to all options in the baseline (as agreed with BA)

POCL: from POCL's *automation* business case, adjusted to reflect no change in policy (therefore BA income in line with BA's assumption)

	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	NPV @ 6%
BA												
CAPS costs (excl those common to all options)	(137)	(137)	(137)	(137)	(137)	(137)	(137)	(137)	(137)	(137)	(137)	(1,080)
CAPS costs common to all options	(59)	(35)	(34)	(17)	(17)	(16)	(16)	(16)	(16)	(16)	(16)	(202)
ITSA costs common to all options	(39)	(36)	(40)	(32)	(27)	(27)	(27)	(27)	(27)	(27)	(27)	(248)
POU costs	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(43)
Payments to POCL (incl payments to Girobank)	(389)	(376)	(370)	(363)	(357)	(351)	(351)	(351)	(351)	(351)	(351)	(2,856)
Total administrative costs	(630)	(590)	(587)	(554)	(543)	(537)	(537)	(537)	(537)	(537)	(537)	(4,429)
Total programme savings (ESNS/rewards)	52	52	52	52	52	52	52	52	52	52	52	410
POCL												
"Avoided costs":												
Benefits Agency/SSA/Girobank costs	(244)	(238)	(236)	(233)	(231)	(228)	(228)	(228)	(228)	(228)	(228)	(1,835)
BA/Girocheques income	389	376	370	363	357	351	351	351	351	351	351	2,856
Total	145	138	134	130	126	123	123	123	123	123	123	1,021
ICL												
Estimated cost of settlement for termination												(150)

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Option A

£m favourable/(adverse) compared to baseline	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	NPV @ 6%
BA												
Pathway (incl BES payments passed through POCL)	(5)	(72)	(92)	(92)	(86)	(80)	(68)	(45)	(31)	0	0	(431)
ACT costs, including contingency	0	0	(0)	(0)	(0)	(10)	(44)	(84)	(97)	(78)	(78)	(232)
Cost of the "unbanked"	0	0	0	0	0	0	(8)	(20)	(30)	(32)	(32)	(70)
CAPS savings	0	80	115	136	137	137	137	137	137	137	137	881
POU savings	0	0	0	0	0	0	0	0	0	6	6	6
Payments to POCL saved	(3)	(11)	16	23	23	23	33	43	53	351	351	514
BA net administrative savings	(8)	(3)	38	67	74	70	49	31	33	383	383	667
BA programme savings	0	86	137	137	137	137	137	137	137	137	137	905
BA net administrative savings and programme savings	(8)	83	175	204	211	207	186	168	169	520	520	1,572
POCL												
Capital costs and non recurring revenue costs	(26)	(19)	(1)	0	0	0	(23)	(119)	(23)	0	37	(126)
BA & girocheque income	(15)	(27)	(32)	(35)	(37)	(37)	(31)	(41)	(237)	(351)	(351)	(714)
BA/SSA & girocheque related ABC costs	8	16	23	33	33	32	47	107	138	161	161	469
Costs of POCL bank	0	0	0	0	0	0	0	0	0	0	0	0
Network banking income	0	0	13	34	43	62	72	96	128	145	147	456
Network banking ABC costs	0	0	(9)	(24)	(30)	(43)	(50)	(67)	(89)	(102)	(104)	(319)
Network banking systems charges	0	0	(4)	(9)	(11)	(15)	(17)	(23)	(31)	(35)	(34)	(111)
Cost of new banking technology	0	0	0	0	0	0	0	0	0	0	0	0
Other POCL contribution	5	5	9	28	32	37	29	23	28	31	30	172
Other systems charges	(14)	(40)	(52)	(64)	(65)	(59)	(52)	(45)	(43)	(42)	(41)	(367)
Loss in other POCL contribution - footfall impact	0	(1)	(2)	(3)	(4)	(4)	(5)	(9)	(9)	(10)	(10)	(36)
Other POCL net costs	11	8	15	9	13	12	16	15	11	8	9	91
Subsidy: retail impact subpostmasters	0	0	0	0	0	0	0	0	0	0	0	0
POCL net impact on profits	(31)	(58)	(40)	(31)	(26)	(15)	(14)	(63)	(127)	(195)	(156)	(484)
ICL funding gap (ie ICL's NPV excluding £126m)	(5)	(4)	(5)	(4)	(5)	(4)	(5)	(4)	(5)	(4)	(5)	(36)
Total cashflow impact on Public Sector	**(44)**	**21**	**130**	**169**	**180**	**188**	**167**	**101**	**37**	**321**	**359**	**1,052**
Less ICL termination payment in baseline												150
Total NPV impact on Public Sector												**1,202**

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KPMG

Option A delay

£m favourable/(adverse) compared to baseline	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	NPV @ 6%
BA												
Pathway (incl BES payments passed through POCL)	(4)	(39)	(82)	(92)	(89)	(83)	(74)	(57)	(38)	(15)	0	(420)
ACT costs, including contingency	0	0	(0)	(0)	(0)	(5)	(27)	(69)	(90)	(88)	(78)	(209)
Cost of the "unbanked"	0	0	0	0	0	0	(8)	(20)	(30)	(32)	(32)	(70)
CAPS savings	0	40	97	125	136	137	137	137	137	137	137	822
POU savings	0	0	0	0	0	0	0	0	0	6	6	6
Payments to POCL saved	(2)	(7)	2	20	23	23	33	43	53	351	351	504
BA net administrative savings	(7)	(5)	18	53	71	72	61	34	32	358	383	632
BA programme savings	0	43	111	137	137	137	137	137	137	137	137	845
BA net administrative savings and programme savings	(7)	38	129	189	207	209	198	171	169	495	520	1,477
POCL												
Capital costs and non recurring revenue costs	(26)	(19)	(1)	0	0	0	(23)	(119)	(23)	0	37	(126)
BA & girocheque income	(14)	(18)	(26)	(34)	(37)	(37)	(31)	(41)	(237)	(351)	(351)	(699)
BA/SSA & girocheque related ABC costs	8	2	20	29	33	32	47	107	138	161	161	451
Costs of POCL bank	0	0	0	0	0	0	0	0	0	0	0	0
Network banking income	0	0	13	34	43	62	72	96	128	145	147	456
Network banking ABC costs	0	0	(9)	(24)	(30)	(43)	(50)	(67)	(89)	(102)	(104)	(319)
Network banking systems charges	0	0	(4)	(9)	(11)	(15)	(17)	(23)	(31)	(35)	(34)	(111)
Cost of new banking technology	0	0	0	0	0	0	0	0	0	0	0	0
Other POCL contribution	5	5	9	28	32	37	29	23	28	31	30	172
Other systems charges	(1)	(23)	(50)	(64)	(65)	(59)	(52)	(45)	(43)	(42)	(41)	(338)
Loss in other POCL contribution - footfall impact	0	0	(2)	(3)	(4)	(4)	(5)	(9)	(9)	(10)	(10)	(35)
Other POCL net costs	6	14	16	11	15	13	17	15	11	8	9	97
Subsidy: retail impact subpostmasters	0	0	0	0	0	0	0	0	0	0	0	0
POCL net impact on profits	(22)	(39)	(34)	(32)	(24)	(14)	(13)	(63)	(127)	(195)	(156)	(452)
ICL funding gap (ie ICL's NPV excluding £126m)	(8)	(7)	(7)	(8)	(7)	(7)	(8)	(7)	(7)	(8)	(8)	(59)
Total cashflow impact on Public Sector	**(37)**	**(8)**	**88**	**149**	**176**	**188**	**177**	**101**	**35**	**292**	**356**	**967**
Less ICL termination payment in baseline												150
Total NPV impact on Public Sector												**1,117**

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Option B1 Core

£m favourable/(adverse) compared to baseline	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	NPV @ 6%
BA												
Pathway (incl BES payments passed through POCL)	(9)	(25)	(24)	(19)	(8)	(0)	0	0	0	0	0	(73)
ACT costs, including contingency	0	(10)	(10)	(83)	(110)	(83)	(78)	(78)	(78)	(78)	(78)	(456)
Cost of the "unbanked"	0	0	0	0	0	0	0	0	0	0	0	0
CAPS savings	0	0	0	51	96	123	137	137	137	137	137	606
POU savings	0	0	0	0	0	0	6	6	6	6	6	16
Payments to POCL saved	(7)	(15)	(28)	12	122	202	351	351	351	351	351	1,243
BA net administrative savings	(17)	(49)	(62)	(39)	99	242	416	416	416	416	416	1,337
BA programme savings	24	72	96	129	134	137	152	152	152	152	152	918
BA net administrative savings and programme savings	7	23	34	90	233	379	568	568	568	568	568	2,254
POCL												
Capital costs and non recurring revenue costs	(26)	(33)	(5)	0	0	0	(23)	(119)	(32)	(3)	41	(147)
BA & girocheque income	(14)	(25)	(30)	(57)	(150)	(211)	(351)	(351)	(352)	(351)	(351)	(1,410)
BA/SSA & girocheque related ABC costs	8	7	7	31	108	159	161	161	161	161	161	715
Cost of smartcards	0	0	0	(11)	(28)	(16)	(12)	(10)	(8)	(6)	(4)	(65)
Card Management Service (CMS)	0	0	0	(5)	(15)	(19)	(15)	(11)	(9)	(6)	(5)	(57)
Account setup	0	0	0	(19)	(29)	(5)	(1)	(1)	(1)	(1)	(1)	(43)
Systems charges for POCL banking	0	0	0	(8)	(33)	(42)	(34)	(25)	(19)	(14)	(11)	(124)
POCL banking ABC costs	0	0	0	(15)	(65)	(87)	(74)	(59)	(46)	(35)	(27)	(269)
POCL banking fraud costs	0	0	0	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(104)
Network banking income	0	0	13	34	43	66	72	79	85	91	96	366
Network banking ABC costs	0	0	(9)	(24)	(30)	(45)	(50)	(55)	(60)	(64)	(68)	(256)
Network banking systems charges	0	0	(4)	(9)	(11)	(16)	(17)	(18)	(19)	(20)	(21)	(86)
Cost of new banking technology	0	0	0	0	0	0	0	0	0	0	0	0
Other POCL contribution	5	5	9	28	32	37	29	23	28	31	30	172
Other systems charges	(14)	(41)	(54)	(66)	(65)	(59)	(52)	(45)	(43)	(42)	(41)	(371)
Loss in other POCL contribution - footfall impact	0	(1)	(1)	(2)	(4)	(7)	(8)	(9)	(10)	(11)	(11)	(40)
Other POCL net costs	19	18	16	16	10	9	0	3	8	6	8	88
Subsidy: retail impact subpostmasters	0	0	0	0	0	0	0	0	0	0	0	0
POCL net impact on profits	(22)	(70)	(58)	(127)	(257)	(256)	(395)	(457)	(337)	(284)	(224)	(1,630)
ICL funding gap (ie ICL's NPV excluding £126m)	(180)	(38)	(39)	(39)	(39)	(39)	(38)	(39)	(39)	(39)	(39)	(439)
Total cashflow impact on Public Sector	**(195)**	**(85)**	**(63)**	**(76)**	**(63)**	**84**	**135**	**72**	**192**	**245**	**305**	**185**
Less ICL termination payment in baseline												150
Total NPV impact on Public Sector												**335**

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Option B1 Sep 01

£m favourable/(adverse) compared to baseline	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	NPV @ 6%
BA												
Pathway (incl BES payments passed through POCL)	(9)	(25)	(22)	(11)	(1)	0	0	0	0	0	0	(59)
ACT costs, including contingency	(10)	(10)	(67)	(110)	(116)	(78)	(78)	(78)	(78)	(78)	(78)	(535)
Cost of the "unbanked"	0	0	0	0	0	0	0	0	0	0	0	0
CAPS savings	0	0	34	82	123	137	137	137	137	137	137	689
POU savings	0	0	0	0	0	6	6	6	6	6	6	20
Payments to POCL saved	(7)	(15)	(15)	102	201	351	351	351	351	351	351	1,488
BA net administrative savings	(27)	(49)	(70)	63	207	416	416	416	416	416	416	1,604
BA programme savings	24	72	107	137	147	152	152	152	152	152	152	954
BA net administrative savings and programme savings	(3)	23	37	200	354	568	568	568	568	568	568	2,558
POCL												
Capital costs and non recurring revenue costs	(26)	(37)	(1)	0	0	0	(23)	(119)	(35)	0	41	(147)
BA & girocheque income	(14)	(25)	(31)	(136)	(212)	(351)	(351)	(351)	(352)	(351)	(351)	(1,618)
BA/SSA & girocheque related ABC costs	8	7	16	48	104	147	161	161	161	161	161	725
Cost of smartcards	0	0	(7)	(24)	(21)	(13)	(11)	(9)	(7)	(5)	(4)	(72)
Card Management Service (CMS)	0	0	(3)	(12)	(19)	(17)	(13)	(10)	(8)	(6)	(4)	(63)
Account setup	0	0	(11)	(29)	(12)	(1)	(1)	(1)	(1)	(1)	(1)	(45)
Systems charges for POCL banking	0	0	(3)	(27)	(42)	(38)	(29)	(22)	(17)	(13)	(9)	(137)
POCL banking ABC costs	0	0	(6)	(51)	(83)	(80)	(65)	(52)	(41)	(31)	(24)	(294)
POCL banking fraud costs	0	0	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(20)	(121)
Network banking income	0	0	13	35	44	67	74	80	85	91	96	370
Network banking ABC costs	0	0	(9)	(24)	(31)	(46)	(51)	(55)	(60)	(64)	(67)	(257)
Network banking systems charges	0	0	(4)	(9)	(11)	(16)	(17)	(18)	(19)	(20)	(21)	(86)
Cost of new banking technology	0	0	0	0	0	0	0	0	0	0	0	0
Other POCL contribution	5	5	9	28	32	37	29	23	28	31	30	172
Other systems charges	(14)	(41)	(54)	(65)	(65)	(59)	(52)	(45)	(43)	(42)	(41)	(370)
Loss in other POCL contribution - footfall impact	0	(1)	(1)	0	(2)	(7)	(9)	(10)	(10)	(11)	(12)	(39)
Other POCL net costs	16	18	16	12	9	7	(1)	3	8	7	6	79
Subsidy: retail impaçt subpostmasters	0	0	0	0	0	0	0	0	0	0	0	0
POCL net impact on profits	(25)	(74)	(96)	(274)	(329)	(390)	(379)	(445)	(331)	(274)	(220)	(1,904)
ICL funding gap (ie ICL's NPV excluding £126m)	(180)	(32)	(33)	(32)	(33)	(32)	(33)	(32)	(33)	(32)	(33)	(395)
Total cashflow impact on Public Sector	**(208)**	**(83)**	**(92)**	**(106)**	**(8)**	**146**	**156**	**91**	**204**	**262**	**315**	**259**
Less ICL termination payment in baseline												150
Total NPV impact on Public Sector												**409**

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KPMG

Option B1 high

£m favourable/(adverse) compared to baseline	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	NPV @ 6%
BA												
Pathway (incl BES payments passed through POCL)	(9)	(25)	(24)	(19)	(8)	(0)	0	0	0	0	0	(73)
ACT costs, including contingency	0	(10)	(10)	(83)	(110)	(83)	(78)	(78)	(78)	(78)	(78)	(456)
Cost of the "unbanked"	0	0	0	0	0	0	0	0	0	0	0	0
CAPS savings	0	0	0	51	96	123	137	137	137	137	137	606
POU savings	0	0	0	0	0	0	6	6	6	6	6	16
Payments to POCL saved	(7)	(15)	(28)	12	122	202	351	351	351	351	351	1,243
BA net administrative savings	(17)	(49)	(62)	(39)	99	242	416	416	416	416	416	1,337
BA programme savings	24	72	96	129	134	137	152	152	152	152	152	918
BA net administrative savings and programme savings	7	23	34	90	233	379	568	568	568	568	568	2,254
POCL												
Capital costs and non recurring revenue costs	(26)	(33)	(5)	0	0	0	(23)	(119)	(32)	(3)	41	(147)
BA & girocheque income	(14)	(25)	(30)	(57)	(150)	(211)	(351)	(351)	(352)	(351)	(351)	(1,410)
BA/SSA & girocheque related ABC costs	8	7	7	31	108	159	161	161	161	161	161	715
Cost of smartcards	0	0	0	(15)	(37)	(26)	(20)	(19)	(17)	(16)	(15)	(110)
Card Management Service (CMS)	0	0	0	(6)	(19)	(26)	(24)	(22)	(20)	(18)	(16)	(97)
Account setup	0	0	0	(24)	(37)	(6)	(2)	(2)	(2)	(2)	(2)	(57)
Systems charges for POCL banking	0	0	0	(10)	(43)	(59)	(55)	(48)	(44)	(39)	(35)	(215)
POCL banking ABC costs	0	0	0	(19)	(86)	(123)	(120)	(113)	(105)	(97)	(90)	(480)
POCL banking fraud costs	0	0	0	(25)	(25)	(27)	(33)	(33)	(32)	(32)	(32)	(154)
Network banking income	0	0	13	34	43	63	67	71	75	79	84	336
Network banking ABC costs	0	0	(9)	(24)	(30)	(44)	(47)	(49)	(52)	(56)	(59)	(235)
Network banking systems charges	0	0	(4)	(9)	(11)	(15)	(16)	(16)	(16)	(17)	(18)	(78)
Cost of new banking technology	0	0	0	0	0	0	0	0	0	0	0	0
Other POCL contribution	5	5	9	28	32	37	29	23	28	31	30	172
Other systems charges	(14)	(41)	(54)	(66)	(65)	(59)	(52)	(45)	(43)	(42)	(41)	(371)
Loss in other POCL contribution - footfall impact	0	(1)	(1)	(2)	(3)	(4)	(4)	(5)	(6)	(6)	(7)	(25)
Other POCL net costs	21	18	17	16	10	7	(1)	3	5	6	7	86
Subsidy: retail impact subpostmasters	0	0	0	0	0	0	0	0	0	0	0	0
POCL net impact on profits	(20)	(70)	(57)	(148)	(313)	(334)	(491)	(564)	(452)	(402)	(343)	(2,069)
ICL funding gap (ie ICL's NPV excluding £126m)	(180)	(20)	(21)	(21)	(21)	(21)	(21)	(21)	(21)	(21)	(21)	(315)
Total cashflow impact on Public Sector	**(193)**	**(67)**	**(44)**	**(79)**	**(101)**	**24**	**56**	**(17)**	**95**	**145**	**204**	**(129)**
Less ICL termination payment in baseline												150
Total NPV impact on Public Sector												**21**

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Option B3 Marketing

£m favourable/(adverse) compared to baseline	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	NPV @ 6%
BA												
Pathway (incl BES payments passed through POCL)	(10)	(26)	(23)	(13)	(5)	(2)	0	0	0	0	0	(66)
ACT costs, including contingency	0	(10)	(83)	(110)	(83)	(78)	(78)	(78)	(78)	(78)	(78)	(515)
Cost of the "unbanked"/New Service Provider(NSP)	0	0	0	0	(22)	(63)	(70)	(59)	(48)	(35)	(21)	(204)
CAPS savings	0	0	7	48	86	108	126	137	137	137	137	584
POU savings	0	0	0	0	0	0	6	6	6	6	6	16
Payments to POCL saved	(7)	(15)	(21)	(1)	267	326	351	351	351	351	351	1,433
BA net administrative savings	(17)	(50)	(120)	(76)	242	291	334	357	368	381	394	1,248
BA programme savings	24	72	104	124	140	148	152	152	152	152	152	933
BA net administrative savings and programme savings	7	22	(16)	48	382	438	486	509	520	533	546	2,181
POCL												
Capital costs and non recurring revenue costs	(26)	(33)	(6)	0	0	0	(23)	(119)	(32)	(3)	41	(148)
BA & girocheque income	(24)	(17)	(10)	(29)	(283)	(337)	(351)	(351)	(352)	(351)	(351)	(1,561)
BA/SSA & girocheque related ABC costs	15	14	40	100	130	151	161	161	161	161	161	821
Costs of POCL bank	0	0	0	0	0	0	0	0	0	0	0	0
Network banking income	0	0	13	35	54	85	88	90	92	94	97	411
Network banking ABC costs	0	0	(9)	(24)	(38)	(59)	(62)	(63)	(65)	(66)	(68)	(288)
Network banking systems charges	0	0	(4)	(9)	(14)	(20)	(21)	(21)	(22)	(22)	(23)	(99)
Cost of new banking technology	0	0	(5)	(39)	(19)	0	0	0	0	0	0	(49)
Other POCL contribution	5	5	9	28	32	37	29	23	28	31	30	172
Other systems charges	(14)	(41)	(54)	(57)	(66)	(64)	(52)	(45)	(43)	(42)	(41)	(368)
Loss in other POCL contribution - footfall impact	(0)	(1)	(1)	(1)	(3)	(5)	(8)	(9)	(10)	(11)	(11)	(37)
Other POCL net costs	7	17	22	55	32	11	3	6	9	10	10	138
Subsidy: retail impact subpostmasters	0	0	(5)	(10)	(20)	(30)	(30)	(30)	(30)	(30)	(30)	(137)
POCL net impact on profits	(36)	(56)	(10)	47	(193)	(232)	(266)	(359)	(263)	(229)	(185)	(1,145)
ICL funding gap (ie ICL's NPV excluding £126m)	(180)	(25)	(24)	(25)	(24)	(25)	(24)	(25)	(24)	(25)	(24)	(340)
Total cashflow impact on Public Sector	**(209)**	**(59)**	**(50)**	**70**	**165**	**182**	**197**	**125**	**233**	**279**	**337**	**695**
Less ICL termination payment in baseline												150
Total NPV impact on Public Sector												**845**

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Option B3 no marketing

£m favourable/(adverse) compared to baseline	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	NPV @ 6%
BA												
Pathway (incl BES payments passed through POCL)	(10)	(26)	(23)	(22)	(16)	(4)	0	0	0	0	0	(84)
ACT costs, including contingency	0	0	0	(10)	(93)	(110)	(78)	(78)	(78)	(78)	(78)	(387)
Cost of the "unbanked"/New Service Provider(NSP)	0	0	0	0	0	(44)	(70)	(59)	(48)	(35)	(21)	(174)
CAPS savings	0	0	0	0	34	103	137	137	137	137	137	505
POU savings	0	0	0	0	0	0	0	6	6	6	6	13
Payments to POCL saved	(2)	(8)	(14)	(13)	53	159	357	357	357	357	357	1,179
BA net administrative savings	(12)	(34)	(37)	(45)	(23)	103	345	362	373	386	400	1,052
BA programme savings	24	72	96	96	110	138	152	152	152	152	152	874
BA net administrative savings and programme savings	12	38	59	51	87	241	497	514	525	538	552	1,926
POCL												
Capital costs and non recurring revenue costs	(26)	(33)	(6)	0	0	0	(23)	(119)	(32)	(3)	41	(148)
BA & girocheque income	(14)	(25)	(25)	(25)	(70)	(175)	(351)	(351)	(352)	(351)	(351)	(1,295)
BA/SSA & girocheque related ABC costs	9	8	7	7	43	128	161	161	161	161	161	627
Costs of POCL Bank	0	0	0	0	0	0	0	0	0	0	0	0
Network banking income	0	0	13	34	50	85	96	98	100	102	105	432
Network banking ABC costs	0	0	(9)	(24)	(34)	(59)	(67)	(68)	(70)	(72)	(73)	(301)
Network banking systems charges	0	0	(4)	(9)	(13)	(20)	(22)	(23)	(23)	(24)	(25)	(104)
Cost of new banking technology	0	0	0	0	0	0	0	0	0	0	0	0
Other POCL contribution	5	5	9	28	32	37	29	23	28	31	30	172
Other systems charges	(14)	(41)	(54)	(57)	(66)	(64)	(52)	(45)	(43)	(42)	(41)	(368)
Loss in other POCL contribution - footfall impact	0	(1)	(1)	(1)	(4)	(11)	(13)	(13)	(13)	(13)	(13)	(52)
Other POCL net costs	9	16	18	18	17	15	6	8	13	12	12	105
Subsidy: retail impact subpostmasters	0	0	0	0	(15)	(30)	(30)	(30)	(30)	(30)	(30)	(121)
POCL net impact on profits	(31)	(71)	(52)	(29)	(60)	(94)	(267)	(359)	(262)	(229)	(184)	(1,052)
Sub total impact on the Public Sector	(18)	(33)	8	22	27	148	230	155	263	309	368	875
ICL funding gap (ie ICL's NPV excluding £126m)	(180)	(21)	(21)	(21)	(21)	(21)	(21)	(21)	(21)	(21)	(21)	(316)
Total cashflow impact on Public Sector	**(198)**	**(54)**	**(13)**	**1**	**6**	**127**	**209**	**134**	**242**	**288**	**347**	559
Less ICL termination payment in baseline												150
Total NPV impact on Public Sector	**(397)**	**(107)**	**(27)**	**1**	**12**	**254**	**419**	**269**	**484**	**577**	**694**	709

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Option C - 2 year ACT migration

£m favourable/(adverse) compared to baseline	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	NPV @ 6%
BA (Option 3 adjusted re POCL payments)												
Pathway (incl BES payments passed through POCL)	(10)	(26)	(16)	(4)	0	0	0	0	0	0	0	(48)
ACT costs, including contingency	0	(10)	(88)	(110)	(78)	(78)	(78)	(78)	(78)	(78)	(78)	(515)
Cost of the "unbanked"	0	0	(8)	(20)	(30)	(32)	(32)	(32)	(32)	(32)	(32)	(163)
CAPS savings	0	0	34	103	137	137	137	137	137	137	137	716
POU savings	0	0	0	0	0	6	6	6	6	6	6	20
Payments to POCL saved	(2)	(8)	10	76	369	363	357	357	357	357	357	1,650
BA net administrative savings	(12)	(44)	(68)	45	398	395	389	389	389	389	389	1,660
BA programme savings	24	72	110	138	152	152	152	152	152	152	152	961
BA net administrative savings and programme savings	12	28	42	183	550	548	541	541	541	541	541	2,621
POCL												
Capital costs and non recurring revenue costs	(55)	(24)	(9)	0	0	0	(23)	(23)	(23)	0	19	(114)
BA & girocheque income	(14)	(27)	(77)	(173)	(358)	(351)	(351)	(351)	(352)	(351)	(351)	(1,797)
BA/SSA & girocheque related ABC costs	8	11	51	126	164	161	161	161	161	161	161	874
Cost of POCL bank	0	0	0	0	0	0	0	0	0	0	0	0
Network banking income	0	0	15	44	59	78	80	82	85	87	89	397
Network banking ABC costs	0	0	(10)	(31)	(41)	(54)	(56)	(57)	(59)	(61)	(62)	(276)
Network banking systems charges	0	0	0	0	0	0	0	0	0	0	0	0
Cost of new banking technology	(12)	(95)	(213)	(235)	(135)	(107)	(118)	(147)	(144)	(80)	(80)	(980)
Other POCL contribution	5	5	9	28	32	37	29	23	28	31	30	172
Other systems charges	0	0	0	0	0	0	0	0	0	0	0	0
Loss in other POCL contribution - footfall impact	0	(1)	(5)	(11)	(14)	(14)	(14)	(14)	(14)	(14)	(14)	(76)
Other POCL net costs	10	10	10	13	2	2	7	9	12	12	12	70
Subsidy: retail impact subpostmasters	0	0	(10)	(20)	(30)	(30)	(30)	(30)	(30)	(30)	(30)	(157)
POCL net impact on profits	(58)	(121)	(239)	(259)	(321)	(278)	(315)	(347)	(336)	(245)	(226)	(1,886)
ICL funding gap (ie ICL's NPV excluding £126m)												0
Total cashflow impact on Public Sector	**(46)**	**(93)**	**(197)**	**(76)**	**229**	**270**	**226**	**194**	**205**	**296**	**315**	**734**
Less ICL termination payment in baseline												0
Total NPV impact on Public Sector												**734**

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Option Cx

£m favourable/(adverse) compared to baseline	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	NPV @ 6%
BA												
Pathway (incl BES payments passed through POCL)	(10)	(26)	(23)	(22)	(16)	(4)	0	0	0	0	0	(84)
ACT costs, including contingency	0	0	0	(10)	(88)	(110)	(78)	(78)	(78)	(78)	(78)	(383)
Cost of the "unbanked"	0	0	0	0	(8)	(20)	(30)	(32)	(32)	(32)	(32)	(114)
CAPS savings	0	0	0	0	34	103	137	137	137	137	137	505
POU savings	0	0	0	0	0	0	0	6	6	6	6	13
Payments to POCL saved	(2)	(8)	(14)	(13)	53	159	357	357	357	357	357	1,179
BA net administrative savings	(12)	(34)	(37)	(45)	(26)	128	385	389	389	389	389	1,116
BA programme savings	24	72	96	96	110	138	152	152	152	152	152	874
BA net administrative savings and programme savings	12	38	59	51	84	266	538	541	541	541	541	1,990
POCL												
Capital costs and non recurring revenue costs	(55)	(24)	(9)	0	0	0	(23)	(23)	(23)	0	19	(114)
BA & girocheque income	(14)	(27)	(33)	(36)	(84)	(170)	(351)	(351)	(352)	(351)	(351)	(1,319)
BA/SSA & girocheque related ABC costs	8	11	16	20	57	125	161	161	161	161	161	655
Cost of POCL bank	0	0	0	0	0	0	0	0	0	0	0	0
Network banking income	0	0	13	34	49	85	96	99	101	103	105	433
Network banking ABC costs	0	0	(9)	(24)	(34)	(59)	(67)	(69)	(70)	(72)	(74)	(302)
Network banking systems charges	0	0	0	0	0	0	0	0	0	0	0	0
Cost of new banking technology	0	(74)	(204)	(217)	(103)	(98)	(118)	(147)	(144)	(80)	(80)	(898)
Other POCL contribution	5	5	9	28	32	37	29	23	28	31	30	172
Other systems charges	0	0	0	0	0	0	0	0	0	0	0	0
Loss in other POCL contribution - footfall impact	0	(1)	(2)	(2)	(5)	(10)	(13)	(13)	(13)	(13)	(13)	(54)
Other POCL net costs	12	10	11	12	14	13	7	9	12	12	13	90
Subsidy: retail impact subpostmasters	0	0	0	0	(10)	(20)	(30)	(30)	(30)	(30)	(30)	(111)
POCL net impact on profits	(44)	(100)	(208)	(185)	(84)	(97)	(309)	(341)	(330)	(239)	(220)	(1,447)
ICL funding gap (ie ICL's NPV excluding £126m)												0
Total cashflow impact on Public Sector	**(32)**	**(62)**	**(149)**	**(134)**	**0**	**169**	**229**	**200**	**211**	**302**	**321**	**543**
Less ICL termination payment in baseline												0
Total NPV impact on Public Sector												**543**

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Appendix 4
Discussion of NPV movements for options B1 compared to option A

Discussion of NPV movements
ICL's NPV excludes £126m
Cashflows exclude VAT and sunk costs (except ICL's NPV includes sunk costs)

	Variance from option A			
Option B1	**B1**	**B1 Sep 01**	**B1 High**	**Discussion of significant movements**
BA				
Payments to Pathway	358	372	358	Only OBCS payments continue
ACT costs, including contingency	(224)	(303)	(224)	This is caused by a change in phasing of ACT migration. Under options B1, migration begins 1-2 years earlier than in A and the steady state is reached in 5 rather than 7 years so that migration costs are compressed.
Cost of the "unbanked"	70	70	70	This is assumed to be eliminated under option B1 since the unbanked would have POCL bank accounts opened.
CAPS savings	(275)	(192)	(275)	CAPS savings are generated by the move away from order books. Since the migration from order books to ACT in option B1 occurs later than the move from order books to ACT in option A, these savings are delayed.
POU savings	10	14	10	
Payments to POCL saved	729	974	729	This is primarily caused by the earlier ending of the floor payment to POCL
BA net administrative savings	669	936	669	
BA programme savings	13	49	13	
BA net administrative savings and programme savings	682	985	682	
POCL				
Capital costs and non recurring revenue costs	(21)	(21)	(21)	Primarily cost of PIN pads (£18m NPV)
BA & girocheque income	(696)	(904)	(696)	Primarily a result of the earlier ending of the floor payment from BA
BA/SSA & girocheque related ABC costs	246	255	246	Costs of orderbook transactions saved, more than offset by POCL banking and network banking costs (see below)
Cost of smartcards	(65)	(72)	(110)	
Card Management Service (CMS)	(57)	(63)	(97)	Card management costs are borne by POCL under option B1 rather than BA as under option A.

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Discussion of NPV movements
ICL's NPV excludes £126m
Cashflows exclude VAT and sunk costs (except ICL's NPV includes sunk costs)

	Variance from option A			
Option B1	**B1**	**B1 Sep 01**	**B1 High**	**Discussion of significant movements**
Account setup	(43)	(45)	(57)	POCL estimate of administrative cost of opening POCL bank accounts of £4.50 per account. Includes counter time for mandate completion (~£2) and PIN selection (~50p), and transmission and storage of physical mandates (~£2).
Systems charges for POCL banking	(124)	(137)	(215)	
POCL banking ABC costs	(269)	(294)	(480)	
POCL banking fraud costs	(104)	(121)	(154)	POCL estimate of the cost of fraud risk together with the administrative costs of initial fraud investigation
Network banking income	(90)	(86)	(120)	In option A, all customers would eventually migrate to ACT into conventional bank accounts, a proportion of which would generate network banking income. In option B1, some of these customers remain with POCL bank, thus reducing network banking income.
Network banking ABC costs	63	62	84	Reduction in network banking costs offsetting the loss of network banking income
Network banking systems charges	25	25	32	Reduction in network banking costs offsetting the loss of network banking income
Cost of new banking technology	0	0	0	Not applicable to this option
Other POCL contribution	0	0	0	
Other systems charges	(4)	(3)	(4)	
Loss in other POCL contribution - footfall impact	(4)	(3)	11	
Other POCL net costs	(3)	(12)	(5)	
Subsidy: retail impact subpostmasters	0	0	0	Not applicable to this option
POCL net impact on profits	(1,146)	(1,420)	(1,585)	
Sub total impact on the Public Sector	(465)	(435)	(903)	
ICL funding gap (ie ICL's NPV excluding £126m)	(403)	(359)	(279)	Note that this includes (£121m) cost associated with the operation of POCL bank accounts. This cost may be overstated since the activity would be subject to competitive tender. However, Girobank's estimate is higher.
Total cashflow impact on Public Sector	(868)	(794)	(1,182)	
ICL termination payment estimate	0	0	0	
TOTAL Impact on Public Sector	(868)	(794)	(1,182)	

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Appendix 5
Derivation of cashflows

All cashflows are to 2009/10, exclude sunk costs (except ICL) and also exclude VAT payments by the public sector

	A	A Delay	B1 Core	B1 Sep 01	B1 High	B2	B3 Marketing	B3 No Marketing	C	Cx
BA	BA 20/4	KPMG estimated impact on A of 6 month slip in rollout, discussed with BA (copy to BA 22/4)	BA 16/4	BA 15/4	Equivalent to B1 Core for BA	BA 8/4 adjusted by KPMG for consistency with other options: reallocation of ACT costs; 100% of fraud savings with ACT	BA 30/4	BA 13/5 adjusted by KPMG for consistency with other options: contingency/ESNS costs; POCL savings based on fixed fee element during ACT migration	BA 17/5	BA 17/5
POCL	POCL 15/4	POCL 15/4	POCL 15/4 less card set off savings and prefunding costs	As for option B1 core, and adjusted by KPMG as instructed by POCL 22/4 to correct 2004/05 BA/SSA income included in error	POCL 15/4 less card set off savings and prefunding costs	As for option B1 core, and adjusted by KPMG in consultation with POCL 22/4 to reflect estimated impact on 'no floor'	Estimated by KPMG 4/5	POCL 18/5 adjusted by KPMG: assume Pathway continues to provide core system/network banking to 2010, based on scorecard pricing	POCL 20/4 adjusted by KPMG: reduce cost of new banking technology; include interim banking; include subsidy to subpostmasters	POCL 20/4 adjusted by KPMG: reduce cost of new banking technology; include interim banking; include subsidy to subpostmasters
ICL	ICL 15/4	ICL 15/4	ICL 14/4 plus bank operating costs as estimated by ICL earlier	As for option B1 core	ICL 14/4 plus bank operating costs as estimated by ICL earlier	ICL 31/3	Estimated by KPMG 4/5	Estimated by KPMG 4/5	N/A	N/A

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Appendix 6
Cashflows for B3 offer to ICL

Introduction

After completion of the value for money analysis presented in this report, the public sector parties entered into negotiations with ICL for the delivery of option B3. During the negotiations, KPMG staff supported HM Treasury in assessing the impact on cashflows of the proposals made by both private and public sectors. For completeness, the table overleaf presents the cashflows relating to the latest offer which was modelled, and which we understand to have been the basis for the heads of agreement.

Note that the BA cashflows in this table are based on 1998/9 prices while those in the other cashflow tables are based on 1997/8 prices.

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Option B3 no marketing - ICL offer	**1999-00**	**2000-01**	**2001-02**	**2002-03**	**2003-04**	**2004-05**	**2005-06**	**2006-07**	**2007-08**	**2008-09**	**2009-10**	**NPV @ 6%**
BA (BA 14/5 98/99 prices, replacing 'Payments to POCL' from Cx to max 360)												
Pathway (incl BES payments passed through POCL)		(26)	(24)	(23)	(16)	(10)	0	0	0	0	0	(86)
ACT costs, including contingency	0	0	0	(10)	(96)	(113)	(80)	(80)	(80)	(80)	(80)	(397)
Cost of the "unbanked"/New Service Provider(NSP)		0	0	0	0	(46)	(72)	(60)	(49)	(35)	(22)	(178)
CAPS savings	0	0	0	0	35	105	140	140	140	140	140	517
POU savings	0	0	0	0	0	0	0	6	6	6	6	13
Payments to POCL saved	(2)	(8)	(14)	(14)	54	163	360	360	360	360	360	1,192
BA net administrative savings	(12)	(35)	(38)	(46)	(23)	106	348	366	377	391	404	1,062
BA programme savings	25	74	98	98	113	141	156	156	156	156	156	896
BA net administrative savings and programme savings		39	60	52	89	247	504	521	533	546	560	1,958
POCL (POCL 18/5, adjusted to assume Horizon continues to 2010)												
Capital costs and non recurring revenue costs (adj'd)		(33)	(6)	0	0	(26)	(23)	(119)	(32)	(3)	41	(148)
BA & girocheque income	(24)	(34)	(34)	(34)	(79)	(184)	(360)	(360)	(361)	(360)	(360)	(1,367)
BA/SSA & girocheque related ABC costs	13	12	11	11	46	132	165	165	165	165	165	658
Costs of POCL bank	0	0	0	0	0	0	0	0	0	0	0	0
Network banking income	0	0	13	34	50	85	96	98	100	102	105	432
Network banking ABC costs	0	0	(9)	(24)	(34)	(59)	(67)	(68)	(70)	(72)	(73)	(301)
Network banking systems charges (adj'd)	0	0	(4)	(9)	(13)	(20)	(22)	(23)	(23)	(24)	(25)	(104)
Cost of new banking technology (adj'd)	0	0	0	0	0	0	0	0	0	0	0	0
Other POCL contribution	5	5	9	28	32	37	29	23	28	31	30	172
Other systems charges (adj'd)	(14)	(41)	(54)	(57)	(66)	(64)	(52)	(45)	(43)	(42)	(41)	(368)
Loss in other POCL contribution - footfall impact	0	(1)	(1)	(1)	(4)	(11)	(13)	(13)	(13)	(13)	(13)	(52)
Other POCL net costs	9	16	18	18	17	15	6	8	13	12	12	105
Subsidy: retail impact subpostmasters	0	0	0	0	(15)	(30)	(30)	(30)	(30)	(30)	(30)	(121)
POCL net impact on profits	(37)	(76)	(57)	(34)	(66)	(99)	(272)	(364)	(267)	(234)	(189)	(1,093)
Sub total impact on the Public Sector	(24)	(37)	4	18	23	149	232	158	266	312	371	865
ICL funding gap (ie ICL's NPV excluding £126m)	(134)	(190)	(28)	(25)	(20)	(29)	(18)	(50)	(27)	(28)	(29)	(463)
Total cashflow impact on Public Sector	**(158)**	**(226)**	**(24)**	**(7)**	**3**	**120**	**215**	**107**	**239**	**285**	**342**	**402**
Less ICL termination payment in baseline												150
Total NPV impact on Public Sector	**(316)**	**(452)**	**(48)**	**(14)**	**7**	**241**	**429**	**215**	**478**	**570**	**685**	**552**