Bringing technology to Post Offices and Benefit Payment (Horizon)

Revised business case for the automation of Post Offices and response to action points from MaPEC 30 April 1996

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1. Summary

This paper provides MaPEC with an update on the latest position. It addresses the outstanding MaPEC action points from 30 April 1996 and details the latest financial position. It asks MaPEC to note that the overall NPV has been maintained in line with the original business case. It also asks MaPEC approval for an increase in one-off cost of £26.4m to £42.2m (all figures at outturn). These increases in one-off costs have been offset by reductions in business as usual costs.

2. Progress to date

Good progress has been made since the original MaPEC hearing and signing of the contracts on 15 May 1996. The initial go live was delivered to time on 21 October. The live trial is on schedule for April 1997 and roll-out is planned to commence in July 1997, in line with ICL Pathway's bid. The project has now been renamed "Horizon".

The final "drop-down" of the contract has been extended with the consent of all parties, and is anticipated to be complete by 29 November. The revised numbers take account of those items agreed, and identifies the financial impacts of those remaining unresolved as at 25 November 1996.

The PFI contract will now last until the end of 2004/ 05 (i.e. 1 extra year). Whilst the length of the PFI contract remains 5 years, the contractual end of roll out is now a defined date rather than five years from an event which is movable. This allows planning etc. to be made with greater certainty.

A management team within POCL and a Programme Delivery Authority (PDA) funded jointly with BA have been set-up. Following the unexpected departure of Andrew Stott as Programme Director, Peter Crahan has been appointed as his successor in the PDA and the organisation structure has been reviewed to ensure it is better equipped to handle implementation and delivery. The conditions of the original concurrence have been addressed.

Good working relationships have been developed with ICL Pathway at all levels covering both the implementation of the system and the development of a partnership to exploit synergy.

TIP has recently received approval (MP(96)98) for an interim solution to take an opportunity arising from Horizon. Although TIP was intended not to create a dependency for the Horizon, in practice this could only be achieved by continuing to receive cash accounts from automated offices. POCL also needs to receive and process automated benefits encashment data and provide test data. These requirements are being met through an interim TIP which would pay back before full TIP (yet to be finally defined and approved) takes over from it.

More detailed information on progress is provided to the Chief Executive, Managing Director Finance and Managing Director Strategy and Personnel at a regular Counters Automation

Steering Committee. The numbers presented in this paper are consistent with those advised to CASC.

3. Key issues
There are a number of key issues:

- significant regional resources are required to support the roll-out of the system. CEC has agreed that adequate provision for training and support was a high priority for the business and endorsed the lowest cost option commensurate with maintaining quality of service and accounting integrity. The financial implications are included in the financial analysis.
- Agreement has been reached on the contents of Release 1 and ICL Pathway's release strategy in general, although formal contractual agreement is not expected until 29 November. Any significant changes required by POCL could have an impact on the timing of costs and benefits.
- there is uncertainty over BA's ability to deliver to time the feeder systems for some of the Benefits. Given the structure of the contracts between POCL and BA, and POCL and ICL Pathway, this should have limited impact on POCL's business case (but could have an adverse impact on ICL Pathway's). Ernst & Young have been contracted by the Secretary of State for Social Security to review the position. A report back is expected towards the end of December 1996.

4. Benefits management
Horizon is part of POCL's strategy for the future of its business, but is only part of POCL's automation investment. CEC have, therefore, set up a transformational steering group comprising executive directors and with expert support from within the business and from Group. This group will lead the change programme and ensure that the business targets which it underpins are delivered within the wider context of POCL's business plan. The group is assisted by an automation working group comprising controllers from all projects supported by external consultants already appointed (MP(96)97).

The inter-relationship between POCL's transformational IT projects will be the subject of an overall business case, expected to be presented to MaPEC in Spring 1997.

For Horizon specifically, a Development Management Team in Strategic Head Office has been created led by a CEC Director. This team has responsibility overall to ensure delivery of the business case and other benefits of the automation programme in post offices

Two key benefit areas are:.

- **client take-on**

  To ensure benefits are maximised a Client Take-On Plan (CTOP) has been developed. The CTOP represents the current view of how and when products will be re-engineered. This re-engineering underpins the Commercial Proposals (from which an income/ contribution benefit is derived for the business case) and is used (along with the associated transaction volumes and scorecard mappings) as the basis for forecasting the ICL Pathway charges shown in the business case. The Development Management Team are working with the account teams, and through them the clients, to ensure the maximum benefit is gained from automation by planning and specifying re-engineered products.

  In addition, the team are working with ICL Pathway and the PDA to ensure the CTOP is fully integrated into the ICL Pathway release plans, and that we have an agreed process by which automated products are documented and developed. To ensure that the benefits are delivered each product re-engineering development will be accompanied by a business case within POCL.

A release strategy for changes to support/data is currently being discussed with ICL Pathway. It ensures that there are adequate controls around risk and cost of change.

The functionality provided under the contract with ICL Pathway is designed to meet our contracted for should cover currently anticipated future business needs. The associated system costs, are included in this case.

The CTOP and associated volumes and scorecard mappings are maintained by the team and will change over time to reflect release plans, client re-engineering plans and revisions to the Commercial Proposal volumes. The impact of any such changes will be reflected in updates to the Business Plan.

- **partnership with ICL Pathway**
  POCL and ICL Pathway are working together to bring benefits to both parties by harnessing the skills and experience of both. Through partnership it is hoped that greater profitable business will be gained. A number of opportunities for new products as well as improved services have been identified. A process for prioritising these is being developed with Pathway..

5. The financials

POCL has evaluated the automation case against a base case verified by independent consultants. The original base case has not been re-visited. It was the most informed view possible at one point in time of what POCL's long term commercial prospects were in a non-automated environment and involved considerable consultancy input and scenario planning by market teams working with clients. As time has moved on the value of re-visiting the base case has diminished. The public announcement of the PFI to automate post offices means that clients expectations have been raised and now underpin all key commercial relationships. There will continue to be changes in volume due to market conditions. By maintaining the base case as a constant we are being prudent, as volumes could decline more sharply and growths be more sluggish without the prospect of automation to improve our competitive edge. Our approach has therefore been to track assumptions underpinning the risks/benefits of the automation case.

The NPV movement from the original business case is detailed in annex 1. Changes to risks and opportunities have worsened the overall NPV marginally at +£63m pre-risks (+£65m in original business case). However, additional potential risks, particularly around VAT, have worsened the post risk NPV to £42m (+£45m in original business case).

Although significant savings have been made in early charges from ICL Pathway, these have been offset by significant increases in project costs which will require Board approval in two key areas:

5.1. Programme costs

The costs of the Programme Delivery Authority which is jointly sponsored and funded by the Benefits Agency and POCL, to plan, implement and manage the delivery of the new system have risen by £8.3m on an anticipated £10.4m.

This is because the original costs were an estimate. Six months working experience of the PFI relationship has shown we did not anticipate the level of sponsor impact that would be required to assist the PFI supplier to convert their bid plan into a quality solution that meets the business requirements. The approach adopted by the supplier in development of products has also meant more resource to support teamworking between Pathway and PDA teams. POCL has also ensured that the right level of technical resource is put in place in line with the original technical concurrence.

There may be some scope to reduce this cost by migrating service and contract management back into business as usual. However it is early days yet and much will depend on the successful achievement of project deliverables to planned timescales. The size and scope of the PDA will be reviewed at an appropriate time, after live trial has commenced.

5.2. Training and support

This was originally estimated at £4.4m, with below the line risks of £10.4m It is now estimated that this will be £18.1m above the line. Detailed discussions with Pathway along with a better understanding of the developing solution and the injection of greater operational experience into the project has shown that not only is more training required than was originally anticipated but that personal support in outlets will be required if the period of transition from manual to automated processes is to be effectively achieved without compromising service and accounting integrity. Previous POCL experience (i.e. the introduction of ECCO into main offices) as well as benchmarking with AnPost has shown this support is vital to successful implementation of the system. Counters Executive Committee have debated the options and agreed (subject to rigorous review) the lowest level of cost commensurate with quality which is reflected in the revised submission.

There are also significant implications for POCL's manpower when c250 temporary counter trained personnel will be needed to enable release of staff to attend training as well as to provide support in agency outlets. This will need to be managed carefully to ensure that completion of roll-out can be achieved without significant ongoing cost to POCL. The programme Team are working closely with Regional General Managers in this area.

The size and scope of the support will be reviewed at an appropriate time, after live trial has commenced. There may be scope for some reduction in training costs if current negotiations with the NFSP are successful in transferring the cost of attendance at training to agents themselves. The situation should be clearer early next year as training plans are finalised.

Overall the significant increase in costs since the original Business case submission is the result of a much better understanding by POCL of Pathways solution and the extent of its contractual commitments. Whilst it is not possible in a project of this size and scope to guarantee that there will not be any further increase in project costs, it is believed that the most significant of these are covered within the present submission and the risks and opportunities at Annex 1.

The live trial should enable assumptions to be tested and confirmed.

5.3. VAT

The supply from ICL Pathway is standard rated. This presents a significant additional cost. In the original case we assumed, supported by advice from Ernst & Young, that the back-to-back charges to BA would also be standard rated. This would mean that we could recover 100% of

VAT on the BA related automation charges. Irrecoverable VAT for non-BA charges was included in the business case. However, the recent view from HM Customs and Excise is that automation services to BA should be exempt from VAT in line with charges for the counter service. This creates a high impact risk of £27m NPV.

We believe that the likelihood of the risk materialising is low, although considerable effort may be required to ensure this. Advice from Slaughter & May and Ernst & Young is that we should be able to include irrecoverable VAT in the charge to BA. This would have a significant adverse impact on BA. Alternative strategies include taking HO Customs ruling to Tribunal. A further approach is for ICL Pathway to charge BA direct. POCL is currently reviewing, with advice from Slaughter & May and Ernst & Young, the next steps.

5.4 Summary
As with the earlier business case, although the NPV of automation is positive over the base case, the cash flows are negative. POCL are continuing to review ways of lowering costs without affecting benefits.

The changes to the detail behind the business case has also changed the impact on the POCL. Lower system costs, which have a large impact in early years, have been more than offset by a reduction in forecast BA volume. These changes have been taken account of in POCL's business planning process.

The revised sum requiring authority is as follows (all figures at outturn):

	Original	Revised	Increase
Sunk Costs			
1995/ 6	£5.4m	£5.4m	
1996/ 7 to end P7		£2.7m	£2.7m
Programme Costs	£10.4m	£16.0m	£5.6m
Training Costs	*	£18.1m	£18.1m
	£15.8m	£42.2m	£26.4m

* The original submission included £10.4m authorised for Programme Costs and provided for £4.4m Training Costs within the case (not separately authorised). A further £10.4m was included in the risks which have materialised.

6. MaPEC action points
From the MaPEC meeting on 30 April 1996 the following action points were raised:

- *additional non-financial benefits and benefits management plan*
  Benefit management is discussed in section 4 above. At this stage there are no further non-financial benefits identified (other than those identified in the original case):
  Recommend item discharged

- *final best bid is consistent to original business case*
  Financials discussed in section 5. Overall, the final best bid continues to be consistent with original view: *Recommend item discharged*

- *if final contract was materially different to re-present financials*
  Financials discussed in section 5. Current position, with drop-down being complete on 29 November, is that the financials are consistent with original position:
  Recommend item discharged

- *financials to re-submitted following contract award and for a 6-monthly report back*
  This paper re-submits the financials. Regular progress reports, including latest view of financials is presented to Chief Executive, MD Finance and MD Strategy and Personnel at the Counters Automation Steering Group, subject to future changes to SDA going back through MaPEC. It is proposed that the report to Counters Automation Steering Group will be the preferred method of report back of issues and latest financial position with regular updates on progress of the project to the main Board.:
  Recommend item discharged

7. MaPEC approval

MaPEC is asked to:

- note that the overall NPV is £63m (+£65m original),
- agree that the MaPEC action points from 30 April 1996 are discharged,
- to authorise for Board approval increased project costs of £26.4m to £42.2m,
- agree that the report Counters Automation Steering Group will be the preferred method of report back of issues and latest financial position with regular updates on progress of the project to the main Board.

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Annex 1

Business Case Changes Since May 1996

	Costs	Savings	Cumulative	
	NPV £m	NPV £m	NPV £m	
Baseline Business Case			65	As reported to MaPEC 30 April 1996. £65m NPV is before previously reported risks of £20m.
1. Fall in BA volumes	(30)			1996 commercial proposal transaction volumes are 10% down on 1995 forecasts.
2. Card issue/ back office	(2)			Relates to delay in realising back of office savings due to later roll out/ delay to CAPS.
3. Time increase		8		Time increase previously included at 6 seconds for BES, now confirmed at 4.5 second maximum (based on marginal cost of 0.7p per second). Also the cost is delayed as in 3. above.
4. Programme costs	(4)			Higher than originally anticipated costs on PDA.
5. System charges (inc. VAT		20		Lower POCL charges from Pathway due to delayed roll out, changes to scorecard and removal of score optional products.
6. Training	(8)			Now incorporates a higher level of POCL support costs than anticipated in April.
7. Contract length		9		Final contract signed in May is still for five years, but does not commence until one year later than originally planned (no delay to physical roll out completion).
8. Fraud		2		Delay to roll out postpones POCL's additional fraud liability.
9. Adjustment on 'Other Costs'	(3)	6		Additional product costs now expected to be lower (original estimate prudent) and kit installation costs transferred in from risks.
Total Impact	(47)	45	(2)	
New NPV before risks			63	

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Assessment of risks and opportunities	**Costs**	**Savings**	**Cumulative**	
	NPV £m	NPV £m	NPV £m	
Previously reported:			(20)	
- Kit installation	(8)			
- Powers problems	(2)			
- Fraud/limit of liability on SLAs	(10)		(20)	As reported to MaPEC 30 April 1996
Changes:				
- Kit installation		(7)		A smaller value has now been included 'above the line' (in 'Other Costs')
- SLAs		(3)		Risk reduced around Service Levels due to better defined contractual assurances
New Risks and Opportunities:				
- Commercial proposals	(4)			1996 Commercial Proposals are more pessimistic but have not been fully evaluated to date. (Likelihood = 50%)
- OBCS Cost Risk	(2)			Additional system cost of Giro Cheque transactions during roll out (Likelihood = 50%)
- Transaction time	(4)	3		QofS costs for longer EPOSS transaction times potentially off set by improved staff scheduling at Branch Offices to reduce transition time impact (Likelihood = 10%)
- VAT on Contract B/A	(28)	10		Customs and Excise initial view on Contract B as exempt. Remedial action under way. Upside potential if contract A determined as standard rated (Likelihood = 10%)
- BA Income		9		Protection from fall in BA income under Contract A (Likelihood = 50%)
- Subpostmaster Training costs		4		Maximum possible saving if Subpostmasters not paid for travel and expenses for training (Likelihood = 20%)
- PDA Costs		1		Quicker re-integration of PDA costs into business as usual (Likelihood = 20%)
Revised Risk Assessment	(38)	37	(1) (21)m	

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One Off Costs - November 1996 Forecast

	1996/97 £000	1997/98 £000	1998/99 £000	1999/00 £000	Total £000
Planning	0	486	558	0	1,045
Training	4	3,776	4,334	0	8,113
Support	0	3,050	3,496	0	6,546
Recruitment	0	112	129	0	241
Modification	0	1,051	1,078	0	2,129
Staff/ Consultants	1,188	4,221	3,614	611	9,634
Goods and services	777	1,126	905	111	2,920
Accommodation	65	155	98	19	338
IT	1,117	900	890	177	3,084
Total Outturn	3,151	14,878	15,102	919	34,050

One Off Costs - May 1996

	1996/97 £000	1997/98 £000	1998/99 £000	1999/00 £000	Total £000
Training					0
Modification					0
Staff/ Consultants	3,500	2,101	1,734	0	7,335
Goods and services	1,000	525	215	0	1,740
Accommodation	200	200	200	0	600
IT	300	210	215	0	725
Total Constant	5,000	3,036	2,364	0	10,400