

The Cancellation of the Benefits Payment Card project



Report by the
Comptroller and Auditor General

Department of Social Security

The Cancellation of the Benefits Payment Card project

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Comptroller and Auditor General

National Audit Office
24 July 2000

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Glossary of Terms

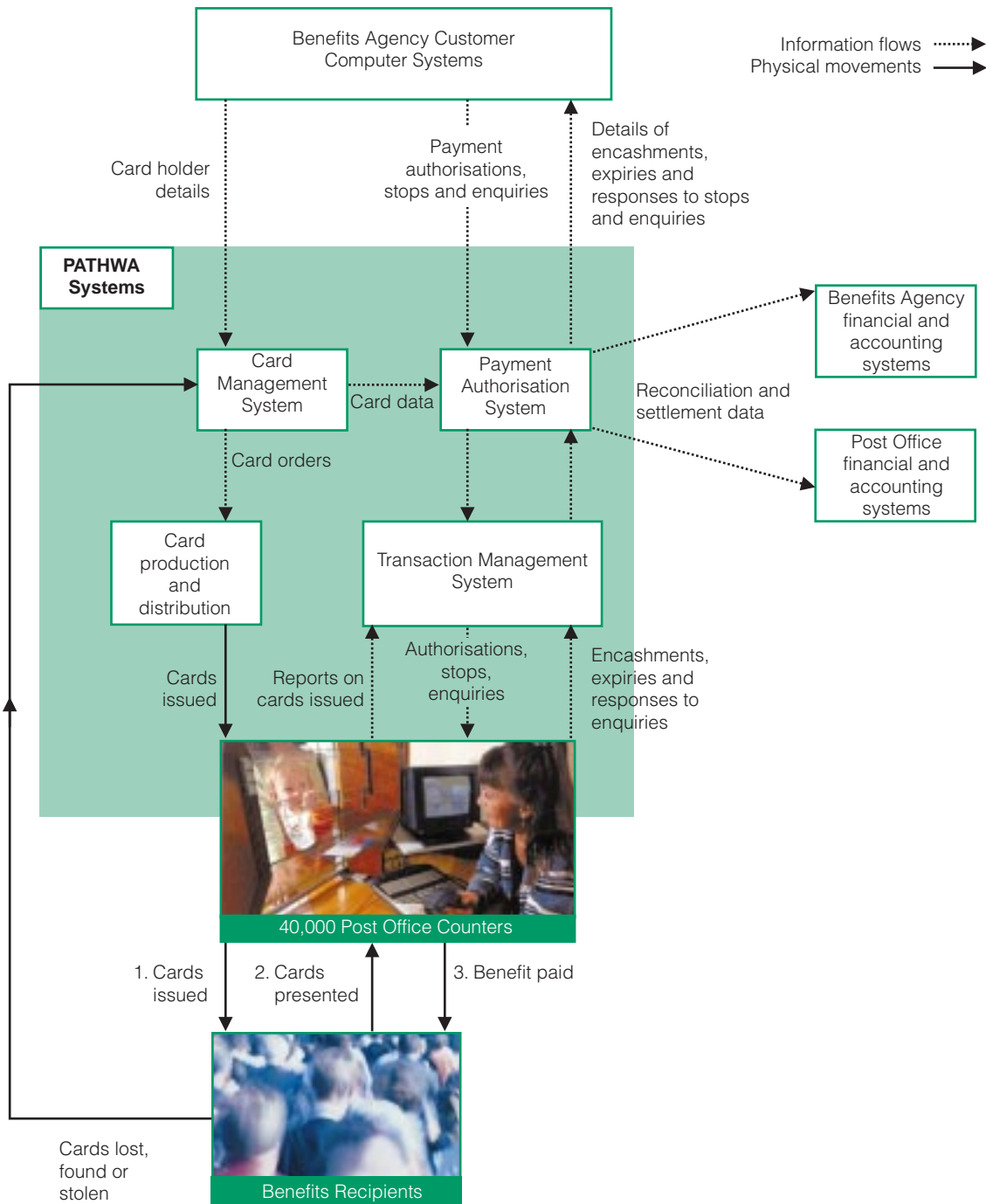
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The Benefits Payment Card System - An overview

The Benefits Payment Card system was a large, complex system, linking transactions at Post Offices with the systems of the Benefits Agency and Post Office Counters Limited. The supplier, Pathway, was responsible for the issue and distribution of payment cards and the processing of transactions and enquiries.



Note: To ensure clarity, other functions particular to Post Office Counters Limited are not shown.

Source: National Audit Office

Executive summary

The Benefits Payment Card project was started in May 1996 and cancelled in May 1999 after continual slippage

1 In May 1996 the Benefits Agency of the Department of Social Security and Post Office Counters Ltd (the purchasers), jointly awarded a contract to Pathway, a subsidiary of the ICL computer services group. The Benefits Payment Card project was intended to replace by 1999 the existing paper-based methods of paying social security benefits with a magnetic stripe payment card, and to automate the national network of post offices through which most benefits are paid across Great Britain and Northern Ireland.

2 The project was vast in its scale and complexity, and estimated to cost some £1 billion in payments to Pathway. It was also one of the first Information Technology contracts awarded under the Private Finance Initiative. Under such deals the supplier receives a contract to design, build, finance and operate an asset, and is paid for the provision of the service only as it is successfully delivered. The purchasers, (the Benefits Agency and Post Office Counters Ltd), used the Private Finance procurement method because they did not expect to have the capital resources to develop the Benefits Payment Card themselves, and wished to transfer to the private sector risks of developing and delivering a working system and preventing fraud. The Department's business case for the project was based on achieving the potential fraud savings from introducing the new system. This meant that any significant delay in delivery would begin to erode the business case.

3 The overall objectives of the project were to:

- provide a virtually fraud-free method of paying benefits at post offices that was automated, had lower end-to-end costs than the current paper-based process, with continuously reducing overall administration costs year on year;
- extend automation to Post Office Counters Ltd's transactions for other customers, its products and its support processes to improve competitiveness, increase efficiency, and to enable greater commercial opportunities;

- enable full and speedy reconciliation of benefits payments, with accounting arrangements consistent with recognised accountancy practices; and
- provide an improved service to both purchasers' customers.

4 By October 1996 the contracting parties had successfully implemented a limited version of the system, which paid child benefit in ten post offices in Gloucestershire. Development work continued and further functionality was added through successive software releases which were used in 205 post offices. But designing and developing a fully functional system proved much more complex and took much longer than had been expected. The programme at the time the contract was signed assumed that it would take ten months to start a live trial of the full system intended to cover 24 different benefits and all of the 19,000 post offices then in the network. In fact, this stage had not been reached at the time the contract was terminated nearly three years later.

5 During the second half of 1996 the two purchasers and Pathway became increasingly aware of the difficulty they faced in developing the full payment card system. Discussions were opened that led in February 1997 to a “no-fault” replan of the project. Under this plan, all parties agreed to defer the final delivery dates by three months and to bear their own costs in doing so. Subsequently the Department introduced new customer accounting and payment systems covering four benefits and holding records of 16 million customers, releasing the software in time to link with equivalent phased releases of Pathway’s new Card Payment systems.

6 Despite the replan, the project continued to make slow progress, for reasons explained in paragraphs 14 to 24 of this summary and in Part 3 of this report. Though Pathway delivered intermediate releases of software, by 21st November 1997 they had not completed, as required by the replan, a live trial to demonstrate satisfactory, sustained operation of child benefit payments and a range of Post Office functions in 300 post offices. The purchasers served on Pathway a formal notice of breach of contract, which Pathway denied and did not accept liability for, counter-asserting breach of obligations by the purchasers. In December 1997 Pathway wrote to the Benefits Agency suggesting that if the project were to continue they would either have to increase their prices by 30 per cent or extend the contract by five years and raise prices by five per cent.

7 The Department were not in a position to take unilateral action, but recognising the continuing difficulties, sought interdepartmental discussions involving primarily HM Treasury, the Department of Trade and Industry and the Prime Minister's office to reach a wider cross-government solution. Post Office Counters Ltd and Pathway were also involved. In July 1998, an independent panel of experts concluded that the project could deliver the functions required, but was unlikely to operate nation-wide much before the end of 2001, three years later than originally planned. They stressed that successful delivery would require renewed commitment from the parties and was not without risk. The cost of continuing was uncertain.

8 Discussions between government and ICL in late 1998 failed to close the gap between both sides' proposals for continuing the full project. From January 1999 discussions turned instead to the terms on which the automation of post offices could proceed without inclusion of the Benefits Payment Card.

9 In May 1999 the government decided that removing the payment card from the project offered better value for money than complete cancellation, would better protect the early automation of the Post Office, and was preferable to continuation. They devised a new strategy with the following key features:

- the Benefits Payment Card element of the project would be dropped, simplifying and assuring post office automation;
- automation of the Post Office would proceed, for completion by 2001;
- benefits payments would be made by automated transfers to claimants' bank accounts; starting in 2003 and completing by 2005. Until 2003 existing arrangements would continue;
- people who wished to continue to collect their cash at post offices would continue to be able to do so. The Post Office would introduce suitable banking technology and commercial arrangements with banks to allow this to happen; and
- for the relatively few people for whom a bank account may remain an unsuitable option, special arrangements would be made.

10 In June 2000 the Secretary of State for Trade and Industry announced a package of measures designed to modernise the Post Office network by;

- ensuring that benefits and pensions can still be paid in full, in cash at the local post office;
- setting up a special fund to improve local offices in deprived urban areas;
- providing help for those on low incomes;
- providing people with new opportunities to use the internet;
- encouraging post offices to act as Government one-stop shops;
- maintaining the rural network by placing a formal requirement on the Post Office to prevent any avoidable closures of rural post offices; and
- supporting the development of the proposed “Universal Bank”, giving banking facilities for up to 3-5 million extra people, and allowing customers, including pensioners, to get cash out of the post office and set up direct debit arrangements.

11 The delays to the Card project and its subsequent cancellation affect benefit claimants, the Department of Social Security, the Post Office and ICL. These consequences are described in Part 1 of this report.

Scope of our examination

12 We have examined the conduct of this project to identify:

- the reasons why the Payment Card project failed to meet its objectives; and
- whether there are useful lessons that should be learned for other projects; particularly in terms of the approach taken towards the management of risk.

13 The project was a tripartite venture, requiring all three parties involved to meet their contracted obligations for the project to be successful. This report, however, focuses on the role of the Department of Social Security in the project. The Treasury and the Department of Trade and Industry, which sponsors the Post Office in central government, were also actively involved in reviewing the project and in the decision to cancel the Benefits Payment Card, taking account of the wider interests across government. The Comptroller and Auditor General has no statutory rights of audit access to Post Office Counters Ltd, but in the interests of completeness and balance the report refers to the objectives and involvement of Post Office Counters Ltd in the Payments Card project and the consequences for them of its cancellation. The Comptroller and Auditor General had certain rights of access to records held by Pathway for the purpose of examining the value for money with which the Department of Social Security used its resources, and Pathway co-operated with us in our examination. Our approach towards the examination is described in Appendix 1.

The project was high risk. It was feasible, but probably not fully deliverable within the very tight timetable originally specified

14 The project was an ambitious one, and with hindsight, probably not fully deliverable within the very tight timetable originally specified. It had special features that added to its risks; notably its status as a pioneering Private Finance Project, the need to join up the systems of two purchasers with differing business objectives, and the need for the development and testing of more new software than was originally envisaged.

Key Statistics of the Project

Estimated contract value, (Payments by Department and Post Office):	£1 billion, net present value over 7 years
Number of post offices to be equipped:	Up to 20,000, with 40,000 counter points in Great Britain and Northern Ireland
Number of post office staff to be trained in use of the system:	67,000 staff, serving 28 million customers per week
Number of social security benefit recipients to be issued with Payment Cards:	17 million, claiming some 24 different benefits
Number and value of benefit transactions:	In 1999/2000 some 760 million payments worth £56 billion were made through post offices

The project was procured through an innovative method

15 As a ground-breaking Private Finance project in the Information Technology sector, there was little by way of precedent to inform it. There was limited experience at the time as to the appetite and ability of the purchasers or potential suppliers to accept important risks, such as the liability for failing to prevent fraud. There was also a perception that because responsibility for delivery could be transferred to suppliers, purchasers should be less concerned with validating the supplier's internal arrangements and had less "need to know" the detail of the supplier's solution.

The Department and Post Office Counters Ltd had different objectives for the project. These were not incompatible but they led to tensions which required a genuine partnership between the two purchasers to resolve.

16 The objectives of the Department of Social Security and Post Office Counters Ltd in undertaking the project were different, reflecting their different business drivers. They rightly agreed a memorandum of understanding between themselves before signing the contract with Pathway, which addressed their commercial relationship. But this did not prevent later disputes on matters of detail. For example, arrangements that the Department wanted to ensure security for payments to people temporarily collecting benefits on behalf of claimants proved difficult to balance against Post Office Counters Ltd's commercial interests in maximising the flow of customers through its outlets.

17 We found significant evidence that the Department had shown commitment to the success of the project. In 1997/98 they employed up to 1100 staff plus consultants in designing and implementing their CAPS computer systems that were to link to the Payment Card. They also agreed to the system being installed in 205 offices without the full range of contracted security features. In late 1997, when the project was clearly in deep trouble, they sensibly began contingency planning for a possible implementation of payment by bank transfers, in case the Benefits Payment Card project should fail. Pathway told us that they felt that the Department's commitment had reduced from around this time, in their view because the project no longer had such strong champions within the Department as before. Argument over difficult issues, mainly to do with how best to ensure the security of the system, tended to raise doubts among the participants as to their partners' commitment to timely delivery of the project. Similarly, because Post Office Counters Ltd had a lower financial incentive than did the Department to achieve a quick changeover from order books to the Benefits

Payment Card, the Department at times questioned their partner's motivation. Post Office Counters Ltd insist that they too had a strong interest in playing their full part in delivering the entire project to time. In our view, such doubts about partners' commitment inhibited a genuinely open and participative approach to tackling the severe problems of the project.

The Department's initial business case did not adequately assess the risk and costs of serious slippage

18 The Department's business case for the project was based on achieving the potential fraud savings from introducing the new system. This meant that any significant delay in delivery would begin to erode the business case. The misuse of order books and girocheques was at the start of the project estimated to cost the taxpayer over £150 million in fraud each year, though from 1996 a system of electronic stop notices implemented in the London area started to reduce this. Payment fraud losses are now estimated at some £100 million. We found that the Department's business case for the project included limited analysis to ensure that it would remain robust in the event of significant slippage. The Department accepted that slippage presented a risk to their business case, but were confident that a large proportion had been transferred to Pathway, who were to be paid only when the service was up and running. Sensitivity testing was done routinely after signature of the contract to assess the impact of revised dates.

The purchasers, the Department of Social Security and Post Office Counters Ltd, established arrangements to manage the risks of the project, though with only limited success

The purchasers identified most of the risks of the project, but were less successful in assessing their probability and impact

19 The purchasers' joint procurement team made strenuous efforts to identify the risks of the project. In March 1995 they compiled a register comprising 224 risks, including virtually all those that could have been foreseen and those that eventually impeded the delivery of the project. However, this register did not include assessments of each risk's probability and impact, nor did it allocate risks to "owners" for management, or propose options to manage the risks. We found no evidence that this formal register was subsequently further developed and actively used in the project, though some of the risks it contained were identified again in subsequent registers later in the project.

20 We found that the purchasers' process for selecting a supplier was diligent. Considerable resources, effort and care went into the evaluation of bidders' proposals, and we found no indication of any impropriety. In mid-1995 the procurement team produced separate risk registers for each of the three shortlisted bidders based on their detailed technical proposals, demonstrations of capability and subsequent negotiations. This approach was fundamentally sound. But though risks were assessed for impact and probability of occurrence, there were significant risks in Pathway's proposals that the procurement team's register did not address. These included risks to delivery from very ambitious proposed timescales for system development and testing, to meet exacting deadlines for implementing the Payment Card, and a lack of information on the resources that Pathway would apply.

When the contract was signed key parts of the detailed specification had not been finalised

21 All high level specifications were agreed ahead of the issue of the Invitation to Tender. However, a decision not to complete the documentation of both purchasers' detailed requirements before contractor selection and contract award was a major contributor to the later problems of the project. The decision was agreed by the joint project board and by the shortlisted bidders, and recognised Ministers' legitimate interest in proceeding with implementation of their policy for the payment of benefits.

22 When the contract was signed much of the detail of how the development and operation of the Card was to be provided had not been agreed between the purchasers and Pathway. From the records it seems that there were some 289 agreements to agree the detail of the service contained in it, of which 38 remained to be agreed by Pathway with the Department of Social Security, 124 with Post Office Counters Ltd, and 127 with both clients jointly. Some of these matters were relatively minor, such as the design of the logos to appear on the card, whereas others, examples of which are shown in Appendix 2, were more significant. Pathway told us they had expected them to be cleared within three months and that when this did not happen they obtained a contract amendment exonerating them from liability for any delays that were a direct consequence of failures to agree. The number of outstanding agreements to agree reduced greatly during the implementation phase. But vital issues, such as the precise nature and specification of the system's security procedures and reports, particularly how these would adapt to changes in patterns of fraud, remained unresolved when the Card project was cancelled three years later. The Department agreed to Pathway's

request to defer full implementation of these security procedures, providing they were fully in place before rolling out the system for higher risk benefits than Child Benefit, such as Income Support.

More rigorous demonstrations by bidders might have better highlighted the risks to deliverability and the extent to which new software had to be developed.

23 One reason why risks to delivery were not properly assessed was the limited scope of the demonstrations mounted by the shortlisted suppliers to show the viability of their proposed solutions. In the case of Pathway this was a demonstrator system based on one already operating in the Republic of Ireland but meeting a requirement much simpler than the Benefits Payment Card. The other two bidders constructed mock-ups of new systems. Though the purchasers had at one point considered a fully-fledged pilot stage, this was not done for reasons of cost and time. There are limits to how much further work bidders will do in such circumstances without funding from the purchaser.

24 This project initially proceeded on the basis of proposals from bidders that it would involve mainly the integration of existing software packages. In the event, the greater than expected complexity of the service requirement obliged Pathway to develop much more new software than they had planned. The Department's view is that Pathway knew what was required but had intended to fit the requirement to match a system they had already implemented in Eire. The extent of new software development had major implications for the degree of difficulty of the project, since this is a high-risk activity with high failure rates, especially in large organisations.

Pathway submitted narrowly the cheapest of the three bids, but the purchasers ranked their proposal third on eight of eleven technical and management criteria

25 To help them decide which bidder to select, the procurement team ranked the proposals of the three shortlisted bidders in terms of their proposed technical solution and management arrangements. Pathway ranked third against eight of the eleven criteria where a ranking was awarded, including areas where the project later encountered problems such as security against fraud. Pathway's proposals were nevertheless considered deliverable. Their proposal ranked a narrow first in terms of direct price, and a clear first in terms of risk transferred.

A decisive factor in the selection of Pathway was their acceptance of greater risk, making their bid compliant with the Private Finance Initiative

26 The purchasers awarded Pathway the contract despite their ranking on technical and management criteria. Pathway's bid included only £20 million to take on the contractual liability to pay up to £200 million in damages to the purchasers in respect of direct losses if their system failed to operate or to prevent fraud. This was deemed to represent transfer of fraud risk, which was considered essential for the project to qualify as PFI and not count against public sector capital expenditure. The other bidders had priced this liability into their bids pound for pound. The choice the purchasers felt they had was therefore either to accept the Pathway bid or to not proceed with the project at all. The purchasers did not in the end demand damages from Pathway when the project began to slip. They felt this would not encourage Pathway to succeed and could deflect the firm's attention away from delivery to a legal battle. When the Card element of the project was subsequently cancelled in May 1999 the government again chose not to claim damages, as part of the agreement with ICL in which the Company also agreed not to counter-claim. Another major consideration was ensuring the successful completion of the continuing project to achieve post office automation. Currently the platform has been installed in around 8,000 of the 18,300 post offices and is planned to reach the entire network by Spring 2001.

The purchasers found monitoring and controlling risks very difficult

27 During the procurement stage of the project, risk monitoring and control involved mainly discussion between the purchasers' joint procurement team and the bidders about how to mitigate the risks identified in their proposals and demonstrations. By the time that the contract was awarded in May 1996 the register for Pathway still carried six risks that had either high probability or high impact. The procurement team downgraded several major risks because the risk of late delivery was seen as falling on the supplier through the payment terms of the Private Finance contract. In fact, delay, whether caused by a supplier or by a purchaser, would cost the Department of Social Security's business, and therefore the taxpayer, some £15 million each month in terms of continuing fraud and additional administrative costs. It is evident from subsequent events that certain risks the purchasers team had identified in Pathway's proposal and demonstration and declared as cleared in their final risk register for the Pathway proposal in March 1996, remained areas of difficulty. Risks to the timely delivery of the CAPS programme, also identified at that time, were subsequently addressed by the February 1997 re-plan. The key risks are described in Appendix 7 of this report.

Pathway told us that they had not seen the purchasers' risk registers after the award of the contract, and they were surprised that the purchasers had assessed these risks as being high. The Department confirmed that while risk registers were not exchanged, joint discussions around risks were a continuing and regular part of the project management process.

28 After the contract was awarded in May 1996 the purchasers assembled new risk management arrangements by building on the earlier work of the procurement team. The contract was not specific about the reporting obligations of Pathway to the purchasers and vice versa. For example, there was no requirement on Pathway to supply their own risk registers or other internal project management documentation. Reporting took the form of summary presentations and discussion at the Project Board, and further joint planning and progress meetings at working level. The information that the purchasers required for assurance was not defined in the procurement phase or reflected in the management arrangements. Consequently the Department felt under-informed about progress, while Pathway told us that it felt subject to interference.

NAO Conclusions

29 There may be a temptation to think that the Payment Card project failed solely because it was large and complex or because it was a pioneer for the Private Finance route. This is not the case. Various factors contributed to the project's failure and their effects are difficult to disentangle. Looking to the lessons that can be learned by Government, important reasons for the project's failure were:

- divided control. The project was run by two organisations, the Department and Post Office Counters Ltd, with different objectives. Although in theory projects can be run by two or more organisations, in practice this is a recipe for dispute and delay, which is what happened in this case. A key lesson to be learned is that it is usually better to let one purchaser take the lead with proper arrangements for information flow;
- inadequate time for specifying the requirement and piloting. To save time and money, insufficient work went into specifying the project and for demonstrations by bidders. The result of skimping at the start was vast delay and as it turned out, wasted money. A key lesson is that allowing realistic timescales for early planning and detailed specification will pay dividends in time, cost and quality; and

- a shared, open approach to risk management across the whole programme was not achieved. A key lesson learned is that contractual obligations must be underpinned by recognition on all sides of the need for openness about risks identified and emerging.

30 Mistakes of this kind are made time and time again. A Report by the Committee of Public Accounts “Improving the Delivery of Government IT Projects” published in January 2000, shows that government has found learning from and applying its previous experience in project management very difficult. And the Government is not alone in encountering problems with such projects. Questions of culture and training arise – here, as with other projects, those with responsibility too often get immersed in details of procurement and negotiation and lose sight of the effects on the wider business. And if there are fundamental flaws in the design of the management of the whole scheme - as here - the impact of this organisational myopia is compounded. In their report, the Committee of Public Accounts called for the training of more skilled project managers and a high degree of professionalism in the definition, negotiation and management of IT contracts to help address this. And a wider perspective must be maintained. Decisions about IT are crucial to the development and success of the business of public bodies, and cannot be treated in isolation from other aspects of their work.

31 A report by the Cabinet Office in May 2000 has produced recommendations for improving the way in which the government approaches and manages major Information Technology projects. These recommendations are summarised in Appendix 5 and in our view should, had they existed and been implemented in the case of this project, have substantially reduced the risk of it failing to meet the Department’s requirements. They may alternatively have led to the project not proceeding in the way it did without changes in terms of its scope and planned timetable. There are lessons to be learned from the project for all three parties involved and for the wider IT community. The Department of Social Security told us that they were seeking to apply the good practice recommended in the Cabinet Office Report, in taking forward their major ACCORD programme to provide new computer systems to underpin their business.

Lessons learned

The lessons learned fall into three main areas; risk management, the procurement of complex Information Technology systems, and procurement by more than one purchaser.

Risk Management

- 1** For all projects, purchasers should maintain from the start of the procurement stage an assessment of the inherent risk of late delivery, and analyse before signing contracts the sensitivity of their business cases to major slippage and cost overrun.
- 2** Risks identified should be registered, assessed for impact and probability, assigned to a risk manager and used as a basis for subsequent management and contingency planning. Closed risks should be retained in a closed risk register and reviewed at regular intervals for “re-incarnation”. Risk identification must be an ongoing activity, as new risks will occur throughout projects.
- 3** Departments should appoint a permanent “risk scrutineer”, independent of the project team and ad hoc input from consultants, to monitor how the project is handling risks and to report to senior management at regular intervals. This is a feature of the PRINCE 2 project management system widely used in government and in the private sector.
- 4** Contracts with suppliers, including Private Finance contracts, require detail and clarity about the reporting obligations of suppliers to support risk management and contingency planning by the purchaser. Contractual obligations must be underpinned by a recognition on all sides of the need for openness, extending beyond oral reporting to sharing their risk management documentation.
- 5** The project illustrates the importance of being able to clarify, quantify and allocate responsibility for risk very clearly if the Private Finance approach is to be a suitable contractual model. In the case of IT development projects in the public sector, this is particularly difficult. Ministers and officials cannot transfer responsibility for the overall service for which they are legally responsible and accountable to Parliament. Some risks, such as the delivery of benefits payments, on which many people depend, are too great for private sector suppliers to absorb and departments therefore must retain a direct interest and involvement in how the service is to be delivered.

- 6 It is vital that all bidders, and if necessary their parent companies, are clear about the extent of risk transfer proposed by the purchasers at the start of procurement rather than towards the end. Purchasers must ensure that the extent of risk transfer they propose is viable, and must evaluate the extent of risk that they retain. Difficulties in this area can result in the loss of otherwise valid bids.

The procurement of complex IT systems

- 7 There is often understandable pressure on purchasers and potential suppliers to conclude a deal and to seize as soon as possible the benefits of the project. But it is never acceptable to sign a contract with fundamental “agreements to agree” the detail of the service in the future, even if as in this case, they are intended to be resolved quickly. Allowing realistic timescales for early planning and detailed specification will pay dividends in terms of overall project delivery and cost.
- 8 Departments undertaking IT procurement projects should fully understand the quality and quantity of resources available which actually will be committed by the supplier to deliver the agreed services. This is particularly important where new software development is required. It should be agreed during the competitive process how resource requirements can be achieved and measured, and the agreement should be drafted into the contract.
- 9 For major, mission-critical, tailored and bespoke projects, there should be proper piloting of technical solutions to address the full service requirement, rather than reliance on part-functional demonstrations. Departments may have to consider part-funding such pilots and should also consider awarding separate contracts for the design and development of systems before contracting with the developer for full implementation of the successful pilot. This approach also allows keener pricing of the later service implementation and operation stages by suppliers because the risks to them are reduced.
- 10 There must be agreement between purchasers and suppliers at the outset of information technology projects on the extent to which new systems will either replicate the purchasers’ existing systems, or re-engineer and simplify them.

- 11 After examining the scope to simplify their business processes, and given certainty as to the detailed requirement, Departments should examine with potential suppliers the scope to use generic and widely used system components where available. This process may in turn suggest modifying the initially proposed solution. A major risk of the Benefits Payment Card elements of the project turned out to be their “bespoke” nature. Building bespoke systems adds to the development costs and the longer-term vulnerability of any solution.
- 12 Where there are major project developments which involve more than one system being developed in parallel, as was the case here with the Benefit card, CAPS and new Post Office systems, it is sensible to plan and monitor these jointly.

Procurement by more than one purchaser

- 13 Joint procurement is always difficult, especially where purchasers have divergent objectives. It is better to let one purchaser take the lead with proper arrangements for information flow and reporting to the other. This requires a clear agreement, embodied in the contractual arrangements as well as in a memorandum of understanding, as to roles and responsibilities.
- 14 Incentives to deliver should pull the same way for both parties to a project: for example, financial and timetable incentives should be mutually supportive: and the parties should agree common objectives and “must-haves” at the outset, as these will influence future behaviour.

Part 1: The contract was signed in May 1996, but terminated in May 1999 following continual slippage

This part of our report describes the objectives that the Department of Social Security and Post Office Counters Ltd sought to achieve through the project, the severity of the slippage it experienced, and the inter-departmental decision to cancel the Benefits Payment Card. Much of the difficulty of decision-making was because some of the business drivers of the Department and of Post Office Counters Ltd were, understandably, different. A decision had to be reached based on the best option for the public sector as a whole, taking account of quantified and unquantified factors.

The Department of Social Security and Post Office Counters Ltd signed a Private Finance contract with Pathway to provide a modern, secure method of benefit payment and to automate post offices

1.1 In May 1996 the Benefits Agency of the Department of Social Security and Post Office Counters Ltd (the purchasers), jointly awarded a contract to Pathway, a wholly-owned subsidiary of the ICL plc computer services group. The project¹ was intended to replace the existing paper-based methods of paying social security benefits with a magnetic stripe payment card and to automate the national network of post offices through which most benefits are paid. An extended chronology of the key events in the life of the project is at Appendix 3 and the three main players are described in Figure 1.

¹ The names "Horizon", BA-POCL (Benefits Agency – Post Office Counters Ltd) and "Bringing Technology to Post Offices and Benefit Payments" have all been applied at different times to all or parts of this programme.

Figure 1

The main players in the Benefits Payment Card Project

	The Department of Social Security and the Department's Benefits Agency¹	Post Office Counters Ltd	ICL plc, through Pathway
Area of Business	The Benefits Agency's purpose is to deliver benefits to the public through services that are active, customer focused, secure and accurate. They operate from a national network of several hundred local offices and from three central directorates. The Agency's Chief Executive is a member of the Management Board of the Department of Social Security and is accountable to ministers of that Department, and to Parliament as an Accounting Officer.	Operates a network of some 18,300 post offices, providing services such as postage, bill payment and financial services, to some 28 million customers each week. One of the three main businesses of the Post Office, a public corporation established under the Post Office Act 1969. Through the Department of Trade and Industry, Government appoints the Post Office's management board.	Owned by Fujitsu of Japan, the company implements systems for major projects and provides services to a range of industries including retail, finance, telecommunications and the education, local and central government sectors. ICL plc participated in this project through a wholly-owned subsidiary, Pathway, that it formed for this specific purpose.
Financial and staffing	The Benefits Agency employs some 70,000 staff and pays over £80 billion each year through over 20 different social security benefits. Its operating costs were £2.4 billion in 1998/99. The other Agencies of the Department are the Child Support Agency and the War Pensions Agency, which, with Departmental Headquarters and various statutory bodies, constitute a group with over 80,000 staff including the Benefits Agency.	In 1999-2000 Post Office Counters Ltd reported turnover of £1.17 billion and profits of £46 million before taxation and exceptional items. It directly employs 12,000 staff and has contracts with nearly 17,000 sub-postmasters.	Operating in over 70 countries and employing over 20,000 people, ICL's revenues for the period ending March 1999 were £3.3 billion generating a pre-tax profit of £41 million before exceptional items.

Note: 1. This description of the Department's structure describes the situation at the time of the project. Since July 1999 the Department have embarked on a programme of restructuring to focus on delivering the Government's welfare and modernisation agenda. This includes setting up a new joint agency for welfare to work services with the Employment Service, and a separate Pensions organisation. Internally, traditional policy and operational responsibilities are being aligned more closely.

Source: National Audit Office

1.2 As Figure 2 and Figure 3 show, the project was vast in its investment, scale and complexity. One of the three shortlisted bidders told us that it was the most complex project their firm had ever bid for, rating 94 points out of a maximum 100 on their scale of complexity. It was also one of the first Information Technology contracts awarded under the Private Finance Initiative. The essence of such a deal is that the private sector supplier receives a contract to design, build, finance and operate an asset, and is paid for the provision of the service only as it is delivered to the public sector purchaser. In the context of information technology, government departments pay for the availability or use of the system to the standards laid down in the contract. In this way, many risks that would normally be borne by the public sector, such as higher than expected development or running costs, should be borne by the private sector.

Key Statistics of the Project

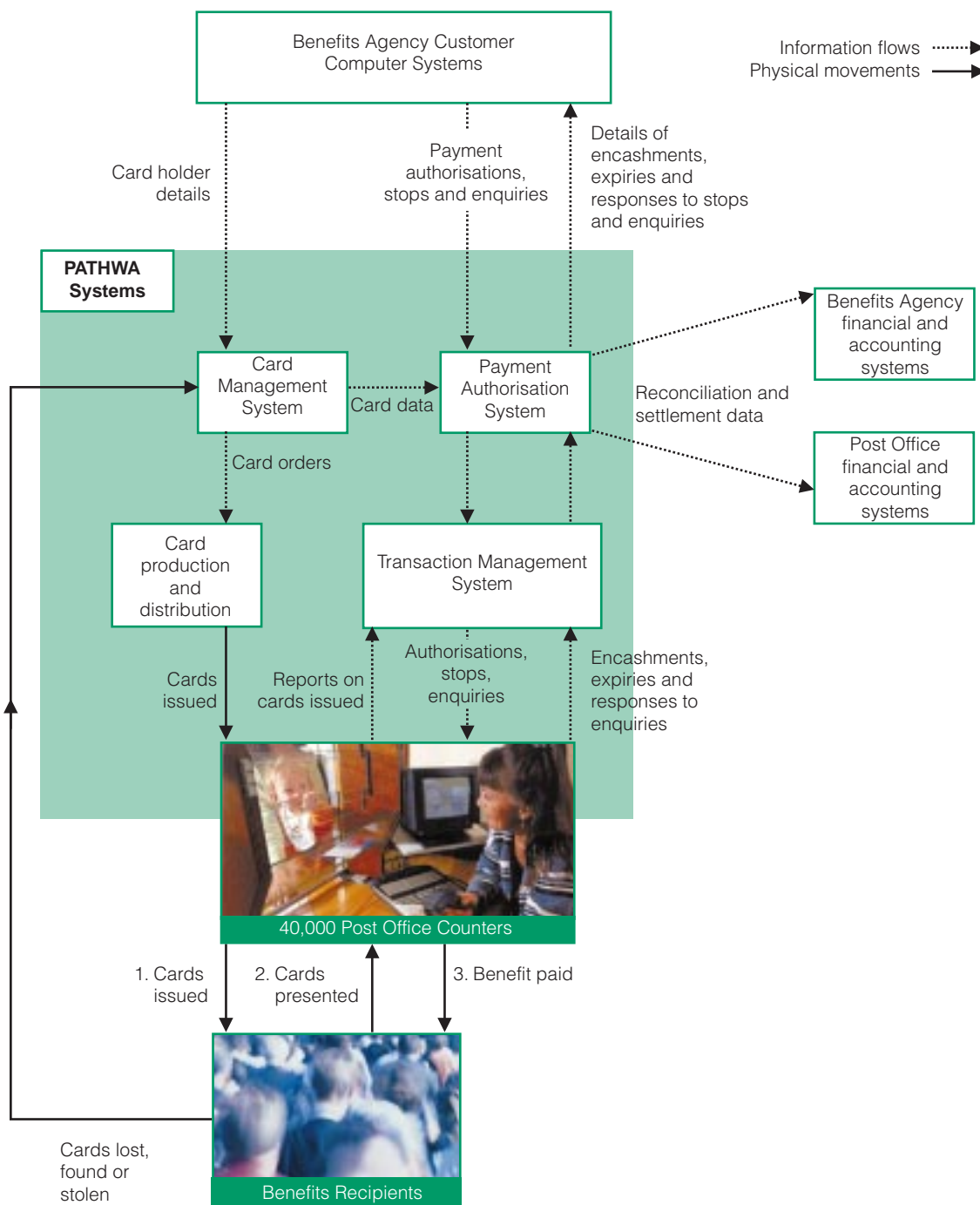
Figure 2

Estimated contract value, (Payments by Department and Post Office):	£1 billion, net present value over 7 years
Number of post offices to be equipped:	Up to 20,000, with 40,000 counter points in Great Britain and Northern Ireland
Number of post office staff to be trained in use of the system:	67,000 staff, serving 28 million customers per week
Number of social security benefit recipients to be issued with Payment Cards:	17 million, claiming some 24 different benefits.
Number and value of benefit transactions:	In 1999/2000 some 760 million payments worth £56 billion were made through post offices

Source: National Audit Office

Figure 3 The Benefits Payment Card System - An overview

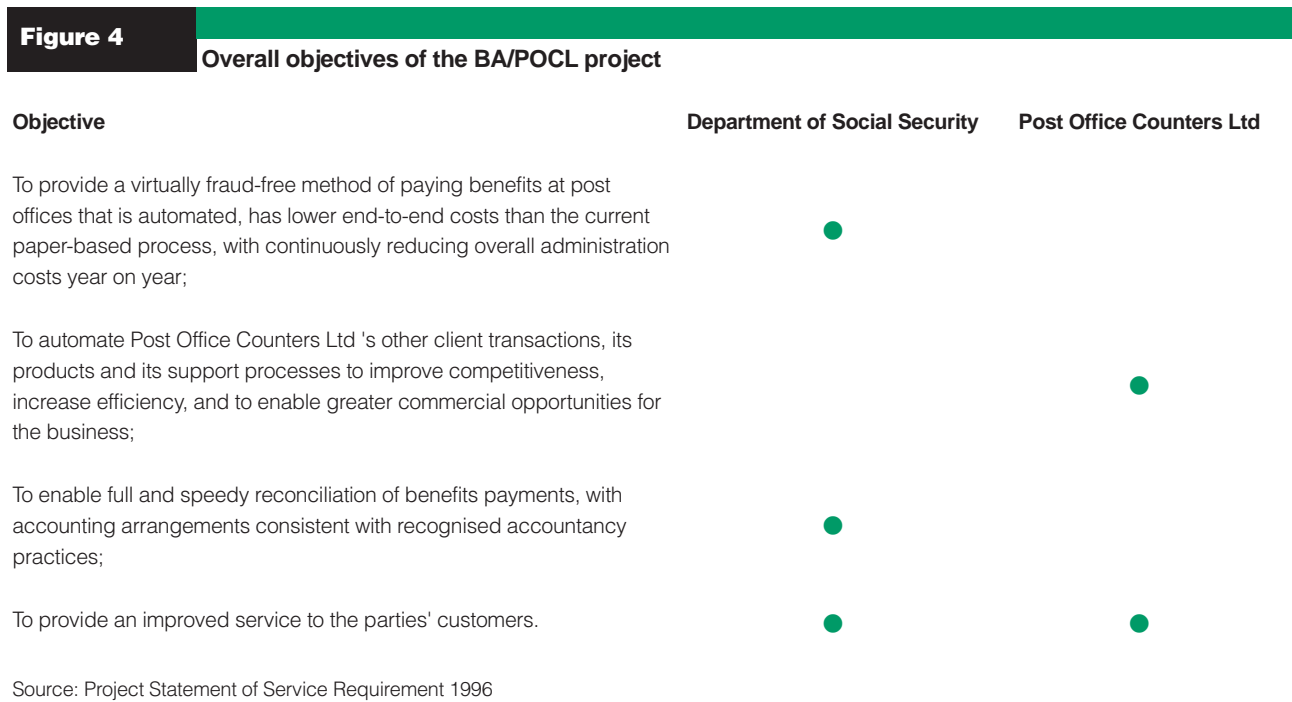
The Benefits Payment Card system was a large, complex system, linking transactions at Post Offices with the systems of the Benefits Agency and Post Office Counters Limited. The supplier, Pathway, was responsible for the issue and distribution of payment cards and the processing of transactions and enquiries.



Note: To ensure clarity, other functions particular to Post Office Counters Limited are not shown.
Source: National Audit Office

The project had multiple aims. For Social Security, the project was intended to deliver savings in benefit fraud and running costs, modernise the delivery of benefits and improve accounting

1.3 The two purchasers’ objectives for the project are summarised in Figure 4. Broadly, the Department of Social Security required a more efficient and secure method of paying benefits, and Post Office Counters Ltd wanted a technology platform that would provide basic automation for its existing (largely clerically handled) business and help it to develop new business.

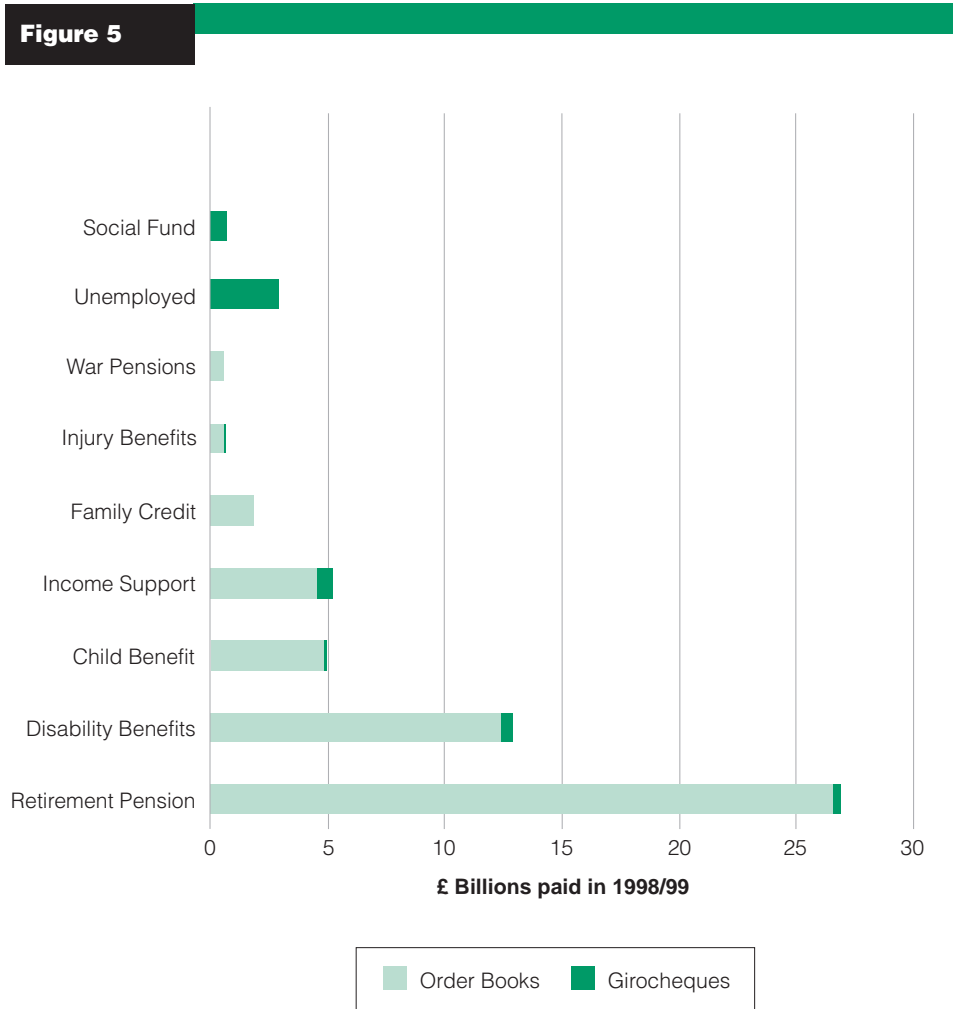


1.4 The Department of Social Security are responsible for administering the social security system, paying the benefits laid down in legislation to those who are entitled to them. Spending accounts for some £90 billion, nearly one third of all government expenditure, and most of this flows to benefits claimants through the Benefits Agency, the largest of the Department’s agencies, Figure 5. The Agency is tasked to:

- deliver active, customer focused services;
- provide secure and accurate services;
- effectively manage money; and

■ use quality, efficient organisational processes.

Social Security benefits paid through post offices in 1998/99



Source: National Audit Office

1.5 Most of the Department’s customers still receive their benefit by order books or girocheques which they cash weekly at post offices. The process is expensive to administer and prone to fraud. In 1997-98, the Department paid over £400 million to Post Office Counters Ltd and Girobank for services related to cashing benefits. In addition, they spent a further £125 million themselves administering their existing payment arrangements. Because currently the encashed order books are not all reconciled to claimants’ details the Department are unable to verify that all have been cashed, as required by basic financial accounting standards, though they can identify individual encashments.

1.6 The misuse of order books and girocheques is now estimated to cause over £100 million of fraud each year, as shown in Figure 6. The Comptroller and Auditor General has qualified his opinion on the accounts of the Department of

Social Security in successive years, in part because of the level of fraudulent encashment of orderbooks and girocheques. In January 2000 the Committee of Public Accounts expressed concern at rising losses from the fraudulent encashment of order books and girocheques and looked to the Agency to tackle it with vigour.²

Figure 6

A comparison of the methods of benefit payment used by the Department of Social Security

Transfers into claimants' bank accounts are by far the cheapest form of benefit payment for the Department. Since this method of payment was introduced in 1983 its use has increased so that today approaching a third of total benefit expenditure is paid this way.

Method of benefit payment	Average Direct cost (pence per transaction)	Share of Benefits payments in 1998/99		Estimated fraud in 1998 £ million, and fraud rate ⁴
		£ billion,	per cent	
OrderBook	49	51	63	85 1.7%
Girocheques and payable orders	79	6	8	22 3.7%
Bank Transfers ^{1, 2}	1	24	29	None identified
Payment Cards ³	67	0.03	0	None identified
Total		81	100	107

Notes: 1. The proportion of new claimants choosing payment by bank transfer ranges from 10% for Income Support recipients to 47% for retirement pensions and 54% for Child Benefit. Some 16 million customers use order books or girocheques and 8 million are paid by bank transfer. There is a continuing trend towards greater use of bank transfers, adding about half a million customers to the total each year. Transaction costs are rounded to the nearest penny.

2. Transfers into claimants' bank accounts are cheaper to the Department, in part because they transfer the cost of providing cash to the banking system already available to 85 per cent of benefit recipients. This cost varies according to the method through which cash is dispensed, and the circumstances of the account owner. The cost of a bank transfer shown here is the direct cost to the Department, and excludes any costs to banks, and costs of extending the Agency's systems.

3. At the time it was cancelled, the payment card had been used to pay some £30 million of child benefit, to 37,000 customers in 205 out of over 18,000 post offices. The use of the card has since been stopped.

4. Fraud figures are for misuse of instruments of payment only, and exclude other types of benefit fraud. The figures cited here reflect reductions in fraud achieved by an Electronic Stop Notice System in the Greater London area since the mid-1990s, (Paragraph 1.7).

Source: National Audit Office collation of Department of Social Security data.

1.7 In the early 1990s the Department considered alternative ways of paying benefits. The mandatory use of automated credit transfers for all benefit recipients offered the greatest potential cost savings for the Department. However, Ministers felt at that time that compulsory extension of bank transfers on its own would have limited recipients' choice of delivery location and put at risk the national network

2 Third Report, Session 1999-2000: Appropriation Accounts 1997-98 Class XII, Vote 1 (Central Government Administered Social Security Benefits and Other Payments)

of sub-post offices and so this had been rejected by Ministers collectively in 1983 and again in 1992 to 1994. Some options for drawing cash, such as through cash-back from retail outlets, did not exist at that time. The Department also considered extending an anti-fraud computer system (the Electronic Stop Notice System) that was used by post offices within the M25 area to check bar-coded order books. This system reduces the incidence of instrument of payment fraud but marginally increases administration costs because it adds to, but does not replace, the existing paper systems.

1.8 When the contract with Pathway was signed in May 1996, the Department of Social Security’s business case concluded that the programme as timetabled represented a good return on investment to public funds, mainly by reducing fraud and running costs. The main costs and benefits to them, excluding those to Post Office Counters Ltd, are shown in Figure 7.

The intended main costs and benefits of the payment card project to the Department of Social Security when the deal was signed

Figure 7

Cost/Benefit	£ million ¹
Payment Service Costs	1480
Less: Administrative Savings	1179
Less: Fraud Savings	1330
NET SAVING	1029
Net Saving (Discounted at 6%)	609

Source: Department of Social Security

Note: 1. This was the estimated value of the Payment Card solution compared to continuing with the existing order book system over the life of the contract to 2005.

Post Office Counters Ltd intended the project to automate and safeguard their business

1.9 The revenue from handling benefits payments account for just over a third of Post Office Counters Ltd’s income of £1.17 billion. This business is also important because of the sheer volume of customer visits that it brings and the opportunity to offer these customers other services available from Post Office Counters Ltd and from co-located private retail outlets. Benefit payments also put cash into the hands of customers visiting post offices. In the early 1990s, Post Office Counters Ltd had operated a pilot counter automation programme in the Thames

Valley area. But they concluded that the business case for counter automation could probably not be sustained without the commitment of the Department of Social Security to allow use of automated systems for benefit payments.

1.10 Post Office Counters Ltd told us that they had seen the benefits of the Benefits Payment Card project to their business as:

- providing a service that the Department of Social Security would wish to use now and in the future;
- supporting the national network of post offices. Though typically some 200 local post offices leave the network each year through natural wastage, Post Office Counters Ltd still expected on award of the contract in May 1996 to automate over 19,000 offices through this project;
- linking the post office network more effectively, (for example to reconcile accounting records);
- to provide scope for generating new business. Increasingly, new and possible clients expect post offices to be linked to an automated network; and
- to support previously automated post office systems.

The timetable for delivery slipped continually, the benefits were deferred and in late 1997 Pathway requested improved terms

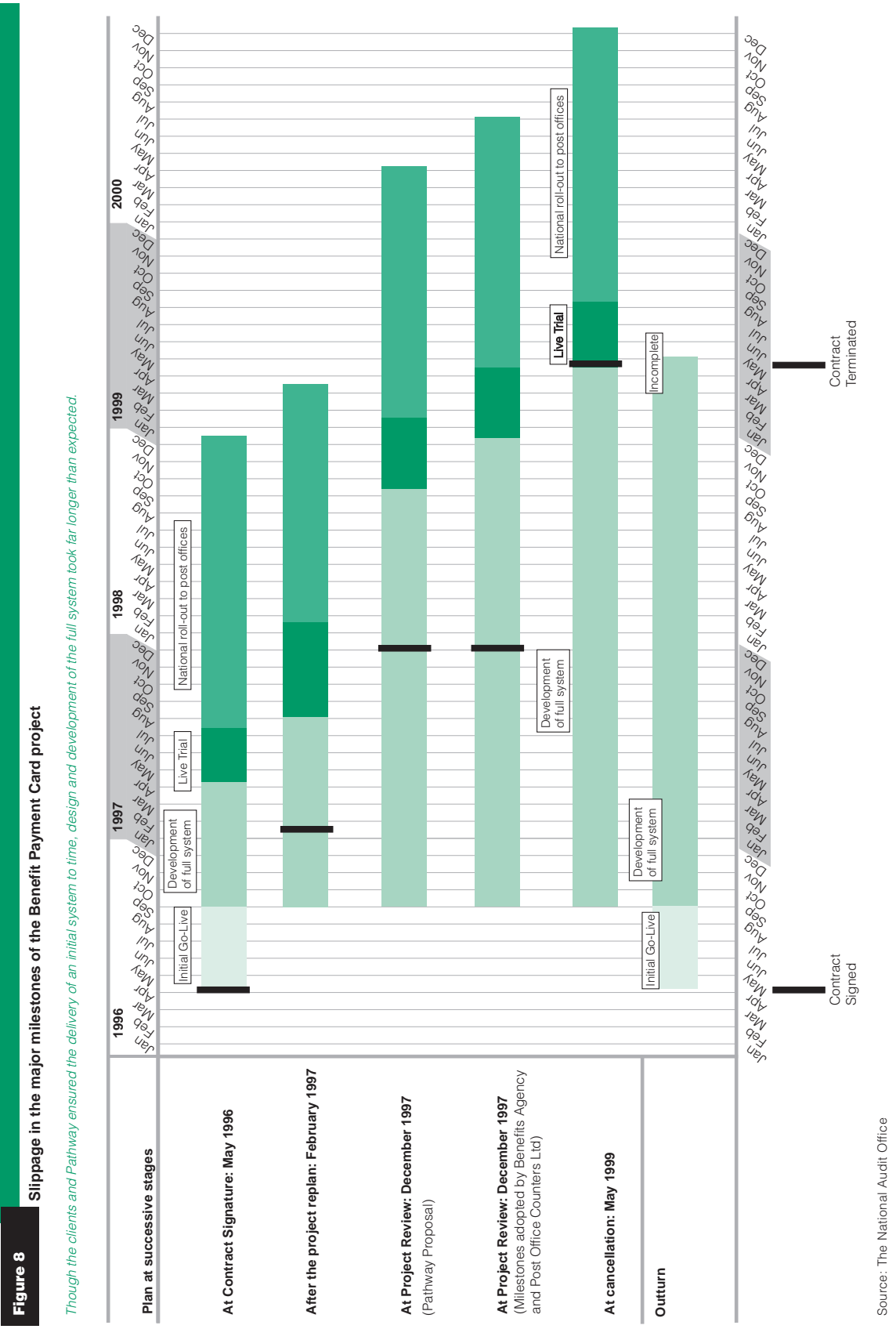
1.11 The Department, Post Office Counters Ltd and Pathway were successful in rolling out a limited early version (the “Initial Go-Live”) of the Benefits Payment Card hardware and software to ten post offices in Stroud, Gloucestershire by October 1996, close to their contractual timetable. As was planned, this system had only partial functionality. For example, it:

- supported the payment of only child benefit, and with only limited volumes of transactions. The system could technically process other benefits, but it had yet to include additional security features which would assure the Department that it could be entrusted with other higher risk benefits, and in higher volumes; and

- did not allow payees to collect benefit from post offices other than their nominated one.

1.12 Though the parties successfully implemented the limited “Initial Go-Live” as planned, the process of designing and developing a fully functional system proved much more complex and took much longer than had been expected. The programme at the time the contract was signed assumed that it would take ten months to start a live trial of the full system. In fact, this stage had not been reached at the time the contract was terminated nearly three years later. The overall timetable for completing roll-out of the full system across the country slipped from 1999 to 2001 although development work continued and further functionality was added through successive software releases, which were used in 205 post offices. Figure 8 shows the extent of slippage in the project after the contract was let in May 1996. The main reasons for this slippage, how key risks to delivery were managed, and subsequent consequences, are described in Parts 2 to 3 of this report. We have found that there were severe delays in Pathway’s development of Card software, though it is clear that Pathway encountered problems resolving with the purchasers agreements to agree and detailed requirements in order to finalise its software. The Department’s delivery of data from its own systems should also be taken into account. The balance of responsibility at different times throughout the life of the project remains a matter of dispute between the parties.

1.13 During the second half of 1996 the Department, Post Office Counters Ltd and Pathway became increasingly aware of the difficulty they faced in implementing the full Benefits Payment Card system. The Department found that the complexity and resource requirements of their Customer Accounting and Payments System (CAPS) project, which was to feed data to Pathway’s Card systems, had been greatly underestimated. At the same time, they were aware from their continuing liaison arrangements that Pathway had encountered similar difficulties in their own work. Pathway expressed concern about some aspects of the agreed high level specification regarding security, which were central to the Department’s business case. Therefore discussions were opened that led in February 1997 to a “no-fault” replan involving all parties of both the projects. Under this agreement, all parties agreed to postpone the delivery dates, as shown in Figure 8, and to bear their own costs in doing so. The parties all committed to achieving the revised dates. The Department agreed to continue development of CAPS separately to Pathway’s development of software for the Card, but ensure that the necessary technical interfaces were in place to meet Pathway’s revised timetable. This was the first and last formal, contractual agreement to change delivery dates, though in 1998 and 1999 when dates slipped again the parties worked without prejudice using a later timetable in order to sustain progress.



1.14 The risk that the project might have to be cancelled became serious during the second half of 1997. By 21st November 1997, a live trial which was intended to demonstrate sustained, satisfactory operation of child benefit payments and a range of post office functions in 300 post offices, had not been completed. The purchasers alleged that Pathway was in breach of contract. Pathway denied liability and in December 1997 wrote to the Benefits Agency suggesting three options to proceed:

- to maintain the existing contract but with Pathway's prices raised by 30 per cent;
- to extend the contract by five years and raise prices by five per cent; or
- terminate the contract.

The Department took steps to preserve their legal rights to cancel the project

1.15 As the project slipped and costs threatened to escalate, the differing business objectives of the Department and Post Office Counters Ltd resulted in differing views over how best to manage the consequences of delay and of cancellation. These differences centred principally around how to handle:

- the consequences of continued slippage of the project in 1997 and the Department's growing concern about delays in securing the intended fraud savings;
- the issue of legal notices against Pathway in November 1997, and May 1998 for failing to complete the live trial to time; and
- Pathway's request to increase the price and/or the period of the contract in December 1997.

1.16 By early 1998 the Department were considering options which included terminating their contracts for the Card element of the project. Delivery dates had continued to slip and the Department's business case for continuing the project could not be sustained if Pathway's proposed new contract terms were accepted. There was no strong financial incentive on Post Office Counters Ltd to minimise the delays or the proposed price increase that the Department could identify. Post Office Counters Ltd maintain that they too had a strong interest in playing their full

part in delivering the entire project to time. The Department sought to maintain a strong position with regard to Pathway's alleged breach of contract in November 1997 and to keep this open as a means of possibly terminating the contract. A termination option would require issuing a "cure notice", starting a 13 week period after which the purchasers could terminate the contract. After discussion with Post Office Counters Ltd and the Department of Trade and Industry the Department issued the notice on behalf of only itself in May 1998. Pathway told us that the notice was uncalled for and ineffective, and that by electing to continue the project after the notice period, the purchasers had waived any rights they may have had to terminate. The Department did not accept this having taken Counsel's advice. Which party was right in this matter could only have been conclusively established in a court of law.

1.17 At the same time as trying to preserve their contractual position, Social Security Ministers recognised that their concerns were not the only considerations for Government, and deliberately sought a wider discussion across Government Departments to enable a joint decision about the future of the project to be made.

The government decided that removing the payment card from the project offered better value for money than complete cancellation, and was preferable to continuation

1.18 The decision to cancel the Payment Card project was the culmination of an Inter-Departmental review of options, beginning in early 1998. The Treasury and the Departments of Trade and Industry and Social Security, as well as Pathway and the two principal purchasers, were all involved in developing the way forward. Their objectives agreed by ministers collectively were to:

- aim to protect a nation-wide network of Post Offices. This was defined as avoiding significant post office closures, though in the longer term it could mean changing the shape of the network so services could be accessed in different ways;
- pay social security benefits in a way that is as cheap, efficient and as fraud free as possible (taking into account the costs of getting cash into claimants' hands) and consistent with welfare reform;
- modernise the delivery of government services and information more generally taking full advantage of new technology;

- improve access to basic financial services, including banking services, for poorer members of the community and the socially excluded;
- maintain a thriving IT sector in the UK, in which ICL is a key player, while ensuring that risks transferred through Private Finance projects do not end up with the taxpayer; and,
- deliver best value overall for the taxpayer.

1.19 The three main options were continuation or cancellation of the entire project, covering both the automation of post offices and the introduction of the Benefits Payment Card, or continuing with post office automation only. Figure 10 shows the financial evaluation of these alternatives, as compared to the existing arrangements. Non-financial factors were equally relevant and were taken into account.

An interdepartmental group facilitated by the Treasury explored the possibility of reaching a settlement with Pathway

1.20 Following Pathway's request for improved terms, the risks associated with reaching the right decision for the public sector as a whole were managed by adopting an interdepartmental approach. Ministers set up in March 1998 an Interdepartmental Working Group made up of officials from the Treasury, Cabinet Office, and the Departments of Trade and Industry and Social Security to assess:

- whether the project was technically viable, and if so how quickly it could be completed and at what cost to government; and
- the direct and indirect costs of cancellation and of any alternative available to deliver the project's objectives.

During this period work continued in Pathway, and in the purchasers' organisations, on developing the Payment Card system. The main conclusions of the Working Group, prior to negotiations with ICL Pathway on the way forward, are in Figure 9.

Figure 9

Main Conclusions of the Interdepartmental Working Group, July 1998

On risks of continuing the project

An independent panel advising the group felt that the project could deliver the functions required, but was unlikely to operate nationwide much before the end of 2001, three years later than originally planned. Successful delivery would require renewed commitment from the parties and was not without risk. The cost of continuing was uncertain; delays and cost overruns already meant that Pathway would make a loss without a contract extension or price increase.

On risks of terminating the project

The group stated that there appeared to be sufficient grounds to terminate Pathway's contract and claim against them for up to £200 million of lost fraud savings. Pathway rejected this and would almost certainly counter-claim against the purchasers for their own abortive costs. Legal advice was that the purchasers' position was strong but the outcome of litigation would inevitably be uncertain. The indirect costs of cancellation depended on the alternative arrangements put in place. The Department of Social Security's preference for a solution based on bank transfers could deprive post offices, earlier than otherwise would have been expected, of their largest source of income, unless a compensatory strategy was provided.

The recommended way forward

A majority of the working group recommended that government offer Pathway an extension of the existing contract to ensure a five year period of operation following full implementation, but no price increase. If Pathway did not accept these terms within two months the contract should be terminated. The Department of Social Security recommended reshaping the contract to exclude the Benefits Payment Card, moving to bank transfers and redirecting administrative savings to help support the post office network for the life of the existing contract.

Source: Working Group report, July 1998

1.21 The interdepartmental approach adopted from March 1998 onwards required the construction of a single business case for the project, addressing the costs and benefits of each option to the public sector as a whole. The Treasury appointed consultants KPMG to undertake this work, drawing on data from the Department of Social Security and Post Office Counters Ltd, while maintaining commercial confidentiality between the two businesses.

1.22 The Department of Social Security's "Notice of Cure" on Pathway preserved their option to terminate but formally expired in August 1998. This placed the Benefits Agency's Accounting Officer, Peter Mathison, in a difficult position. Whilst awaiting the outcome of the interdepartmental decision on the fate of the project, his own responsibility to obtain value for money was at risk. He informed the Secretary of State for Social Security that he could no longer justify continuing the contract. This was on the grounds of the delays to date, signs of further slippage, their impact on costs and continuing concerns about the deliverability of the project. For each month of delay the Department were incurring some £15 million of additional administration costs and lost fraud savings. Mindful that Ministers were considering the future of the project, Mr Mathison sought formal instruction not to exercise his rights to terminate. In response, the Secretary of State instructed him not to cancel until a joint Ministerial decision involving the Treasury and the Department of Trade and Industry could be reached.

1.23 In September 1998, Ministers asked the Department of Social Security and Post Office Counters Ltd to join discussions with Pathway about the way forward. The Secretary of State therefore issued a further instruction to Mr Mathison not to cancel or otherwise prejudice the outcome of these discussions. As required by Government Accounting practice, both instructions were reported to the Comptroller and Auditor General, who brought their existence to the notice of the Chairman of the Committee of Public Accounts.

Continuation of the entire project, though apparently the cheapest option, carried significant risks

1.24 The option of continuing the project reflected the outcome of discussions between the government and ICL brokered by Mr Graham Corbett, then a Deputy Chairman of the Monopolies and Mergers Commission. Mr Corbett facilitated proposals that would have extended Pathway's contract by two years and improved other terms of their agreement. The Department of Social Security and Post Office Counters Ltd broadly accepted this proposal but ICL rejected it. For Pathway this would have meant a small profit from that point on, but a loss over the life of the project of around £200m. Pathway insisted that the most they could accept would be break even, and Mr Corbett informed the government in October 1998 that he had been unable to find a basis for proceeding. The government informed ICL that discussions were now at an end, but gave them time to negotiate a possible partnership arrangement with Post Office Counters Ltd.

1.25 In the period October to December 1998, ICL negotiated with Post Office Counters Ltd and made successive proposals to government. Their final offer in December 1998 brought concessions that officials estimated as acceptance of a loss of £126 million. At the same time Pathway proposed a change in the contract such that the purchasers would accept the system on the basis of technical tests and model office tests. It was not intended that a full live trial would take place before roll-out could commence. The Department of Social Security refused to accept these new terms, because they were concerned about the implications, if the system should not work, for benefit recipients, many of whom are dependent on timely and accurate payments. They were particularly conscious of the risks associated with acceptance criteria from their recent experience with the system for National Insurance Contributions (NIRS2) procured through a Private Finance Contract with Andersen Consulting. Pathway's proposal was subsequently revised such that acceptance would take place on successful completion of all tests according to a modified set of test criteria.

1.26 The numerical analysis shown in Figure 10 indicated that continuation appeared to be the lowest cost option for the public sector as a whole. But the analysis was seen against the background of continuing uncertainty about the prospects for timely delivery of the system. In practice this would have depended heavily on whether the project could be implemented against the background of growing tensions between the parties. From early 1999 Ministers became increasingly concerned about the deliverability of the project because of continuing slippage and the consequent increasing reluctance among the parties to commit themselves to it. In April 1999 officials estimated for illustrative purposes that a further delay of six months to the planned timetable could reduce the value of the deal to the public sector by up to £110 million. Ministers were concerned that the delay could be considerably longer than just six months. In early May 1999, ICL formally withdrew their December 1998 offer.

Outright cancellation of the entire project appeared to be worse value for money than continuation

1.27 With outright cancellation the contract with Pathway would have been completely abandoned and progress towards the automation of the Post Office halted. In order to retain Post Office Counters' customer base, the Department of Social Security would have been required to continue to pay beneficiaries through the paper based order book system until such time as Post Office Counters Ltd had the capability to offer customers a facility to draw cash from their bank accounts.

The estimated net value of the options considered by the government prior to cancellation of the Payments Card project

Figure 10

The financial evaluation of options was a forward look produced in mid 1999 showing estimated cash flows between then and 2010. It indicated that continuation of the contract would give the best overall return to the public sector, assuming no more than six months further slippage and acceptable revised terms being agreed between the parties.

Public Sector Body	Full Continuation Net Present Value £m²	Full Cancellation Net Present Value £m^{2,3}	Partial Continuation <u>The terms agreed with ICL Net Present Value</u> £m^{2,4}
Department of Social Security (1)	+1,477	+1,990	1958
Post Office Counters Ltd	-361	-1,447	-1406
Overall net value to the Public Sector	1,117	543	552

- Notes:
1. The figures for the Department of Social Security include the net benefits of options over the period up to 2009/2010 and should not be compared directly with those in Figures 7 and 11 of this report which cover different periods.
 2. Positive numbers are savings compared to the existing arrangements; negative numbers are losses. This figure shows net present values (at 1998-99 prices) of the main options considered by the government. The evaluation compared the options against a "business as usual" baseline which assumed the continuation of payments by order book and girocheques. The analysis was purely financial and under the continuation option excluded outstanding contractual issues (principally around acceptance testing), the risks of further slippage in addition to the six months already factored into the figures, and in the wider context the increasing trend towards payment of benefits by ACT.
 3. Cancellation was likely to lead to litigation. This option incorporated possible litigation costs. Although the purchasers considered they had a strong case against Pathway in which they could sue for damages of up to £200 million, they recognised that there was likely to be a counter claim from ICL in respect of Pathway's abortive project costs. Pathway told us that they too had a strong case. On the basis of legal advice, the Treasury reflected on these factors when costing the cancellation option.
 4. The figure highlights the terms for partial continuation agreed by the government and ICL on 21st May 1999. The precise allocation of some of the costs under this option was considered in the re-negotiation of the service contract between the Benefits Agency and Post Office Counters Ltd. Post Office Counters' position worsens under this option mainly because they sustain progressive loss of benefit payment business from 2003, and because of the higher up-front cash requirement of the revised deal.

Source: Analysis by consultants
KPMG for the government

The government decided to halt the Benefits Payment Card but continue with post office automation

1.28 By late April 1999 the main remaining alternative to outright termination of the entire project was that Post Office Counters Ltd would extend arrangements that would allow them to cash benefits paid by the Department of Social Security into existing accounts at the commercial banks. This option eventually formed the basis for the agreement with ICL plc, which comprised:

- Cancellation of the benefits payment card system;
- A fixed payment contract to Pathway for rolling out by 2001 the basic post office automation infrastructure to support post office services and to support the national use of bar-coding of benefit order books to reduce encashment fraud;
- Development of a network banking strategy by Post Office Counters Ltd with a view to introducing extended banking facilities in good time for the start of the withdrawal of paper-based benefit payment methods in 2003; and
- the Department of Social Security to take no active steps in marketing bank transfers as their normal method of payment until 2003, to allow the Post Office an adequate period to manage the transition.

The Government saw this solution as giving Post Office Counters Ltd the earliest route to automation and through this, further comfort to sub-postmasters about maintaining their customer base and support for the Post Office's strategy to sustain its long-term commercial viability by developing new services and allowing it a reasonable time to achieve this. It also reduced the complexity and risk of the automation project.

1.29 On 24th May 1999 the Government announced that:

- the Benefits Payment Card element of the project would be dropped, simplifying and assuring post office automation;
- automation of post offices would proceed, for completion by 2001;

- nearly all benefit payments would be made by bank transfers, starting in 2003 and completing by 2005. Until 2003 existing arrangements would continue;
- people who wished to continue to collect their cash at post offices would continue to be able to do so, the Post Office would introduce suitable banking technology and develop its commercial arrangements with banks to allow this to happen; and
- for the relatively few people for whom a bank account might remain an unsuitable option, special arrangements would be made.

The consequences of the cancellation of the Benefits Payment Card project are substantial

1.30 The delays to the Card project and the consequences of its cancellation affect benefit claimants, the Department of Social Security, the Post Office and ICL.

1.31 The effects of the delays to the Card project between 1996 and 1999 were such that the Department's positive business case for the project reduced from £667 million net present value to £148 million, due mainly to the delay in achieving estimated fraud savings. The Department also lost its planned savings in the cost of administering order books, but these were broadly matched by savings in lower than expected payments to Pathway for processing card transactions. Benefit claimants have not received as soon as originally intended certain quality of service improvements claimed for the payment card, such as quicker response to changes in their entitlement.

1.32 The effects of the cancellation of the Payment Card project are more diverse, though the Government's new strategy for benefits payment is intended to address these.

1.33 **For Benefits Claimants**, the precise future arrangements for payment will depend on how the Department decide, in agreement with Post Office Counters, to take forward the phased migration to bank transfers. The minority of claimants who cannot operate bank accounts will require alternative arrangements, also using the bank transfer system, which are currently being considered.

1.34 For the Department of Social Security some £127 million of the £270 million costs of their CAPS programme, which was to link to the Card, may be wasted because not all the system will now be required. Some of this investment may be able to be redirected to support the new bank transfer payment systems. Until the full introduction of payment by bank transfers in 2005, the Department's financial accounting and audit will continue to be hindered by the absence of full reconciliation between benefit encashment and entitlement. Conversely, by introducing an electronic system for the control of order books, the Department expect to eliminate 85 per cent of fraudulent misuse of order books, pending the full introduction of bank transfers. By moving over to payment by bank transfer between 2003 and 2005, the Department will also make administrative savings earlier than if the Payment Card project had continued.

1.35 Post Office Counters Ltd and their sub-postmasters are exposed to different risks, including progressive loss of benefit payment business from 2003, (two years earlier than the end of the Benefits Payment Card contract), and acceptance as sole purchaser of the risks involved in the automation of post offices. In November 1999, Post Office Counters Ltd recorded in their accounts an exceptional charge of £571 million "*for acquiring an asset which does not at this stage yield sufficient income to justify the cost.*" This reflects the fact that under standard accounting practice, the Post Office cannot take account of income that may be generated from the system but cannot be guaranteed. The Treasury has adjusted the Post Office's financing to reflect the higher up-front cash requirement of the revised deal. Automation is being funded by £480 million of the Post Office's cash investments that had previously been earmarked for surrender to the Treasury in 2002-03, but a wider review of the Post Office's finances is ongoing.

1.36 ICL wrote off project development costs of £180 million in June 1999. Further development costs not written off may not be recoverable from their revised contract to automate post offices. Their experience may increase caution and aversion to risk on the part of ICL and other bidders for other Private Finance IT projects. This project has received much publicity in the national, business and specialist press. Much has been negative, and based on only selective information.

1.37 The cancellation of the Card element of the project is one of a series of failures in government's procurement of Information Technology. In January 2000 the Committee of Public Accounts published a report drawing out lessons from more than 25 cases from the 1990s where the implementation of IT systems has resulted in delay, confusion and inconvenience to the citizen and, in many cases, poor value for money to the taxpayer. The Committee's main conclusions are summarised in Appendix 4 of this report. Some are of particular relevance to this project.

1.38 The Prime Minister requested that a study be undertaken by the Cabinet Office IT Unit to examine in detail the experiences the UK Government has had of major IT projects, both successful and unsuccessful, and to compare them to those of the private sector and governments overseas. The study completed its work in May 2000 and has produced recommendations for improving the way in which the government approaches and manages such projects. These recommendations are summarised in Appendix 5 and in our view would, had they existed and been implemented in the case of this project, have substantially reduced the risk of failure. In April 2000 the Treasury Task Force on Private Finance published new guidance for departments undertaking procurement of Information Technology through the PFI. Amongst other changes, the guidance recommended that major, complex, system development projects should be designed through separate, more conventional contracts, before being built and operated through Private Finance arrangements.

The Government now plan an expansion of benefit payments through automated transfers to claimants' bank accounts

1.39 Following the cancellation of the Card system, the Department have adopted a two-stage Payment Modernisation Programme to provide “a secure and fully accountable route for benefit payments” and to form part of a wider government strategy to modernise government services:

- Up to 2005, the Department will extend the use of bar codes on order books. This has now been installed in all the 7,000 post offices automated to date, as an interim measure to reduce encashment fraud; and
- from 2003 to 2005 the Department will migrate from using order books to using transfers to claimants' bank accounts as the normal way of making benefits payments. The change will further improve accounting and is expected to make very significant administration and fraud savings of some £500 million a year.

1.40 It is planned that Post Office Counters Ltd will extend its relationships with commercial banks so that benefit recipients will be able to access their benefit money at post offices, and bank customers generally will have improved access to cash. An alternative payment mechanism available at post offices will also be established for those benefit recipients who are unable to open a bank account. These measures will help to generate income for the company and sub-postmasters, whilst automation will help Post Office Counters Ltd to retain existing business and attract new clients and types of business.

1.41 The strategy is intended to balance Social Security and Post Office objectives, and to take into account wider issues including:

- overall value to the taxpayer;
- the wider policy objectives of Government, particularly around combating financial exclusion; and management issues around the planning and implementation of large business change projects involving Information Technology.

1.42 The Government's current plans are designed to achieve substantial and increased savings from 2005 that will be available for redeployment elsewhere, and a new benefits payment service that:

- takes account of benefit recipients' increasing preference to have payments made into their bank accounts: the provision of encashment facilities in post offices will enable customers to collect their cash there if they so choose;
- has regard to the future commercial viability of Post Office Counters Ltd and the vulnerability of some offices in rural or deprived urban areas, by ensuring the Post Office can continue to have a role in benefit payment arrangements;
- protects the security of paper-based payments in the interim through extending the electronic control of Order Books; ensuring that the future change programme is broken down into manageable components; and
- so far as possible, builds on generic Information Technology systems rather than having to invest in a new one, thus minimising the risk of failure and maintaining the ability to keep abreast with the developments in modern technology.

1.43 In June 2000 the Secretary of State for Trade and Industry announced a package of measures designed to modernise the Post Office network by:

- ensuring that benefits and pensions can still be paid in full, in cash at the local post office;
- setting up a special fund to improve local offices in deprived urban areas;

- providing help for those on low incomes;
- providing people with new opportunities to use the internet;
- encouraging post offices to act as Government one-stop shops;
- maintaining the rural network by placing a formal requirement on the Post Office to prevent any avoidable closures of rural post offices; and
- supporting the development of the proposed “Universal Bank”, giving banking facilities for up to 3-5 million extra people, and allowing customers, including pensioners, to get cash out of the post office and set up direct debit arrangements.

Part 2: How well did the purchasers set clear objectives for the project and manage its benefits and risks to their services to claimants?

This part of our report examines the key risks to the Department's business of this large and complex Information Technology project and how well these were managed. It shows that the purchasers felt that they had transferred the risk of late delivery to Pathway through the Private Finance contract. This indeed ensured that Pathway, and not the public sector, eventually bore the £180 million abortive costs of the system's development. But the Department retained substantial business risk associated with continuing benefit fraud and with constructive losses on their linking CAPS project.

Key risks to the project and to the Department's business needed to be managed

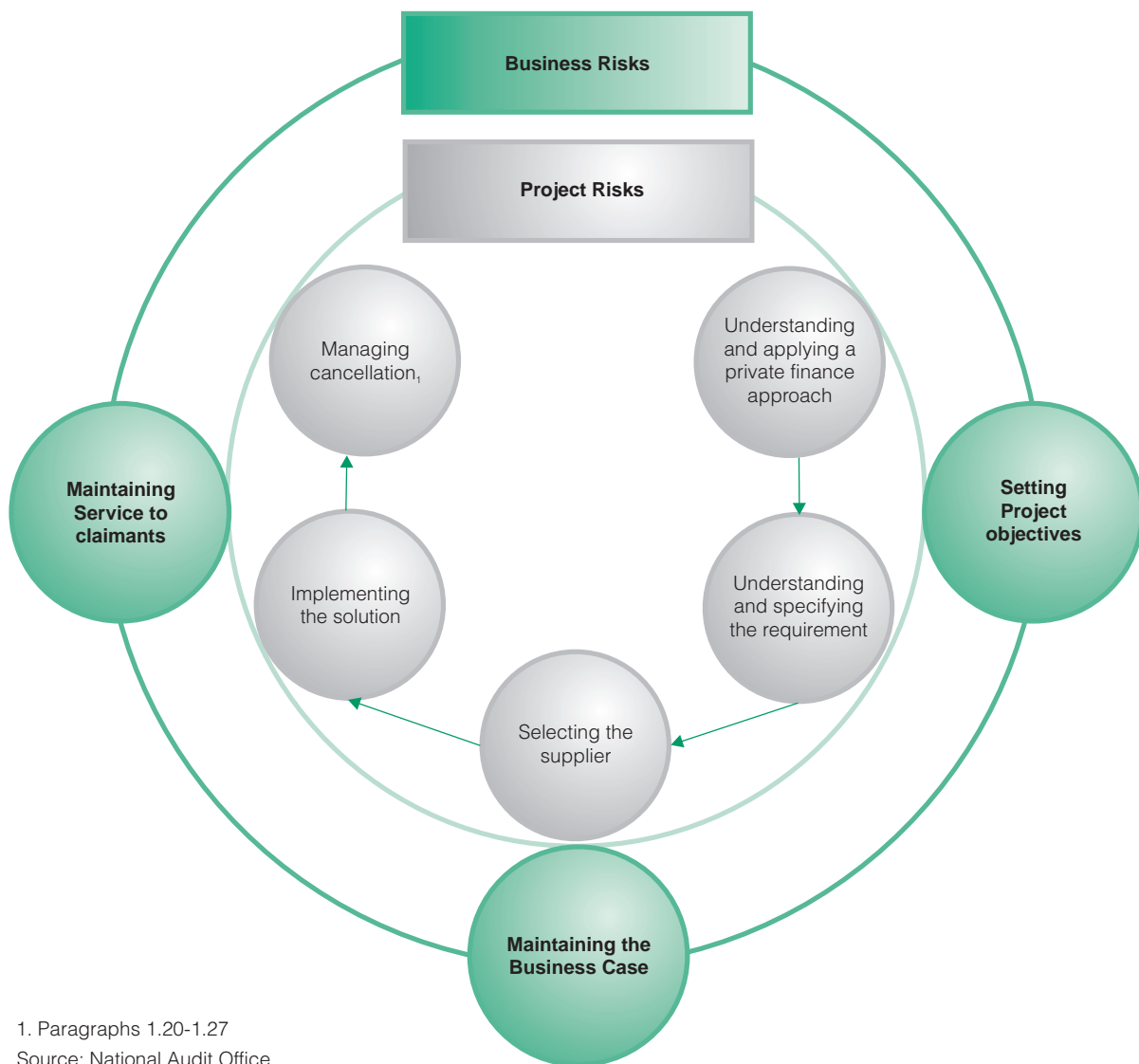
2.1 The role of risk management is to reduce the risk exposure of the organisation or project to a level that is acceptable. The use of formal risk management systems has been developing in UK government since the early 1990s, but all such systems will incorporate the following main elements:

- **Setting clear objectives:** defining aims and objectives which can be used as a basis for identifying risks to the project and to the purchaser's wider business and reputation;
- **Risk Identification:** listing each risk that could conceivably occur, and recording them for future management in a risk register or other control system. Risk registers are a common feature of successful Information Technology projects;
- **Risk assessment:** assigning to each risk an estimate of the probability of it occurring and the impact on the project if it does; and

- **Risk mitigation, monitoring and control:** including the allocation of each risk to a named individual or entity with the responsibility and authority to manage it, the selection by risk managers of options to deal with unacceptable risk, and regularly monitoring identified risks and the effectiveness of the actions taken.

2.2 Some risks originate and are managed entirely within projects, but others arise from change in the customer’s wider business. Figure 11 provides an overview of the key areas of risk in the Benefits Payment Card project.

Figure 11 An overview of the key risk areas of the Benefits Payment Card project



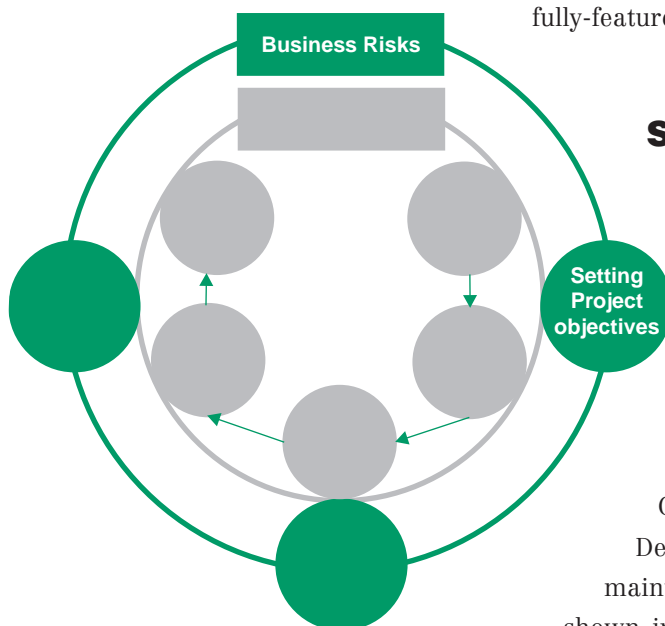
1. Paragraphs 1.20-1.27
Source: National Audit Office

The purchasers identified the risks of undertaking such a project a year before the contract was signed, but not all these risks were managed

2.3 The purchasers’ joint procurement team made strenuous efforts to identify the risks of the project. In March 1995, seven months into the procurement stage, they compiled a comprehensive register comprising 224 risks. These covered the specific risks within the project and the wider business risks that could affect it. The register included virtually all those that could have been foreseen such as:

- inadequately specified requirements;
- delays in the Department’s CAPS project which would link to the Card system;
- deterioration in service to customers, such as unacceptable queuing time at post offices; and
- poor performance by the supplier.

2.4 However, this register did not include assessments of probability and impact, nor did it allocate risks to “owners” for management, or propose options to mitigate the risks. We found no evidence that it was then further developed into a fully-featured risk register and actively used in the project.



Setting clear and consistent project objectives

The Department and Post Office Counters Ltd took steps to manage their divergent objectives, but tensions remained

2.5 The project was unusual in that one of the joint purchasers is a service provider to the other. Post Office Counters Ltd provided benefit encashment services to the Department of Social Security, and both organisations sought to maintain a degree of commercial confidentiality from the other. As shown in Figure 4, the Department’s objectives were primarily to

reduce benefit payment costs through a fraud free system as quickly as possible. Post Office Counters Ltd's objectives were primarily longer term - to safeguard its commercial business and those of its agents in the sub-post office network. The risk was that the two purchasers might steer the project in different directions or not act in a co-operative manner. All three shortlisted suppliers told us that there were clear commercial tensions between the two project purchasers during the procurement phase.

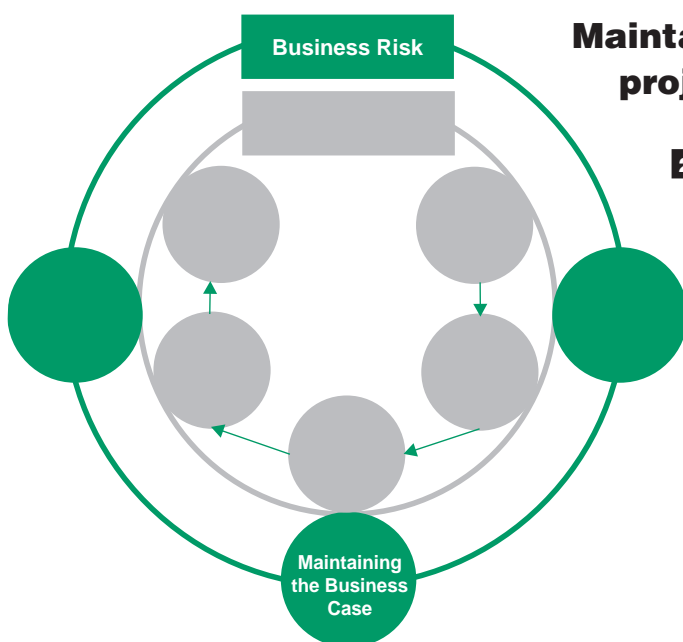
2.6 To manage this risk the Department and Post Office Counters Ltd negotiated during the procurement stage a Memorandum of Understanding between themselves. Agreement took longer than expected, and delayed the issue of a statement of service requirements to the three shortlisted bidders by two months. The Memorandum, which was mainly used to summarise the business and commercial understanding between the parties, did not entirely resolve the fundamental differences in objectives, which later had to be resolved in the handling of detailed issues. For example, Pathway pointed to areas such as the design of the card, and the arrangements for allowing claimants to nominate agents to collect payments on their behalf, which highlighted continuing tension and disagreements between the purchasers. The purchasers co-operated to minimise the effect of such disagreements on Pathway's progress, for example by instructing them to proceed with designing the system on one basis and undertaking to reimburse their costs if the disagreements were resolved the other way.

2.7 The purchasers also sought to manage this risk by creating a joint project procurement and delivery team, staffed by both organisations and reporting to a joint project board and steering committee with senior Department of Social Security and Post Office officials. This provided a forum for the resolution of specific issues between the two purchasers, but the basic differences in their objectives for the project remained. Although the Authority resolved some differences itself, it had to refer some back to the purchasers for resolution at a higher level. Pathway told us that this resulted in substantial delays. The Authority's project management role was transferred to Post Office Counters Ltd in April 1998, in response to a recommendation by PA Consulting, (Figure 19). The Department of Social Security also felt that this would make Post Office Counters Ltd more directly responsible for project management as the system rolled out to post offices.

2.8 Post Office Counters Ltd and Pathway were aware from the outset that the Department saw bank transfers as the most cost-effective long term answer for social security payments. The Department had been administering bank transfers as an option for social security benefits since the early 1980s, an option which new

claimants in particular were increasingly choosing. An important advantage of the Benefits Payment Card to Post Office Counters Ltd was that it committed the Department to make payments at a guaranteed level through post offices for the duration of the project. This guarantee constituted a potential financial risk to the Department. This divergence of interests at times led to some doubts about other parties' positions; for example that the Department was not committed to the project's success. This was regrettable because it was in the Department's interests that once commenced the project should succeed, in order to yield the planned savings in fraud and running costs as soon as possible.

2.9 We found that the Department had shown commitment to the success of the project. In 1997/98 they had employed up to 1100 staff plus consultants in designing and implementing their CAPS computer systems that were to link to the Payment Card. In late 1997, when the Benefits Payment Card project was clearly in deep trouble, they sensibly began contingency planning for a possible implementation of payment by bank transfers, in case the project should fail. Pathway told us that they had perceived that the Department's commitment had reduced from around this time. In their view the project no longer had such strong champions with the Department as before. The Department do not agree with Pathway's view; they consider that all the mechanisms and senior support remained in place up to May 1999 to drive the project forward at the pace which could be sustained by Pathway, and that they had delivered releases of CAPS software to time after the project replan in February 1997.



Maintaining a viable business case for the project

2.10 The main risks to the Department's business case shown in Figure 7 were; that the costs of developing the system could increase, that the benefits in terms of administrative savings and reduced fraud could be delayed, or that the wider environment (including technical advances), and ministerial policy might change to make bank transfers a viable alternative to the Payment Card. As with all Government projects, there is a basic risk around changes in Ministerial policy.

The Private Finance contract protected the purchasers from the direct cost increases of developing the card system itself

2.11 The purchasers managed the risk of cost increases by entering into a Private Finance arrangement with Pathway. Under the terms of the contract, Pathway were responsible for the design, build, finance and operation of the system. Pathway's development, trialling and roll-out costs were only to be recoverable from transaction charges that, for the most part, would commence after acceptance of the system and national roll-out had commenced. On this basis the purchasers would be liable for their own cost overruns during the development phase. In their 1997-98 financial statements published in 1999, ICL reported that they had made a provision of £180 million for losses arising from this contract. In a conventional contract, development costs would have been met by interim payments from the purchasers. It is Pathway's view, disputed by the Department and Post Office Counters Ltd, that because risks of delay had been transferred to them, this led to a less than urgent attitude on the part of the purchasers to resolving "agreements to agree" and carrying out their responsibilities.

2.12 The risk of cost increases in the development of the Benefits Payment Card also had to be managed during the implementation phase of the project when Pathway requested an increase in prices in 1997. The Department managed this by keeping their business case updated and using this to inform the interdepartmental negotiations with Pathway during 1998 and 1999 that led to cancellation.

The Department of Social Security's business case was highly vulnerable to slippage in delivery of the project

2.13 The Department's business case was periodically reviewed and updated over the life of the project. Figure 12 shows the extent to which its value for money to the Department was eroded by slippage. The original business case justifying the contract signature in 1996 indicated major savings by preventing fraud, and substantial potential to yield intangible benefits, but it was marginal in terms of reduced running costs once the costs of the related CAPS system were taken into account.

The erosion of the Department of Social Security's original business case, for the contract period 1996 to 2005

Figure 12

	Case as at Project Signature April 1996 £ million²	Case after Project replan May 1997 £ million³	Case at Cancellation May 1999 £ million⁴
Payment Service costs	1477	1464	1112
less: Administrative Savings	1180	1022	598
less: Fraud savings	1428	1395	765
Net Saving	1127	953	251
Net Saving (Discounted) ¹	667	564	148

Notes: 1. Costs and savings are expressed as net present values discounted at 6 per cent per annum compounded over the planned life of the project, and converted to constant May 1996 price levels. For comparability, all figures take the assumption that the contract ends in 2005.

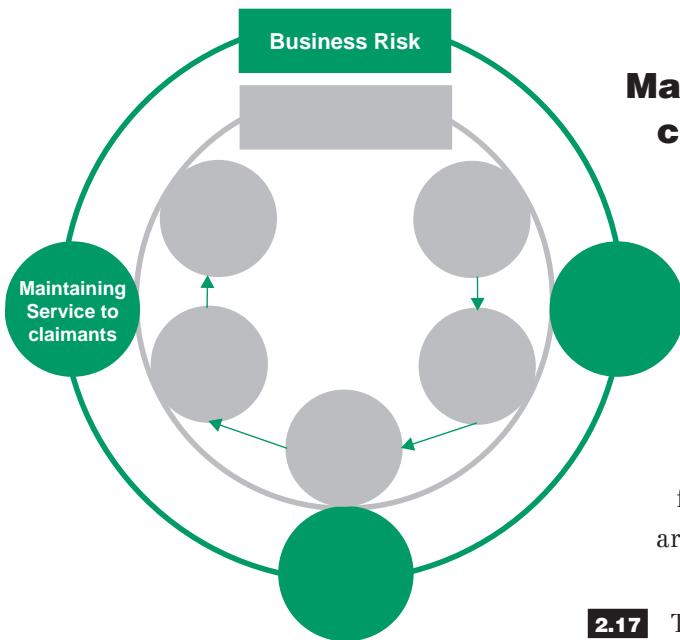
2. The 1996 Business Case compared the costs and benefits of the Card project against those of continuing with the existing paper-based payment arrangements. At that time a comprehensive move to payment through transfers to claimants' bank accounts was not an option under policy, though it remained the most cost-effective method of payment to the Department.
3. In early 1997 the comprehensive introduction of payment through bank transfers was still not an option under government policy, though it remained the Department's preferred long term option.
4. By this stage, incoming Ministers had reopened the option of a comprehensive move to benefit payment through bank transfers, should the Card project fail. Also, Pathway had requested a contract extension or price increases.
5. Running cost savings included planned reductions in the Department's payments to Post Office Counters Ltd due to the introduction of the more efficient card system at post offices; and savings from replacing the operation of order books.

Source: Department of Social Security

2.14 The Department took only limited steps to evaluate this risk before signing the contract. Their May 1996 business case included no analysis to assess its sensitivity to major slippage in the project, since this was seen as largely outside the Department's control. It demonstrated the effect of three months slippage by the CAPS project on the Benefits Payment Card project, but no assessment of major slippage by the Card itself. The Department have estimated that slippage cost them some £5 million a month in additional administration costs and some £9 million a month in lost fraud savings. Any potential further running cost savings foregone by deferring the introduction of payment by bank transfers are additional to this estimate.

The Department’s business case for the project could be affected by changes in policy on methods of benefit payment

2.15 Benefit payment through transfers to claimants’ bank accounts was the cheapest and most efficient method of payment. But when previously raised as a serious option in 1993 it was rejected by Ministers on the grounds that it would have put at risk the national network of sub-post offices. The joint Department/ Post Office feasibility study of February 1994 had been asked to report on the feasibility of automating payments at post offices. The risk that ministerial policy might change was therefore not considered likely. It was only from July 1997, in the light of continued delays in delivery of the Payment Card, that a review of options was instigated. The Department and the Agency then commenced contingency planning for the possible introduction of bank transfers as the normal method of benefit payment should the Payment Card project slip further.



Maintaining services to benefits claimants

The purchasers confirmed the acceptability of the system to customers, at successive stages

2.16 Moving millions of customers from a familiar system of order books and girocheques to a new system based on Card technology was a major area of business risk for the Department. They had to ensure that the new arrangements would be acceptable to benefits claimants.

2.17 The purchasers managed this area of risk from the earliest stages of the project. Customer acceptance was one of the criteria taken into account in their joint feasibility report in February 1994, where for example the security features of the Payment Card were considered more acceptable than fingerprint reading.

2.18 During procurement in 1995, customer acceptability was an important stream of the purchasers’ evaluation of bidders’ proposals. Each bidder’s proposals in this area were acceptable: in the case of Pathway it was one of the stronger elements of their bid. Post Office Counters Ltd also obtained market

research into the acceptability of the Card at this time, which established that most claimants felt they would adapt easily to the new system. Younger claimants and girocheque recipients were particularly in favour of the change.

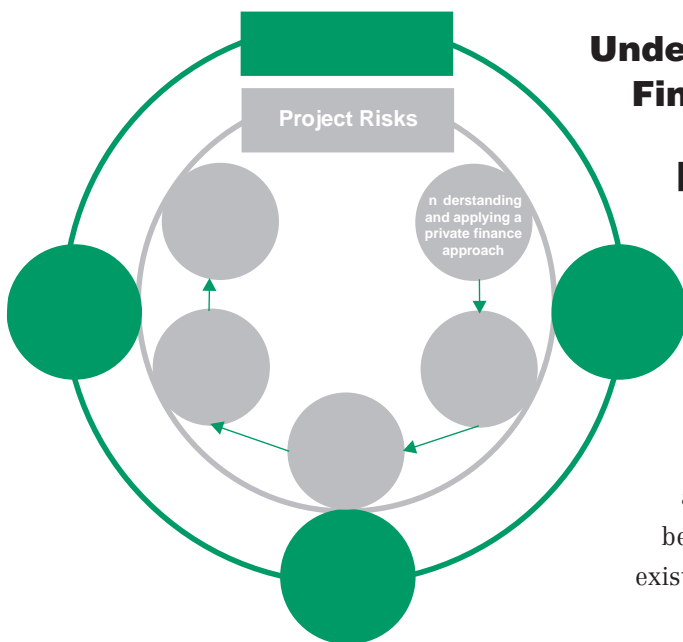
2.19 The purchasers and Pathway also undertook customer research in November and December 1996, as soon as possible after the introduction of the initial limited versions of the Benefits Payment Card system in the first ten post offices to be automated. The customers, at this stage for Child Benefit only, felt the change to be generally positive. The later roll-out to 200 post offices confirmed that the system was acceptable to customers.

2.20 Customer acceptance had to be balanced against the extent of complexity this required in the new system. The customer survey in October 1995 showed that claimants wanted to retain the ability to draw cash from Post Offices other than their own and to have a nominated Agent collect their benefit for them. These later proved to be areas of difficulty in developing the system, as shown in the next section of our report.

Part 3: How well did the purchasers manage the risks of delivering the project?

This part of our report examines the key risks of this large and complex Information Technology project and how well these were managed. It shows that:

- well before signing the contract the two purchasers clearly identified the key risks that eventually delayed delivery and led to the Card's cancellation. But they were much less successful in assessing these risks for probability and impact and in actively owning and managing them subsequently; and
- the project had a high probability of failure as soon as the contract was signed, though this was not fully evident at the time. The pressures this caused during the implementation stage would have severely tested any project organisation. Understandable differences in the business drivers of the Department and Post Office Counters Ltd weakened the complementary business objectives and hence the positive relationships that are essential if such challenges are to be overcome.



Understanding and applying the Private Finance approach to procurement

3.1 The purchasers issued an invitation for potential bidders for the Benefits Payment Card project in August 1994 and the contract was awarded in May 1996. The only other comparable Private Finance deal, the Contributions Agency's requirement for the replacement of the National Insurance Recording System (NIRS2), was advertised in July 1994 and awarded in April 1995. Such groundbreaking projects face risk and uncertainty associated with the lack of precedent. Such contracts had to be drafted and negotiated from first principles rather than existing templates.

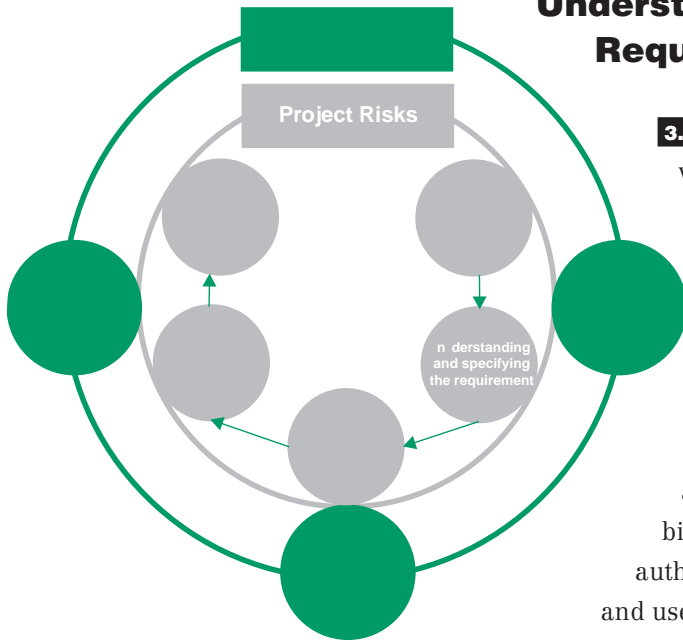
The purchasers appointed appropriate advisers

3.2 The purchasers sought to mitigate this risk of the lack of direct experience by equipping themselves with appropriate advisers. They appointed Bird and Bird, a firm experienced in Information Technology contracting as their legal advisers and as members of their negotiating team. They also obtained assistance from Charterhouse, a merchant bank, on financial matters. They received specific advice on Private Finance practice from the Private Finance Panel Executive. Towards the later stages of the project in 1998 and 1999 they were able to learn from experience on the NIRS2 project, for example the importance of acceptance criteria that ensured the system actually worked as intended when activated. The purchasers also imported specialist advice and assistance in the area of IT project management from PA Consulting, Andersen and Kermons. Kermons also provided procurement advice.

But the Purchasers, the bidders and their advisers had to learn to apply Private Finance mainly through experience

3.3 But difficult issues about how to apply Private Finance principles in practice had to be tackled. A school of thought in Private Finance at that time was that purchasers should specify their requirements at high level so as not to stifle the scope for bidders to innovate in proposing solutions. This influenced the approach of the purchasers in specifying their requirements and relying on the expertise of bidders to understand the detail and devise workable solutions. For example, notwithstanding the customer service requirements highlighted in paragraph 2.20, the purchasers did not see it as their role in a Private Finance arrangement to document the detailed rules for benefit payment in the form to be automated. Nor did they request from the shortlisted bidders, to the extent they would have done on a conventional project, details of the resources the bidders would employ on the project. Another issue was uncertainty about the extent of risk transfer that bidders would accept. Precisely how the risk of fraudulent use of payment cards was to be allocated between the Department, Post Office Counters Ltd and Pathway became a major issue only in the final stages of the procurement, and it effectively ruled out two of the three bids.

Understanding and specifying the Requirement



3.4 The key risk in this area was that the project requirement would be underestimated and that the resultant solution would prove to be not deliverable to the required timescale and level of functionality. This risk was managed mainly through a structured procurement process, in which the purchasers' joint procurement authority issued a statement of requirements, which was subject to quality management and change management processes. Also to test the three shortlisted bidders' understanding of the requirement, the authority evaluated demonstration systems developed by the bidders in response to the statement of requirements. The authority then acted as an interface between the shortlisted bidders and users representatives in the Department and Post Office Counters Ltd during subsequent negotiations up to the submission of priced bids.

The complexity of the service requirements for the system began to emerge late in the procurement and this continued after the contract was signed

3.5 At the time the purchasers invited private sector interest their requirements were defined only at high level. A formal Statement of Service Requirements was only agreed by the Department and Post Office Counters Ltd in February 1995 and issued to bidders in April 1995, eight months into the procurement. This statement changed subsequently. Consultants producing an assessment of "lessons learned" for the purchasers in November 1997 reported that requirements had increased by between 10 and 20 per cent in the period from April 1995 to February 1996. They said that the increases resulted from clarifications, new requirements not included in the original statement, and detailed documentation of the rules and constraints under which services were to be provided. Customer Surveys in late 1995 had also emphasised the need to continue to provide customers with existing facilities to use post offices other than their own and to nominate agents to collect benefit on their behalf. The former Director of the Procurement Authority told us that this was a period in which there had been increased involvement of Department of Social Security officials responsible for aspects of service to benefit customers. As a result the Department's service requirement emphasised to a greater extent the need to replicate existing payment rules, as opposed to reengineering a simpler process.

3.6 In October 1995, in an effort to draw together the detailed requirements, the Purchasers started to set up a Requirements Catalogue. It was intended that the catalogue would provide detailed service definitions and that service providers would respond with solutions to these in their bids. However, in November 1995 in response to increasing concerns from the service providers and the purchasers about the time and cost of the procurement the Authority stopped work on developing these service definitions. With the agreement of all three shortlisted bidders the Purchasers stated that detailed requirement definitions would be agreed with the selected supplier after the contract had been awarded, and invited tenders on the basis of higher level specifications. Though work on the Requirements Catalogue was stopped, the purchasers continued to direct additional information on their requirements to the bidders right up to the issue of the formal invitation to submit priced bids. Some 333 additional details and clarifications to requirements were issued between November 1995 and the end of January 1996.

3.7 From the records it seems that when the contract was signed there were 289 “agreements to agree” the detail of the service contained in it, of which 38 remained to be agreed by Pathway with the Department, 124 with Post Office Counters Ltd, and 127 with both clients jointly. Pathway told us that they had expected these to be cleared within the first three months during a process of drop-down, but drop down instead focused on legal arrangements rather than the technical and service aspects in the agreements to agree. The Department told us that it had never been intended to resolve the agreements to agree during drop down; only the mechanisms for completing them. Some of the outstanding agreements were relatively minor, such as the design of the logos to appear on the card, whereas others, examples of which are shown in Appendix 2, were more significant. Resolving the more important agreements to agree was essential to finalise the detailed design of the system and deliver the full service.

The emerging complexity of the requirement increased the difficulty of the solution

3.8 Pathway told us that the emergence of complexity in the service requirement after the contract was signed caused them acute problems in two main areas:

- **temporary tokens** – the arrangements that apply when someone collects a benefit (prior to issue of a Card) or on behalf of another person at short notice on a temporary basis; and,

- **extended verification processes** – through which the Department could change the targeting of identity checks on particular groups of payees. Payees were asked to verify their identity at the counter by giving personal details in answer to computer-generated questions when presenting their payment card. This important anti-fraud feature is explained further in Figure 13.

Figure 13

A case study in emerging complexity: Arrangements for verifying the customer's identity

Statement of Service Requirement: March 1995

"...an authentication stage will be required to ensure that the customer is the recorded card holder. This is likely to require the customer to provide details that correspond to those on the system (rather than the card). Collection of these details must be such that no other customer could gain access to them. It is for the Service Provider to propose the means of authenticating card holders". "...Bidders should demonstrate that successively more secure anti-fraud measures can be deployed using the proposed underlying architecture, without the need for significant re-engineering".

The Statement identified types of customer data available from DSS and issues that bidders should consider when designing verification.

In the Contract with Pathway: May 1996

Agreements to Agree: "Pathway confirms that cardholder verification methods will be resistant to impersonation and will include an agreed mechanism for identifying the attempted use of a card or temporary token by unauthorised persons." "The contractor shall ensure that any chosen security verification details or procedures are updated when agreed between the parties without adversely affecting the authorised person's ability to collect authorised payments and without having an adverse impact on the overall time of transaction".

In the system development phase: 1996-1999

Complexity emerged from the requirement for extended verification procedures.

1. In June 1996 Pathway requested from the Programme Delivery Authority definition of the "High Risk Transactions" that required an "extended verification process". DSS provided initial thoughts later in 1996.
2. Post Office Counters Ltd then requested a limit on the number of transactions that could be subject to extended verification of customer's identity.
3. DSS agreed subject to taking up an offer of flexibility to target particular types of transaction for customer verification. ("Soft EVP")
4. Pathway agreed, but the way in which verification in post offices could be varied remained under discussion.

Contract cancellation: May 1999

Requirement still not fully agreed

Source: Project documents reviewed by the National Audit Office

Pathway felt that complexity lay not so much in each individual area but in the way they combined across the different types of benefit recipient (normal beneficiaries, permanent agents, temporary agents, and alternative payees). Different rules for different benefits needed to be reconciled. Complexity thus related to a small minority of payment collections (estimated to be between one and five per cent), often where agents collected more than one benefit. Pathway told us that the Department appeared inflexible in simplifying the application of rules to lessen the complexity of the resulting system. We noted that the Department had attempted simplification, but were constrained by legislation and by the need to meet benefit recipients' expectations in this difficult area, (paragraph 3.11).

3.9 In accordance with Private Finance practice, the Department's part of the requirement was specified mainly in terms of the performance they required, rather than how the service was to be delivered technically. Pathway, like the other bidders, responded with their own technical solutions. Tokens and extended verification processes were elements of Pathway's proposed solution. At the time the contract was signed there was not a detailed design that demonstrated how the solutions in each of these areas would work in practice. Pathway's position is that their solution was robust enough at that time to be developed to meet the full requirement. This was also the view of the Department.

3.10 The Department gave us their own perspective of how complexity emerged in areas identified by Pathway. On the issue of verification procedures, the Department felt that they had sought to preserve their requirement for flexibility to target verification procedures in response to changing patterns of fraud. They had agreed to Pathway developing initial software using "hard coding", but had required the full version to be written using "soft-coding", to ensure verification questions could be targeted effectively in practice.

3.11 Pathway also noted that at the time the contract was signed there was no authoritative document which collated and reconciled all the different rules which governed payment of different benefits. The rules differed between benefits partly for historic reasons, and partly because the differing circumstances of different types of claimants determined the extent of their reliance on emergency payments and on agents to collect benefit on their behalf. This proved to be a very difficult area to resolve. It required the Department and Pathway to identify and harmonise historically divergent payment practices between different benefits, tracing these back to often conflicting regulations and legislation, to produce a single set of rules that could be programmed into the Card system. Pathway produced the first version of the new document which documented these rules in 1996 and submitted it to the Department for agreement. Five subsequent iterations followed, during which time the Department examined at length the need to

change legislation, which proved to be difficult. The document was not finally agreed until February 1999, just before the Card project was cancelled. Pathway continued designing and redesigning software while this reiteration continued. The Department told us that they had provided a statement of rules they had considered definitive as early as October 1996, and had worked hard with Pathway on the correct interpretation of these rules.

3.12 Pathway told us that they had expected more scope to redesign the Department's business rules and requirements so that they could use software more closely based on the solution that they had installed in the initial ten post offices in September 1996. This initial go-live was always intended to be an interim system. It did not offer full functionality, and included some extemporised processes which would have to be replaced with permanent software for the subsequent roll-out to 200 post offices. It was a development based on software running live in post offices in Ireland. The purchasers had, during the procurement phase of the project, identified as an issue the extent to which Pathway would have to change software running on the system in Ireland.

3.13 The project initially proceeded on the basis of proposals from Pathway that it would involve mainly the integration of existing software packages. In the event, the greater than expected complexity of the service requirement obliged Pathway to undertake much more development of new software than they had planned for in their winning bid. This had major implications for the degree of difficulty of the project since software development is a complex and high-risk activity, especially against a requirement specified largely at high level. The most comprehensive, published research known to us in this area is that undertaken by the Standish Group into the outcome of software development projects in the United States. The key findings are shown in Figure 14.

The outcome of software development projects

Figure 14

Project failure rates in software development projects across private and public sectors are high, and more severe still in larger organisations

	In small companies (per cent)	In medium companies (per cent)	In large companies (per cent)
Project successful: Completed on time, on-budget, with all features and functions as initially specified	28	16	9
Project "challenged": Completed and operational but over budget, or over the time estimate, and offers fewer features and functions than originally specified	50	47	62
Project cancelled: at some point in the development cycle	22	37	29

- Notes:
1. The Standish Group research also reported that for projects that were "challenged" or cancelled, average time overruns were 230 per cent in large companies and the average cost overrun was 189 per cent of the original cost budget.
 2. For the purpose of this survey, large companies were defined as those having an annual turnover greater than \$500 million, and a medium-sized company as those with turnover of \$200 million to \$500 million.

Source: The Standish Group, based on 1995 survey responses from 365 IT executive managers in the USA across major industry segments including finance, manufacturing, retail, services and local, state and federal government institutions. Some 8380 development projects were represented.

3.14 An increased need for bespoke software development also places additional demands on a supplier's resources. ICL is primarily a software integration company and most of its staff work in this area. Department of Social Security officials told us that they felt Pathway had had difficulties mobilising and managing sufficient resources to deliver the revised solution. This was supported by the conclusions of a review in 1997 by PA Consulting (Figure 19), which concluded that Pathway did not initially have the resources in place to complete the development work required. The Department understood that the full range of software to be integrated was not delivered to Pathway by its sub-contractors until late 1997. Pathway's position is that the speed of this mobilisation was never a cause of project delay and that their system integration staff had the necessary skills for system development and testing.

The Department had to manage the risk that slow progress on their CAPS system could affect the Benefits Payment Card project

3.15 Issuing benefits payment cards and making payments to claimants depended on the successful flow of payment information between the Department's and Pathway's systems. In May 1995, while negotiations with bidders for the Card contract were proceeding, the Department commenced development of the Customer Accounting and Payments (CAPS) system that would provide this information to the benefits payment card system. The objectives of the CAPS project were to:

- support card payments, to meet commitments given by Ministers, the Department and Post Office Counters Ltd;
- support security initiatives to prevent programme losses;
- support improved accounting, to provide proper stewardship of programme money and to position the Department to produce resource accounts;
- facilitate the alignment of benefit systems, bringing commonality to business processes and to harmonise data; and
- make data available that meets the Department's information needs.

Developing CAPS and the Payment Card in parallel added to risks

3.16 All three shortlisted bidders told us that they were conscious of the size and complexity of CAPS and that any slippage in its development would be likely to affect the Benefits Payment Card Project. The proposed CAPS timetable at the time the Benefits Payment card contract was signed specified that by December 1996, half of all post offices would have been converted and half of all CAPS benefit payments would be converted to a card basis. Both systems would continue to roll out in parallel over the following two years. This development project was managed by the Department and was comparable in size and complexity to the Benefits Payment Card itself, thus compounding the complexity, challenges and risks of the programme as a whole.

3.17 Developing these two large, linking projects and Post Office systems in tandem added substantially to the development risk of the whole programme. Pathway have said that one of the major technical obstacles to their progress was that the CAPS system was not available when promised. In particular they point to a clause in the contract which they interpret as meaning that the Department would provide Pathway with complete data and interfaces with CAPS for testing purposes by September 1996. This did not happen. This was important because Pathway's system had to change in response to changes in CAPS interfaces. The Department's view is that this interpretation is unrealistic in terms of the way the development programme operated, and is based on the contract as signed, and not as modified by the "no-fault" agreed replan in February 1997. They also contend that Pathway did not have a complete system to test by September 1996 in any case. The clause and the interpretations placed on it, are reproduced in Appendix 6.

3.18 During 1996 the CAPS project and Pathway had both slipped against their original plans. Pressure to meet the timescale for the initial go live with Pathway in ten post offices resulted in software being designed specifically to work in the low risk context of handling a relatively small number of Child Benefit payments. Much more work was necessary to develop it further to provide a generic, high volume, solution with the full range of security features that the Department required to support all benefits.

After initial delays, the Department improved their management of CAPS to meet the needs of the Benefits Payment Card

3.19 It is clear that the risks of late delivery of CAPS were not well managed prior to the replan of the whole CAPS and Payment Card programme in February 1997. A new project director took up post in mid 1996, around the time that the Payment Card contract was awarded to Pathway. He found that the project had not been appropriately resourced. The Department also commissioned a review by consultants Ernst and Young which in December 1996 reported:

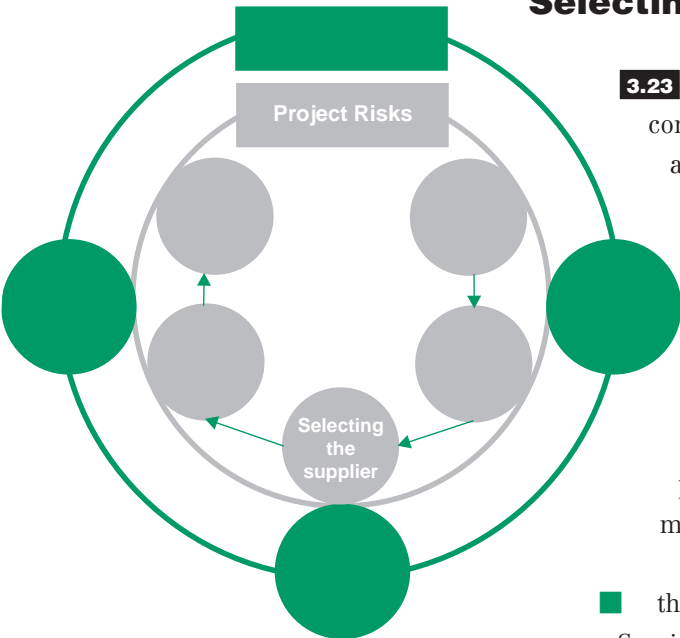
- a lack of project management expertise at the right level within the CAPS senior management team;
- a focus on short term objectives to support the initial go-live, at the expense of developing a set of plans and designs for the programme as a whole; and
- doubts over the strength of financial projections and cost control.

3.20 Ernst and Young made recommendations for improved management and planning which the Department implemented to reduce the risk of subsequent slippage on CAPS. While CAPS along with the other two parties, had contributed to delays in the project up to the project replan in February 1997, thereafter the Department successfully released software and data from CAPS in time for the equivalent releases of Payment Card software by Pathway. We found no evidence that from then onwards the releases of CAPS software had delayed the implementation of the Payment Card.

3.21 Besides sustaining progress on the CAPS project, the Department had to co-ordinate it effectively with the Payment Card. The CAPS project management structures and risk management processes were separate from those for the Payment Card. An alternative arrangement would have been to create a common programme management tier to oversee the Card Project, CAPS, and related activities in Post Office Counters Ltd. This would have ensured that due weight was given to interdependencies between constituent projects. But the project was only one part of Post Office Counters' wider transformation programme and similarly CAPS had a wider remit for the Department than just supporting the Card. So a single management structure was not thought feasible in this case due to the commercial sensitivities of the two purchasers.

3.22 Though the Department and Post Office Counters Ltd did not set up an overarching programme structure, the Department managed the risks of inadequate co-ordination between CAPS and the joint Delivery Authority by establishing close links at board and management team level. Key Departmental staff attended meetings for both projects. Pathway were not directly involved in CAPS board meetings and had no direct, formal access to CAPS staff until late in the programme when the joint Delivery Authority was wound up. Pathway told us that in the absence of a common programme management tier, and of direct formal interaction with CAPS, they had found it impossible to ensure dovetailing of the two programmes at the detailed level or to avoid surprises during the phased releases of software. The Department pointed out that plans were continually shared with Pathway.

Selecting the supplier



3.23 The purchasers perceived the importance for such a large and complex project of selecting a strong supplier capable of delivering a working system. The evaluation of proposals was run by the joint Procurement Authority, staffed by Department of Social Security and Post Office personnel and was supported by contracted legal, procurement, project management and IT specialists. The Authority was controlled by a single Director who reported to a Project Board, which met at least monthly to oversee and advise on the procurement process, and act as the committee for the shortlisting and evaluation of suppliers' proposals. The main streams of work the authority undertook to manage the risks of supplier selection were:

- the evaluation of five bidders' responses to the Statement of Service Requirement, against a range of criteria, as a basis for selecting a shortlist of three bidders, followed by;

- examination of system demonstrations mounted by the three shortlisted firms; and

- formal evaluation of priced bids from the shortlisted suppliers against technical, managerial and commercial criteria.

The purchasers effectively identified the risks of Pathway's proposals, but were less successful in evaluating and reducing these risks

3.24 After receiving bidders' responses to the statement of requirements the Procurement Authority set up risk registers for each of the three shortlisted bidders and established procedures to identify, evaluate, control, monitor and report these risks to the Project Management Board.

3.25 Risks were classified according to their perceived severity. "A-class" risks were "show stoppers" which if still present at the time of invitation to tender would mean that the service provider would not receive an invitation. Serious "B-class" risks were categorised into those with an impact on the project of more than £5 million a year, £1 million to £5 million a year and under £1 million a year. They

would not preclude a service provider from tendering, but the costs would be taken into account in bid evaluation. “C-class” risks were minor, which though considered in evaluation, would not add costs to a bid.

3.26 The procurement authority managed these risks through discussions with the service providers and evaluation of their written responses. Pathway’s responses were comprehensive and detailed, and some proposed significant changes in their proposals for design and implementation of the project. These included the use of verification procedures to confirm the identity of claimants at post offices, and upgrading key software from 16 bit to 32 bit technology. On the basis of these responses the purchasers cleared and downgraded risks. It is evident however from subsequent events that some of the risks identified in Pathway’s solutions and recorded as cleared at the time the contract was awarded were still live, as shown in Appendix 7 of this report. These included areas such as the system’s ability to meet security requirements and the dependence of the system on the development of new software. Pathway told the National Audit Office that many of the risks identified by the purchasers as re-emerging post contract were not shared or discussed formally with them, and that they had not been aware that the purchasers saw many of them as still live.

3.27 Just before the issue of the invitation to tender the risk register for Pathway’s proposal showed one outstanding “A” - grade “show-stopper risk”, which according to the purchasers’ procurement strategy should have precluded them being invited to tender. This risk, of Pathway’s reliance on a key piece of messaging software which would need to be scaled up to meet the requirement, was downgraded on the basis of proposals from Pathway. At this stage Pathway’s bid had the highest number of outstanding serious B - grade risks, each with an even or higher chance of occurring.

3.28 Though the approach to identifying risk to the project, based on the analysis of each service provider’s proposal was sound, it focused heavily on financial risk transfer. This was based on the premise that the business risk of late delivery could be transferred to the service provider to manage, whereas in fact, as subsequent events showed, much business and commercial risk for the benefits card payment project still lay with the Department. In fact, delays in delivering the project would cost the taxpayer some £15 million a month in terms of continuing fraud and administration costs. In principle, the purchasers had some protection against these costs through their rights under the contract to sue Pathway for damages of up to £200 million. However, the purchasers did not sue for damages because the agreement reached with ICL in May 1999, by mutual consent and in agreement with Ministers, was in full and final settlement of their claims against Pathway and Pathway’s claims against them.

3.29 During the pre-contract period all three shortlisted suppliers offered and provided the joint Authority with versions of their own risk registers for the project. Pathway submitted a risk register containing 20 risks. The most severe risk recorded related to the technical boundaries between Pathway's and the purchasers' systems. It also put a marker down for other risks, such as the late delivery of the CAPS system and the handling of temporary tokens and casual agents, which became major issues after the contract was signed. While clearly the Procurement Authority would have to consider the content of Pathway's risk register very carefully, we found no evidence that they had fed anything from it into their own risk assessment process.

The purchasers' evaluation of suppliers' system demonstrations gave only limited assurance about the quality of the proposed solutions

3.30 In 1995 the Procurement Authority required the three shortlisted suppliers to demonstrate the credibility and viability of their proposed solutions. The demonstrations formed a key part of the purchasers' technical evaluation of the suppliers' proposed solutions. They were used by the purchasers to identify the risks associated with each bid and to invite proposals for the bidders as to how they would deal with them. They also offered the suppliers the opportunity to "sell" the benefits of their solution.

3.31 The technical evaluation of bids was undertaken during the demonstrator phase. The evaluation could only ever have provided very limited assurance about the capability and viability of the service providers, because all three demonstration systems had only limited functionality and were not fully fledged prototypes. They were to help convince the purchasers that the suppliers knew what they were getting involved with and, for example could demonstrate some understanding of the speed with which business could be transacted at post offices. One bidder described the phase to us as "just smoke and mirrors". Nevertheless, one losing bidder told us that they had spent up to £1 million in simulating the environment and systems for their bid.

3.32 In 1994, when the Department and Post Office Counters Ltd established their project procurement strategy they considered having two bidders entering into a pilot competition through which each would develop and trial a system. Such an approach is particularly suitable where there are substantial development risks. Costs of the pilots may be shared between the bidders and the purchaser. The purchasers however did not adopt a piloting arrangement, on the grounds that it would have delayed the project.

The purchasers decided to accept the lower confidence of delivery that they had in Pathway’s proposed solution compared to other bidders’, because only Pathway’s bid was clearly compliant with the Private Finance Initiative

3.33 The purchasers evaluated bidders’ technical proposals on a scale of zero to ten against the eleven criteria shown in Figure 15. Zero represented an unacceptable proposal with serious shortcomings and ten an outstanding proposal. Most scores under each criteria were in the range four to six, where four indicated that the proposal was viable but raised some outstanding issues that were relatively minor or manageable; and six that the proposal was sound with no significant issues. The evaluation team consistently assessed Pathway’s proposal as being less strong overall than those of the other two bidders under most of the eleven criteria.

3.34 The technical evaluators’ overall assessment of the credibility and viability of the Pathway solution was that while acceptable, they ranked behind the other two consortia. The final evaluation identified and confirmed a significant number of risks inherent in the Pathway solution, many of which were potentially high probability and high impact risks and which were factors in the later problems in the project.

3.35 Pathway’s proposed solution had some attractions because it was based on a simpler benefits payment system already working with the Post Office in the Republic of Ireland. The solution featured a “distributed architecture” in which each post office held its own database of payments due. In principle this offered advantages of improved availability and shorter transaction times, an important factor for Post Office Counters Ltd. It contrasted with the other two bidders’ proposals which were based on centralised databases, as used by UK banks for credit card systems. Neither of these bidders had already developed a working social security benefit payments system. The risks associated with the Pathway architecture were seen to be in terms of scaling up of the system, the software required to support it and the changes needed to cope with the full service requirement.

3.36 The purchasers’ evaluation team reported their strong concerns about the reliance on unproven third party software to support Pathway’s solution for post office automation and the benefits payment card system. This matter, they said, generated little confidence in Pathway’s ability to deliver to time and quality and left a question mark over the delivery of the service.

Figure 15

How the purchasers assessed the bidders' proposals in April 1996

Pathway's solution was ranked behind its competitors' in terms of delivery, but was deemed acceptable and was the only one that was clearly compliant with the Private Finance Initiative. The lowest evaluation in each of the criteria is shaded.

Criteria	Weighting, (out of 200)	Cardlink	IBM	Pathway
Price (£ million)¹		1257 - Third	1026 - Second	1005 - First
Compliance with the Private Finance Initiative (See Figure 16)		Probably compliant	Not compliant	Compliant
External factors affecting potential success²				
Acceptability of the system to the customers of the Department of Social Security and post offices.	30	5.8	5.3	5.3
Acceptability of the system to Department of Social Security & post office staff and agents.	15	6.0	5.0	5.5
Flexibility, in terms of reacting to external change.	20	4.7	4.2	4.4
Reliability and support in terms of helping ensure continuity of service.	20	5.3	5.2	4.5
Innovation	15	5.3	5.8	5.4
Viability factors, in terms of service delivery²				
Fraud free method of payment for benefits payments.	30	5.5	5.4	4.0
Credibility to manage and deliver the start up of services.	15	5.4	5.1	4.4
Credibility of service delivery once implemented.	20	5.7	5.5	4.1
Management capability of the bidding team shown in the demonstrator phase.	20	4.7	4.5	3.7
Stability and coherence of the bidding organisation, including the prime contractor and other consortium members.	15	6.2	6.0	4.4

Notes: 1. Price is shown as Net Present Value, discounted at six per cent per annum, for the duration of the contract. The values given are for the most likely outcome. Total prices could be higher or lower depending mainly on the volume of transactions and on inflation over the life of the contract

2. In this scoring system a score of "4" meant "Ordinary" - that the proposal was viable but nothing special, and raised some outstanding issues that were considered relatively minor or manageable; and "6" was "good" - that the proposal was a basically sound solution with no significant issues.

Source: National Audit Office

3.37 Foreseeing the areas of difficulty that were to arise after the contract was signed, the evaluation team reported that they had a low belief in Pathway’s appreciation of, and empathy with, either of the purchasers’ business requirements or ability to deliver a service which would meet the required service levels. They reported that they considered that Pathway had weak authentication procedures, the weakest security proposals and that Pathway had manifest lack of understanding of the management of fraud risk.

3.38 The evaluation team reported that Pathway’s performance in managing the demonstration phase of the procurement had been substantially below those of the other two service providers and raised concerns about Pathway’s lack of internal controls. They reported that Pathway had not shown itself to be adept at foreseeing and preventing problems.

3.39 The results of the financial evaluation of bids showed that the Cardlink consortium’s bid was the most expensive. The IBM and Pathway prices were very close together.

Figure 16 How the purchasers assessed the bidders’ proposals for compliance with the Private Finance Initiative

Only Pathway’s bid offered the extent of risk transfer that would ensure compliance with the Private Finance Initiative and enable the investment in the system to be off the public sector’s balance sheet.

The risks the purchasers wished to transfer to the supplier	Cardlink’s proposal	IBM’s proposal	Pathway’s proposal
<i>Liability for up to £200 million of fraud over the life of the contract, should it continue</i>	Onus of proof on the purchasers, no acceptance of cardholder verification fraud	Liability limited to £10 million a year, no acceptance of cardholder verification fraud ¹	✓ ¹
<i>That the system would be delayed or not work</i>	✓	✓	✓
<i>That the volume of transactions would be lower than expected</i>	guaranteed volumes to be set at end of first year of roll-out	92 per cent of revenue to be guaranteed	✓
<i>That inflation would increase the supplier’s costs</i>	Charges to increase at inflation less 1 per cent	Charges to increase in line with inflation	✓
<i>That the system would not be operated to agreed standards</i>	Financial limits of liability set per year and per event	✓	✓

Note: 1. The purchasers estimated the risks accepted by Pathway in the area of fraud at a value to them some £34 million higher than the risks accepted by IBM.

Source: National Audit Office assessment of the purchasers’ bid evaluation

3.40 Whilst acknowledging the implications of selecting Pathway, the evaluation team considered this preferable to awarding the contract to IBM. IBM's bid would be unlikely to be PFI compliant and accepted less risk than Pathway's in terms of having to pay penalties if they failed to prevent fraud. The group therefore unanimously recommended to the Evaluation Board that any contract award should be made to Pathway. On 29th April 1996 the Project Board accepted that to proceed with Pathway implied a degree of risk but concluded that such risks were manageable and were outweighed by the relative merits of other aspects of their bid.

Pathway's acceptance of part of the risk of fraud was a key factor in their selection as supplier

3.41 One of the Department's key objectives, and in contemporary Private Finance Initiative thinking an imperative in terms of getting the project off the public sector's balance sheet, was to reduce the risk of fraud. Their business case for the project relied fundamentally on eliminating the cost of this fraud. In the existing paper system, such fraud includes:

- loss or theft of order books and girocheques which are used by the wrong person;
- manipulation, for example amounts changed or order book covers and foils swapped;
- counterfeiting of payment instruments; and
- customers continuing to cash a book which has been recalled.

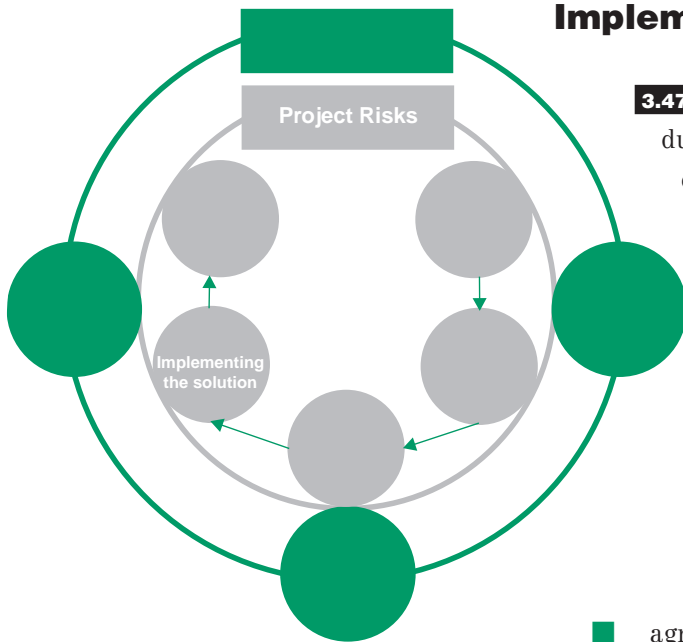
3.42 The areas where the purchasers sought risk transfer to the supplier were set out in early project documents, such as the Prospectus, Request for Statement of Capabilities and the Statement of Service Requirements. But the purchasers did not hold detailed discussions about the exact transfer of fraud risk with each service provider until January 1996, just before the issue of the formal Invitation To Tender in February 1996. Where such unique and significant liabilities are involved, it is now recognised as good practice to reach an acceptable understanding with service providers much earlier in the process. Because there was at the time little experience and formal guidance in government on risk transfer the purchasers had to develop their own approach.

3.43 The differing readiness of the shortlisted bidders to accept fraud risk played a major role in the selection of Pathway as supplier. As well as being potentially massive, exposure to fraud broke new ground for the service providers. The two unsuccessful shortlisted bidders told us that they were very concerned about the risk exposure that bidders were being asked to accept. This concern focused on the maximum liability of £200 million to cover fraud and system failure or poor performance over the life of the contract. This suggested to them that they could be exposed to fraud or failures attributable in some way to failures by post office staff who operated the system or by the Department. They told us that these factors were reflected in very large risk premia within their bids. One bidder had decided not to bid at all until urged to do so by the purchasers.

3.44 Conversely Pathway told us that having assessed the security measures in their technical solution they had concluded that their probable exposure was only a handful of millions each year. So they were not deterred by this element of the Invitation To Tender. Under the contract they saw the Department and Post Office Counters Ltd as still being liable for instrument of payment fraud attributable to Department and post office staff and systems.

3.45 At the time the Card project was cancelled there had been no proven cases of fraud attributable to misuse or misappropriation of payment cards at the 200 post offices disbursing child benefit. Pathway had paid refunds to the Department totalling £2,000 in respect of duplicate payments to claimants attributable to deficiencies in the performance of their initial go-live system.

3.46 The failure to implement the new benefit payment arrangements nationally for all benefits by 1999 as planned had exposed the Department to an estimated £100 million or more of fraud a year through continued misuse of order books and girocheques.



Implementing the solution

3.47 Given the extent to which difficulties were not resolved during the procurement period, the risks to the project when the contract was awarded to Pathway were likely to have a major effect on the cost and timescale of the project, however strong were the arrangements for managing implementation. The purchasers attempted to manage the major risks that re-emerged during the system development and implementation stage mainly through:

- formal risk management procedures operated by a joint delivery authority, replaced in April 1998 by a Post Office Counters Ltd team;
- agreeing a project replan with Pathway in February 1997;
- commissioning an independent review of the entire programme from PA Consulting when slippage continued, and acting on the recommendations; and
- the risk management arrangements of Post Office Counters Ltd from April 1998, when their Horizon team took over responsibility for the contract with Pathway.

Formal risk management arrangements continued after the contract was signed, though they were not fully effective

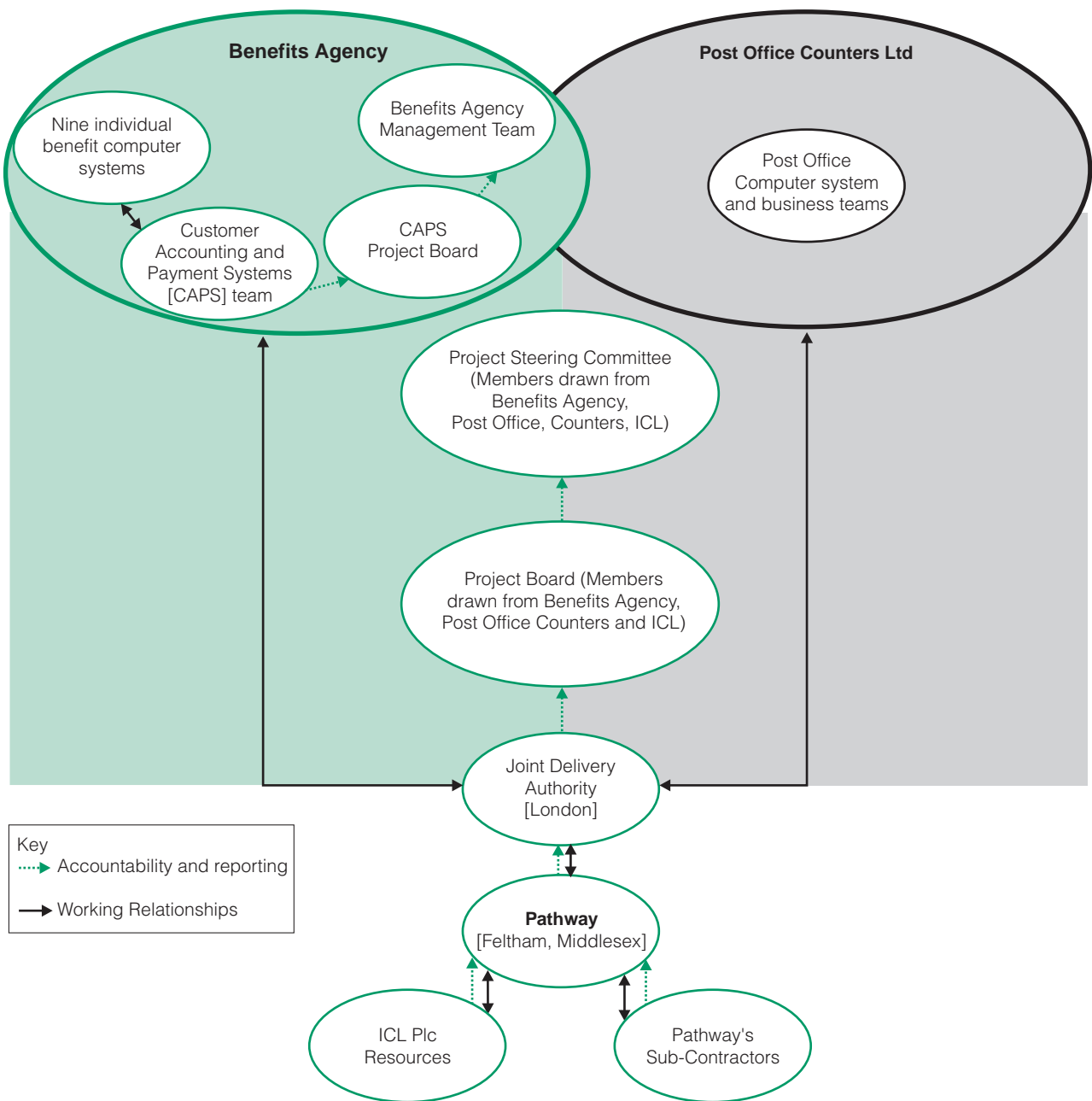
3.48 When the contract was awarded to Pathway in May 1996, the Department and Post Office Counters Ltd established a joint Delivery Authority to manage the development, system acceptance and roll out phases. Like its predecessor, the Authority was staffed and funded jointly by Department and Post Office Counters Ltd. This body effectively stood between Pathway and the intended users of the system in the Department of Social Security and Post Office Counters Ltd. The new Project Steering Committee included the Chief Executive of ICL and Managing Director of Pathway, as well as the Chief Executive of the Benefits Agency and the Managing Director of Post Office Counters Ltd. Similarly, below the Steering Committee the new Board included the Managing Director and Programme

Director of Pathway. Progress against the project plan was regularly reported to the Steering Committee and Board. Figure 17 shows the organisation adopted for the project in this period.

Figure 17

The organisation adopted for the Benefits Payment Card Project

This was the organisation between the signature of the deal in May 1996 and the transfer of responsibility for dealing with Pathway from the joint Delivery Authority to Post Office Counters Ltd in April 1998. There was no overall programme management body overseeing progress in the Agency, Pathway and Post Office Counters.



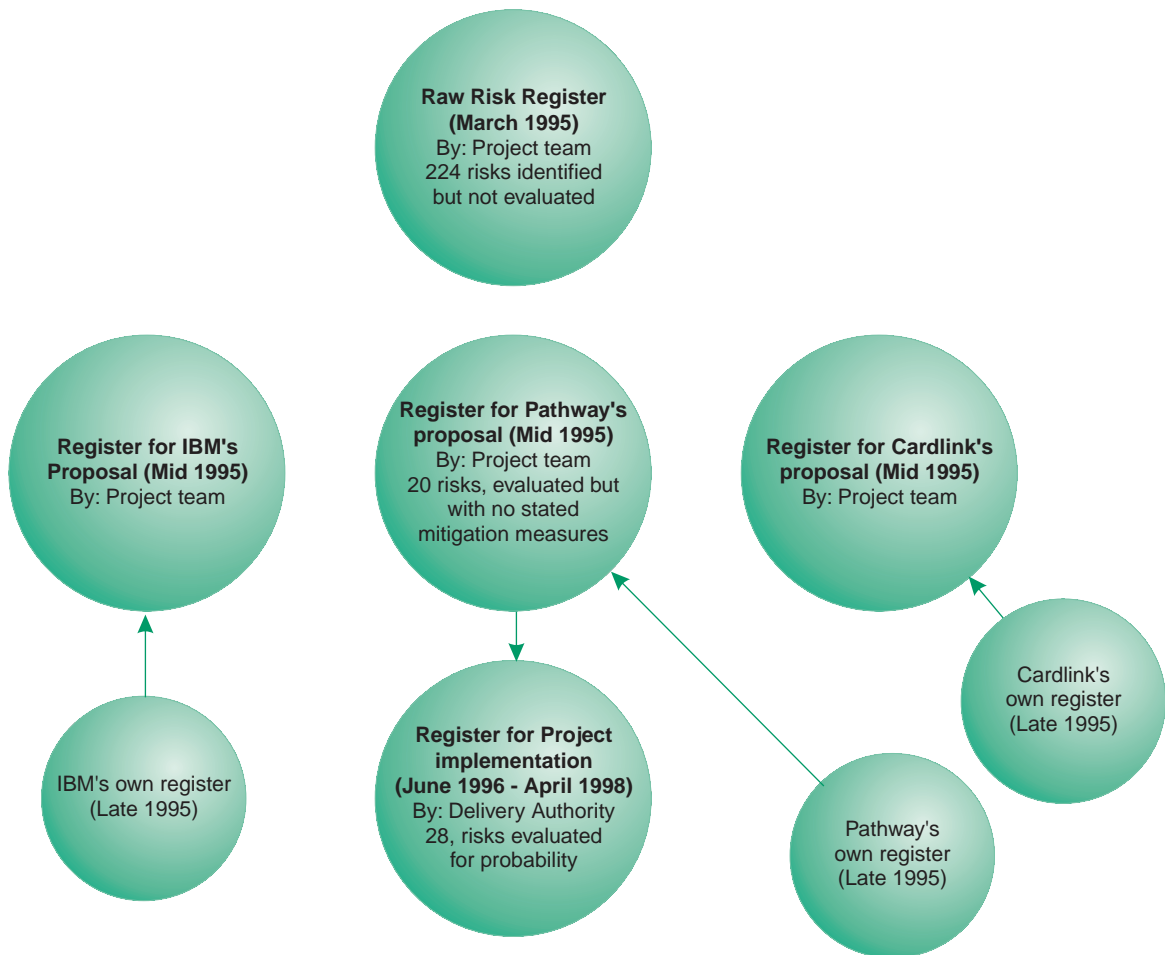
Note: The organisation during the earlier procurement stage was similar, but without the inclusion of ICL Pathway.

Source: National Audit Office

3.49 The Delivery Authority established a new risk register incorporating risks from the pre-award project register (paragraph 2.3), those outstanding on the procurement team’s risk register for Pathway’s solution (paragraph 3.24), and others arising from further review. Most risks were managed within the Delivery Authority and were described in regular highlight reports made to the new Project Director and his team. Key risks and issues were reported to the Board and the Steering Committee.

Figure 18

A summary of the risk registers produced at different stages of the project



Source: National Audit Office

3.50 Our examination of the Delivery Authority's risk register revealed that not all on-going risks were captured from the procurement phase. For the majority of identified risks the register did not show the countermeasures or mitigating action

taken. We noted also that assessments of the probability of risks occurring were not consistently applied, in that there were inconsistencies in the numerical systems used.

3.51 None of the project documentation we saw provided evidence of the use of project planning tools to identify the potential impact of delay. Project plans maintained by Pathway and by the Delivery Authority appeared to lack “earliest” and “latest” estimates of duration for each major activity, using instead only single point estimates. We found no evidence of the use of sensitivity analysis in detailed project plans; this resulted in repeated instances of “unforeseen” project slippage. Such estimates are a fundamental cornerstone to all project planning, and delivery measurement.

The purchasers and Pathway replanned the project in early 1997

3.52 Following the project replan in February 1997, (paragraph 1.13), the Department diverted additional and more highly experienced staff to CAPS in order to reduce the risk of slow progress on their part impeding Pathway's implementation of the Card. From July 1997, Pathway strengthened their management team for the project and they increased staffing and technical resources.

The purchasers and Pathway obtained and acted on an independent review of the project

3.53 Despite the replan in February 1997 the project continued to make slow progress. In July 1997 the Chief Executive of the Benefits Agency, Peter Mathison, and the Permanent Secretary of the Department of Social Security, Ann Bowtell, met ICL to register concern at the further slippage and the uncertainty surrounding future releases of software. As a result, Pathway, the Department and Post Office Counters Ltd commissioned PA Consulting to provide an independent review of weaknesses and risks in the programme, the implications for delivery and the options available. The key conclusions of PA Consulting's report are shown in Figure 19.

Figure 19

Key conclusions of the Review of the PA Consulting Review of the project

<i>Overall</i>	The programme was "world class in its ambitions";
<i>On CAPS</i>	The Department 's plans for delivering its own systems were well thought through but continuation of tight management control would be vital.
<i>On work in Post Office Counters Ltd</i>	Post Office Counters Ltd had made satisfactory progress, though PA registered concerns about the resources available to manage the roll-out of the infrastructure, and the skills available for managing both the implementation and the continuing service.
<i>On Pathway's work</i>	The extent of development work that Pathway needed to do had been seriously misjudged and Pathway were still implementing new management arrangements and disciplines to reflect their enhanced understanding of the demands of the programme. There was uncertainty about delivery, due in part to the deferral of known problems and system functionality to later releases of software. Though PA had received satisfactory answers to their questions on the robustness of Pathway's technical solution, there would continue to be reservations until the final design was completed.
<i>On the Programme Delivery Authority</i>	The Delivery Authority had spent too much time on aspects that might be better managed directly between the Department, Post Office Counters Ltd and Pathway, and recommended that the Authority could be reduced to a quarter of its current size by transferring its functions to the two purchasers. The Authority was wound up over the following six months and replaced by the Post Office "Horizon" project team.

Source: PA Consulting Report: October 1997

3.54 The purchasers responded to the PA Consulting Report with the measures examined in the remainder of this part of the report.

From April 1998 the Department relied on the risk management arrangements of Post Office Counters Ltd for implementing the system with Pathway

3.55 During this period the main risk facing the Department was that the software being developed by Pathway to handle payments for all benefits and in greater volumes might not be sufficiently secure or stable for a live trial. They initially sought to manage this by receiving and responding to regular progress reports from Post Office Counters Ltd.

3.56 When the Post Office took over from the Delivery Authority the lead in managing the contract as recommended by PA Consulting, the Department moved to an arms-length role and drew the management of their side of the Benefits Payment Card project into their expanded CAPS project. Post Office Counter's Horizon Project Manager reported fortnightly to the Department's CAPS Board and attended the Board monthly. The Department was never invited to attend the Post Office Project Board. Links continued at working level between the CAPS and

Horizon Project Management Offices and at joint liaison meetings on implementation and technical issues. The Department actively sought, but did not obtain, an open, shared risk management process from the Post Office Horizon team, who maintained direct reporting arrangements between themselves and Pathway.

3.57 Later in 1998 the Department met Horizon and Pathway and discussed with them the extent of further testing of Pathway's system before the live trial. Lack of agreement on this point meant that the Department refused to authorise the start of the live trial, which had been planned for May 1999. Also at this point, further work still needed to be done on CAPS to test benefit systems “end-to-end”. This remained the position when the Card project was cancelled.

Glossary of terms

BA/POCL project	The complete project including the Benefits Payment Card and the automation of post offices.
Initial-Go-Live	The limited pilot stage which took place in 1996 in ten post offices
Instrument of Payment Fraud	Misuse of order books or girocheques by benefit claimants or other persons for financial gain
Notice of Cure	A legal document issued by a party to a contract giving the other party a period of notice after which the contract may be terminated.
Order Book	Social Security payment instrument, containing tear-off sheets similar to cheques, which claimants present to post offices in exchange for cash.
Post office counter automation	The programme to install in post offices modern computer technology to manage and record a wide range of counter transactions.
The Purchasers	The Department of Social Security and Post Office Counters Ltd
Software Development	The design and writing of new computer programmes.
Software Integration	The linking of existing computer programmes to form a new end-to-end application.

Appendix 1

Scope and methodology of the National Audit Office's examination

Scope of this study

- 1** We examined the conduct of this project to identify:
 - the reasons why the Payment Card project failed to meet its objectives; and
 - whether there are useful lessons that should be learned for other projects; particularly in terms of the approach taken towards the management of risk.

The study focused on the role of the Department of Social Security and of the Benefits Agency in the project. The National Audit Office has no statutory rights of access to Post Office Counters Ltd.

Main aspects of the National Audit Office's methodology

- 2** To carry out the examination we :
 - **Designed the examination** using experience acquired on our several earlier studies of Private Finance Initiative deals for Information Technology services, authoritative publications on best practice in risk management, and recognising the conclusions of the Committee of Public Accounts in their report on Information Technology Projects [HC65 1999-00];
 - **Collected information** about the pre-procurement, procurement and implementation stages of the project, and the government's plans that supplanted it;
 - **Took specialist advice** from Admiral plc, a company experienced in project management and risk management on the standards achieved in the project;
 - **consulted various parties involved in the project;** and

- **evaluated the information** and advice received.

Design of the study

3 The National Audit Office has acquired recent relevant experience on the following Private Finance Initiative deals for Information Technology services:

- The Contract to Develop and Operate the Replacement National Insurance Recording System, (published May 1997);
- The Immigration and Nationality Directorate's Casework Programme (March 1999);
- The Passport Delays of 1999 (October 1999).

These examinations provide an understanding of the issues that government purchasers faced in taking forward ground-breaking private finance deals, contemporaneously with the Benefits Payment Card. Further National Audit Office studies of other such deals are in progress.

4 We also had regard to guidance on Private Finance Information Technology projects that emerged from HM Treasury while we drafted our report.

5 Authoritative publications on best practice in risk management that we consulted included:

- "Management of Risk": Central Computer and Telecommunications Agency (1994);
- "Management of Risk: Case Study 1: Implementing a systematic process for the management of risk across an organisation": Central Computer and Telecommunications Agency (1994);
- "Risk Management: Guidance note": HM Treasury (1994);
- the PRINCE 2 Project Management handbook.

Collection of information

- 6** We collected information from the following main sources:
- the documentation issued to bidders during the project procurement phase;
 - the detailed proposals of the three shortlisted bidders before the award of contract;
 - interviews with members of the joint DSS and Benefits Agency/Post Office procurement team, including officials and advisers, on how they handled the specification of the service and the negotiation of the deal;
 - the legal agreements and schedules underpinning the purchasers' contract with Pathway;
 - the project management documentation of the Joint Benefits Agency/ Post Office Counters Ltd' Delivery Authority during the implementation phase;
 - risk management documentation, particularly risk registers and reports, raised during both the procurement and implementation stages of the project.
 - scrutiny of the reports of successive external reviews of the project and interviews with authors of these reports where we required clarification;
 - a visit to a post office operating the Card payment system prior to its cancellation; and
 - interviews with each of the three short-listed bidders, including Pathway, who also made available to us selected project documentation, demonstrated to us the operation of the system, and shared with us lessons they have learned.
- 7** We also searched the internet, using search engines, for international evidence on Information Technology project outcomes.

Use of specialist advice

8 We engaged after competition Admiral plc, a leading international Information Technology services group with over 2,500 staff. It manages major programmes and provides consultancy advice in the public and private sectors. An experienced Admiral consultant and project manager worked as part of the National Audit Office team, focusing on how the risk management and project management arrangements of the joint procurement team and the programme delivery authority compared to best practice.

9 We also obtained advice on our methodology and on our draft report from David Taylor, President of the Institute of IT Directors in the UK.

Evaluation of information and advice received

10 Our evaluation proceeded whenever possible through corroboration of independent sources; for example our interpretation of the risk registers used by the joint purchasers was cross-referenced to equivalent risk documentation and interview evidence from bidders representatives.

11 As is our standard practice, we circulated copies of the draft report in confidence to the Department and to the bidders identified in the report. We asked for and obtained comments from them, and after a process of clearance, received confirmation from them that the facts contained in the report, their presentation and the conclusions we had reached were fair.

Appendix 2

Agreements to Agree

The contract between the two purchasers and Pathway included 289 agreements to agree later the detail of aspects of the service.

Agreement required from	Statement of the agreement required after contract signature
Department of Social Security	The contractor shall distribute cards by secure methods agreed in advance of their distribution by DSS and the Contractor.
Department of Social Security	The contractor shall ensure that any chosen security verification details or procedures are updated when agreed between the parties without adversely affecting the authorised person's ability to collect authorised payments and without having an adverse impact on the overall time of transaction.
Department of Social Security	The number of DSS staff with access shall be limited and agreed between DSS and the Contractor.
Department of Social Security	It is for DSS's operator of CAPS services and the contractor to agree, subject to DSS approval, the technical nature of the connection.
Department of Social Security	Pathway confirms that the card authentication method will be positive rather than negative, resistant to forgery or other unauthorised manipulation and will include an agreed mechanism for identifying the attempted use of counterfeit or invalid cards
Department of Social Security	Pathway will agree a Service Level Agreement with DSS prior to service commencement.
Joint	Contingency plans to be based on impact and risk assessments and agreed between the contractor and the authorities.
Joint	The contractor shall agree with the authorities the overall business processes at the counter, before roll-out.
Joint	On presentation of a terminated card, the system shall prompt the counter clerk to take action in line with procedures agreed between the contractor and the authorities.
Joint	The contractor shall reconcile card management actions against instructions received from DSS. Details of such reconciliations shall be agreed within three months and shall depend upon the proposed solution.
Joint	The contractor and the authorities shall define and agree training requirements for both BA and Post Office Counters Ltd training. The training services provided shall ensure that 95% of trainees on completion of training shall be able to demonstrate achievement of the agreed level of competence. Pathway has defined its solution for training; this document is with the authorities for discussion and agreement.

continued...

The Cancellation of the Benefits Payment Card project

Agreement required from	Statement of the agreement required after contract signature
Joint	DSS require access to the management information collected as part of the response to the Benefit Payment System management information catalogue requirements. The nature and form of presentation of this information is not as yet defined but is expected to be presented in report formats to be agreed with DSS by a date consistent with the project plan...
Joint	The planned roll-out of the Post Office Counters Ltd Service infrastructure for each post office shall be agreed by the contractor and the authorities.
Joint	The contractor shall produce a testing strategy and plan to be agreed with DSS by a date consistent with the project plan agreed by the parties.
Joint	Customer Education. The specific objectives and activities of the campaign will be agreed as part of the process started on 31 January 1996.
Joint	Audit. To agree means of achieving comprehensive audits of various kinds. The content of the audit trail will be agreed between Pathway and BA/POCL.
Joint	Pathway confirms that cardholder verification methods will be resistant to impersonation and will include an agreed mechanism for identifying the attempted use of a card or temporary token by unauthorised persons.
Joint	[In the event of the customer being indisposed] ... If only a short indisposition is anticipated a temporary agent arrangement will be established, using a procedure to be established in detail with the DSS...
Joint	In as much as the authorities reserve the right to determine the strategy and pace of roll-out, the effect on service levels, public and user acceptance cannot be quantified by Pathway until such time as the strategy has been agreed and evaluated. Pathway reserve the right to reject an implementation strategy which it cannot sustain or which would give rise to unacceptable contractual, operational or financial constraints.
Note:	Due to the scope of this report, this appendix does not list examples of "agreements to agree" involving only Pathway and Post Office Counters Ltd.

Source: National Audit Office review of contract documents

Appendix 3

Chronology of events

Date	Stage
1988	The Monopolies and Mergers Commission recommended that the Post Office should replace its existing mainly annual service agreements with its major clients with longer-term contracts. Such a longer-term contract with the Department of Social Security was eventually signed to support the Benefits Payment Card project.
	<i>Feasibility stage</i>
1993	A joint Department of Social Security/Post Office development group is set up to examine the alternatives to the paper based payment of benefit (through Order Books and Giro) and to report into the feasibility of automating the payment at post offices.
February 1994	The joint development group report recommends that benefit payment should be automated.
1994	The Government's Green Paper on the future of the Post Office states that "automation is the best way of securing a future for the business, its employees and agents."
May 1994	Secretary of State announces to the National Federation of Sub-Postmasters the intention to move towards a new automated system for paying benefit.
	<i>Procurement stage</i>
30th August 1994	Invitation Notice to bidders published - 92 expressions of interest received by 23rd September 1994.
19th October 1994	Request for statement of capability issued to bidders - nine subsequently received. The timetable projects contract award by December 1995.
December 1994	Announcement of the five shortlisted suppliers.
Late 1994 to 6th March 1995	Development of the two purchasers' Statement of Service Requirement
March to April 1995	Five-week delay while Department of Social Security and Post Office Counters Ltd agree a Memorandum of Understanding for proceeding with the project, (13th April).
13th April 1995	Issue of Statement of Service Requirements (SSR) to shortlisted suppliers.
8th June 1995	Five responses received to the Statement of Service Requirement. Pathway consortium became a special purpose vehicle comprising ICL, De La Rue and Girobank.
July 1995	Evaluation board selects the shortlist and negotiations commence with three remaining bidders, Pathway, IBM and Cardlink (Andersens).
June to September	Risk Registers are drawn up and issued to each bidder, and used during later procurement, as each strove to resolve or eliminate the risks of their proposals.

continued...

The Cancellation of the Benefits Payment Card project

Date	Stage
October 1995	Secretary of State publicly states that the Benefits Payment Card will be introduced in 1996.
November 1995	The procurement team postponed detailed negotiation with bidders on requirements and solutions until after selection of the contractor. Negotiations focused on contract clauses and schedules.
29 February 1996	Invitations To Tender issued to three bidders. Bids received, on 21 March, were all priced above the level acceptable to the purchasers and only one bid was compliant in terms of risk acceptance.
16th April 1996	Invitations To Retender issued to all three bidders in order to obtain affordable and compliant bids. The tenders were received on 22nd April.
29th April 1996	Project Evaluation Board accepted that to proceed with Pathway implied a degree of risk but agreed that such risks were acceptable and manageable.
15th May 1996	Pathway are awarded the contract on basis that operational trial is to be completed by June 1997 and roll-out to be completed by 1999. Secretary of State for Social Security announces award at National Federation of Sub-Postmasters conference.
	<i>Implementation stage</i>
September 1996	Initial "Go-Live" system achieved on time for 10 post offices in Stroud, Gloucester for the payment of Child Benefit only, and the first payment to Pathway for handling a transaction is made.
February 1997	Major replan of the project on a "no-fault" basis. Both the purchasers and Pathway had missed the dates required to meet the initial contract date for completion of the operational trial.
July 1997	Senior Social Security officials propose an independent review of the project including Pathway, the Department of Social Security and Post Office Counters Ltd.
September 1997	DSS Ministers bring slippage to the attention of Treasury and Trade & Industry colleagues. PA Consulting employed to carry out a three party review of the project
November 1997	The Benefits Payment Card system is extended to a further 205 post offices in the north-east and south-west of England, but still only to pay Child Benefit.
21st November 1997	Contractual deadline for the completion of the operational live trial is missed, and the purchasers allege that Pathway is in breach of contract. Pathway denies liability.
December 1997	Pathway inform the purchasers that they require improved terms if the project is to be completed. Development of the Card system continues in the meantime.
1998	Ministers commission an inter-departmental working group to review the project - to include a review by an Independent Panel of experts chaired by the Chief Executive of the Treasury Task Force on Private Finance.
April 1998	Majority of the functions of joint BA/Post Office Counters Ltd project team transferred to the two sponsor bodies. Joint team retains contract management role.
May 1998	The Department of Social Security issue a "notice of cure" to Pathway to protect their negotiating position.

continued...

The Cancellation of the Benefits Payment Card project

Date	Stage
July 1998	Interdepartmental working group report to Ministers states that the project is feasible but dependent on successful renegotiation with ICL based mainly on extension of contract period.
September 1998	Ministers authorise Mr Graham Corbett to facilitate discussions between the purchasers and ICL, while officials prepare a fall-back position if talks are unsuccessful. Department of Trade and Industry request strengthening of Post Office Counters Ltd' management of the project.
October 1998	Mr Corbett informs ministers that discussions with ICL have proven unsuccessful.
October - November 1998	Discussions between ICL and Post Office Counters Ltd.
1999 January-May 1999	Negotiations proceed to agree terms on which the Benefits Payment Card may be removed from the project.
24 May 1999	Announcement of agreement that Department of Social Security's contract has been terminated and that Post Office Counters Ltd and Pathway have agreed in principle to set up a new conventional (non-PFI) contract to continue the project to automate the national network of post offices.
July 1999	Post Office Counters Ltd and Pathway signed an agreement to automate post offices
Position as at June 2000	Department of Social Security and Post Office Counters Ltd have signed an agreement to extend the use of the order book control system to reduce order book fraud as post office automation is rolled out. Post Office Counters Ltd have accepted the automated system, national roll-out has started and implemented in 5,000 post offices.

Appendix 4

Key Conclusions and Recommendations by the Committee of Public Accounts, “IMPROVING THE DELIVERY OF GOVERNMENT IT PROJECTS” January 2000³

- Decisions about IT are crucial to the development and success of the business of public bodies, and cannot be treated in isolation from other aspects of their work. Failure to deliver an IT system can have a profound effect on an organisation's ability to provide services to its customers. Key decisions on IT systems are, therefore, business decisions, not technical ones, and should involve senior management. And the commitment of senior management can be a critical factor in securing a successful outcome.
- Projects are conceived and grow from identified business needs. However, what seems a clear objective at the beginning can easily become blurred and confused as events progress. The end users must be identified before the project commences so that their needs are taken into account fully during design and development.
- The scale and complexity of projects is a major influence on whether they succeed or fail. Departments should consider carefully whether projects are too ambitious to undertake in one go. This consideration is particularly important if a project connects with the business operations of other parties, or depends on the development of IT undertaken by other parties.
- The management and oversight of IT projects by skilled project managers is essential for ensuring that projects are delivered to time and budget. But the successful implementation of IT systems calls for imagination and well-conceived risk management, as well as sound project management methodologies.

3 Committee of Public Accounts - First Report 1999-00

- The increasing use of complex external contracts for the delivery of major public sector IT projects and the supply of strategic IT services has highlighted the need for a high degree of professionalism in the definition, negotiation and management of IT contracts. It is essential that public sector bodies get the right contracts in place. With large sums of public money at stake, any lack of clarity, or debatable interpretation in a contract can lead to expensive misunderstandings that might have to be resolved in the courts.
- The implementation of an IT system is not an end in itself. It is important that sufficient attention is paid to ensuring that staff know how to make full and proper use of it. Without this it is unlikely that the anticipated business benefits will be realised. Training of staff can take up considerable resources, often a significant proportion of the overall cost of the project. Training must address the needs of users, and of those operating and maintaining the system.
- As well as wasting enormous sums of public money, failures in IT can have disabling impacts on public services and on citizens. These have included the failure to pay social security benefits to vulnerable people and major delays in issuing people their passports. In addition to planning and managing projects positively, Departments should therefore have contingency plans in place to maintain adequate levels of service in the event of project failures.
- It is essential that organisations learn lesson from the projects undertaken. A post-implementation review is designed to establish the extent to which they have secured the business benefits anticipated. The review may encompass whether the project has met its business objectives, user expectations and technical requirements.

Appendix 5

The Action Plan for Departments and Suppliers arising from the Cabinet Office Review of Major Government IT Projects, May 2000

The report was produced by a review team comprising public and private sector members, which reported to a steering group also drawn from government departments and major private sector IT users and chaired by Mr Ian McCartney, Minister of State at the Cabinet Office.

Whilst these action points have relevance for all projects, the National Audit Office consider that **those in bold** have particular relevance to the Benefits Payment Card project, and could have improved its chances of success.

Actions for Departments

Ensure that a single Senior Responsible Owner is appointed for all projects, including those that cut across more than one department or agency, and that personal objectives set for these individuals include the responsibilities of this role.

In all dealings with suppliers, both on new and existing projects ensure that activities aimed at co-operation and open communication are encouraged.

Nominate a contact point for contributions to the database of lessons learned and notify the Office of Government Commerce of all current and pending projects in order to benefit from lessons learnt and to contribute to the ongoing database.

Ensure that pre-contract review of supplier's plans is carried out for all major IT projects and that review continues through the life of the project. Ensure that own plans are in order as well.

Ensure that periodic reviews are carried out during the life of a project to monitor and capture the realisation of benefits.

Ensure that a post implementation review is carried out for all projects.

Adopt a formal project management approach, such as PRINCE2, for all new projects.

Provide audit of skills as part of the Modernising Government action plan based on IS Skills framework.

Ensure that all major projects have a business case for business change, in line with the guidelines, and that this business case is monitored and updated throughout the life of the project.

Ensure that all projects follow the risk evaluation and reporting guidelines.

Liaise with the Office of Government Commerce and use the Project Profile Model to determine the complexity of new projects, to determine the required level of project management experience and conduct Peer Reviews of all new projects following guidelines supplied and feeding information back to the central review database.

Conduct a review of training provided to Project managers and ensure that all Project Managers have the appropriate training in accordance with guidelines published by the Office of Government Commerce.

Ensure that all projects follow the revised procurement guidelines.

Ensure that all projects follow a modular approach unless for overwhelming and documented reasons.

Undertake on-going assessment and improvement of Information Systems skills.

Actions for Suppliers

Suppliers should work with departments and agencies to ensure their proposed solutions meet business needs not just technical or operational requirements.

Produce realistic plans, including financial, technical, personnel and communication plans, through the lifecycle of the procurement to ensure continuing alignment of supplier activity with business need.

Share information about problems at the earliest opportunity to ensure small issues do not escalate.

Agree processes at the start of the procurement that will actively encourage co-operation and an open dialogue between supplier and client.

Whilst Government ultimately has responsibility for the assessment and acceptance of bids, suppliers must ensure that they fully understand the requirements, that bids are realistically priced and the timescales proposed are achievable.

Appendix 6

The availability of the Department's CAPS system to integrate with Pathway's Payment Card system

Pathway contend that one reason why the development of their Payment Card system encountered difficulties is that the Department's CAPS system was not designed in time to provide stable interfaces with the Payment Card. They contend that they had been led to believe that CAPS would be available in its entirety by September 1996. There is no dispute that the complete version of CAPS was not available by then. The relevant clause in the contract was as follows.





Schedule B07 Clause 2.5

"The dates in the contractual milestones table are conditional on CAPS releases and functionality being available to the contractor as set out in the table below this paragraph, and shall be delayed by an amount equal to any delay of such availability:"

Available for technical testing	1 June 1996
Available for full integration testing	1 September 1996

The Department contend that this interpretation is unrealistic in terms of the way the development programme actually operated, and is based on the contract when it was signed in May 1996, and not as it was modified in the light of the "no-fault" agreed replan in February 1997. They also contend that Pathway did not have a complete system to test by September 1996 in any case, and that CAPS releases did not slip behind equivalent releases of Payment Card software by Pathway after February 1997.

Appendix 7

The re-emergence of cleared risks in the purchasers' registers										
Risk Number	Risk Description	Procurement Stage				Implementation Stage				
		Sept 1995 Purchasers' Risk Assessment of Pathway's Proposal		Sept 1995 Pathway's own Risk Register		March 1996 Purchasers' assessment of Pathway tender	April 1997 assessment by purchasers' delivery team		April 1998 review by purchasers' delivery team	
Key:  Very high  High  Medium  Low										
		Probability	Impact	Probability	Impact	Risk Status	Probability	Impact	Probability	Impact
1	Pathway's solution is dependent on sole source third party software (from Escher Riposte)					Outstanding				
2	Supplier does not fully understand POCL Accounting Requirements, leading to software risks					Cleared				
3	Design deficiencies in the supplier's system architecture					Outstanding				
4	Post Office and Department security requirements not fully addressed by supplier's system design					Cleared				
5	POCL requirements for simple (rural) post offices not fully addressed by supplier's system design		N/A			Cleared				
6	Proposed solution dependent on bespoke software development					Cleared				
7	Requirements for payment to permanent agents and proxies are not addressed by supplier's design					Cleared				
8	Automated transactions will take longer and be less reliable than current manual process					Cleared				
9	Inadequate planning/plan not acceptable/plan out of date					Cleared				
10	Supplier is proposing inadequate testing					Cleared				
11	Pathway's lack of a track record					Outstanding				
12	Inadequately specified requirements and system interfaces between Pathway's and the purchasers' systems.					Outstanding				
13	Availability of the Department's CAPS and benefit systems for testing the Pathway solution.					Outstanding				
14	Pathway design does not map onto the BA/POCL requirements					Outstanding				
15	Inadequate project management methods, planning and risk management					Not identified				

Source: Analysis by Admiral plc, for the National Audit Office, of project documentation.