

Report of the Post Office Working Group

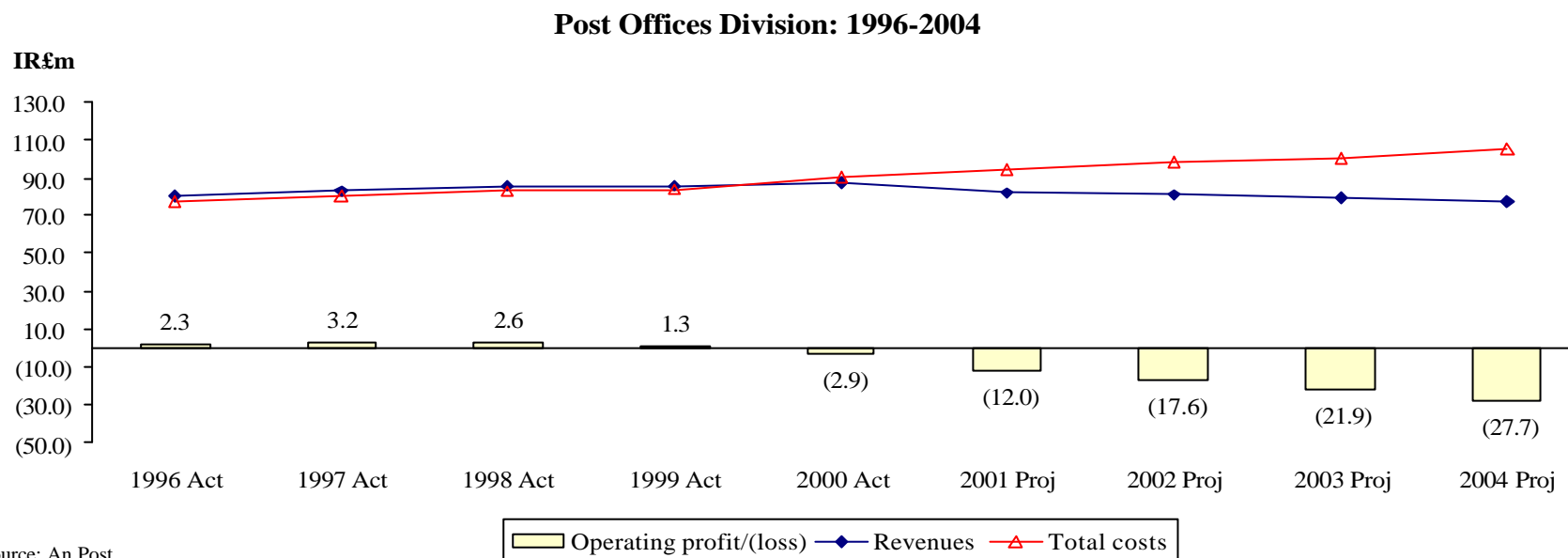
Appendices
23 July 2001

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Appendix I - Analysis of Historic Revenues

Significant losses are projected by An Post



- A comparison of the recent trading performance of the Post Offices division with An Post’s projections for the years 2001 to 2004 is set out above.
- The division was marginally profitable up to 2000, when a small loss of £2.9m was recorded. However, this was considerably less than the budgeted loss of almost £9m.
- Significant losses are projected by An Post from 2001 onwards due to the impact of:
 - A rising cost base. The division has an annual payroll of £54.5m (plus pension cost £4.2m). Increases in wages and agency costs account for £16.2m of the increase in losses projected by 2004;
 - Static to falling revenue streams: 78% of revenue is derived from three Government related contracts (DSCFA, NTMA and RTE), the medium to long term outlook of which are uncertain. In addition price pressures are being experienced on the DSCFA and TV licence contracts.
- 50% of the workforce (based on An Post estimates) are former civil servants who have certain statutory rights entitling them to the same rights and benefits in operation prior to the establishment of An Post as a semi-State company in 1983.

YTD 2001 out-turn and comparison to plan

- The Post Office division recorded a loss of £4.1m in the first four months to 30 April 2001.
- The favourable variance in the four months to 30 April 2001 mainly relates to the timing of software licencing income (£0.3m) and cost savings due to delays in the roll-out of the post shops (£0.2m). Thus non-network reasons account for the favourable performance.
- This was slightly less than budgeted (£4.8m) although it compares very unfavourably with the corresponding performance for 2000, when the division almost broke even.
- The rising payroll related costs is the single most significant contribution to the poor 2001 performance (£2m higher than 2000). Revenues are only marginally down on 2000 levels with the balance of the losses caused by higher overhead costs and the Euro project.
- While An Post consider it to be too early in the year to consider the expected out-turn for 2001, it would appear to be extremely likely that the delivered performance will be a material loss.

Post Office Result (4 months to 30 April)

Figures in IR£m	2001		2000
	Actual	Budget	Actual
Revenue			
Outpayment (mainly DSFCA)	11.6	11.6	11.6
Inpayment/Billpay*	2.5	2.6	2.5
Banking/investment	7.9	7.7	7.5
Licencing services	2.5	2.5	2.4
Money transmission	1.1	1.0	1.0
Agency services	0.2	0.2	0.4
Retail services	1.1	1.1	0.9
Software licencing	0.7	0.4	1.9
Total third party income	27.6	27.1	28.2
Interest income	0.7	0.7	0.5
Interservice income	0.1	0.1	0.2
Total sales	28.4	27.9	28.9
Costs			
Payroll	(19.0)	(19.0)	(17.0)
Pension	(1.5)	(1.5)	(1.5)
Non-pay costs	(11.4)	(11.6)	(10.0)
Inter-service costs	(0.6)	(0.6)	(0.6)
Profit/(Loss)	(4.1)	(4.8)	(0.2)

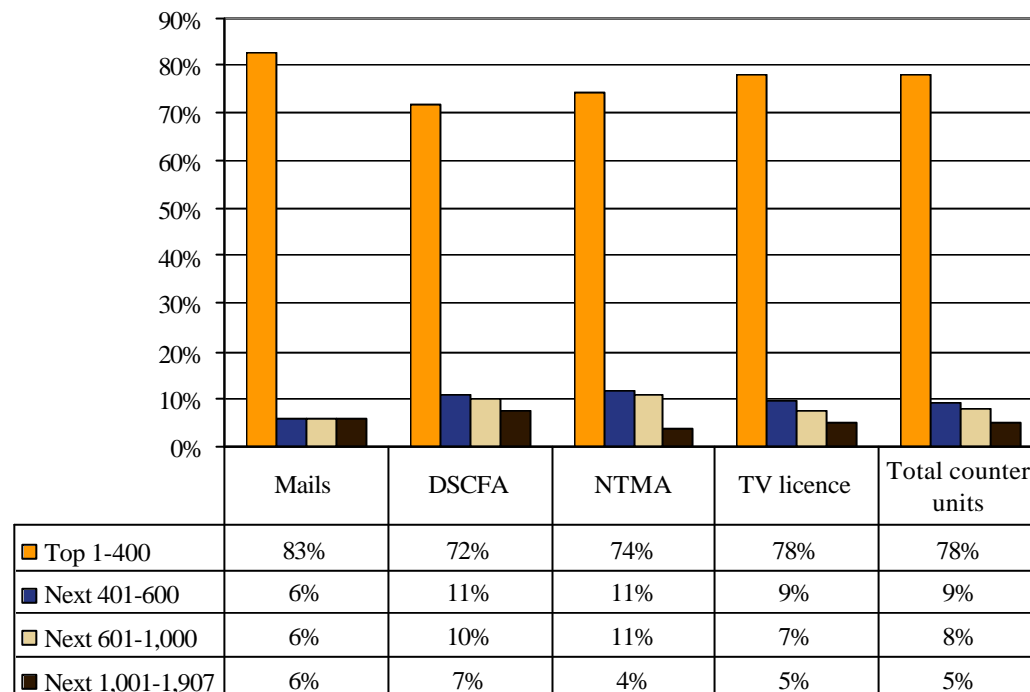
*Inpayment includes £0.4m in New Business

Source: An Post Management Accounts

Existing transactions are heavily concentrated in a relatively small number of Post Offices

- The volume of business in An Post is measured by the time required to perform individual transactions. These are aggregated to a common measure - counter units. These counter units form the basis for scale payments to postmasters (on a regressive basis, subject to agreed minimum payments).
- As the table opposite demonstrates, 78% of total counter units budgeted for the Post Office network in 2000 related to the top 400 offices. This is broadly consistent with the split of activity levels across the three main contracts in place with the DSCFA, NTMA and RTE.
- The top 400 offices represent 21% of the total network, but account for 938 (61%) of 1,541 automated positions.
- The Post Offices division provides (“mail”) services to the Letter Post and SDS divisions, which are recharged on a cost-recovery basis. These include postage stamp sales, acceptance of postal packets, provision of high value mail services (registered mail, SwiftPost etc) and delivery co-ordination at 500 rural post offices.
- This recharging only takes place on a cost-recovery basis (Post Offices do not charge a margin). As An Post calculates its costs on an absorption costing basis, the cost recharged for services provided by the Post Offices division will therefore include an element of any spare capacity.
- These recharges amounted to approximately £22m in 2000. These are not reflected in the Business Unit Accounts, with revenues and costs shown net of mail recharges.

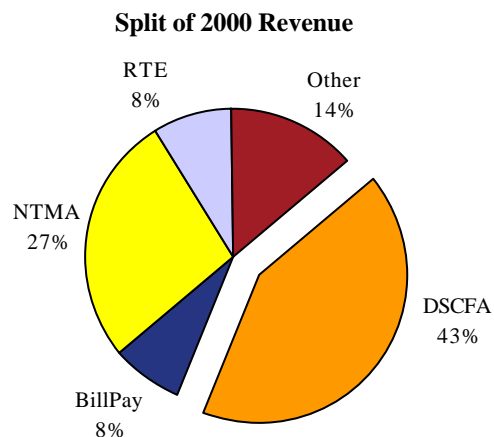
Analysis of Counter Business (by office size)



Source: An Post

The Post Offices division is currently critically dependent on 3 key customers; the medium term outlook of each of these contracts is uncertain

- The Post Offices division is dependent on three key customers for 78% of its revenues; the DSCFA (social welfare “out payments”), the NTMA (savings services) and RTE (licence fee collection).
- **These customers are held under short term contracts, all of which are either currently or shortly up for renewal.**
- The status of these major financial contracts and likely out-turn over the medium term (3 - 5 years) is described in the following slides.



Post Office Revenue

Figures in IR£m	2000	1999	1998	1997
Outpayment (mainly DSFCA)	36.2	36.5	37.1	37.3
Inpayment/Billpay	6.5	6.1	5.9	5.4
Banking/investment	23.4	23.1	22.1	20.1
New services	0.5	0.2	-	-
Licencing services	7.4	7.6	7.6	7.9
Money transmission	3.1	3.1	3.0	2.9
Agency services	1.1	1.5	1.6	1.7
Retail services	3.2	2.6	1.7	1.4
Software licencing	3.8	2.3	3.4	2.7
Total third party income	85.2	83.0	82.4	79.4
Annual change	2.7%	0.7%	3.8%	2.7%

Source: An Post

Impact of losing certain key contracts

- As is demonstrated opposite, the counters business is critically dependent on the DSCFA (social welfare) business. Higher elements of RTE licencing (activities such as inspection and database maintenance) and NTMA (excluding Savings Bank) income is non-network dependent.
- In 1999, the Government decided to extend the contract with An Post to cover the period 2000 to the end of 2002. This decision is the subject of two complaints to the EU Commission. **As a consequence of the EU decision, should An Post ultimately fail to secure the renewal of the DSCFA contract, it would be difficult to eliminate the related costs in the short to medium term.** Some savings would be made in the next triennial negotiation of the scale payment fees to Postmasters, although this would require acceptance by the Irish Postmasters' Union ("IPU") - the same would apply should either of the contracts with RTE or the NTMA be lost.
- The TV Licence Collection function employs approximately 84 staff. An Post would hope to re-deploy these staff in the short term (through natural wastage) if the contract with RTE were lost. In addition savings would be made in certain direct costs (stationery and postage for reminders etc).
- NTMA services are supported by approximately 200 Headquarters (operational) staff. An Post do not feel it would be as easy to re-deploy these staff in the event of the NTMA contract expiring, given the grades involved and the overall numbers, relative to the total Headquarters staff.
- However it is important to recognise that the loss of any of these key contracts, particularly the DSCFA contract, could have implications on other income streams.** For example, customers in receipt of certain social welfare payments (such as children's allowance) at the counters are likely to also avail of other Post Office services, such as the Savings Bank. However such inter-dependencies are not readily quantifiable.

Revenue Split (by Key Contract)

Figures in IR€m	2000 Budget			1999 Actual
	Non-network	Network	Total	
RTE licence	4.8	3.2	8.0	7.4
DSFCA outpayments	1.1	34.0	35.1	36.3
NTMA				
Savings Bank	1.9	11.4	13.3	13.6
Other savings	4.8	3.2	8.0	8.5
Total sales	12.6	51.8	64.4	65.8
RTE licence	60.0%	40.0%	100.0%	
DSFCA outpayments	3.1%	96.9%	100.0%	
NTMA				
Savings Bank	14.3%	85.7%	100.0%	
Other savings	60.0%	40.0%	100.0%	

Source: Post Offices Division - Network Profitability report; 1999 Business Unit accounts

- A detailed breakdown of actual revenue for 2000 by activity (network/non-network) is not yet available (this forms part of the network profitability report, which appears to be prepared very much on an ad-hoc basis).

Out payment services: DSCFA contract threatened by falling volumes, electronic substitution and a legal challenge

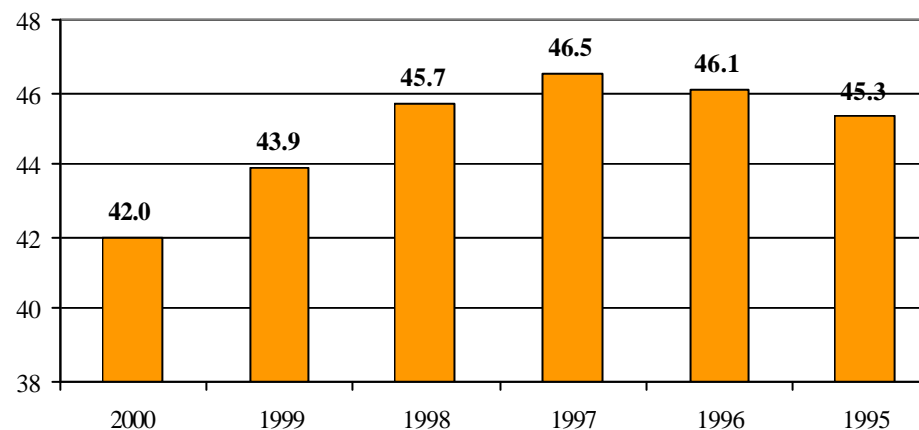
- The Department of Social, Community and Family Affairs (“DSCFA”) represents the most significant single source of revenue to the Post Offices division, accounting directly for 43% (£36.0m) of total third party revenues in 2000.
- The Post Office network currently (April 2001) handles 71% of welfare recipients. The remainder paid by electronic funds transfer (EFT: 19%) and cheque (10%).
- Due to the strong Irish economy, volumes of DSCFA transactions have been falling by approximately 4% per annum in recent years (due mainly to lower unemployment levels).
- The migration of benefit recipients to EFT accounts for the decreasing post office volumes to a lesser extent.
- In addition the rates charged have not changed since 1999. With decreasing volumes and unchanged fees, revenue has declined. A 3% increase in rates would benefit revenues by approximately £1m per annum. Given the ongoing EU Commission investigations into the complaints made, the DSCFA has been advised that any new price structure for the years 1999 – 2002 could breach the undertaking which has been given to the Commission that Ireland will not take any action which could prejudice the Community interest until such time as the complaints being examined are resolved. An Post is aware of this position and has agreed to continue providing services.
- In 1999 the Government decided to extend the contract with An Post up to the end of 2002. However this decision was challenged by a third party and is currently being reviewed by the European Commission, on procurement and competition grounds. The outcome of this action, which remains unknown, could threaten the retention of this contract by An Post.

Out Payment Services

Figures in IR£m

	2000 Draft	1999 Actual	1998 Actual	1997 Actual
DSCFA (social welfare)	36.0	36.3	36.9	37.2
Household budget fees	0.2	0.2	0.2	0.1
	36.2	36.5	37.1	37.3
Annual change	-0.8%	-1.6%	-0.5%	-1.3%

Welfare Transactions (millions)



Source: An Post

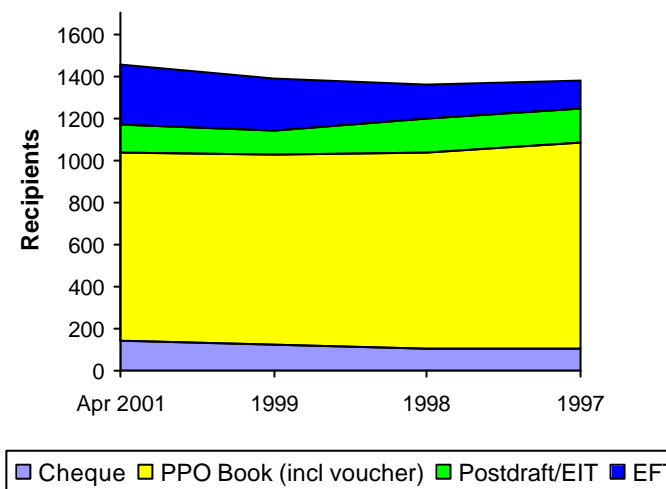
DSCFA income is under threat in the medium term due to increasing EFT substitution; this is partly explained by the mix of recipients

- The table opposite shows the relative growth in the choice of EFT as a means of paying benefits in terms of the number of benefits recipients. In trying to conclude from the trend the following should be noted:
 - Numbers of recipients of unemployment benefit/assistance decreased 45% from December 1997 to April 2001 as a result of the strong Irish economy. EFT penetration in the unemployment benefit/assistance area is low but increasing (11.2% of recipients: April 2001).
 - Population trends have resulted in children’s benefit and old age pension recipients increasing slightly. These categories of benefit have a high proportion of EFT recipients (25.3% and 17.4% April 2001 respectively).
 - Thus the relative growth in EFT is made greater by the change in the mix of recipients and not just due to overall recipient preference.

Trend in UK

- High levels of UK recipients of retirement benefit (39%: 1999) and child benefit (55%: 1999) use EFT, and the trend has been upward for the last few years (*Source: PIU Counter Revolution, 2000*).
- In the UK one third of all benefits are paid over the Post Office counter (*Source: PIU Counter Revolution, 2000*). Thus, cheques and EFT account for two-thirds of payments. Only 29% of recipients in Ireland opt for cheque and EFT.

Social Welfare Recipients By Payment Type



Source: Department of Social Community and Family Affairs

Out payment services: DSCFA revenues threatened by EFT

Threats

- Given the recent advances in money transmission technology and its potential opportunities the DSCFA as a matter of customer service and cost reduction favours the introduction of card-based electronic payment delivery services.
- This would involve giving each recipient a welfare account with smart card access to banking systems, point of sale and ATMs. This would be operated by the Banks, a third party or through a Universal Bank. The DSCFA gives the following benefits of such payment methods:
 - Less cost to the Exchequer: EFT currently costs the DSCFA considerably less than 10p per transaction. In 1999 the average cost per transaction through Post Offices was 83p based on the sliding scale;
 - Greater customer service: recipients will have greater flexibility and means of access to their funds;
 - Recipient dignity and social inclusion: recipients can pay for goods using welfare card.
- However there are obviously other costs associated in establishing an alternative payments structure.

Banking/investment services: POSB has limited opportunities for revenue increases in its current structure.

- Approximately 2.4m accounts are handled by An Post, of which 0.6m are considered active. Individually, balances are quite small, averaging at £172, with 90% of balances under £300.
- The POSB is restricted in its operation:
 - No banking licence;
 - Account fees prohibited;
 - Loans prohibited;
 - Interest rates set by NTMA;
 - No minimum deposit levels;
 - Limited number of savings products offered by NTMA;
 - Impact of the new SSIA is expected to be limited;
 - Little appetite in the NTMA for funds from this source.
- This compares to other countries (such as Sweden) where a full range of services are offered with the banking business operating on a stand alone basis.
- An Post have estimated the level of dormancy in their accounts based on the following profile (total fund December 1999: £4.14bn):
 - Inactive 15 years: £35m
- This translates to a possible loss of revenue of £0.3m as a result of the potential fund decrease, based on An Post estimates - depending on the profile.

Banking/Investment Services				
Figures in IR£m	2000	1999	1998	1997
	Actual	Actual	Actual	Actual
POSB management fee	14.3	13.6	12.9	12.3
Other saving services	8.1	8.6	8.5	7.2
Prize bonds	0.9	0.7	0.5	0.4
Bureau de change	0.3	0.2	0.2	0.1
	23.6	23.1	22.1	20.0
Annual change	+2.2%	+4.5%	+10.5%	+3.4%

Source: An Post Management Accounts

Licencing services

TV licences

- Currently An Post provides two main services to RTE: retailing of licences and inspection/detection (the latter includes administration and database maintenance). It is possible these services could be performed separately. In addition RTE are putting pressure on An Post for a fee reduction.
- The function is headed up by TV Licence Administration, based at the GPO in Dublin. In addition, some Company office staff time is spent updating the database (an overall total of 78 staff).
- A one year contract was agreed for 2001 following the completion of the 1998-2000 contract. The threat of RTE putting the contract out to tender remains.
- The basic fee has declined slightly, however targets have increased resulting in static revenue and decreased margins.
- Services provided to RTE on behalf of Department of the Arts, Heritage, the Gaeltacht and the Islands include database management, licence sales (through the Post Office network), non-payment detection and investigation and prosecution. This service is exclusive to An Post.
- An Post have indicated that the Post Offices division has consistently reached or exceeded its targets in recent years.
- Licence sales have grown slowly but steadily over the period 1996 to 1999, at an average annual rate of 2.1%. Given the nature of the product (there is essentially a finite level of transactions), the growth potential appears limited.

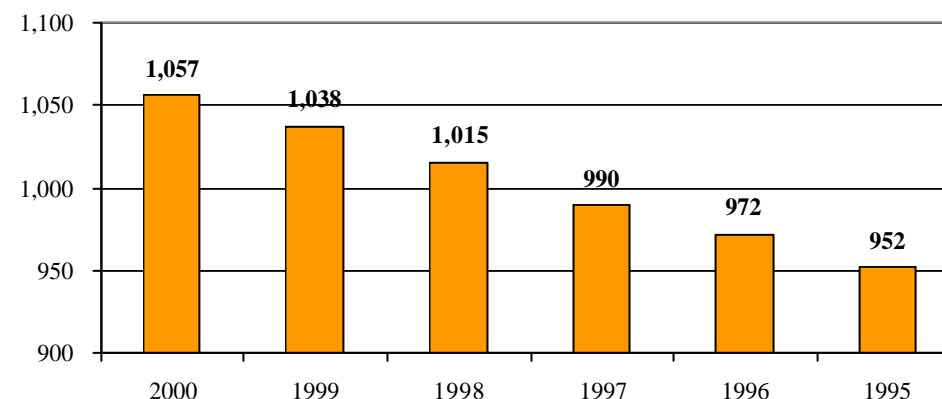
Licencing Services

Figures in IR£m

	2000 Draft	1999 Actual	1998 Actual	1997 Actual
TV licences	7.2	7.4	7.4	7.7
Dog licences	0.2	0.2	0.2	0.2
	7.4	7.6	7.6	7.9
Annual change	-2.6%	+0.0%	-3.8%	+2.6%

Source: An Post Management Accounts

TV Licence Sales (No's in '000)



Source: An Post

Licencing services (cont'd)

TV licences (cont'd)

- The size and spread of the Post Office network offers An Post a distinct competitive advantage in the area of licence fee collection at present, although it is likely that the service could be replicated to a large degree by the leading retail banks and other similar, outlet-oriented entities.
- However in the medium to long-term the provision of this service faces considerable threat from the advent of Digital TV services, which is likely to allow broadcasters direct access to viewing information for subscribers.
- Other weaknesses in the current system are:
 - Licence fee increases must be authorised by the Government. Only one increase has been granted in the last 10 years. The erosion of the relative value of the income stream to RTE has resulted in increased cost-consciousness, translating into pressures on the fees paid to An Post.
 - An Post is not allowed to cross-sell other services to its TV licence database.
- In June 2000, RTE announced that they were seeking a substantial increase in the price of a licence. This is in the process of being finalised.
 - An increased licence fee may relieve price pressure on An Post. However, considerable losses in RTE (£16.6m: 1999) in recent years may mean that price pressure will continue.

Other

- The structure of the Post Office network, along with the increasing automation of the counters network, makes it suitable for many forms of licence fee collection.
- However, excluding TV licencing, the provision of such services is currently limited, with only approximately £0.2m per annum generated through dog licence sales.
- One potential area of growth which has not materialised in recent years, despite being targeted by An Post, is the collection of motor tax.
 - An Post consider the possibility of getting the Motor Tax business as remote. An Post estimate that (assuming 60% on average of payment market share for Vehicle Licencing, Parking Fine Collection and Driving Licence Issuance) revenue of £3.6m per annum could be achieved.

In payment services are characterised by rising volumes and decreasing prices

Inpayment update – ESB contract

- The ESB contract is currently out to tender. An Post have made an application and are awaiting the outcome in July 2001.
- An Post estimate that revenue of £1.75 million could be obtained on 4.3m transactions if the contract for receiving ESB bills at Post Office counters was obtained.
- Margins on transactions business is estimated at 5p per transaction based on the existing network size and cost structures. Thus, a contribution of £215,000 is possible.

Eircom Contract

- The Eircom contract rate has remained static at 48p per transaction since July 2000. According to An Post transactions have increased and revenue has remained static.

Internet Bill Payments

- Billpay.ie is the internet bill payment and presentment service available from An Post. Although a non-network activity, it is owned by the Post Office division. Revenue (£0.1m) is included under New Services. Income is projected to increase to £3.5m by 2004. The potential exists for Billpay.ie to expand it's customer base through co-operation with the main banks.

In Payment Services

Figures in IR£m

	2000 Actual	1999 Actual	1998 Actual	1997 Actual
BillPay	<u>6.5</u>	<u>6.1</u>	<u>5.9</u>	<u>5.4</u>
Annual change	+6.6%	+3.4%	+9.3%	+8.0%

Source: An Post Management Accounts

Deal with Banks

- In April 2001, AIB and BOI agreed to transfer their counter bill payments business to An Post. An estimated 5-6 million bills will be paid over post office counters following a three month phased introduction. Margins are expected between £0.2m-0.3m.
- The main banks have also entered into a joint venture with An Post to establish a national postal bill payment centre in Kilrush, Co. Clare. Although Post Office division was involved in developing the business, An Posts involvement in this venture is likely to be through a subsidiary.
- An Post already had revenue of £0.2m from postal bill payments (Billpost) in 2000 included under New Services.

Appendix II - Analysis of Historic Costs

Costs: Analysed by Sub Post Office, Company Offices and Central/HO

Post Office Costs

- We were unable to obtain an analysis of non-pay costs between Company Offices and HO/Central for YE2000. Set out opposite is an analysis of pay and non pay costs based on the 2000 budget figures. An Post state that these proportions are relevant for the actual figures in 2000. This includes the cost of mails-related work.
- An Post estimate that the entire full time equivalent staff numbers 1,270 approximately. This is made up of 40 Head Office staff, 280 Central Operations and 950 Dublin and Provinces. In 1999, 1,816 people were employed as postmasters.
 - Central Operations staff (280) are involved in TV licence administration (80) and NTMA administration (200).

Figures in IR£m

	Budget 2000			
	Company	SPO	General	Total
Pay costs				
Operations pay	19.5	3.6	3.2	26.3
Head Office	3.5	4.4	3.9	11.8
Scale payments	-	32.3	0.2	32.5
Pensions/accruals	2.6	2.6	1.3	6.5
	25.6	42.9	8.6	77.1
	33%	56%	11%	100%
Non pay costs				
Accommodation	1.8	0.5	0.5	2.8
Security	0.3	0.6	0.0	0.9
Computer	0.9	1.7	0.7	3.3
Counter automation	2.3	6.3	0.0	8.6
Operational	0.6	0.4	5.7	6.7
Administration	2.3	1.9	0.0	4.2
Marketing	0.6	1.3	0.1	2.0
Finance	0.4	0.7	0.0	1.1
Use of mails	0.3	2.9	2.5	5.7
	9.5	16.3	9.5	35.3
	27%	46%	27%	100%
Total costs	35.1	59.2	18.1	112.4
	31%	53%	16%	100%

Source: An Post network Profitability Report

Payroll costs: Post Office has limited scope to reduce payroll costs

- The Post Office division is limited in its scope to reduce payroll costs as follows:

Scale Payments

- The scale payments system is regressive in nature with a guaranteed minimum payment (£4,500). With fixed network of over 1,900 offices and 1,800 postmasters receiving scale payments the Post Office division is faced with a mainly fixed wage cost.

Former civil servants

- 50% of employees (based on An Post estimates) are former civil servants, who have certain statutory rights entitling them to the same rights and benefits in operation prior to the establishment of An Post as a semi-State company. Significant costs may be incurred in a redundancy, redeployment or rationalisation situation.
 - An Post state there are approximately 100 surplus staff. Although problems exist in transferring staff to address shortages in some of the larger Dublin Company Offices.
 - Note: Postmasters are contractors and do not have such statutory rights.

Programme for Prosperity and Fairness (PPF)

- Both company staff and postmasters payments are bound by the terms of the PPF:
 - Company office pay and Head Office pay are budgeted to increase 25% and 20% from 2000 to 2004 as a result of the national pay agreements.

- Scale payments are budgeted to increase 34% (£7.2m impact) in the same period on the basis of PPF terms and as a result of regular reviews. Individual scale payment reviews take place every three years. Thus reductions in payments where transactions decline do not have immediate effect. This is exclusive of any additional payments arising from the Flynn Report (estimated by An Post £3-5m p.a.)

Flexible working

- In recent pay negotiations, the Irish Postmasters Union (IPU) agreed to 26 postal agencies. Agencies would provide limited transactions based on a new fee arrangement with less back-office and accounting work.
- The implementation of flexible working arrangements in company offices and Head Office could reduce costs in the short term.
 - An Post estimate that £1m could be saved annually if College House was closed and staff were relocated to the GPO.
 - Rationalisation of company offices is budgeted to save up to £2.0m by 2004.

Staggering DSCFA business

- The DSCFA outpayments business has been allocated throughout the week to assist Post Office business processes. This has been the case for some time. An Post state that no significant savings can be made through changing the arrangement.
 - In the UK, it has been proposed that post offices open on alternate days in rural areas.

Post Office Network size 1995-2000

- In overall terms the number of post offices has decreased since 1995. Approximately 50% of sub post offices are part of a shop (Source: Foley and McKeown, 1991).
- A number of post offices are closed due lack of applications for the position. An Post estimate that 100 sub post offices are temporarily closed as a result of postmaster retirements and insufficient take up of vacancies.
- The post office has a nationwide network, including 1,000 automated offices, with an average of one outlet per 1,900 people (Source: Flynn Report). However, 78% of transactions are performed in the top 400 offices. According to An Post, 50% of the network accounts for 96% of network revenue. An Post predict losses of £19.0m by 2004 were 907 offices closed.
- The post office has a well established social role (Source: Foley and McKeown 1991). The socio-economic role of the sub-post office has undergone fundamental change in the past five decades as a result of higher levels of personal mobility/ car ownership, and the advent and wide-spread adoption of new communication technologies.
 - The former has enhanced the accessibility of urban centres and impacted negatively on levels of retail activity in rural areas, while the latter has reduced reliance on the post office network for national and international communications.
- In 1999, 82% of post offices were in rural areas compared with a (1996) population share of 42%. Alternatively stated, there are an average 1,000 people per post office in rural areas compared with an average 5,700 people per post office in urban areas.

Post Office Network Size

	Number of Offices					
	2000	1999	1998	1997	1996	1995
Company offices	97	97	97	96	96	96
Sub Post offices	1,817	1,816	1,814	1,818	1,825	1,838
	1,914	1,913	1,911	1,914	1,921	1,934

Source: An Post, Projections 2000-2004

- The proposed option of using post offices as Government Service Outlets would involve providing a range of services including:
 - Information and advice about all Government services;
 - Reception point for applications and assisted access to internet application mechanisms via the Public Services Broker (see Reach initiative);
 - Access to the internet;
 - Links to community development activities, family support services, health board services, FAS training and job referral services.

Agency/reorganisation option

Agency/Reorganisation arrangement

- An alternative means of providing post office services is possible through an agency arrangement. This would allow a post office agency be offered to a suitable candidate based on a per transaction fee for all transactions carried out.
- In the first instance it would be expected that the present post office operation would be offered the agency. If they declined then it would be offered to a shop or suitable premises in the immediate locality.
- Post Offices division would provide an imprest to cover transactions. Reduced levels of administration and accounting are possible. Fees will decline in direct proportion to transactions.
- A pilot scheme of 26 Agencies has been agreed with the IPU as a result of the recent negotiations. However, no agencies have been introduced.
- The benefit for the postmaster would be a “once off” severance payment. An Post have noted amounts in the region of £10,000 for this payment. In addition they would be paid a “transaction” payment for transactions carried out. This payment would be at a reduced rate to the present scale payment rate.
- Another benefit to the Post Office operator is that they could open at hours to suit themselves. At present they are obliged to remain open for 5.5 days per week. With an agency agreement an agreed number of hours per day may be an allowable option.
- An Post predict losses of £19.0m by 2004 were 907 offices closed. The costs of an agency are likely to be less than that of a full post office according to An Post. Thus, the projected losses would be between £19.0m (907 closures) and £27.7m (expected by 2004 with no closures). Thus, a significant agency conversion alone would do little to reduce projected losses.

Postal Agency	Sub Post Office
Licenced PO	Full service PO
Hours tailored to customer needs	40 hours pw/5.5 days
Tailored service, mainly: Social welfare Stamps some postal services	Full service
Paid by transaction	Minimum annual salary irrespective of transactions
Simplified payment reclaim system	Comprehensive accounting

Source: An Post

Appendix III - Projected Revenue/Costs to 2004

Projections show turnover declining in the period 2000-2004, however increasing pay costs lead to significant projected losses

- Set out opposite is a summary of the movement in revenue and cost from 2000 that brings about the projected operating loss (net of transformation savings) in 2004 of £27.7m.
- In the An Post projections, turnover declines in the period, however costs increase and in greater proportions leading to the significant losses increasing each year. The main drivers of the significant and increasing losses are rising pay costs and revenue decreases.
 - Operational (company office) and head office pay together have a greater effect on the projected operating result than scale payments to postmasters, although postmasters outnumber company staff by 45% (based on 1999 numbers).
 - The decline of £9.2m in revenue is net of new business. If we assume £4m new business, this means a £13.2m (15.5%) decline in core business over the period 2000-2004.
- The most significant assumptions in the projections are set out as follows:
 - Key contracts are retained (DSCFA, RTE, Eircom, NTMA);
 - DSCFA volume decrease;
 - Eircom fee reduced to 48p from 77p;
 - RTE fee reduced slightly on increased volumes;
 - Significant outflows from Post Offices Savings Bank and Savings Services;
 - Growth in retail and agency services;
 - Network size remains the same;
 - Postmasters payments will rise by the amount of the PPF increases over the next three years (approximately 5 % per annum);

Operating Profit - 2000 vs 2004 Projected

Figures in IR£m	Projected change	vs 1999 balance
2000 operating loss	(2.9)	
Third party revenue	(9.2)	-10.8%
Interest/other income	(1.0)	-41.8%
Scale payments	(7.2)	+33.8%
Operational pay	(5.3)	+24.8%
Head Office pay	(2.4)	+20.3%
Pensions	<u>(1.3)</u>	+31.0%
Payroll/Agency Fee related	(16.2)	+27.6%
Non-pay costs	0.9	-3.1%
Inter-service (non-mail)	(2.3)	+105.8%
Transformation (non-network)	3.0	
Projected 2004 operating loss	<u>(27.7)</u>	

Source: An Post

- Company pay is expected to rise in line with national pay agreements.
- An Post have confirmed that while a number of variables may since have changed since these projections were prepared (an understatement of PPF increases, offset by more favourable income variances from new business), the current expected position is not materially different (+/- £1m per annum). Scale payments increases recommended in the Flynn report (and estimated by An Post to be £3-5m p.a.) have not been reflected in these projections.

Post Office division losses dominate the An Post group business plan

- The Post Office division budget and forecast (pre and post the transformation measures proposed as part of Employee Share Option Proposals in 2000), when compared to the business plan for the remainder of An Post, demonstrates that the significant losses dominate the group.

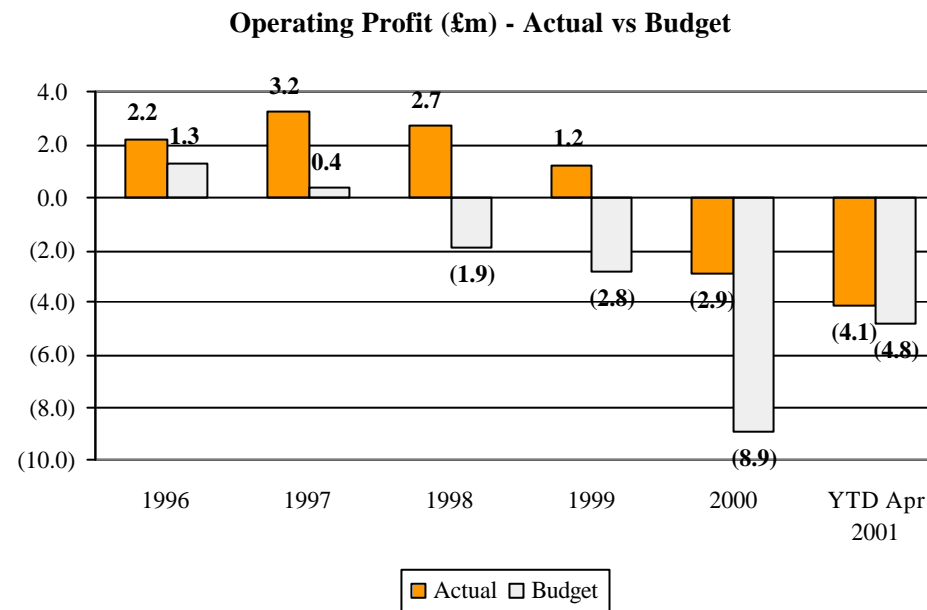
Figures in IR€m	Overall Business Plan			
	2001	2002	2003	2004
Pre transformation				
By Division:				
Letter Post	6	(2)	4	(9)
Post Offices	(14)	(19)	(25)	(31)
SDS	(1)	(1)	-	-
Corporate	1	3	3	3
Profit/(loss)	(8)	(19)	(18)	(37)
Post transformation				
By Division:				
Letter Post	9	9	23	10
Post Offices *	(12)	(17)	(22)	(28)
SDS	-	-	1	1
Corporate	(4)	1	1	2
Profit/(loss)	(7)	(7)	3	(15)

* Ignoring subvention and transformation proposals re network (sub-office) rationalisation

Source: An Post Business Plan and Projections 2000 to 2004

Recent historic performance has been consistently favourable to budget

- The performance of the Post Offices division and variances from budget are set out opposite.
- The Post Offices division has consistently delivered an operating profit in excess of budget. This is obviously significant in light of the high losses projected.
- Due to non-recurring favourable income variances of £4.2m (primarily software licencing: £2.8m) and cost variances of £1.8m (mainly pay, £0.9m, due to the timing of increases to postmasters) the operating loss for 2000 was £2.9m. Thus non-network income and timing of costs has accounted for the majority of the favourable performance.
- In 1999, the favourable performance to budget was driven by higher than expected revenues and by lower than expected payroll costs. Banking / Investment Services, Software Licencing and Social Welfare performed strongly.
- In 1998, the actual Post Office profit (£2.7m) was £4.6m over budget due to a favourable sales variance in Saving Services, TV licences and callcards. The non-pay adverse variance was primarily due to counter automation software costs, building and marketing expenditure.
- In 1997, Post Offices profit (£3.2m) was £2.8m over budget due to lower than budgeted counter automation expenditure, strong interest income and favourable pay costs.



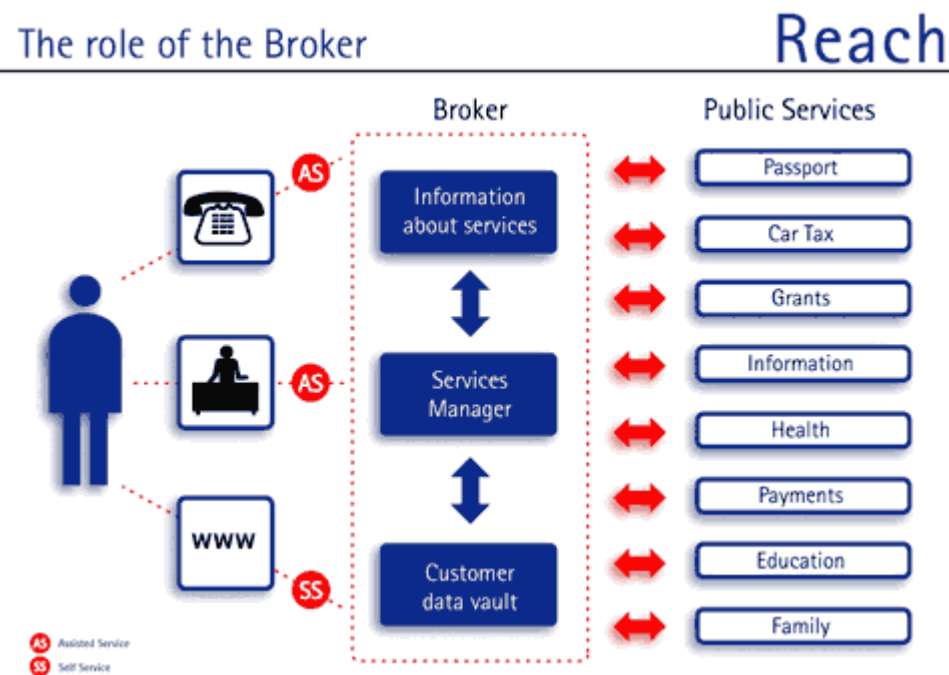
Source: An Post Management Accounts

- In 1996, the Post Offices division had a favourable variance of £0.9m. Income was marginally over budget by £0.4m. The main cause of the overall favourable variance was lower than budgeted non-pay expenditure which included marketing of savings products.

Appendix IV - eGovernment/REACH

e-Government strategy: REACH agency to unify the provision of public services

- It is the Government’s intention to e-enable citizens and businesses - the customers of the Government. In May 2000 the Government decided that this will be done by providing a new alternative model of Government service delivery (eBroker or Public Service Broker) which will offer these customers a single point of access to services with the potential to eliminate the disparity and duplication inherent in current models.
- Customers of Government will be given the option to do their business, including interactions with the public service, online (through the internet, PCs, telephone, television, call centres, etc), whether as citizens or businesses.
- It is intended that the eBroker should also facilitate direct ePayments to and from Government.
- The REACH initiative provides part of the framework for the achievement of the eGovernment objective. The REACH initiative will develop an approach for the delivery of public services on the basis of the eBroker model. This will provide integrated services based on the personal public service number (PPSN) and the public services card (PSC) together with the necessary certification and verification services.
- Legislation (eCommerce Act 2000) has been enacted to support the strategy. The act establishes an environment to support ecommerce and provides the framework for the delivery of Government services electronically.
- The REACH initiative intends to unify the provision of public services through three main channels: web, call centres and public service counters. (see opposite).



Source: REACH website: www.reach.ie

e-Government strategy: REACH offers opportunities for An Post; however impacts not quantified by An Post

- The Post Office division has identified three potential product offerings arising out of eGovernment opportunities:
 - Government Information and Advice Services
 - Broker Infrastructure and Management Services
 - Unified Messaging Infrastructure and Management

Government Information and Advice Services

- An Post have bid for work arising out of the Governments REACH initiative.
- The Post Office division consider that a role exists for Post Offices to provide Government forms through electronic hosting.
- Acting as a one-stop shop in the provision of advice in relation to Government services is seen as a network opportunity by the Post Office division.
- With the development of the Public Service Broker the potential may exist for the Post Office to provide the public with an intermediary to help interface with the services.
 - In March 2001 the DTI launched the latest phase of preparations to pilot post offices in Leicestershire and Rutland as “Government General Practitioners” - a new service that will offer a wide range of information and access to government services aimed at the general public.
 - In the UK it is envisaged that Post Offices will receive a fee per transaction in this role. Thus allowing government to fund the public service role of the post office in a measurable, transparent and predictable fashion.

Broker Infrastructure and Management Services

- The Division propose the provision of registration, authentication, information and payments services arising out of the REACH initiative.
- The provision of digital certification to users is required to enable the Public Services Broker. This could be carried out by An Post’s subsidiary Post.Trust which is already in this business. However such work would not involve the existing post office network.

Unified Messaging and Management Services

- The Division intends to offer an out-sourced end to end messaging management services to business enabling them to move to full electronic messaging models.
- This could involve the Post Office division, in coordination with other An Post Group divisions, providing scanning operations, secure mail products, Electronic Bill Presentment and Payment (EBPP), call centre and authentication services. This business would have also little network impact.

Income Potential

- According to the Post Office division, planning on these new products is at an early stage and markets, revenues and costs have not been accurately determined. **Availing of Public Service Broker opportunities would be subject to procurement rules and An Post would need to compete for business against other players.** REACH is a long term government project and opportunities may not arise in the short term.

e-Government strategy: Provision of counter based services within REACH is undecided – conflicts possible and competition likely

Potential Conflicts Exist

- A Ministerial direction (27 May 1999) approved the future development of the Post Office as a one stop shop.
- The Department of the Environment, under guidelines arising from the Government Programme for Better Local Government 1996, are encouraging local authorities to establish a decentralised network of offices providing and facilitating government services.
 - Decentralised offices are grant-aided if they provide a range of public services.
 - The Donegal County Council is participating in a pilot project for REACH by establishing six one-stop shops in the county.
- REACH sources state that Post Offices could play a role in the implementation of the Public Service Broker.
 - However, the Broker may take up to 5 years before fully rolled-out.
 - Broker services will be open to full commercial tendering and there is likely to be third party competition to provide services.

e-Government strategy: To provide IT access for all, Government could use the Post Office network

Information Society

- The Information Society is a term used to describe a society and an economy that makes the best possible use of new information and communication technologies (ICTs). In an Information Society people will get the full benefits of new technology in all aspects of their lives: at work, at home and at play. Examples of ICTs are: ATMs for cash withdrawal and other banking services, mobile phones, teletext television, faxes, and information services such as the Internet and e-mail.
- The Government stated that there will be increased investment and associated funding arrangements to provide a phased roll-out of community-based access to the Information Society with particular regard to the recommendations of the Information Society Commission's examination of IT Access for All (Programme for Prosperity and Fairness: February 2000).

Implications for Post Office Division

- The Report of the Information Society Commission (IT Access for All: March 2000) stated that post offices could make an important contribution to the development of the Information Society in Ireland by action as IT Access Centres in the future. It recommended that consideration should be given by An Post to the commercial viability of establishing Public Internet Access Devices in appropriate branches.
- The Flynn report recommended that the Government examine the potential for partnership with An Post to provide community based internet access.
- An Post could provide access to it's existing network in such a venture.
 - Adequacy of some premises would have to be considered for such a venture.
 - The funding of such an arrangement is likely to require significant cost to government to fulfill its objective of access to IT for all.
 - Post office opening hours could be restrictive in providing such a service.

Appendix V - Universal Bank

Universal Bank may help to fulfill eGovernment objectives; Post Offices have a central role according to Banking Industry

- A Universal Bank involves the provision of a basic card-based banking service which could include some or all of the following:
 - Deposit facilities;
 - ATM access;
 - Set up direct debits;
 - Use at point of sale for payment or as a debit card.
- This service could be provided by one of the main banks, An Post, a third party or any combination of these.

Advantages of the Universal Bank include:

- Reduces inefficiency and costs in paper payments methods;
- Reduce financial exclusion by providing bank accounts to everyone;
- Would facilitate Electronic Benefits Transfer - cheaper than traditional manual payments methods used at present;
- Increased benefits recipient service: confidentiality, greater access to cash, increased functionality of card, security;
- Opportunities to pay budget increases to recipients more quickly;
- Benefits recipients that find work can continue to use the account;
- Potential reduction in benefits fraud and administration costs.

Disadvantages of the Universal Bank include:

- People may be reluctant to use the new technology;
- Some benefits recipients have a high demand for cash which may not be fully facilitated by the card.

Current Position

- An Post consider the expansion of banking services through post offices as an opportunity for the company.
 - The banking industry, through the Irish Payment Services Organisation Limited (IPSO), are developing a Universal Bank model through discussions with An Post.
- On 6 September 1999, IPSO wrote to the Taoiseach's office stating that, on the basis of a detailed review by the Boston Consulting Group, a Universal Account was required to ensure the success of the Government's "information society" approach.
- Proposals have been invited from An Post and the banks by Government. These are still outstanding and would have to be assessed in the context of wider consultations.

UK thinking on Universal Bank concept; issues in an Irish context

Alternative - Virtual Benefits Account

- A virtual benefits account would provide benefit recipients with a card to access their benefits through ATMs or at the Post Office counter but without the full functionality of a bank account.
- In the US all but two states pay unemployment benefit using EBT. In New York, the operator, Citicorp, has made large losses on the business and other difficulties were experienced – including insufficient access points and higher costs to welfare authorities (Source: New York Times 17 August 1999).

Opportunity for Post Office division

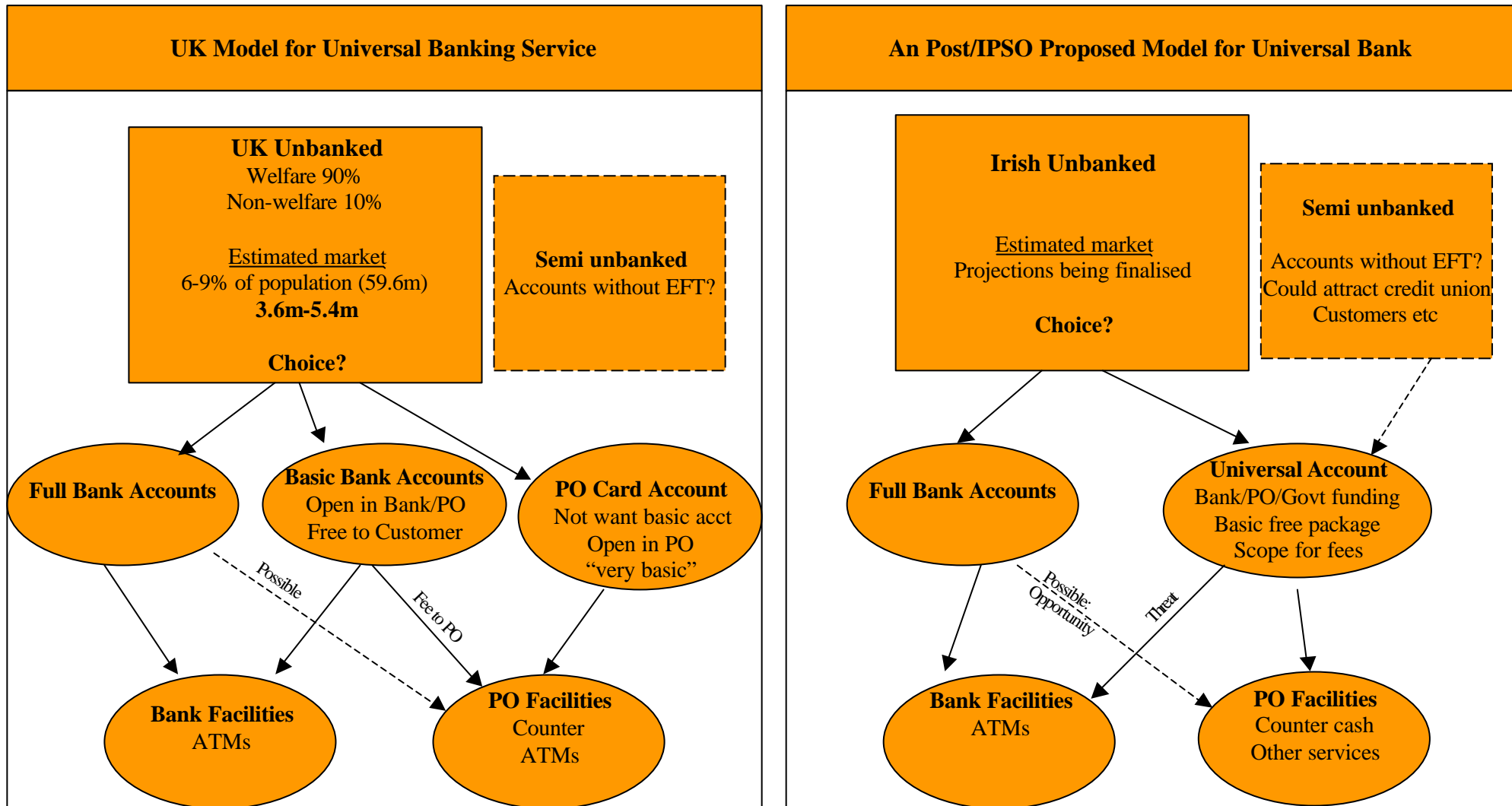
- If agreement is reached on the structure of a Universal Bank and An Post achieves a central role the following opportunities could arise:
 - Revenue from other services: billpay, savings, postpoints. Utilities pay for billpay and retailers pay for postpoint transactions;
 - Were the main banks and the Post Offices to arrange interconnectivity of systems the opportunity exists for existing bank customers to use the Post Offices as an access point. The Post Office could benefit from additional revenue from these customers.

UK thinking on Universal Bank concept

<i>Banking Industry</i>	<i>Post Office</i>	<i>Government</i>
<ul style="list-style-type: none">• Helps meet financial exclusion responsibilities• Cost-effective method of dealing with certain customer groups:<ul style="list-style-type: none">– avoids branch/ATM queues– avoids enquiries, training, marketing etc for benefit-related issues	<ul style="list-style-type: none">• Offers new products to help retain benefit footfall• “Jump starts” Post Office as banking distribution channel• Positions Post Office as complementor not competitor	<ul style="list-style-type: none">• Ensures smooth transition of ACT (ie EFT benefits)• Addresses financial exclusion• Avoids need for compulsion on benefit customers to take out bank accounts

Source: PWC UK research.

Universal Banking UK model vs. An Post/IPS0 proposed model



Source: Conversations with PWC UK, An Post, IPSO. UK DTI memorandum of understanding.

Universal Banking concept: UK model has significant uncertainties for Government and Post Office

UK Model has several key uncertainties

- Cost to Government will consist of transactions fees (electronic transfer of welfare) for those opting to open basic bank accounts (PAT14) and post office card accounts (POCA). The mix of BBA and POCA has a significant impact on the cost to Government of paying welfare payments. Savings in administration and benefits fraud costs are expected by the UK Government.
- UK post office revenue in the future will depend on the following:
 - Levels of migration to BBA and POCA (note margin on POCA business may be low);
 - Use by BBA holders of PO counters (“manned ATMs”);
 - Further agreements with banks for extra services and cross-selling;
 - Take up/financing of “Government General Practitioner” service.

An Post/IPS0 proposed model of Universal Bank:

- Discussions in relation to funding of the Universal Bank are ongoing. However, it is proposed by An Post that the Irish model of the Universal Bank will be funded by transaction fees. A suite of initial account services would be available to welfare customers (assumed paid for by the Government). Other transactions such as ATM withdrawals, debit card transactions and subsequent OTC cash withdrawals will be charged to the customer. Other unbanked customers will be charged commercial rates on all transactions.
- Estimates of the likely investment required to establish the Universal Bank incorporating An Post access have not been prepared. Banking sources state that it will be considerably less than that in the UK.

An Post/IPS0 proposed model (cont.)

- The An Post/IPS0 proposed model only offers one choice to the unbanked. However, post office revenue will be dependant on the take up of the universal account. This will be influenced by a number of factors including the number of welfare recipients already with a bank account which are capable of electronic transfer. Estimates of this population were not available. To a lesser extent, welfare recipients and other unbanked people may opt for full bank accounts. Cultural studies in the UK have indicated that large proportion of people without bank accounts do not trust banks.
 - The post office are likely to receive less per counter transaction for each person transferring to a universal bank account. The banks will be seeking a portion of the fee for use of their systems.
 - The potential exists for the post offices to provide services to full banking customers as a result of the universal bank initiative although this is not part of current negotiations.
 - Additional revenue from extra transactions by welfare recipients: outside of basic suite of services e.g. small OTC withdrawals.
 - Revenue from new customers: previously unbanked customers may be able access their funds at Post Offices.
 - In a Universal Bank environment existing customers of the Post Office may use other means to get their funds, which could result in a direct cost or opportunity cost to the Post Office.
- Cost to Government would be likely to decline but not significantly. This would be dependant on the cost of running a universal account and Government funding considerations.

Funding requirements:

UK model

- The UK post office network has operated with a small annual profit for the last five years.
- Estimates of revenue from basic bank accounts and post office card accounts are subject to considerable variation. The expectation is that post office revenue will decline as a result of the move to automatic credit transfer of benefits in spite of the POCA and BBA initiative.
- The onus remains on the UK post office to fill the void left by benefits with alternative means these have not been formally estimated but include the following:
 - Significant reliance is being placed on the UK Government General Practitioner project. Pilots in one county are commencing in July 2001. Business plan incorporating full roll-out has not been prepared. No decision has been made in relation to government funding. Thus post office revenue has not been estimated;
 - Contracts with banks may provide extra income. A number of banks have signed up for additional services;
 - Other sources: internet learning; retailing, etc.

An Post/IPS0 Proposed Model

- The funding of the proposed model is still the subject of discussions between An Post and IPSO. Government costs would fall with savings on electronic payment of benefits. However, the establishment and ongoing running costs of the universal bank might mitigate this.
- The division was marginally profitable up to 2000, when a small loss of £2.9m was recorded.
- The post office revenue is also likely to decline with a move to electronic benefits payment. The onus will be on the post office to make up the shortfall and indeed exceed it to reduce forecast losses through other sources of income.
- Additional sources of income proposed by An Post include:
 - Opportunities arising from the Public Service Broker (subject to competition);
 - New businesses (postpoint, stamp retailers); and,
 - ESB, Motor Tax, Revenue business.
 - Public Service Broker opportunities have not been estimated and opportunities from other transactions revenue and new businesses may be insufficient alone to reverse existing losses or make up for the shortfall expected from a universal bank concept.

Appendix VI - Other Discussion Matters

Post Office Division Properties

- PWC reviewed the 1996 Hamilton Osborne King (HOK) valuation of An Post owned properties 9 July 2001 on behalf of the Working Group. The valuation was carried out on 118 selected properties (90 outside Dublin and 28 in Dublin), which were valued at £55.2m in 1996.
- The properties were valued on an existing use value and an open market rental value.
 - Existing use value is the best price at which the sale of an interest in the property would have been unconditionally sold.
 - Open market rental value is the best rent which the letting would get on the open market.
- The main assumptions were as follows:
 - Assumed statutory rights of each leasehold to acquire freehold of the relevant property (the majority of properties are held freehold or long leasehold or a combination of both);
 - Sites owned by Office of Public Works (OPW) are assumed to be freehold for An Post (valued at £1.7m in 1996).
 - Capitalisation factor was applied less assumed costs: stamp duty (6%), solicitors fees plus VAT and agents costs plus VAT.
- On review 85 properties in which Post Office division activities were carried on were identified. In the majority of these premises a sorting area was identified and other common areas. Sorting activities generally took up the majority of the floor space in these company owned properties. It was not readily possible to determine what element of the valuation related to non-Post Office division activities.
- The valuation did not include such properties as the General Post Office (GPO) Dublin (on a long lease to 2023 – capitalised at £12m in 2000 accounts), College House and Saxonne House, Dublin (held on short lease and not capitalised). These house the main central operations staff of the Post Office division.
- In 1999 KPMG carried out a valuation of An Post as at 30 June 1999, which estimated (based on the HOK valuation and applying a retail capital index to reflect market increases over the period 1996 to 1999) an uplift on the book value of fixed asset portfolio of £43m. This valuation has never been reflected in the financial accounts of the Group. The book value of fixed assets per the 2000 accounts was £163.2m.

Funding requirements:

Internal sources of funding

- An Post has options for funding expansion including:
 - Use of the cash resources of An Post including those earned from the sale of Postgem/IoL;
 - Funding from other An Post businesses; and
 - Sale and leaseback of Post Office division properties.
- An Post have stated that the Postgem/IoL resources are intended for other capital expenditure projects.
- Sale and leaseback of Division properties would require the approval of the An Post board.

Legal matters

- An Post is a commercial semi-state company, 100% Government owned. It was created under the 1983 Act to facilitate separate development of postal and telecommunications services.
- It is committed to discharge the public service obligations conferred on the company through legislation, government policy and ministerial direction.
- An Post inherited its counter services obligations from the Department of Posts and Telegraphs. Section 12(1) of the Act describes the principal objects of the Postal Company (An Post). Section 12(1)(d) obliges An Post;
 - *“to provide counter services for the Company’s own and Government business and provided that they are compatible with those services and with the other principal objects set out in this sub section, for others as the Company thinks fit, and ...”*
- Under its Memorandum and Articles of Association An Post is obliged;
 - *(8) “to provide all types of counter services and facilities for the business of the Company and for Government business including services and arrangements for the payment, distribution, collection or receipt of monies, benefits, fees, papers, documents or other materials or goods payable or deliverable by or to any State Authority or other body or agency”*

Irish Legal Framework and impact on An Post

- The principal legislative provisions affecting the operation of the Post Office are set out below:
- Section 110 of the 1983 Act, which underpins Government policy on the retention of the network and which constrains An Post from adjusting the network size in line with commercial considerations, balanced with its social obligations. An Post would contend that its agency proposals would adequately address the needs of users and would be sufficient to ensure that social obligations are fulfilled at a lesser cost.
- The Post Office Act (1908), Section 48 enables the Company to establish Post Offices, and could give the Company the authority to operate a network on the basis of a subsidy.
- In addition to the direct provisions in legislation referred to above, An Post has obligations imposed indirectly through the provision of Section 110 of the PTS Act (1983) which provides that “The Minister may issue directions in writing requiring An Post to comply”.
- The following Ministerial directions could be considered in this context;
 - 10 December 1998 - which effectively prohibited office closures
 - 27 May 1999 - (1) Approved in principle extension of Social Welfare contract.

Legal matters (cont'd)

- (2) Approved the future development of the Post Office network as a one stop shop.
 - August 1999 - a White Paper was published setting out strategy for Rural Development with the following provision:
 - *“The Government remains committed to the retention of the Post Office Network and to its use for the delivery of the most comprehensive range possible of state services to all citizens. Delivery of Social Welfare payments will continue to be a substantial element of the services provided by post offices in the future.....”*
 - It is necessary to consider the principal Irish and European legislative provisions in considering the future of the post office network.
- ### European Legal Framework
- The principal European legislative provisions are set out below
 - European Communities (Postal Services) Regulations, 2000 (SI 310 of 2000);
 - Directive 92/50 EU as amended by 97/52 EU which sets out the procurement framework and rules applying to Government Departments;
 - Directive 97/67/EC on the development of an internal market in postal services;
 - Commission Notice on the application of the competition rules to the postal sector (February 1998).
 - Cross-subsidisation of reserved areas (areas of postal service which have been reserved for An Post in accordance with SI 310 of 2000) by profits from competitive areas would not appear likely to involve a breach of Article 82 of the EC Treaty. Such cross-subsidisation might be regarded as State aid, although it would probably be possible to persuade the Commission that such a State aid was, by virtue of Article 86(2), compatible with the EC Treaty.
 - Other important issues for consideration include:
 - The role of the branch network in fulfilling the universal service obligation, which includes access to the basic mail services, registration and money transmission (obligations imposed on An Post under the PTS Act (1983) and Regulation 7(2)(a) EC (Postal Services) regulations; An Post is therefore an undertaking entrusted with the operation of services of a general economic interest, under Article 86(2) of the EC Treaty.
 - Article 87(3) also enables the granting of state aid for the development of certain economic areas deemed to be disadvantaged compared to the national average (such as rural areas) or for the development of certain economic activities. In particular, the Commission has considered that a subsidy granted to a postal operator to enable it to fulfil its universal service obligations did not constitute state aid, as the cost of the universal service obligation exceeded the benefit received. In the Commission’s view, this did not lead to cross-subsidisation of that operator’s competitive operations.