

## Financial arrangements for procurement

### Financial accounting framework

7.1. In this chapter we consider how the accounting arrangements for procurement operate within the general framework of the Post Office financial accounting and monitoring systems. We also examine the accounting and budgetary control systems that the Post Office adopts to achieve its financial objectives in relation to procurement. Because of the method of recording and accumulating data weekly by accounting codes (types of expenditure) rather than by expenditure location, it is not possible to reconcile the SD operating expenditure figures to the Post Office's published accounts. We were told that the new accounting system code-named Apex,<sup>1</sup> which will be fully operational in financial year 1986-87, does not have this drawback.

7.2. Cost information in the Post Office's published accounts derives from summations of 52 weekly expenditure schedules which are prepared at each local and regional office and at PHQ and also at the SD depots at Swindon and Hemel Hempstead. The costs incurred by the Edinburgh depot, however, are amalgamated with those of the Philatelic Bureau and these are included in Scottish Postal Board's accounts. The running costs of the recently formed regional purchasing and supply offices are currently included within the regional operating figures.

7.3. The expenditure schedules when balanced are submitted to Corporate Finance Department at Chesterfield. Income and expenditure is then entered line by line on to a computer sub-system where the data are collated and fed into another system which compiles a trial balance.

7.4. Head Office and regions incur expense either by purchasing locally or under call-off and direct delivery contracts or by receiving goods from SD. Only those items issued solely by SD and charged to users can be matched to Post Office operating cost totals in the financial accounts.

### SD accounting and budgetary control system

7.5. SD bids for both staff and non-staff expenditure for each of its three main depot locations and its other offices. Swindon depot also deals with the budgets relating to the SD Headquarters sections based there. The budget-setting process is based on a 'bottom up top down'<sup>2</sup> approach but is related to the need to meet overall financial targets. Each budget is based on the previous year's figures and adjusted for inflation and anticipated changes within the context of three-year plans. SD says that, wherever possible, evidence from scrutiny studies and similar reviews is used in budget preparation.

7.6. The overall SD bid is approved by the General Manager, Supply, and SD's Board member before being forwarded to the Corporate Finance Department for inclusion in the total business budget.

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<sup>1</sup> The national nominal ledger accounting system.

<sup>2</sup> Bids are developed at budget centre level and referred to management and by an iterative process matched with overall Post Office financial targets.

7.7. When the budgets are approved, the SD budget is disaggregated back to depot locations under detailed management account heads. SD costs are monitored on a monthly basis and variances to date against budget and the forecast out-turn are compared to the full year budget.

7.8. Individual depot locations and Headquarters sections are expected to remain within their own budgets for staff and non-staff expenditure. Previously virement<sup>1</sup> has been allowed within SD, except between staff and non-staff expenditure, but we were told that virement would not generally be allowed from the financial year 1986-87 onwards. SD says that when it becomes clear that a potential overspend cannot be absorbed within the total SD budget, it approaches its Board member's budget officer to determine whether virement can be effected from within the Board member's area of responsibility or whether there is a need to apply for a budget supplement.

### **RHQ budgetary control system**

7.9. The Post Office acknowledges that the present system of regional monitoring for each type of non-staff expenditure is capable of improvement, particularly in respect of better flows of information and more detailed analyses of out-turns and forecasts so as to control expenditure before rather than after the event as at present.

7.10. We were told that in the Midlands postal region revised control systems were being implemented from September 1986 and in some budget areas a change of responsibility for the whole regional function has been proposed (eg the Personnel Manager is to hold, monitor and forecast the miscellaneous overheads budget instead of the RPSO).

### **SD expenditure budgets**

7.11. SD is not a cost centre because:

- (a) SD operating costs (see Table 7.1 and Appendix 2) do not include any charges for notional rents, depreciation, the Post Office's own transport costs, PHQ central costs or finance costs on stockholding. The cost of stores or supplies purchased are not treated as an SD budget responsibility except for the charges from BT for supplies acquired on behalf of the Post Office, and from 1985-86 onwards for the national costs of printing and stationery. (We have estimated the costs of operating the depot at Swindon including notional rents (see Table 4.1) at £6.690 million plus £1.5 million finance costs.)
- (b) Edinburgh depot is not charged by the Scottish Postal Board with accommodation costs such as rent, rates, energy and catering.
- (c) SD's own central service costs are not attributed or allocated to the depots.
- (d) Monies received by SD from external sales (which totalled £0.4 million in 1985-86) are accounted for to the Corporate Finance Department at Chesterfield and are not treated as part of SD's own budgeting process.

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<sup>1</sup> The offsetting of overspending on one expenditure sub-head against underspending on another sub-head.

7.12. SD operating costs, excluding BT procurement costs, are shown in Table 7.1.

TABLE 7.1 Operating costs

	£ million	Increase/(decrease) over previous year %
1982-83	9.6	—
1983-84	9.5	(1.0)
1984-85	10.5	10.5
1985-86	11.3	7.6

Source: Post Office.

7.13. The Post Office told us that, apart from general inflation, the increases were due in 1984-85 to:

- (a) staff costs—a 10.9 per cent increase in workload, overtime required for an extra stamp issue which had not been anticipated and problems with the production of stamps;
- (b) travel—increases in staff (some involving reimbursement of removal costs), more foreign travel and greater monitoring of suppliers than in the past; and
- (c) consultants—increased use of consultants during the year; and in 1985-86 to:
  - (d) staff costs—increased workload and overtime working at both Swindon and Edinburgh depots, the former resulting particularly from the bankruptcy of a major clothing supplier;
  - (e) printing and stationery—resulting from the expansion of the reprographic unit at Swindon and increased workload; and
  - (f) depot consumables mainly due to increased expenditure on pallets, containers, cartons etc because of issue of new uniforms.

7.14. 81 per cent of Swindon depot and Headquarters non-staff expenditure for 1985-86 (see Appendix 3) is devoted to running the depot and the balance to SDHQ (11 per cent) and Post Office engineering R & D<sup>1</sup> (8 per cent).

### SD capital budget allocations and expenditure

7.15. SD does not have its own capital expenditure budget. It bids for allocations from the budgets of the Estates Department (accommodation), Corporate Planning Department (office machines) and Letter Operations Department (plant) (see Table 7.2). We were told that the main reason for the large differences between budget allocations and actual expenditure for office machines was because plans for the development of the reprographic unit at Swindon depot were delayed and there was some delay on machinery required for Hemel Hempstead because of investigation into siting problems.

### Stores control

7.16. Details of SD stock levels and issues for the five years 1981-82 to 1985-86 are shown in Table 7.3. At 2 April 1986 stocks were valued at £13.5 million and issues during the year amounted to £19.8 million, a stock turnover of 1.47 times per annum, slightly lower than that for 1984-85 for which stocks were

<sup>1</sup>Included because budget allocations are available only for the Swindon site as a whole, even though the engineering R & D unit is not part of SD.

TABLE 7.2 Summary of SD capital budget allocations and actual expenditure for the four financial years to 2 April 1986\*

	<i>Swindon</i>		<i>Hemel Hempstead</i>		<i>Totals</i>		<i>£'000</i>
	<i>Allocation</i>	<i>Actual</i>	<i>Allocation</i>	<i>Actual</i>	<i>Allocation</i>	<i>Actual</i>	
<i>Accommodation</i> (part of Estates Department budget)							
1982-83	176.0	69.9	6.5	3.7	182.5	73.6	
1983-84	346.9	346.9	Nil	Nil	346.9	346.9	
1984-85	108.2	102.2	110.0	43.7	218.2	145.9	
1985-86	188.0	130.6	53.8	33.0	241.8	163.6	
<i>Office machines</i> (part of Corporate Planning Department budget†)							
1982-83		26.6			805.0	26.6	
1983-84		165.6			460.0	165.6	
1984-85		87.8			431.0	87.8	
1985-86		67.8			287.0	67.8	
<i>Plant</i> (part of Letter Operations Department budget‡)							
1982-83		Nil		4.9	N/A	4.9	
1983-84		Nil		Nil	N/A	Nil	
1984-85		16.3		Nil	N/A	16.3	
1985-86		Nil		Nil	N/A	Nil	

Source: Post Office.

\* There were no budget allocations or expenditure for Edinburgh depot.

† No separate budget allocation was made to the individual depots.

‡ No separate budget allocation was made for SD within the Letter Operations Department budget.

TABLE 7.3 Value of Swindon SD stock and issues for the five financial years to 2 April 1986\*

Product	1981-82		Stock- turn times	1982-83		Stock- turn times	1983-84		Stock- turn times	1984-85		Stock- turn times	1985-86		Stock- turn times	£'000
	Stock	Issues	pa (1)	Stock	Issues	pa (1)	Stock	Issues	pa (1)	Stock	Issues	pa (1)	Stock	Issues	pa (1)	
General stores	497	2,598	5.2	524	2,956	5.6	477	3,156	6.6	758	3,061	4.0	849	3,890	4.6	
Bicycles, handcars and trolleys (CHT)	348	658	1.9	390	435	1.1	390	N/A†	—	301	394	1.3	298	885	3.0	
Mailbags	3,434	4,304	1.2	3,265	4,536	1.4	2,347	3,590	1.5	2,215	3,985	1.8	2,687	4,587	1.7	
Uniforms and protective clothing	6,378	4,493	0.7	5,509	3,911	0.7	4,026	4,319	1.1	3,926	6,081	1.5	6,268	6,936	1.1	
Engineering	N/A‡			N/A‡			2,694	3,299	1.2	2,915	2,933	1.0	2,657	2,555	1.0	
Counter and sorting office equipment	N/A‡			N/A‡			1,175	727	0.6	565	1,324	2.3	695	902	1.3	

Source: MMC from Post Office data.

\* Excludes printing and stationery stocks (these are not evaluated).

† Prior to June 1984 BT was responsible for stocking and issue of CHT. Due to a misunderstanding BT did not produce data for 1983-84.

‡ No figures available—responsibility for accounting for these transferred from BT to SD in 1983-84.

(1) Based on year-end stock levels.

£10.7 million and issues £17.8 million, a stock turnover of 1.66 times per annum. The equivalent figures for 1983-84 are £11.1 million, £15.5 million (estimated) and a stock turnover of 1.40 times. Stores procedures generally are dealt with more fully in Chapter 4. Although there is some evidence of improving stock turnover for some stock lines none of these figures indicate very tight control of stock levels. (See also Table 4.3 which identifies stock levels in months.)

7.17. The Post Office's policy is to treat most stores as consumables and bring them to revenue account immediately on purchase, other than mailbags, uniforms and fuel stocks which are presently included in the Post Office balance sheet. These include items such as engineering stores, general stores, counter and sorting office equipment and printed matter. The values of these items are maintained in a central ledger control account for SD depot stores only. Post Office policy generally does not require an annual stock-take of these items nor is the Post Office able to estimate the value of stock in its stores nation-wide. Issues from Swindon store to engineering stores are monitored but control of other items has been regarded as a low priority task.

7.18. In view of the lack of any information on the extent of retained stores in the regions, we asked the Post Office whether it had any system to check that orders placed with Swindon were necessary. The Post Office told us that when unusually large orders were placed, or there was a series of orders, the Swindon staff would try to ascertain the need for these requirements. It acknowledged, however, that this was an exceptional procedure and that there were no arrangements enabling the level of local stocks to be checked before new issues were made from Swindon.

### **SD supplies and services**

7.19. The accounting arrangements for supplies provided by SD to users are as follows:

- (a) Payments against specific contracts placed by or on behalf of the PHQ departments are made direct by these departments against either their capital or revenue budgets and they are responsible for monitoring the payments.
- (b) Payments on national call-off contracts raised by SD are made by the user (RHQ in the case of fuel) and accounted for directly against RHQ or HPO budgets.
- (c) Payments for goods stocked at Swindon or ordered via Swindon but delivered direct from the supplier to the user are made either by the Accounts Payable group based at Swindon depot or, in some cases of direct delivery, direct by the user. Of those products where Swindon is responsible for payment, only printing and stationery and a part of the General Stores category (generally low value/high volume items) are now on free issue; the remainder are re-charged by SD to users at purchase cost (paragraph 7.21). The accounting arrangements for the supply of stores items re-charged from Swindon are essentially the same for all product groups. Starting with the basic requisition from the field, SD produces a multi-part document, one copy of which acts as a priced despatch note to accompany the goods. SD summarises these priced despatch notes at monthly intervals on a RHQ and HPO accounting location basis and then issues statements.

- (d) RHQs are charged for all engineering stores and for all other items requisitioned for RHQ controlled activities. With the reorganisation of the Regional Engineering and Motor Transport functions,<sup>1</sup> the Post Office is devolving accountability to local HPOs for these stores in all engineering and motor transport units under their control. HPOs are currently charged for all other items which have been requisitioned by them, except for mailbags, the cost of which is a mails network responsibility. The value of mailbags issued is charged to appropriate PHQ departments responsible for the particular services.
- (e) The value of stores shown on the monthly statements from SD is regarded as the charge upon the user for the stores ordered from or via SD. In order to verify the accounts on the statement, the documentation accompanying the stores from SD is certified as correct (or otherwise) and forwarded to the Corporate Finance Department. In the case of 'direct delivery' items paid for by SD and re-charged on the monthly statement, similar verification procedures are followed.
- (f) In principle the method of accounting is similar to that used for the transfer of value stock (stamps, cash remittances etc) between offices (paragraph 7.22). The value of stores issued by SD, as shown on monthly statements, is treated as a remittance and is credited to users' cash accounts. When the local office certifies that all the entries are correct, it then charges the amount in its expenditure schedules (Regional Cost Statement in the case of engineering items) against appropriate account code headings. In this way, the cost of stores 'charged' to users is set directly against the user's budget without the need for actual cash to change hands.

7.20. SD says that when the remaining items of general stores are on the Pilgrim computerised system they also will be charged to users (paragraph 7.24).

7.21. The price basis for charging users is purchase cost without any addition for the overheads involved in purchase, storage, issue and transport. The purchase cost is calculated once or twice yearly from contract files to enable the aggregate cost value of purchase orders to be averaged.

7.22. Hemel Hempstead and Edinburgh are responsible for supplying the stamps, stamped postal stationery and first day cover requirements of post office counters. Relevant documentation is prepared at Hemel Hempstead or Edinburgh. All stocks held and distributed are recorded and accounted for at face value. Monthly statements are submitted to Corporate Information Systems Department (CISD) and these show opening balances, receipts, issues and closing balances. Weekly statements are sent to CISD and these show the value of each product issued to individual post offices. All accounting procedures at Hemel Hempstead and Edinburgh are manual. The practicality of implementing a computer system has been considered and rejected, although the Post Office told us this is now being re-examined.

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<sup>1</sup> A new Road Transport Information System for control of vehicle spares and maintenance is being developed (paragraph 4.21).

## **Computer applications**

7.23. A computerised stock control system was established in SD during 1983 to cater for certain engineering stores using as a basis a Sirius micro-computer. This incorporated a basic accounting function which enabled the cost of stores issued to particular locations to be identified and allowed SD to charge users for supply to their stores. A similar system of control was implemented, as free issue was gradually being abolished between April 1984 and April 1985, for the supply of certain other product lines (paragraph 2.9).

7.24. SD told us that computerised stock control will be extended to other general stores areas to enable users to be charged, but because these items tend to be of a high-turnover, low-value nature, micro-computer application is not suitable. The comprehensive system known as Pilgrim, which is planned for completion in March 1987 (see paragraph 2.9), is intended to have the ability to identify, over time, stores issued to any particular location. SD explained that because of the low value of many orders a quarterly billing system may be used or charges may be aggregated and charged to businesses at national level for some items.

7.25. We were told that the department's computer applications relating to basic accounting records and reporting systems conform to the requirements of Post Office Corporate Headquarters.

7.26. SD is currently reviewing its development programmes. In view of the recent establishment of separate businesses for Letters, Parcels and Counters a consultant has been commissioned to undertake a review of the options open to the Post Office for extending internal charging arrangements and improving the accuracy of on-charging. We have taken account of his findings and recommendations and have noted that the consultant has estimated the Swindon 'on-costs' (defined as the cost of warehouse operations, stockholding, notional rent and an allocation of central services) at 38 per cent of the value of throughput during the year 1985-86. The Post Office told us that after further consideration this percentage may be reduced a little.

## **Conclusions and recommendations**

7.27. We agree with the Post Office's intention to put the SD depots at Swindon, Hemel Hempstead and Edinburgh on a cost centre basis so that they operate at arm's length with their users. We consider that operation on this basis will require the full attribution and allocation of all costs and income arising in relation to the SD procurement function including a charge for notional interest on capital employed.

7.28. We recommend that all stores issued by SD should be charged on a fully costed basis, including a structured charging system for distribution costs.

7.29. We recommend that when businesses purchase supplies under centrally negotiated direct delivery and call-off contracts SD's costs in respect of these contracts should be recovered perhaps as a general management charge.

7.30. We recommend that all staff and non-staff costs and the cost of supplies incurred by the PSO groups be separately identified on a cost centre basis.

7.31. We recommend that all staff and non-staff costs incurred in maintaining local stores in the operating businesses be periodically identified and allocated to each store on a cost centre basis. This will enable the business managers to identify the costs of such stores and compare costs between different locations.

7.32. We approve the present practice of budgeting capital expenditure allocations to SD against bids. This complements the Post Office conventional departmental budgetary control system. However, we are concerned about the large discrepancies between amounts allocated and actual expenditures arising (paragraph 7.15 and Table 7.2). We recommend the extension of the basic bid system to cover all depots and all types of departmental capital expenditure.

7.33. Whilst there have been some signs of improvement since 1981-82 in the stock-turn ratios of some stores items at Swindon SD depot we consider (paragraph 4.37) that stocks should be reduced and the improved storekeeping controls, including use of demand forecasting techniques, would lead to the release of capital tied up in stores.

7.34. We consider that the Post Office's corporate practice of treating most stores items as consumables and charging them immediately on purchase to revenue may tend to encourage a casual approach to stock management and tie up capital unnecessarily. We recommend that, while the present practice continues, all these stores should at least once yearly be subjected to stocktaking and returns submitted to group finance and RPSOs for information and action. We also recommend that in the longer term the Post Office review its policy of treating these stores items as consumables and consider treating major items as stocks in the financial accounts to ensure that usage is matched by the appropriate charge in the accounts.

7.35. The Post Office told us that systems were currently being developed which would provide more purchasing and stock management information and would be interfaced with the computerised accounting system PLAINS. The Post Office assured us that the systems would be able to provide for the changes brought about by the reorganisation of the postal services. We have noted this but in view of the importance of these developments to SD's operations, we recommend that:

- (a) existing data on stock levels and other management information should be carefully checked before initial input; and
- (b) progress reports be submitted to the Board member responsible for SD on the development of the computer systems so that action can be taken to deal with any problems or delays.