Report by the
Comptroller and Auditor General

Cabinet Office
(Office of Public Service)

The Sale of The Stationery Office

HC 522 Session 1997-98
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This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

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National Audit Office
2 February 1998

The Comptroller and Auditor General is the head of the National Audit Office employing some 750 staff. He, and the National Audit Office, are totally independent of Government. He certifies the accounts of all Government departments and a wide range of other public sector bodies; and he has statutory authority to report to Parliament on the economy, efficiency and effectiveness with which departments and other bodies have used their resources.

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Executive summary

1 This report is about the sale of The Stationery Office which was formed from Her Majesty's Stationery Office and was sold by the Office of Public Service in the Cabinet Office (Cabinet Office (OPS)) to the National Publishing Group on 30 September 1996 for £54 million. £50 million of the purchase consideration was used to repay debt owed by Her Majesty's Stationery Office to the National Loans Fund before privatisation.

2 As part of the final sale negotiations the Cabinet Office (OPS) had to pay to the National Publishing Group £3.8 million representing Her Majesty's Stationery Office's remaining cash balances as compensation because the business had failed to trade normally by ceasing to pay trade creditors ten days before the sale. Failure to have compensated the National Publishing Group in this way may well have led to a breakdown in sale negotiations.

3 The Stationery Office took over most of the functions of its predecessor including its printing, publishing and office supplies activities, together with almost all the 2,500 staff in the business at the time of sale. The remainder of Her Majesty's Stationery Office, consisting of some twenty-four staff, continues to carry out a range of statutory and other functions including the administration of Crown and Parliamentary copyright. It is headed by a Controller who is appointed as Queen's Printer of Acts of Parliament. This body remains in the public sector as a Division of the Cabinet Office (OPS). It is still known as Her Majesty's Stationery Office but for ease of understanding it is referred to in this report as "Residuary HMSO".

4 The report begins with an examination of the background to the sale, particularly the important impact on the privatisation of a restructuring programme undertaken by Her Majesty's Stationery Office which was implemented ahead of and during the privatisation process (Chapter 1).

5 The objectives for the sale of The Stationery Office, which were set by the Chancellor of the Duchy of Lancaster after discussion with the Treasury and Her Majesty's Stationery Office, were to:

- complete the privatisation as soon as reasonably practicable (Chapter 2 of this report);
- ensure that staff were treated fairly and that their rights were respected in the sale process (Chapter 2);

- implement the privatisation so as to maximise value for money for the taxpayer (Chapter 3); and

- ensure that the needs of Parliament and other existing customers were satisfied, as appropriate, by contracts or other suitable arrangements for the provision of services (Chapter 4).

The impact of the restructuring of Her Majesty's Stationery Office on the sale of The Stationery Office

6 In mid-1994 the management of Her Majesty's Stationery Office with the approval of Ministers decided to embark on a three year restructuring programme possibly to be followed by a flotation of the business in 1997. The restructuring programme aimed to reduce overhead costs, particularly through a substantial reduction in staffing levels, and to improve the commercial focus of the business. It was started before any firm decision had been taken on privatisation, involved the creation of 14 new business units from the three that existed previously, and included the devolution of accounting systems to the new units. **We consider that the restructuring programme was badly executed, resulted in a progressive loss of management and financial control and led to severe difficulties in the reconciliation of inter-business unit accounts. This gave rise to concern on the part of potential purchasers of the business and contributed in part to reductions in their bids as the consequences of the restructuring became increasingly apparent (paragraphs 1.17 to 1.30).**

7 The Cabinet Office (OPS) agree that this restructuring resulted in major difficulties in the reconciliation of the inter-business unit accounts but consider that these would have been resolved in the full course of the restructuring programme had the sale not intervened. The Cabinet Office (OPS) told us that the acceleration of the sale timetable from a 1997 flotation to a mid-1996 trade sale meant that HMSO went into the sale process (itself disruptive of normal management of the on-going business) in the middle of a three year restructuring and with only an acting Chief Executive instead of the permanent appointment which had been intended before the acceleration. They also believe that the impact of the reconciliation difficulties on bidders' perceptions of the business was of relatively minor significance compared to the impact of the deterioration in Her Majesty's Stationery Office's financial performance, which was symptomatic of a fundamental decline in its traditional marketplace in the public sector and a limited ability to seek new business elsewhere, and of the likely additional cost to complete the associated reduction in staffing **(paragraphs 1.29 and 2.5)**.

8 Management could not identify the costs of the restructuring since they did not prepare budgets for the overall cost of the restructuring programme or keep records of the costs incurred **(paragraph 1.31).**

9 Her Majesty's Stationery Office was a Department in its own right with a separate Accounting Officer. It was also given Executive Agency status in 1988. Relations between Ministers, the Cabinet Office (OPS) and Her Majesty's Stationery Office as an agency were guided by a framework document which set out the strategic issues on which the Cabinet Office (OPS) could be expected to advise Ministers and stated that Ministers would not normally become involved in operational matters. Prior to the September 1995 decision to privatise, the Cabinet Office (OPS) saw their role in relation to Her Majesty's Stationery Office as limited to providing Ministers with advice when asked. Under the framework document, the Cabinet Office (OPS) were responsible for helping Ministers discharge their responsibilities for the management and finances of Her Majesty's Stationery Office, including providing independent advice to Ministers on Her Majesty's Stationery Office's five year Corporate Plan and annual Business Plan but they did not see it as their role to advise on operational matters such as the detailed planning for the restructuring or its execution. They did not therefore consider it their responsibility to evaluate the implications of the programme for the business's management and control systems which they viewed as the responsibility of the Controller. The Cabinet Office (OPS) became aware of some weaknesses in the management and financial control of the business, but the extent of the problems with the accounting systems was not clear at the time the sale was announced and it was not until January 1996 that significant problems began to manifest themselves **(paragraphs 1.2, 1.3, 1.9, 1.10, 1.28 and 2.7).**

10 Although Her Majesty's Stationery Office had provision for up to three non-executive directors only two posts were ever filled and there were none in post after July 1995. We consider that one or more non-executive directors with appropriate expertise could have provided Her Majesty's Stationery Office with useful external advice at a time when it was trying both to improve its performance and to prepare for privatisation. **(paragraphs 1.11 and 1.12).**

Objective 1: Completing the privatisation as soon as reasonably practicable

11 **The Cabinet Office (OPS) achieved their objective of completing the privatisation as soon as reasonably practicable.** Ministers initially set the Cabinet Office (OPS) a timetable to privatise The Stationery Office by the end of July 1996 but during the summer of 1996 this was extended to the end of September. Given the declining performance of Her Majesty's Stationery Office

between 1994 and 1996, the increasing loss of financial control and the potential scale of investment which would have been required to turn the business around we have found no evidence to suggest that a delay in the sale to improve the profitability of the business would have produced better value for money **(paragraphs 2.3 and 3.4).**

Objective 2: The treatment of staff

12 The trade unions representing staff in Her Majesty's Stationery Office were able to talk to bidders. The Cabinet Office (OPS) gave the trade unions information on future pension arrangements and the rights of staff during and after the privatisation immediately before the publication of the Information Memorandum (a formal selling document giving financial and other information about the company). Later, the Cabinet Office (OPS) also provided the trade unions with the content of the Information Memorandum relating to Her Majesty's Stationery Office's business in the format which was supplied to Parliament. The management of Her Majesty's Stationery Office issued regular news sheets to staff from the start of the commercialisation review in 1993 and throughout the sale process. The trade unions told us that both the Cabinet Office (OPS) and Her Majesty's Stationery Office could have done more to keep staff informed at a time of uncertainty regarding their future employment prospects **(paragraphs 2.12 to 2.15).**

Objective 3: The extent to which value for money was achieved

13 The value of bids declined during the sale process with final offers ranging from £6 million to £86 million compared with £25 million to £170 million at indicative bid stage. The Cabinet Office (OPS) believe that this was because it became increasingly clear to bidders that the business was failing to generate the levels of turnover and profit anticipated in the Information Memorandum. In addition, we consider that poor financial and management control and accounting difficulties which arose out of the restructuring programme contributed to bidders losing confidence in the business **(paragraphs 3.2 and 3.25).**

14 The Cabinet Office (OPS) transferred the responsibility for the inevitable cost of further restructuring and future investment in The Stationery Office to the National Publishing Group as the new owners of the business. Since privatisation the National Publishing Group have made almost 1,000 staff redundant, out of total staff at the time of the sale of some 2,500, at a cost of nearly £54 million over a period of nine months **(paragraph 3.3).**

15 The Cabinet Office (OPS) followed Treasury Guidance and previous Committee of Public Accounts recommendations in commissioning a benchmark valuation (a pre-sale valuation carried out before any bids are received) of The Stationery Office which was completed in May 1996. The exercise was used to identify a value (£47 million) below which the Cabinet Office (OPS) were not prepared to sell the business **(paragraph 3.5).**

16 The bidding process commenced on 26 March 1996 when the Cabinet Office (OPS) despatched an Information Memorandum to 48 organisations. The Cabinet Office (OPS) received 14 indicative bids in May 1996. The forecasts produced by Her Majesty's Stationery Office's management which were included in the Information Memorandum were overly optimistic and led to higher bids in the initial round of bidding than justified from a full appreciation of the business **(paragraphs 2.3, 2.8, 2.9, 2.10, 3.2, 3.12 and 3.23 to 3.25).**

17 Four bidders were shortlisted at the end of May 1996 and a preferred bidder was selected at the end of July 1996. In the two months before completion of the sale the preferred bidder, the National Publishing Group, reduced their final bid of £86 million to an eventual purchase price of £54 million. The National Publishing Group attribute this to the following:

- they became increasingly aware of Her Majesty's Stationery Office's problems of declining business prospects, financial and management control weaknesses and the poor quality of information available **(paragraphs 3.2 and 3.30);**

- they reached a more cautious conclusion of the realisable value of stock and debtors. In particular they considered that the net assets of the business were worth less than stated by Her Majesty's Stationery Office and felt it necessary to make higher provision against known liabilities **(paragraphs 3.30 and 3.32);**

- they agreed with the Cabinet Office (OPS) not to rely on completion accounts for a final adjustment to the selling price, but to make an estimated adjustment instead. This reduced the final bid price but in return the National Publishing Group agreed to give up all possibility of further reductions based on completion accounts **(paragraphs 3.31 and 3.32).**

18 **Her Majesty's Stationery Office failed to keep their commitment to trade normally** because they suspended payments to suppliers in the run-up to privatisation. This was done to avoid the business breaching its £50 million borrowing limit with the National Loans Fund. **The Cabinet Office (OPS) paid the**

purchasers of Her Majesty's Stationery Office ¼3.8 million following the sale, representing cash balances in the business at the point of sale. It is not possible to determine with certainty who benefited from these completion arrangements because Her Majesty's Stationery Office now have no means of providing a figure for the value of bills which had remained unpaid. The National Publishing Group told us, however, that the amount of additional creditors that they subsequently had to pay exceeded the £3.8 million cash payment by about £2 million **(paragraphs 3.33 to 3.36).**

Objective 4: Parliamentary and other customers' satisfaction with the sale

19 Parliament and other customers entered into new contracts with The Stationery Office on the same terms as their old agreements with Her Majesty's Stationery Office. The sale process was helped because Parliament had already concluded Supply and Service Agreements with Her Majesty's Stationery Office prior to privatisation through which they were able to address any concerns they had about quality or continuity of service. Other customers were free to translate their existing agreements into contracts but did not have to do so or agree to longer contracts than they wished. The conversion of the previous arrangements into contracts provided The Stationery Office with a secure customer base in the short to medium term following privatisation. On expiry these contracts will need to be the subject of competitive tender in accordance with European Union legislation **(paragraphs 4.8, 4.9, 4.11, 4.15, 4.18 to 4.20)**.

Recommendations

1. Where there is a possibility that a business may be privatised, the impact of any restructuring programme on the sale process should be considered. Restructuring that is undertaken should be monitored and controlled very carefully so that it does not risk prejudicing a successful sale. Where public sector organisations engage in major restructuring programmes, budgets should be established and costs fully recorded **(paragraphs 1.30 and 1.31).**

2. Vendors should effectively impress upon the management of a business the need for realistic assumptions in their business plan in the run-up to the sale **(paragraphs 2.8 to 2.11).**

3 Where privatisation is a possibility and a public enterprise is being restructured to put it on a more commercial footing the vendor department should monitor major decisions of the management of the business to guard against the risk of adverse impact on the possible sale **(paragraphs 1.9, 1.10, 1.15 to 1.30 and 2.7).**

4 In keeping with best practice, departments should secure that, if at all practicable, non-executive director posts are filled in Government owned businesses in the run up to privatisation in order to provide useful external expertise **(paragraphs 1.11 and 1.12).**

5 Following the example set by the Cabinet Office (OPS), vendors should commission a valuation of businesses to be sold before bids are received because this provides useful information about the nature of those businesses and insights into the bids themselves which are likely to be helpful in negotiations, even where the quality of the financial information available is not fully satisfactory **(paragraph 3.5).**

6 Parliamentary and departmental officials should monitor regularly the contracts with The Stationery Office to ensure that they continue to represent value for money **(paragraphs 4.15 and 4.22).**

1. Background to the sale

1.1 This section of the report describes the business of Her Majesty's Stationery Office, why its management embarked on a major restructuring of the business in 1994, the problems which arose from the restructuring and the impact that these had on the privatisation of The Stationery Office. It also examines the role of the Cabinet Office (OPS) in the privatisation process.

The business of Her Majesty's Stationery Office

1.2 Her Majesty's Stationery Office was founded in 1786 and over the next two centuries became a Government Department which was the main supplier to Parliament and Government of publishing, print and stationery. Its status and the extent of its financial and operational independence from Government underwent significant change while in the public sector. To put the organisation on a more commercial footing it was constituted as a Trading Fund in 1980. This meant that it was required to operate on an accruals accounting basis and was allowed to borrow from Government to finance its year on year operations. Its principal accountability was to meet the financial and performance targets set for it by Ministers such as the need to achieve specified levels of profit and delivery times for customers.

1.3 In 1988 Her Majesty's Stationery Office became an Executive Agency whereby it continued to secure further operational freedoms such as the ability, within overall limits, to control its pay and grading structures. This aimed to improve management's ability to control its own affairs while management of strategic policy remained the responsibility of Government. As a Government Department in its own right Her Majesty's Stationery Office was headed by a Controller who was also Accounting Officer and, after its establishment as an agency, Chief Executive. Since he did not report to or through other Accounting Officers, the principal relationship with Government was directly between the Controller of Her Majesty's Stationery Office and the Minister responsible.

1.4 On 30 September 1996 (the date of sale) Her Majesty's Stationery Office was separated into two entities:

- The Stationery Office which was privatised; and
- Her Majesty's Stationery Office, which remains in the public sector - referred to as "Residuary HMSO" in this report.

1.5 The Stationery Office was established to take over most of the business of Her Majesty's Stationery Office at the point of sale including its publishing, printing, consultancy services and sales of stationery, office machinery, books, furniture and information technology equipment. Its main customers were Parliament, Government Departments and Agencies, and the wider public sector. Before privatisation the Government only allowed it to supply private sector customers using surplus capacity, so these customers represented a very small part of The Stationery Office's business at privatisation. At the end of 1995 Her Majesty's Stationery Office employed 2,898 staff at locations throughout the United Kingdom (Figure 1), of which 1105 staff, or 38 per cent, were based at its headquarters in Norwich.

1.6 Residuary HMSO has been retained within Government as a small organisation consisting of twenty-four staff. It discharges statutory and quasi-statutory functions such as:

- carrying out the Queen's Printer responsibilities in relation to Acts of Parliament, Church of England Measures, Statutory Instruments and Statutory Rules of Northern Ireland;

- superintending the London, Edinburgh and Belfast Gazettes;

- control and administration of Crown copyright;

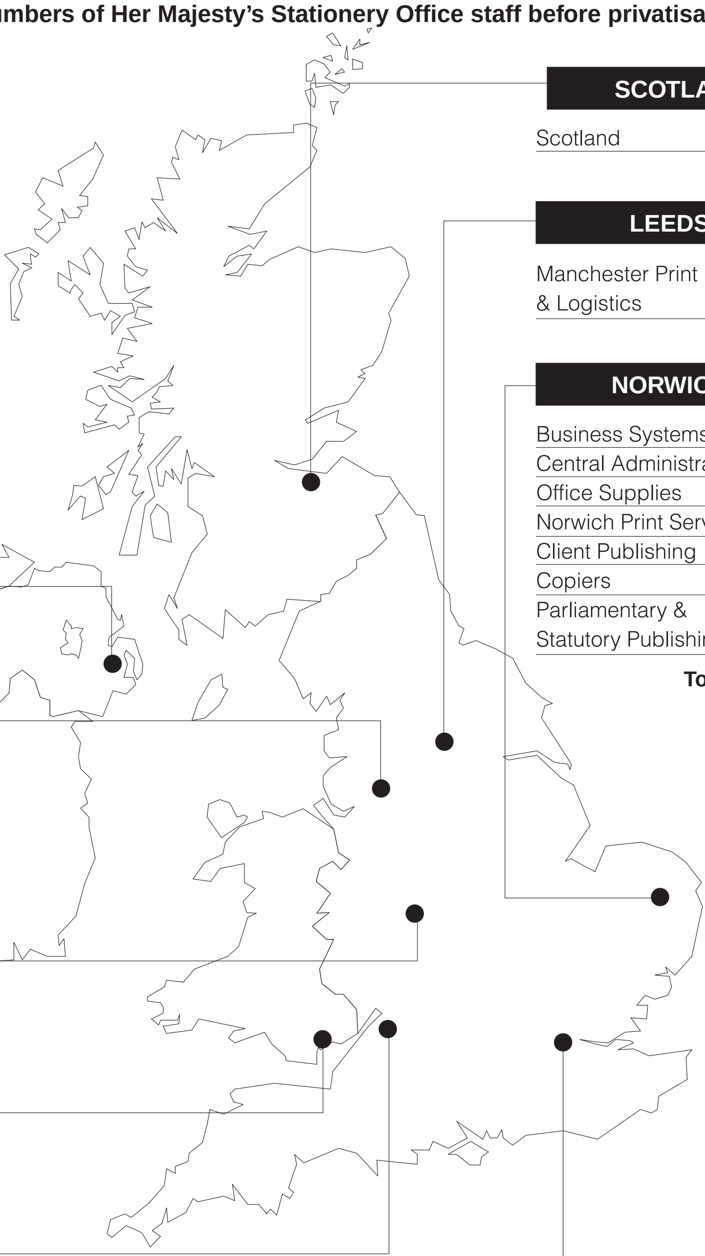
- administration of Parliamentary copyright; and

- control of the Votes for subsidy of publication to United Kingdom Members of the European Parliament and the Public Library Subsidy.

1.7 Her Majesty's Stationery Office was the sole agent for the procurement of publishing, printing and stationery supplies to Parliament and Government until the early 1980s. As Departments began to undertake their own procurement activities, Her Majesty's Stationery Office concentrated on its role as a direct supplier of products. As a Trading Fund Her Majesty's Stationery Office was required to break even taking one year with another and to make a specified return on capital. Her Majesty's Stationery Office met the financial targets set by Government on all but two occasions between 1980 and 1994 but during the 1990s it faced rising competition leading to an increasing use by customers of other suppliers for work which it had traditionally performed. This contributed to declining levels of turnover and profit as shown in Figures 2 and 3. Figure 2 illustrates how turnover declined by 23 per cent in real terms and eight per cent in

Figure 1

The locations and numbers of Her Majesty's Stationery Office staff before privatisation



SCOTLAND

Scotland	210

LEEDS

Manchester Print & Logistics	10

NORWICH

Business Systems	295
Central Administration	288
Office Supplies	153
Norwich Print Services	130
Client Publishing	124
Copiers	109
Parliamentary & Statutory Publishing	6
Total	**1,105**

NORTHERN IRELAND

Northern Ireland	67

MANCHESTER

Manchester Print & Logistics	210
Security Printing & Systems	175
Books Sales & Service	14
Total	**399**

BIRMINGHAM

Norwich Print Services	10
Books Sales & Service	7
Total	**17**

CARDIFF

London Print Services	42
Books Sales & Service	7
Total	**49**

BRISTOL

Office Supplies	191
Books Sales & Service	7
Total	**198**

LONDON

Parliamentary & Statutory Publishing	291
Books Sales & Service	309
London Print Services	210
Furniture	16
Business Systems	6
Client Publishing	6
Total	**838**

GERMANY Mönchengladbach

Norwich Print Services	5

Figure 1 shows the locations of the 2,898 staff employed by the different business units that made up Her Majesty's Stationery Office as at 31/12/95.

monetary terms between 1990 and 1995. Figure 3 shows that over the same period profits (before exceptional items) peaked at just under £14 million (3.8 per cent of turnover) but that by 1995 Her Majesty's Stationery Office was sustaining losses.

Figure 2

Her Majesty's Stationery Office's turnover 1990-1995

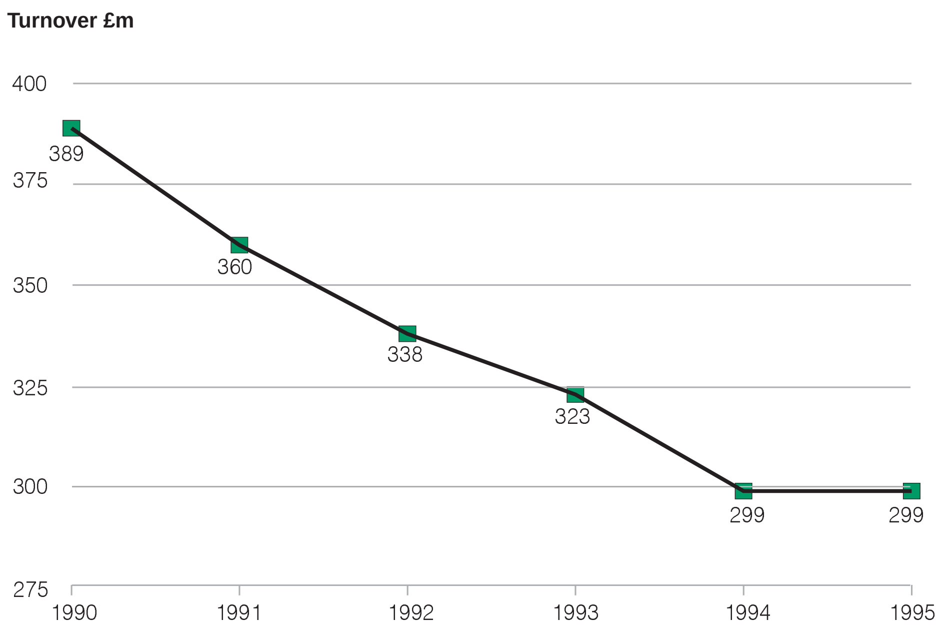
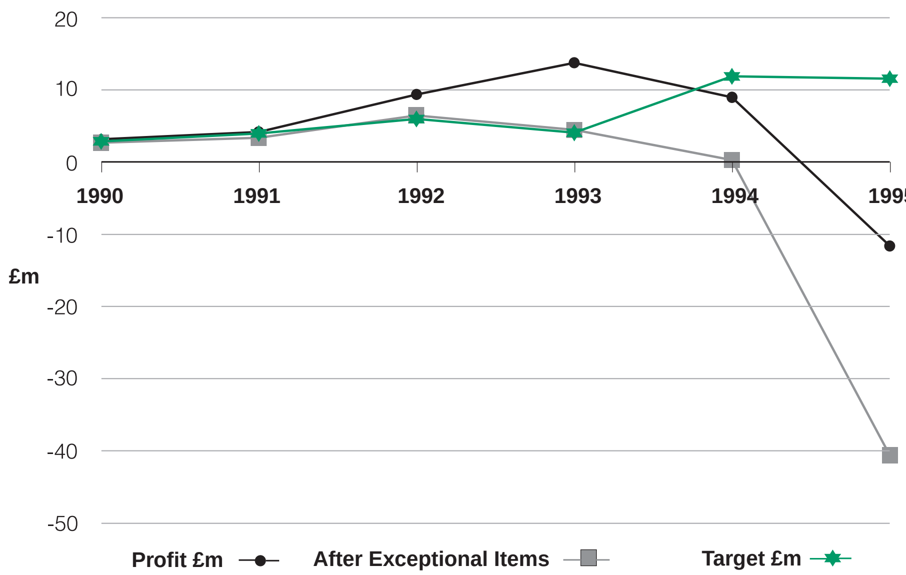


Figure 2 shows the annual turnover of Her Majesty's Stationery Office between 1990 and 1995 expressed in 1990 prices based on the Retail Price Index. The rates of change in the price of print, paper and office machinery were not always in accord with this index but they would not have had a significant impact on the trend shown.

Source: National Audit Office

Figure 3

Her Majesty's Stationery Office's profit 1990-1995



Source: Her Majesty's Stationery Office Trading Fund Accounts

Figure 3 shows the annual profit of Her Majesty's Stationery Office between 1990 and 1995 compared against the targets set by the Cabinet Office (OPS) and shows the severe decline in profitability in 1995. Exceptional items affecting profit in 1994 and 1995 were redundancy and future pension costs and a provision for losses on trade with Uzbekistan (1995 only).

1.8 We were the statutory auditors of Her Majesty's Stationery Office until privatisation. In 1990 we contracted the audit to Ernst and Young who were acting on our behalf as auditors during the privatisation process in 1995 and 1996.

The Role of the Cabinet Office (OPS)

1.9 The Controller of Her Majesty's Stationery Office was responsible to the Chancellor of the Duchy of Lancaster who was advised by the Cabinet Office (OPS) on strategic matters arising out of Her Majesty's Stationery Office's status as an Executive Agency. These included the policy and financial framework in which Her Majesty's Stationery Office would operate, business plans and targets, and on performance against these plans and targets, as reported by the Controller, normally on a quarterly basis. The framework document under which Her Majesty's Stationery Office operated as an agency gave the Cabinet Office (OPS) some discretion over the degree to which they became involved in the activities of the business but neither Ministers nor the Cabinet Office (OPS) would normally become involved in day to day management. The Cabinet Office (OPS) saw their role in Her Majesty's Stationery Office as limited to providing high level advice to Ministers when requested. This was because Her Majesty's Stationery Office was a

Department in its own right with a separate Accounting Officer. Her Majesty's Stationery Office was required to seek Treasury approval for major expenditure projects, and/or where additional borrowing was necessary. The Cabinet Office (OPS) did have a role in such approvals following the decision to privatise Her Majesty's Stationery Office in so far as such expenditure might not have represented value for money in the context of the sale. Notification arrangements were put in place between Her Majesty's Stationery Office and the Cabinet Office (OPS) so that decisions on major expenditure proposals were discussed with both parties.

1.10 The Cabinet Office (OPS) were responsible for helping Ministers discharge their responsibilities for Her Majesty's Stationery Office's management and finances, including providing independent advice to Ministers on Her Majesty's Stationery Office's five year Corporate Plan and annual Business Plan but they did not see it as their role to advise on the detailed planning for the restructuring nor to intervene in its execution. They did not therefore consider it their responsibility to evaluate the implications of the programme for the business's management and control systems which they viewed as the responsibility of the Controller.

1.11 Her Majesty's Stationery Office had provision for up to three non-executive directors. The Controller of Her Majesty's Stationery Office's had the responsibility of deciding whether he wished to have non-executive directors on the Board and for making recommendations to the Chancellor who approved the appointments. Unlike a limited company the role of non-executive directors in Her Majesty's Stationery Office was to provide advice to the Controller and they had no responsibility for the operation of the business which remained the sole responsibility of the Controller. In practice only two appointments were made, both from 1990. One non-executive director retired in 1992 prior to the transfer of responsibility for Her Majesty's Stationery Office from the Chancellor of the Exchequer to the Chancellor of the Duchy of Lancaster, the other retired in June 1995. In July 1993, the Chancellor of the Duchy of Lancaster appointed an Adviser on Agencies, who had extensive business experience and expertise. The Adviser attended meetings at the invitation of the Controller and with the approval of the Chancellor. He was not a formal member of the Board but occasionally advised the Controller, for example, at Board meetings and on other occasions. He continued in this role until the sale.

1.12 In June 1995 when the last non-executive post fell vacant the outgoing Controller wrote to the Chancellor of the Duchy of Lancaster advising of the desirability of further appointments but made no recommendations at that time because the Government had yet to make a decision on the future of Her Majesty's Stationery Office. Following the announcement of the sale in September 1995 the acting Controller took no action to find replacement non-executive directors because of the pressures of running the business and the impending privatisation. The Cabinet Office (OPS), who were available to advise Ministers on the appointment of non- executive directors, if requested, felt that at that time to have commenced a search to find new appointments would have added little value, and believed it would have been difficult to persuade anyone of standing to serve because of the transient nature of the posts. They considered that the Chancellor of the Duchy of Lancaster's Adviser on Agencies, who occasionally advised the Controller, for example at Board meetings, provided both the Chancellor and the Controller with adequate expertise. We consider, however, that one or more non-executive directors with appropriate expertise could have provided Her Majesty's Stationery Office with useful external advice at a time when it was trying both to improve its performance and to prepare for privatisation.

1.13 The Cabinet Office (OPS) had responsibility for the privatisation and established an internal team to control the privatisation process, set up a sale management board, appointed advisers, conducted the bidding process and made recommendations to the Chancellor of the Duchy of Lancaster on key decisions in the sale.

Objectives for the sale

1.14 The objectives for the sale, which were set by the Chancellor of the Duchy of Lancaster after discussion with the Treasury and the Board of Her Majesty's Stationery Office, were to:

- implement the privatisation so as to maximise value for money for the taxpayer;
- ensure that staff were treated fairly and that their rights were respected in the sale process;
- ensure that the needs of Parliament and other existing customers were satisfied, as appropriate, by contracts or other suitable arrangements for the provision of services; and
- complete the privatisation as soon as reasonably practicable.

The restructuring programme

The reasons for undertaking the restructuring programme

1.15 In 1992 following a review, Ministers had decided that Her Majesty's Stationery Office should remain in the public sector. In early 1994 Her Majesty's Stationery Office on behalf of the Minister appointed Binder Hamlyn to review again whether Her Majesty's Stationery Office could:

- be privatised;
- be abolished;
- have its functions contracted out; or
- be retained in the public sector.

1.16 Binder Hamlyn advised that the options which would have provided the optimum financial benefit to the Government were either further commercialisation in the public sector or privatising in due course the whole of Her Majesty's Stationery Office in separate businesses, but retaining the Print business in the public sector. They concluded that there was scope for significant business improvement including a radical approach to cost reduction. Later in 1994, following this review and in response to declining performance and poor results, Her Majesty's Stationery Office's management with the approval of Ministers decided to embark on a three year business restructuring aimed at increasing the business's commercial focus and reducing costs and staffing, particularly at its headquarters, irrespective of whether it remained in public ownership or was privatised. This involved the restructuring of the three existing operating divisions (Business Supplies, Print and Publications) into fourteen new, customer-focused business units. Responsibility for these units was devolved to business unit directors within a framework of policies, objectives and values drawn up by Her Majesty's Stationery Office's senior management, with the objective that the new corporate structure would enable the business to respond to the changing market place by becoming more customer-orientated and more commercially aware. The decision to undertake the restructuring was not linked to privatisation (although the programme was consistent with a possible future flotation at the end of three years). It was started a year before the decision to privatise was announced in September 1995 and was still in progress at the date The Stationery Office was sold.

Impact of the restructuring programme

1.17 The restructuring programme was designed to make Her Majesty's Stationery Office more commercially-focused within the public sector. We consider that it was badly executed and resulted in a progressive loss of management and financial control which concerned potential purchasers of The Stationery Office and contributed in part to reductions in their bids as the consequences of restructuring became increasingly apparent.

1.18 The restructuring programme was carried out by sub-dividing three operating divisions into 14 smaller individual business units. Figure 4 shows the chronological sequence by which Her Majesty's Stationery Office altered its organisational structure between the end of 1993 and January 1996. In 1994 the Business Supplies Division was divided into two business units - Office Equipment and Office Supplies. In January 1995 the Office Equipment unit was divided into three further units, Copiers, Furniture and Business Systems, while two regional business units in Scotland and Northern Ireland were formed. The other main organisational change was the creation of seven additional business units in October 1995, while the fourteenth unit, Wales Print, was established early in 1996.

1.19 The restructuring also involved the devolution of power and decision making to the individual business units. This included the authority for each unit to cease using the central accounting system and introduce its own operational and accounting systems independent of each other so as to provide management and financial information best suited to individual business needs. The Office Supplies unit was the first to implement its own accounting system in June 1995. The Business Systems, Copiers and Furniture units started the implementation of their systems towards the end of 1995. The regional business units in Scotland and Northern Ireland operated semi-autonomous accounting systems from January 1996. Two units - Manchester Print and Logistics and Manchester Security Print - implemented devolved accounting systems in July 1996. The remaining six business units continued to use Her Majesty's Stationery Office's central accounting system for their financial accounting.

Figure 4

Her Majesty's Stationery Office's restructuring programme (1993-96)

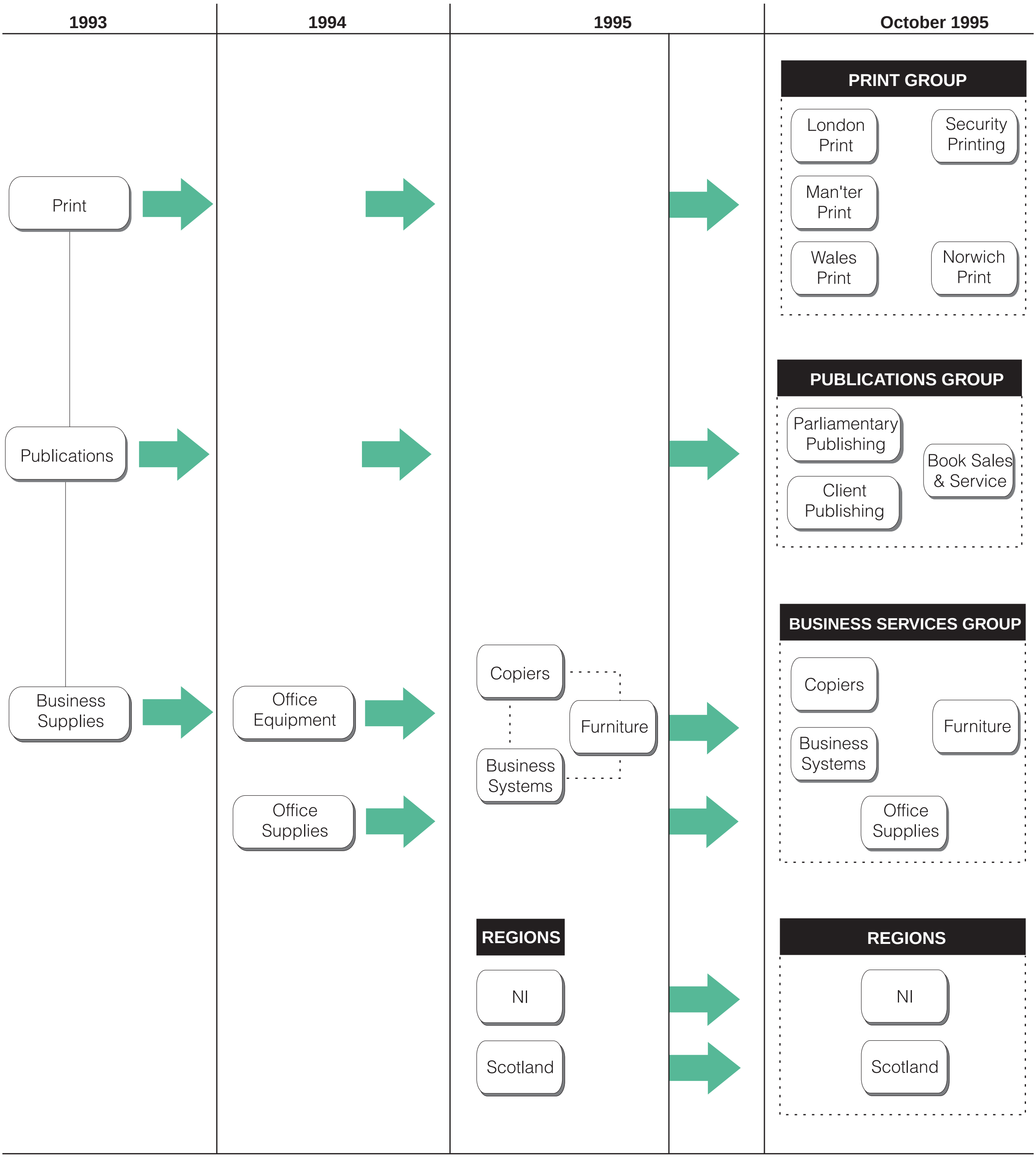


Figure 4 shows the order of Her Majesty's Stationery Office's restructuring from 3 business units into 14 business units between the beginning of 1994 and January 1996. This restructuring has been largely reversed by the new owners since privatisation. Wales Print was constituted as a business unit in January 1996.

Source: Her Majesty's Stationery Office

1.20 The new units were given considerable discretion in the design and operation of their accounting systems. As a consequence, inconsistent practices developed in the accounting for three main types of inter-business transaction:

- the sale and purchase of goods and services between business units;
- the transfer and reallocation of cash between business units; and
- the allocation of charges from corporate accounts to those of individual business units, such as payroll costs, and between business units.

1.21 These inconsistencies led to difficulties in reconciling balances in Her Majesty's Stationery Office's accounts which were further compounded because the process of devolving authority to individual units itself increased the volume and value of inter-business trading.

1.22 In November 1995, as a consequence of the restructuring, we commissioned a report from Ernst and Young into financial controls and in particular the risks to internal controls arising from the organisational changes. Their report highlighted the following areas where problems were encountered:

- there was no framework of necessary controls to guide business directors in setting up a proper system of financial control;
- the implementation of new information systems, which was devolved to the business units, involved risks which were not always properly addressed;
- inadequate planning and control of business units' strategy for developing their businesses led to significant stock write-offs in two business units;
- the then director of Her Majesty's Stationery Office Scotland authorised the purchase and despatch of goods worth nearly £5 million to Uzbekistan despite promised letters of credit failing to materialise. (We have already reported on Her Majesty's Stationery Office's trading with Uzbekistan in reports on the Trading Fund Accounts for 1995 (HC 349 session 1995-96) and 1996 (HC 6 session 1997-98), and a Supplementary Memorandum submitted to the Committee of Public Accounts on 3 January 1997).

1.23 These findings were brought to the attention of the Chief Executive at the start of 1996 but throughout that year problems of control persisted. In particular, there were inadequate procedures to ensure that the central finance function (which reported to the Board) and the business units reconciled inter-business accounts. Nor was it possible, under the procedures adopted for reporting monthly results, for the central finance function to ensure that the inter-business accounts were in balance across the organisation as a whole.

1.24 Her Majesty's Stationery Office's management recognised these problems and asked their internal auditors to report on the development and adequacy of the financial systems. They reported in July 1996 that the manner in which the devolution of financial systems was taking place did not give the central finance function the ability or authority to confirm that independent reliable information would be available in the format required to compile consolidated accounts readily. They recommended that priority should be given to the establishment of a framework of inter-business accounting. Their recommendation was accepted but not implemented by the time of the sale of The Stationery Office in September 1996, when purchasers would, in any case, have had their own financial reporting requirements.

1.25 Binder Hamlyn, who as reporting accountants had the task of producing a report on the business which would be examined by final bidders, were asked by Her Majesty's Stationery Office's management to assist in identifying the main imbalances on the inter-business accounts. They completed this exercise at the end of August 1996 having identified numerous adjustments that were necessary to eliminate the imbalances in the inter-business accounts. It was not possible, however, to reconcile all inter-business accounts within a reasonable timescale.

1.26 The absence of adequate procedures and controls to enable the reconciliation of accounts between business units, or to ensure the balancing of inter-business accounts at corporate level, meant that the business could not produce complete and accurate consolidated accounts at the end of September 1996, when Her Majesty's Stationery Office was split into The Stationery Office and Residuary HMSO immediately prior to the sale. The bidders were aware of this and that in mid-1996 gross unreconciled balances were some £19 million. This contributed to the lack of confidence of bidders in the business which in turn was one of the reasons why they reduced the value of their initial bids (see paragraphs 3.23 to 3.25). The Board member of Her Majesty's Stationery Office responsible for overseeing the privatisation process told us that in the period leading up to the sale both management and accounting staff had a number of conflicting priorities to handle, including running the business, completing the accounts and finalising the privatisation process and that this made it difficult to assess the nature and extent of the accounting problems and to take corrective action.

1.27 The consolidation of the accounts after the sale showed gross imbalances between business units of £9,425,000 (net imbalance £2,720,000). Accounting staff employed by The Stationery Office, acting on behalf of Her Majesty's Stationery Office, undertook a review of the largest imbalances in the months following the sale and as a consequence made several adjustments to correct accounting errors. This reduced the total imbalance to £1,267,000 (net imbalance £482,000). The net unmatched balance increased Her Majesty's Stationery Office's operating deficit to £965,000 on ordinary activities for the nine months to 30 September 1996.

1.28 In September 1995 when the intention to privatise was announced six of the 14 business units (Copiers, Furniture, Business Systems, Office Supplies, Northern Ireland and Scotland) had been established. Seven of the remaining eight became independent business units in October 1995 while Wales Print was established early in 1996. The first free-standing accounting system arising out of the restructuring was introduced by the Office Supplies business unit in June 1995. This was followed by the introduction of new accounting systems in a further three units towards the end of 1995 and two more in both January and July 1996. By July 1996, therefore, eight units had devolved accounting functions while another six continued to maintain their financial accounting on Her Majesty's Stationery Office's corporate systems. The Director within Her Majesty's Stationery Office with responsibility for the privatisation considered that it would have been difficult, but not impossible, to stop some of the restructuring programme in September 1995. The Cabinet Office (OPS) have told us that although they became aware of some weaknesses in the management and financial control of the business, the extent of the problems with the accounting systems was not clear at the time the sale was announced and it was not until January 1996 that significant problems began to manifest themselves at which point it would not have been possible to revert back to a unified accounting system.

1.29 The Cabinet Office (OPS) told us that various actions had been put in hand to resolve the problems of reconciliation and believe that these were problems of implementation which would have been resolved in due course as part of the completion of the restructuring programme had the sale not intervened. Moreover, the Cabinet Office (OPS) believe that the impact of the reconciliation difficulties on bidders' perceptions of the business was of relatively minor significance compared to the impact of the deterioration in Her Majesty's Stationery Office's financial performance, which was symptomatic of a fundamental decline in its traditional marketplace in the public sector and a limited ability to seek new business elsewhere, and of the likely additional cost to complete the associated reduction in staffing. They also point out that without the necessary staff reduction which had been made possible by the restructuring, the bid values would have been lower.

1.30 The problems with Her Majesty's Stationery Office's restructuring programme highlight the need for vendors to exercise care when a business to be sold is engaged in such activities and to inform themselves fully about the potential consequences of such an exercise. Major changes to business structure and accounting systems inevitably involve risk and the quality of financial information is crucial to the privatisation process. Moreover, the purchasers of a business are likely to have their own plans for these aspects of its operation. Good practice and Treasury guidance also suggest that the vendor should have full access to information relevant to the business being sold and should be informed of all proposals which are likely to influence the value of the business being sold. ("Trade Sales including Management Buyouts" (HM Treasury, July 1996).)

Cost of Her Majesty's Stationery Office's restructuring programme

1.31 Her Majesty's Stationery Office's management did not prepare budgets for the overall cost of the restructuring programme or keep records of the costs incurred during its execution. These costs were either charged to operational expenditure or, in the case of redundancies, which formed the major part of these costs, were shown as exceptional items in Her Majesty's Stationery Office's profit and loss accounts. Management had on-going plans to reduce staffing levels substantially over the period of the restructuring and beyond. Their three-year business plans for the periods 1994-96, 1995-97 and 1996-98 showed the following projected staff reductions as set out in Figure 5. The costs of these reductions were not identified.

Her Majesty's Stationery Office's projected staff numbers at year end 1994 to 1998

Source: Her Majesty's Stationery Office Business Plans, Trading Fund Accounts and Information Memorandum

Figure 5

Year	1994	1995	1996	1997	1998
Business Plan 1994-96	2,890	2,723	2,602	-	-
Business Plan 1995-97	-	2,710	2,520	2,365	-
Business Plan 1996-98	-	-	2,703	2,607	2,580
Actual Staff-in-post	2,906	2,898	2,530	-	-

Figure 5 shows Her Majesty's Stationery Office projected reductions in staff numbers under business plans from 1994 onwards compared with the actual staff in post.

1.32 At 31 December 1995 Her Majesty's Stationery Office employed 2,898 staff and envisaged at that stage a reduction of 195 to 2,703 by 31 December 1996 as Figure 5 shows. In the light of the impending privatisation and having secured Treasury approval for the funding of an accelerated redundancy programme Her Majesty's Stationery Office reduced staff by 368 to 2530 at 30 September 1996 at a cost of approximately £11 million.

2. The Cabinet Office (OPS)'s management of the sale process

2.1 This part of the report investigates the Cabinet Office (OPS)'s management of the privatisation process, why they decided on the chosen method of sale, and how the Cabinet Office (OPS) met the objective of completing the privatisation process as soon as reasonably practicable. It then analyses the detailed management of the project, evaluates whether information provided to bidders was accurate or adequate and examines how the Cabinet Office (OPS) sought to secure that staff were treated fairly and that their rights were respected in the sale process.

Method of sale

2.2 At the beginning of 1995 the Cabinet Office (OPS) had favoured floating Her Majesty's Stationery Office on the stock market, but in September 1995, when the decision to sell was announced, flotation was no longer a feasible option. This was because the sale timetable at the time required disposal by July 1996 at the latest, and Her Majesty's Stationery Office would not have been able to meet the Stock Exchange's normal requirement of a three year profitable track record by then. The Cabinet Office (OPS) therefore commissioned Binder Hamlyn to consider whether privatisation by means of a trade sale was feasible. In the light of Binder Hamlyn's advice the Chancellor of the Duchy of Lancaster announced to Parliament in December 1995 that he proposed to proceed with privatisation by this method.

Completing the privatisation as soon as reasonably practicable

2.3 A key objective of the Cabinet Office (OPS) was to implement the privatisation as soon as reasonably practicable. Ministers initially set them a timetable of privatisation by the end of July 1996 but during the summer of 1996 this was extended to the end of September 1996. The bidding process formally commenced on 26 March 1996 when the Cabinet Office (OPS) despatched an Information Memorandum (prepared by Coopers & Lybrand based upon information supplied by Her Majesty's Stationery Office) to the 48 organisations which had expressed an interest in acquiring the business and had also pre-qualified in the bidding process. The Cabinet Office (OPS) in turn received 14 indicative bids in May 1996 and four final bids in July 1996. The time between the issue of the Information Memorandum to pre-qualifiers in March 1996 and the sale on 30 September 1996 was comparable to a number of recent trade sales we have examined. Figure 6 shows the time taken between the issue of the Information Memorandum and the completion date in five other recent sales and demonstrates that the time taken by the Cabinet Office (OPS) to sell Her Majesty's Stationery Office was similar to that in three of the other five sales. Achieving the sale within a six month period between the issue of the Information Memorandum at the end of March 1996 and the completion on 30 September 1996, particularly since problems were experienced in relation to the reliability of financial information, indicates that the Cabinet Office (OPS) met the objective of privatising as soon as reasonably practicable.

Comparison of the times taken from the issue of an Information Memorandum to the completion of a sale in recent trade sales

Figure 6

Trade Sale	Issue of Information Memoranda	Completion of Sale	Elapsed time (Months)
British Rail: Sale of Maintenance Depots	July 1994	June 1995	11
Sale of Rolling Stock Leasing Companies	May 1995	January 1996	8
Swift	March 1995	September 1995	6
British Coal	June 1994	December 1994	6
Her Majesty's Stationery Office	**March 1996**	**September 1996**	6
Atomic Energy Authority: Facilities Services Division	October 1994	March 1995	5

Figure 6 shows the time taken from the issue of an Information Memorandum to the completion of a sale for the last six trade sales we have examined.

Source: National Audit Office

Management of the sale process

2.4 The key stages of the sale process are set out in Figure 7 starting from the announcement of the sale on 27 September 1995 to the sale completion on 30 September 1996. To manage the sale process the Cabinet Office (OPS) set up a Project Management Board which met approximately monthly to take key decisions. Its terms of reference were to set and review policy and direction, resolve major issues and agree key milestones to be achieved taking into account the Cabinet Office (OPS)'s sale objectives. The Board included representatives from the Cabinet Office (OPS) and Her Majesty's Stationery Office and, as appropriate, the Cabinet Office (OPS)'s financial and legal advisers, and officials from the House of Commons and House of Lords as observers. There was also a working group which met at least fortnightly which was primarily comprised of officials from the Cabinet Office (OPS) and their financial advisers and staff from Her Majesty's Stationery Office.

Key stages in the sale of The Stationery Office

Figure 7

Milestone	Date Achieved
Announcement of sale	27 September 1995
Announcement of trade sale in Parliament	12 December 1995
Advertisement of sale	26 March 1996
Issue of Information Memorandum	26 March 1996
Deadline for indicative bids	13 May 1996
Deadline for final bids	8 July 1996
Selection of preferred bidder	31 July 1996
Call option granted to preferred bidder	12 September 1996
Payment of creditors stopped	20 September 1996
Completion of sale	30 September 1996

This figure shows the key stages in the sale process between the announcement of sale on 27 September 1995 and the completion of the sale on 30 September 1996.

Source: Cabinet Office (OPS)

2.5 When the restructuring was started in 1994, it was expected to take until 1997 to complete both in terms of structural re-organisation and reduction in staffing. The Cabinet Office (OPS) intended that the then Chief Executive, who was due to retire in July 1995, would have been replaced following an open recruitment competition and the new Chief Executive could have then led Her Majesty's Stationery Office towards flotation in 1997. In the summer of 1995 a new privatisation timetable was introduced which aimed to privatise by way of a trade sale by July 1996. As a result the Cabinet Office (OPS) judged that it was impractical to recruit a permanent Chief Executive by open competition since a trade purchaser was most likely to want to install their own candidate. The Cabinet Office (OPS) therefore appointed an Acting Chief Executive from within the existing staff of Her Majesty's Stationery Office. The business therefore went into the sale process in the middle of a three year restructuring programme facing a declining and constrained market and with only an Acting Chief Executive instead of a permanent appointment which had been the original intention before the acceleration. Her Majesty's Stationery Office's management and staff worked under considerable pressure to maintain the business under these difficult circumstances being faced with the dual task of supplying information to enable the privatisation to proceed and continuing to run the business.

2.6 The Cabinet Office (OPS) recruited senior staff from the Department of Trade and Industry who had previous privatisation experience. In addition, Coopers & Lybrand, the Department's financial advisers and Binder Hamlyn, the reporting accountants, had widespread expertise in selling businesses and preparing key sale documentation. The Cabinet Office (OPS) were therefore able to acquire the relevant experience and skills to enable them to sell The Stationery Office.

2.7 The Cabinet Office (OPS) were aware of some of the weaknesses in the management and financial control of the business but they did not realise in the early stages of the process their true extent. This only started to become apparent in January 1996 when Binder Hamlyn in preparing their Long Form Report (a detailed and carefully compiled financial report on the business) recognised the over-optimistic nature of Her Majesty's Stationery Office's management's assumptions about business prospects. At about the same time the Cabinet Office (OPS) also began to become aware of problems in reconciling the inter-business accounts together with the other problems in financial and management control.

Information provided to bidders

2.8 The Cabinet Office (OPS) had a key role in attempting to ensure that bidders received accurate information at appropriate stages of the bidding process. An Information Memorandum which was prepared by Coopers & Lybrand was issued to bidders on 26 March to enable them to put in indicative bids on 12 May 1996. This contained financial and other information derived from Her Majesty's Stationery Office's 1996 business plan which was finalised in February 1996. The forecasts used in this plan, which were the responsibility of Her Majesty's Stationery Office's management, and which were later included in the Information Memorandum, turned out to be overly optimistic. Verification of the business plan was limited to legal examination by the Cabinet Office (OPS)'s legal advisers Field Fisher Waterhouse in conjunction with the Cabinet Office (OPS) and Coopers & Lybrand.

2.9 Bids at this stage were therefore higher than would have been the case (ranging from £25 million to £170 million) had bidders known of the doubts about the ability of Her Majesty's Stationery Office's management to meet their forecast targets and the problems of reconciling the inter-business accounts. Final bidders only became aware of these difficulties when they received the Long Form Report in May 1996 and conducted their due diligence from June 1996. Binder Hamlyn, in their role as reporting accountants and authors of the Long Form Report, tested the assumptions made by management in making their forecasts and in their description of the outlook of the business. The historical and forecast financial information contained in the Long Form Report was the same as that in the Information Memorandum but while the figures remained unchanged, the Long Form Report made clear to bidders how difficult it would be for the business to achieve the performance assumptions made by Her Majesty's Stationery Office's management in the business plan. Bidders told us that much of the Information Memorandum (particularly the non-financial information) had been useful in obtaining an understanding of the business, that they viewed Information Memoranda as selling documents and that due diligence usually revealed a different picture. They had been surprised, however, that the Long Form Report provided to them in May 1996 had differed in tone so markedly from the Information Memorandum which they had seen only some eight weeks earlier.

2.10 The poor quality of financial information in the Information Memorandum meant that final bidders had to do more work than they expected in the subsequent due diligence process. They were concerned at Her Majesty's Stationery Office's inability to reconcile inter-business accounts and by the absence of management accounting information (such as cash flow positions and forecasts, profit statements and stock levels) which the private sector would expect as part of the normal business process. As Chapter 3 explains in more detail, the fact that indicative bids were over-optimistic inevitably meant that final bids were based on more realistic assumptions and led generally to lower bids.

2.11 We consider that the sale process offers a useful lesson for future privatisations or contracting out in that vendors should impress upon the management of a business the need for realistic assumptions in their business plan in the run-up to the sale since this information will be relied upon by external parties. This is consistent with the Treasury's guidance in their publication "Trade Sales including Management Buy-outs" (July 1996) which advises departments to ensure that business plans are not over-optimistic and open to misinterpretation. This is especially true in cases such as Her Majesty's Stationery Office given the poor performance of the business.

Treatment of staff

2.12 One of the four objectives of the sale set for the Cabinet Office (OPS) was to ensure that staff were treated fairly and that their rights were respected in the sale process. We were told both by trade union representatives and by ex-Her Majesty's Stationery Office management that the great majority of management and staff were opposed to privatisation.

2.13 Her Majesty's Stationery Office maintained a flow of information to staff through a news sheet and had open channels for staff and trade unions to ask questions about the commercialisation review from its start in 1993. This continued during the sale process when the Cabinet Office (OPS) told the trades unions the names of the bidders who had proceeded to final bid stage and agreed that they could have access to them. The trades unions told us that they had not received sufficient information from the Cabinet Office (OPS) and only obtained an edited version of the Information Memorandum and of the Business Plan. For their part the Cabinet Office (OPS) were aware of the need to maintain commercial confidentiality but they included information on future pensions arrangements and the rights of staff during and after the privatisation in the Information Memorandum. These extracts were supplied to the trades unions before the publication of the Information Memorandum. They were also provided with the content of the Information Memorandum relating to Her Majesty's Stationery Office's business at a later stage in the format which was supplied to Parliament. The trades unions considered that both the Cabinet Office (OPS) and Her Majesty's Stationery Office could have done more to keep staff informed at a time of uncertainty regarding future employment prospects.

2.14 The rights of Her Majesty's Stationery Office's staff stem from the Acquired Rights Directive issued by the European Community which has been implemented in the United Kingdom through the Transfer of Undertakings (Protection of Employment) Regulations 1981 and subsequent measures which are often collectively known as TUPE. Under TUPE the staff of Her Majesty's Stationery Office were transferred to The Stationery Office on the same terms and conditions as existed previously and these apply unless and until changed by agreement between employers and employees.

2.15 The trades unions told us that their members' principal concern was to retain their jobs on the same terms and conditions after privatisation as they enjoyed previously. They were also concerned about possible large scale redundancies after privatisation and would have liked a greater commitment on the part of bidders to maintain employment levels. The trades unions told us that at meetings with final bidders in June 1996 they had understood that redundancy levels would be around 500-600 over two to three years. The final bids submitted in July 1996 showed proposed redundancies ranging from 440 to 900 staff, but bidders were not prepared to make firm commitments. Following the sale of The Stationery Office the National Publishing Group, having undertaken a fundamental review of the business, announced in November 1996 that redundancies of the order of 1000 staff would be necessary to turn the business round and these have been made within a year.

2.16 Prior to the sale the Government Actuary's Department, which was responsible for certifying that the new pensions schemes proposed by bidders would have provided scheme members with benefits comparable with those they had enjoyed under the scheme operated by Her Majesty's Stationery Office (the Principal Civil Service Pension Scheme), examined the pension arrangements proposed by each shortlisted bidder to ensure that they conformed with the requirement that pension arrangements were broadly equivalent to the existing pension scheme. The Government Actuary's Department were satisfied that the scheme proposed by the National Publishing Group (which offered full index-linking for transferring pensioners), was in conformity with this requirement.

3. The extent to which value for money was achieved

3.1 This part of the report examines what steps the Cabinet Office (OPS) took to maximise the proceeds obtained from the sale of The Stationery Office. It describes how the business was valued and marketed and evaluates the different stages of the bidding process. Finally it describes those liabilities incurred by the Cabinet Office (OPS) as a result of the sale process and examines the appointment of advisers and the costs of the sale.

Overall assessment of achievement of value for money

3.2 The value of bids declined during the sale process with final offers ranging from £6 million to £86 million compared with £25 million to £170 million at indicative bid stage. The central estimate of proceeds of £110 million produced by Coopers & Lybrand in their benchmark valuation was not achieved. The Cabinet Office (OPS) believe that the decline in value was caused because it became increasingly clear to bidders that the business was failing to generate the levels of turnover and profit anticipated in the Information Memorandum. In addition, we consider that poor financial and management control and accounting difficulties which arose out of the restructuring programme contributed to bidders losing confidence in the business.

3.3 The Cabinet Office (OPS) transferred the responsibility for the inevitable cost of further restructuring and future investment in The Stationery Office to the National Publishing Group as the new owners of the business. The National Publishing Group have since privatisation made almost 1,000 staff redundant over a period of nine months at a cost of nearly £54 million. This is part of a total of £65 million which the new management disclosed in their 1997 interim results had been needed to turn the business round. If Her Majesty's Stationery Office had remained in the public sector it would have continued to require public money to carry out further restructuring. By selling the business the Cabinet Office (OPS) transferred this business risk to the purchasers.

3.4 A number of bidders told us that the fact the sale occurred before the restructuring programme was completed was not helpful but also considered that delaying the sale and keeping the business in the public sector with the intention of turning the business round and thereby improving sale value was unlikely to have represented value for money because of the poor state of the business. Bidders also believed that the introduction of new senior management was essential. As referred to in paragraph 2.5 the accelerated sale timetable meant that the Cabinet Office (OPS) judged that it was impractical to recruit a new Chief Executive and therefore appointed the then Deputy Chief Executive of Her Majesty's Stationery Office to be acting Chief Executive to run the business before the sale. Given the declining performance of Her Majesty's Stationery Office between 1994 and 1996, the increasing loss of financial control and the potential scale of investment which would have been required to turn the business around we have found no evidence to suggest that a delay in the sale to improve the profitability of the business would have produced better value for money.

Valuation of the business

3.5 The Cabinet Office (OPS) followed Treasury guidance and previous Committee of Public Accounts recommendations by commissioning Coopers & Lybrand to carry out a benchmark valuation of The Stationery Office which was completed in May 1996 prior to the receipt of indicative bids. The valuation, which included three different scenarios for the prospects of the business (optimistic, central and pessimistic) (see Figure 8), was of limited worth in initial negotiations because of the poor quality information on which it was based. Nevertheless, as Figure 8 shows, it did identify a threshold value of £47 million below which the Cabinet Office (OPS) were not prepared to sell the business.

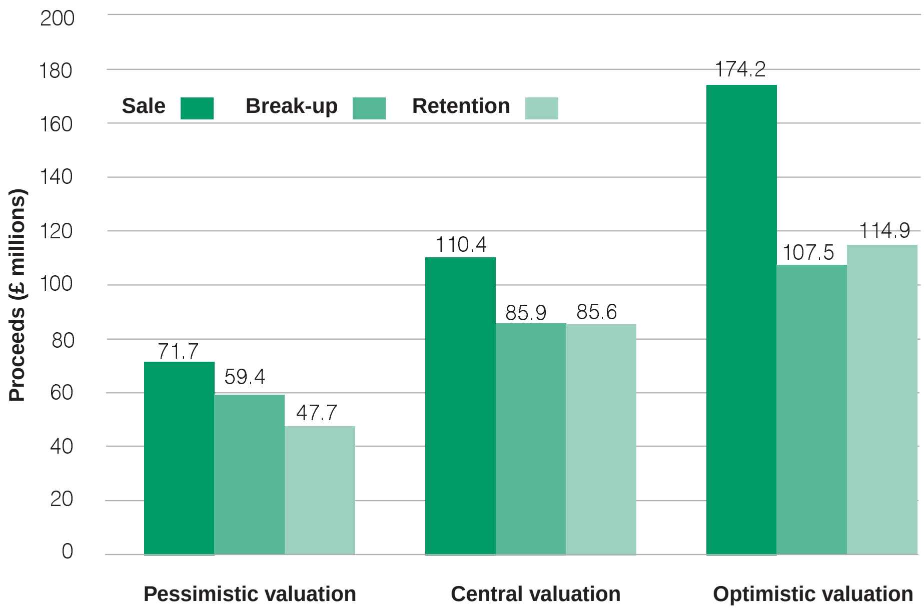
3.6 Ideally the valuation should have been revised using more up-to-date information. In this case we accept that a further valuation would have been hindered by lack of reliable information and would have reflected a poorer picture of the business leading to a reduction in the threshold value below which the Cabinet Office (OPS) were not prepared to sell.

3.7 Coopers & Lybrand valued the cashflows which they believed would accrue to Government over a 10 year period (1997 - 2006) under the following options:

Sale	Sale of The Stationery Office to a private buyer;
Retention	Retention of The Stationery Office within the public sector;
Break-up	Sale to private sector of part of Her Majesty's Stationery Office, retention of part within the public sector and closure of remainder.

The benchmark valuation produced by Coopers and Lybrand on 10 May 1996

Figure 8



Source: Coopers and Lybrand

Figure 8 shows Coopers and Lybrand's forecast of the cash flows which might accrue to the Government under three options for the future of The Stationery Office: sale, break-up into smaller businesses and retention in Government ownership. Each option was then modelled under three scenarios: pessimistic, central and optimistic giving a threshold of £47 million below which the Cabinet Office would not have been prepared to sell the business.

3.8 Coopers & Lybrand provided an indicative valuation of the business including sensitivity analysis which showed optimistic, central and pessimistic scenarios relating to the three possible options.

3.9 The valuation took into account an assumed repayment of debt and the value to the Government of potential Corporation Tax receipts. Figure 8 shows the net present value to the Government of the three options dependent upon the three types of assumed scenarios. On these assumptions the sale option was the most attractive.

Attracting interest in the sale

3.10 The Cabinet Office (OPS) attracted significant interest in the sale.

3.11 Even prior to the announcement of privatisation in September 1995 Her Majesty's Stationery Office's management had already received a number of enquiries from potential bidders for the business. In addition Coopers & Lybrand had visited over a dozen potential bidders to establish or confirm their interest in the sale. This interest continued after the announcement so that by the time the Cabinet Office (OPS) asked for indicative bids for The Stationery Office in March 1996 many potential bidders already knew of the opportunity.

3.12 Following the announcement of the sale 52 organisations applied to pre-qualify in order to take part in the bidding process. Forty-eight of these organisations were successful and were sent an Information Memorandum in March 1996. The sale was also advertised in the Financial Times and the Official Journal of the European Community in order to attract interest.

3.13 Fourteen indicative bids were received from 13 consortia on 12 May 1996 which indicated that there was initially a good deal of interest in buying The Stationery Office.

Bidding process

Evaluation of indicative bids

3.14 Of the 14 bids received, 10 were for the whole business (Figure 9) and ranged from £25 million to £170 million. Four bids were submitted for particular parts of the business (Figure 10 on page 35) but these were rejected by the Cabinet Office (OPS) because their aim was to sell the business as a whole and the proposals put forward might have left substantial parts of The Stationery Office unsold and no longer viable. The Cabinet Office (OPS) did not receive attractive bids for the whole business from trade buyers (ie. companies with interests in publishing, printing or allied businesses) and only consortia led by financial institutions put in competitive bids for the whole business.

3.15 Coopers & Lybrand adjusted some of the bids to put them all on a comparable basis. For example, some bidders proposed that the Government should pay for more redundancies prior to sale as a condition of their bids while others did not. We examined the impact of these different assumptions upon the proceeds offered by bidders at indicative bid stage and found that the adjustments did not materially alter the order of bids in terms of proceeds offered and so did not affect the selection process.

The range of indicative bids for The Stationery Office

Figure 9

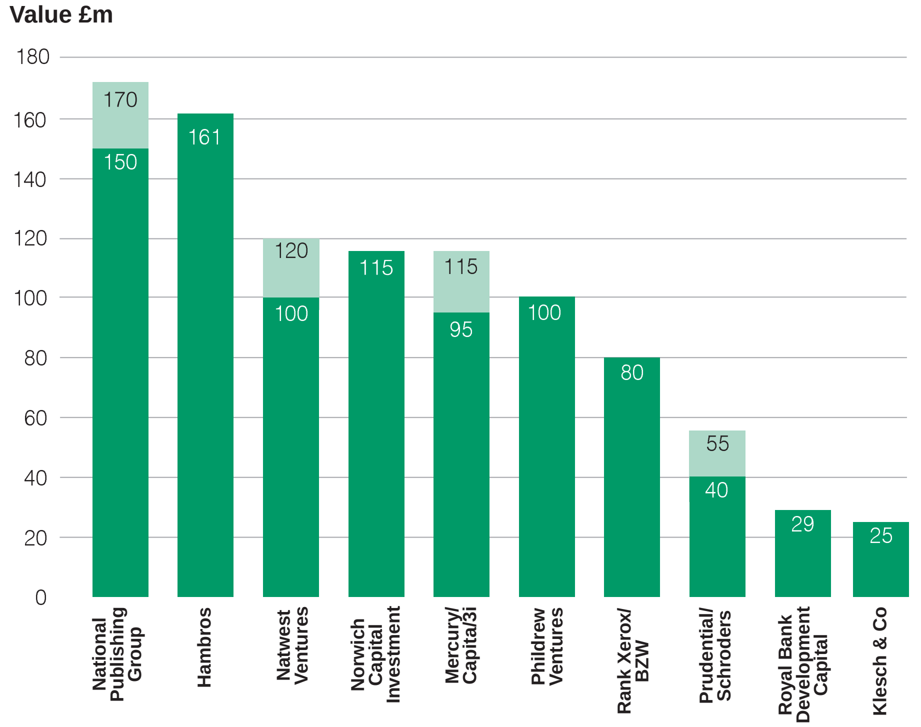


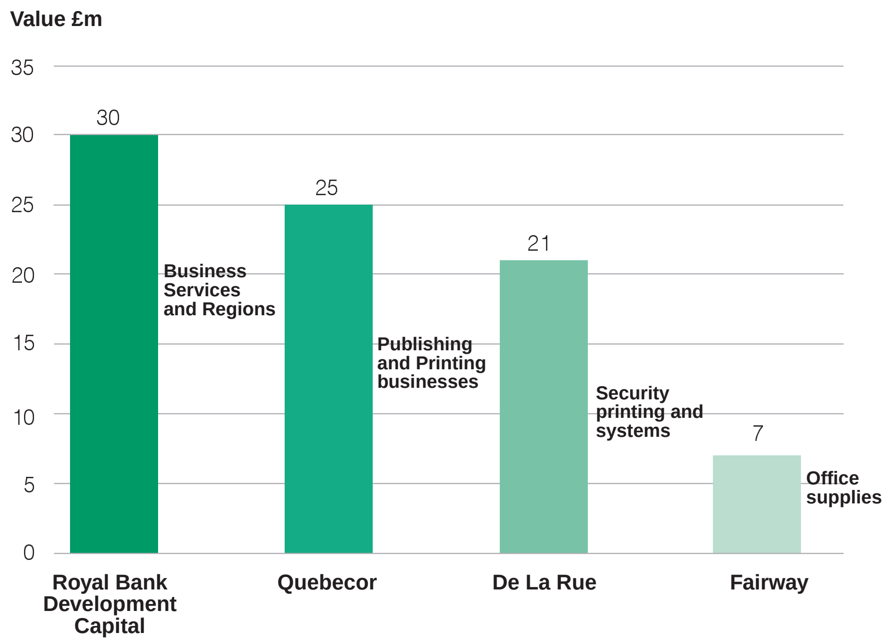
Figure 9 shows the range of headline indicative bids received for the whole of The Stationery Office in May 1996.

The shaded area in four of the bids represents ranges of consideration offered by these bidders at the indicative bidding stage.

Source: Cabinet Office (OPS)

The range of indicative bids for specific parts of The Stationery Office

Figure 10



Source: Cabinet Office (OPS)

Figure 10 shows the four bids received for parts of The Stationery Office. The Cabinet Office (OPS) stated in the Information Memorandum that bids for parts of the business would have to keep together The Stationery Office's printing and publishing operations.

3.16 The Cabinet Office (OPS) evaluated all bids based upon criteria set out in the Information Memorandum. These are shown in Figure 11. The Cabinet Office (OPS) made it clear that they would prefer to sell the business as a whole to one buyer rather than sell different parts of the business to separate buyers.

3.17 Four bidders were shortlisted at the end of May 1996 on the basis of the amounts offered and the quality of their bids measured against the evaluation criteria. Coopers & Lybrand advised the Cabinet Office (OPS) to shortlist four rather than three bidders because of concerns about sustaining competition in the later stages of the sale and the risk that the vendor might be left in a weak bargaining position if too few bidders were selected. Had a shortlist of three been chosen, the eventual purchaser (the National Publishing Group) would not have reached the final bidding stage because they had been placed fourth in the evaluation of indicative bids, though second in terms of proceeds offered. Although some bidders expressed concern at the size of the shortlist, they recognised that this was in the vendor's interest.

Criteria used in evaluating bids

Figure 11

The following criteria were used by the Cabinet Office (OPS) to evaluate indicative bids:

- the financial value of each offer;
- the purchaser's financial status, including the availability of parent company guarantees if appropriate;
- the preference to sell the business as a single entity;
- the credibility of the purchaser's long-term business plans;
- the purchaser's commitment to ensuring continuity of service to existing customers and acceptance of terms and conditions in existing contracts;
- the specific arrangements put forward by the purchaser to satisfy the needs of the Houses of Parliament and other existing customers;
- the purchaser's commitment to developing The Stationery Office;
- the purchaser's intentions regarding The Stationery Office staff and the prospects for them;
- the requirement for the purchaser to provide a pension scheme for The Stationery Office staff which is broadly comparable to the Principal Civil Service Pension Scheme.

3.18 One of the unsuccessful bidders told us that they were not satisfied that they had been excluded justifiably from the shortlist. Their bid was assessed by the Cabinet Office (OPS) and their financial advisers, Coopers & Lybrand, on the basis of the criteria shown in Figure 11. Although they had submitted one of the four highest indicative bids for the business their bid was not selected when the various quality factors were taken into account. But like three other failed bidders, they believe that they may have understood the business better than other bidders, who they believe put in unrealistic bids based on Her Majesty's Stationery Office's management's trading forecasts contained in the Information Memorandum which turned out to be over-optimistic. They believe that the reduction in shortlisted bids which followed due diligence raises questions about the equity of the sale process and the value for money achieved in the sale. As we stated in paragraph 3.2, a range of factors contributed to the decline in bid values and it is not possible to determine the impact of any single element. Nor is it possible to determine how any other shortlist of bidders would have reacted to the changing circumstances. We have examined the shortlisting process carefully and found no evidence that any bidder was unfairly treated.

Final bids

3.19 At the start of the due diligence process (ie. when the final bidders were given the opportunity to carry out detailed verification of the facts and assumptions that they used as the basis upon which to bid) Coopers & Lybrand were concerned that some bidders might withdraw because they did not see the chances of winning warranted the significant bidding costs. Because of this Coopers & Lybrand decided to recommend, exceptionally, that payments of £100,000 should be made to each unsuccessful shortlisted bidder at the conclusion of the bidding process. They considered that without these payments bidders might not have been willing to continue bidding.

3.20 We asked bidders whether this was an important factor in keeping them involved in the bidding process. Views differed in that some stated that they considered £100,000 was not significant when compared to their total bidding costs while others felt that the contribution had been helpful, particularly in circumstances where four bidders were conducting due diligence.

3.21 We note that the Cabinet Office (OPS) and their advisers considered the issues carefully before agreeing to contribute to the advisory costs of unsuccessful bidders. They did so on the basis that some bidders would otherwise have withdrawn and that this would have had a serious impact on the bidding process. We would only expect such payments to be justifiable in exceptional circumstances and that vendors in future sales should consider the options very carefully as the Cabinet Office (OPS) did in this case and ensure that there is documented justification of their detailed consideration.

3.22 Each shortlisted bidder was provided with further information on The Stationery Office to enable them to carry out due diligence before the submission of final offers, including:

- Her Majesty's Stationery Office's Business Plan for the period 1996 to 1998;
- The Long Form Report prepared by Binder Hamlyn;
- Discussions with key managers and others as appropriate;
- The Draft Sale and Purchase Agreement and related legal documentation;
- Access to a data room containing further information.

3.23 During the due diligence process it quickly became apparent to bidders that the Information Memorandum and the business plan had been over optimistic in their assumptions about the business. Furthermore, during this key stage of the sales process bidders saw that despite good initial results monthly targets for profitability and margins were not being achieved. Bidders also had concerns that management were unable to provide all the financial information which they said that they would have expected, and were worried about internal financial and management controls which were exemplified by the business's inability to correct unreconciled balances of the order of £19 million between the new business units of Her Majesty's Stationery Office. These problems experienced by the four shortlisted bidders contributed in part to a decline in the value of final bids received.

3.24 Bidders' concerns about the business were expressed in a number of ways and contributed to an increasingly pessimistic view of the business. For example, one bidder suggested in June 1996 to the Cabinet Office (OPS) at the end of their first week of due diligence that they could not proceed to make a final bid since they had doubts about whether the business remained a going concern. Another asked for an agreement whereby if the unreconciled balances could not be resolved they should be compensated by £9 for every £1 of unreconciled balance. Two bidders also told us they doubted whether it was sensible to sell a business in the midst of a complex restructuring programme.

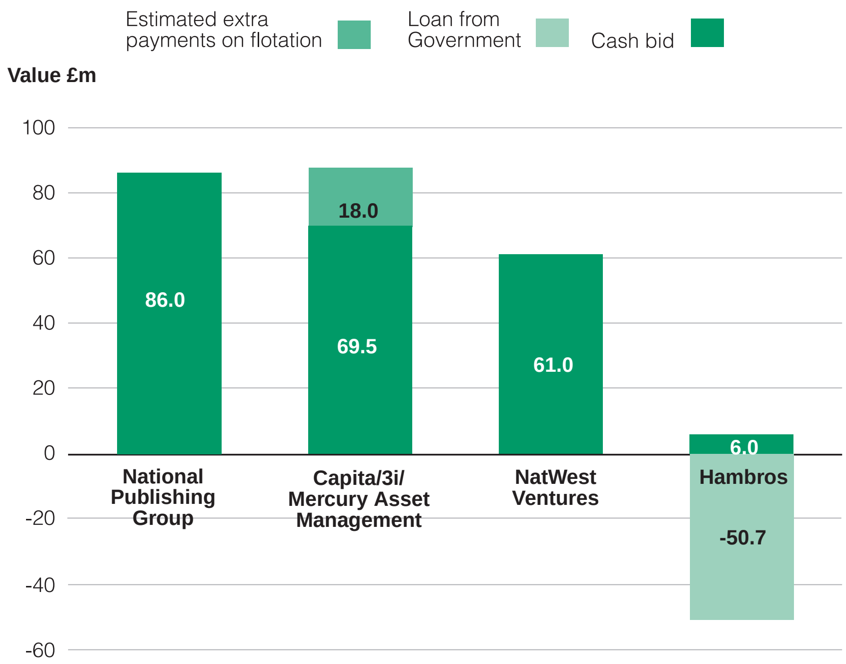
3.25 Final bids were received in early July 1996 and ranged from £6 million to £86 million (compared with £25 million to £170 million at indicative bid stage) as shown in Figure 12. Bidders generally reduced their bids between the indicative and final bidding round because of the deterioration in Her Majesty's Stationery Office's performance, poor financial and management control and accounting difficulties. They found that their initial assumptions based on the Information Memorandum that the purchase of The Stationery Office would be achieved with relatively little investment in the business and the prospect of a good and positive cash flow proved optimistic. Some bidders also had wrongly assumed that they would be able to derive significant sums from the exploitation of Crown copyright.

Selection of preferred bidder

3.26 The Cabinet Office (OPS) decided to take forward bids from a consortium led by Capita involving Mercury Asset Management and 3i, and the National Publishing Group including Electra Fleming. The National Publishing Group's bid was in cash whereas Capita's offer included a share of any profit made in the event that The Stationery Office was floated on the stock market.

The range of final bids for The Stationery Office

Figure 12



Source: Cabinet Office (OPS)

Figure 12 shows the range of final bids for The Stationery Office received in July 1996. The Capita/3i/Mercury Asset Management bid included extra payments to the Government in the event of a future flotation of the business. The shaded area shown in this bid reflects the Cabinet Office (OPS)'s assessment of the likely value of such payments.

3.27 Coopers & Lybrand analysed Capita's offer using sensitivity analysis and concluded that it did not represent a better deal for the taxpayer than that from the National Publishing Group. They calculated that the total value of Capita's bid was unlikely to exceed the proceeds offered by the National Publishing Group. The difference was, however, marginal if Capita had been able to float the business at a value of at least £250 million (which was considered to be towards the top end of the range achievable) and had been able to float before 2000.

3.28 The Cabinet Office (OPS) wished to keep both bidders interested on the basis that competition between the bidders would lead to the best price and to act as a fallback in case the chosen bidder dropped out. During negotiations at the end of July, however, Capita asked the Cabinet Office (OPS) to name either them or the National Publishing Group as the preferred bidder and made it clear that they were not prepared to incur heavy bidding costs if both parties' bids continued in the contest. The Cabinet Office (OPS), faced with this position, decided on the advice of Coopers & Lybrand to reject the Capita bid and to select the National Publishing Group as the preferred bidder. They judged that the National Publishing Group's bid was higher in terms of both proceeds and quality and that it left fewer issues to be resolved than the competing Capita bid. The need to choose a single preferred bidder at this stage weakened the Cabinet Office (OPS)'s negotiating position in the two months prior to sale, particularly when the state of the business's finances encouraged the preferred bidder to demand further concessions.

3.29 During the period leading up to the selection of the preferred bidder there was competition between bidders at all key stages of the sale process and the confidentiality of the bidding process was maintained. In particular, bidders did not succeed in obtaining information about the ranking of their bids.

Negotiations with the National Publishing Group

3.30 During the negotiations the National Publishing Group had stated that while their offer of £86 million at the final bidding stage was a firm offer this would be dependent upon securing an agreement on the final value of the business's net assets. Further negotiations in August 1996 resulted in the £86 million being reduced to £69 million because the National Publishing Group's bid required the use of accounting policies which they believed were more in line with those generally accepted in the private sector. They were also not prepared to accept the risks associated with the poor quality of the information available from the business and considered that the accounting policies should be applied prudently. The reduction of £17 million represented a provision in respect of certain items which included:

- the revision of plant and machinery net book values to historic cost;
- the write-off of leasehold property values;
- the amendment of depreciation method and rates;
- additional provisions for repairs and dilapidations;
- an accrual for holiday entitlement;
- a provision for the costs of maintaining surplus leasehold properties;
- extra provision for sundry known claims.

3.31 It had originally been intended that the closing sum received by the vendor would depend on "completion accounts" that accurately quantified the net asset value of the company on the date of sale. All four final bidders made it clear that their figures would be adjusted in the light of these accounts since without such a safeguard a buyer would be concerned that a vendor could (for example) manipulate debtors and creditors to maximise and then extract cash balances, leaving the business with a disproportionate level of liabilities.

3.32 Towards the end of August 1996, however, it became clear to both the Cabinet Office (OPS) and the National Publishing Group that the finalisation of completion accounts would involve considerable further delay and difficulty. The National Publishing Group therefore made a proposal to the Cabinet Office (OPS) that it would reduce its offer of £69 million by a further £15 million to £54 million (representing a reduction of £32 million compared with their initial final bid of £86 million). In return the National Publishing Group would give up all possibility of later reductions based on completion accounts thereby transferring any further risks to the new owners. This proposal was accepted by the Cabinet Office (OPS) who judged that had they not agreed to the £15 million additional reduction they could have suffered negative adjustments to the sale price under completion accounts of up to £22 million.

3.33 At the beginning of September 1996 the Cabinet Office (OPS) agreed with the National Publishing Group an option for the National Publishing Group to buy the business on 30 September for £54 million payable in cash on completion. There were to be no post-completion adjustments whilst exchange and completion were to occur simultaneously on 30 September 1996. This option agreement was signed on 10 September 1996. This also provided that cash left in the business at completion would be retained by the Cabinet Office (OPS). All aspects of the agreement, including the retention of cash, were dependent upon the business being required to "trade normally" until completion so that net assets could not be manipulated to the vendor's advantage.

3.34 Traditionally, Her Majesty's Stationery Office's cash flow has always been at its worst during the August to October period because of the cyclical pattern of customer demand and in the period leading up to the completion of the sale, it became apparent that the business was running short of working capital and might breach its statutory borrowing limit of £50 million. How much money was available, however, was not clear, partly because of the problems described in paragraphs 1.15 to 1.30, concerning devolved accounting, and partly because cash was spread across 76 bank accounts. Her Majesty's Stationery Office also had no means of knowing how many bills would be presented in the last few days before the sale of The Stationery Office took place or how much money would be received from customers. It seemed likely, however, that without tighter credit control procedures, they would breach the statutory borrowing limit by several - perhaps six - million pounds. Therefore, on 20 September Her Majesty's Stationery Office, with the agreement of the Cabinet Office (OPS), decided to suspend all payments to suppliers and they thereby ceased to trade normally, contrary to the undertaking that they had given to the National Publishing Group.

3.35 The Cabinet Office (OPS) and Her Majesty's Stationery Office intended to release the cash on 30 September to enable bills to be paid before the sale but neither could be sure about the amount of cash available and the purchaser could not have confidence that the position was not being manipulated to his disadvantage. The Cabinet Office (OPS) therefore agreed with the National Publishing Group in a side letter to the main agreement dated 27 September 1996, that all unpaid supplier invoices would be transferred to The Stationery Office in return for the accompanying transfer of all cash at 30 September. It later transpired that the total cash in hand and at bank at 30 September 1996 was £3,824,000. Of this sum, £3,803,000 was held in Her Majesty's Stationery Office's bank accounts and £21,000 was held in cash at the close of business and was duly transferred to The Stationery Office.

3.36 Failure to compensate the purchaser in this way may well have led to a breakdown in the deal negotiations. It is not possible to determine with certainty who benefited from these completion arrangements because Her Majesty's Stationery Office told us that it now has no means of providing a figure for the value of bills which had remained unpaid. The National Publishing Group, however, told the Cabinet Office (OPS) immediately after the sale in October 1996 that they believed that the Cabinet Office (OPS) had benefited by about £5 million. Later, after the resolution of the accounting problems they informed us that the amount of additional creditors that they subsequently had to pay probably exceeded cash by about £2 million.

Liabilities

3.37 During negotiations between the National Publishing Group and the Cabinet Office (OPS) it was agreed that while liabilities would generally transfer to the purchasers at the point of sale some claims would remain with the Cabinet Office (OPS) as the bidders refused to accept them at what the Cabinet Office (OPS) judged a reasonable price. These have been already disclosed in our report on the Her Majesty's Stationery Office Trading Fund Accounts for the year ended 30 September 1996 (a table of liabilities which remain with the Cabinet Office (OPS) is shown in Appendix 2).

3.38 Her Majesty's Stationery Office had incurred a long term liability on their former Headquarters building, called Sovereign House, in Norwich where the under floor computer block was in poor condition and required considerable repairs. The sale and purchase agreement gave The Stationery Office the right to re-assign the lease of the building to the Cabinet Office (OPS) at any time up to 30 March 1997. In October 1996 the landlord served a list of dilapidations on The Stationery Office at an estimated cost of £1 million. On 23 December 1996, The Stationery Office exercised its re-assignment option and the Cabinet Office (OPS) thus became liable for the cost of repairs and for rent obligations of £97,500 per year until 2011.

Appointment of Cabinet Office (OPS) advisers and sale costs

3.39 We found that the Cabinet Office (OPS) advertised and appointed advisers competitively in all cases, in line with previous recommendations made by the Committee of Public Accounts. Given the problems encountered during the course of the sale we consider that the increases in advisers' costs were reasonable. We commend the approach of the Cabinet Office (OPS) in strictly adhering to agreed ceilings for fees with advisers. The list of main advisers appointed during the sale process is shown in Appendix 3.

3.40 From the outset the Cabinet Office (OPS) attempted to estimate the overall cost of the project. At the start of the process in the autumn of 1995 they hoped that Her Majesty's Stationery Office's long history as a Trading Fund would mean that accounts, reporting systems and business plans would be reliable and easily accessible. Based on this assumption the total estimate for fees was put at £967,500 (excluding VAT and expenses).

3.41 By February 1996 it had become clear that to privatise The Stationery Office successfully would cost more than originally thought. This was primarily because advisers such as Coopers & Lybrand found that they had to undertake much more work than they had anticipated and that, for example, the later emergence of a difficult and worsening financial picture had rendered some of the completed work unreliable and meant that a significant but realistic increase in fees was inevitable. In the case of Coopers & Lybrand their fees rose from some £382,500 to £679,000. This latter figure was capped which avoided the Cabinet Office (OPS) having to pay an additional £140,000 (excluding VAT) that would otherwise have been payable.

3.42 Figure 13 shows the budget for sale costs compiled in February 1996 and compares it with the outturn for the whole privatisation. Overall the outturn exceeded the budget by 11 per cent. More work was required by the Cabinet Office (OPS)'s legal advisers, Field Fisher Waterhouse because they had to provide advice to finalise the contracts under which Residuary HMSO and The Stationery Office were to operate after privatisation and to provide legal support during the final two month negotiation period with the National Publishing Group. Both these tasks proved more complex and demanding of time than expected.

Advisers' fees

Figure 13

Advisers	Budget £(000)	Outturn £(000)	Variation
Coopers & Lybrand	701	696	-1%
Binder Hamlyn	139	223	60%
Field Fisher Waterhouse	607	802	32%
Government Property Lawyers	125	56	-55%
Government Actuary's Department	50	51	2%
Other Expenditure	79	56	-29%
Total	1,701	1,884	11%

Notes:
1. The budget was calculated in February 1996. All amounts are shown net of VAT and exclude expenses incurred by advisers which totalled an additional £84,423.
2. The three unsuccessful shortlisted bidders (Capita, NatWest Ventures and Hambros) were each paid £100,000 towards their bidding costs. The amounts are not shown in this table.
3. The £696,000 total for Coopers & Lybrand fees includes payments of some £17,000 representing extra work performed outside the privatisation contract.

Figure 13 shows that the outturn costs of the privatisation amounted to £1.88 million compared with the budget of £1.7 million.

Source: Cabinet Office (OPS)

3.43 More effort was also required from the reporting accountants, Binder Hamlyn, because the initial financial information on which they based their early work in January 1996 proved inadequate and they had to update significantly the Long Form Report in April and May 1996 to include commentary on the audited accounts and Her Majesty's Stationery Office's Business Plan. Later they also advised the Cabinet Office (OPS) on whether it would be possible to compile completion accounts which would be acceptable to the purchaser. Savings were made, however, on the use of Government Property Lawyers because the legal problems of Her Majesty's Stationery Office's freehold and leasehold property proved more straightforward than anticipated. The costs of printing sale publications were borne by Her Majesty's Stationery Office itself rather than paid for by the Cabinet Office (OPS).

4. The needs of Parliament and other customers

4.1 This part of the report examines the extent to which the needs of Parliament and other customers were satisfied in the sale process. It describes how Residuary HMSO was created, and explains why it will continue to have an important function in supervising Crown and Parliamentary copyright. It also explains how a framework agreement was established between Residuary HMSO and The Stationery Office so that existing trading relationships could be continued for Crown Departments which did not conclude contracts with The Stationery Office prior to sale.

4.2 The report then examines the contracts put in place for both Parliamentary and other customers and explains why these were of particular lengths. The report also examines how customers were treated and investigates whether they were satisfied with the sale process.

The creation of "Residuary HMSO"

4.3 Residuary HMSO has been retained within Government to discharge statutory and quasi-statutory functions such as:

- carrying out the Queen's Printer responsibilities in relation to Acts of Parliament, Church of England Measures, Statutory Instruments and Statutory Rules of Northern Ireland;
- superintending of the London, Edinburgh and Belfast Gazettes;
- control and administration of Crown copyright;
- administration of Parliamentary copyright; and
- control of the Votes for supply of publications to United Kingdom Members of the European Parliament, and the Public Library Subsidy.

4.4 The Cabinet Office (OPS) considered it appropriate to keep such statutory responsibilities, which safeguarded Crown and Parliamentary copyright, within the public sector. These functions had been performed by part of Her Majesty's Stationery Office before privatisation.

4.5 It was necessary, however, to draw up contracts between Residuary HMSO and The Stationery Office because of the latter's new commercial status. For example, a series of contracts of between four to five years' duration was put in place to allow the printing of Acts, Statutory Instruments and Gazettes. The production of these key Government documents has therefore been protected for the length of the contracts and Residuary HMSO will be able to hold a normal competitive tendering process prior to the expiry of the contracts.

The residuary HMSO framework agreement with The Stationery Office

4.6 A framework agreement was established between Residuary HMSO and The Stationery Office to provide services to Residuary HMSO and other Crown bodies for a period of 18 months following the sale. This was designed to maintain in the short term existing trading relationships between The Stationery Office and those Crown Departments which did not agree to formalise agreements prior to sale. The framework agreement essentially replicated the suppliers' terms and conditions which Her Majesty's Stationery Office had offered to customers prior to the sale. These agreements ensured that:

- The Stationery Office continued to provide Residuary HMSO and other Crown bodies which did not have separate contractual agreements with the new company, with goods and services listed in its general catalogues, and at prices which reflected preferred customer status. Print and publishing services, copiers and business systems machines were supplied on a similar basis;

- the goods and services to be provided included the supply of stationery, copier paper, envelopes, consumables, machinery, equipment and furniture listed in its catalogues.

4.7 We consider that the framework agreement allows customers to trade with The Stationery Office on similar terms to those in operation before privatisation. In particular the framework agreement, which does not commit customers to using The Stationery Office, maintains existing trading relationships and protects small customers from losing a long-standing supplier with no immediate alternative.

Contracts with customers

4.8 During the year prior to the sale each customer was approached by Her Majesty's Stationery Office and offered the opportunity to formalise agreements which had previously been in existence between the business and its public sector customers. (There were no contracts in place prior to sale because a public sector body cannot conclude contracts with another part of the public sector). These agreements would then convert into contracts on privatisation.

4.9 There was no compulsion on customers to formalise the agreements and while many chose to translate the agreements into contracts, not all considered it in their interest to do so. The contracts were designed to mirror the existing agreements (many of which had already been subject to a competitive tendering process) and particular care was taken either to secure that the length of the contracts did not extend beyond the length of the pre-existing supply and service agreements or that where new contracts were put in place these were kept as short as possible (about 18 months). The contracts with the House of Commons and House of Lords are rather longer, being of over three years duration.

Parliamentary customers

4.10 We discussed the outcome of the sale process with officials from the House of Commons and the House of Lords and examined the extent to which Parliamentary customers were satisfied with the outcome of the sale process and whether Parliamentary concerns as expressed by the Speaker of the House of Commons in a letter to the Chancellor of the Duchy of Lancaster had been properly taken into account when the contracts were drawn up. The Speaker's concerns are shown in Figure 14.

The concerns of the Speaker of the House of Commons

Figure 14

The following concerns were expressed by the Speaker of the House of Commons in a letter to the Chancellor of the Duchy of Lancaster of 28 November 1995:

- the retention of overnight production facilities in inner London;
- the making available of adequate space and facilities in the Parliamentary Press for House staff for as long as the House requires;
- substantial continuity in the staffing and management of the relevant sections of The Stationery Office after privatisation and adequate training for new staff;
- prior consultation with the House before any significant changes in the management or organisation of The Stationery Office's directorate of Parliamentary and Statutory publishing;
- there should be a nominated individual within The Stationery Office responsible for contact with the House;
- no attempt should be made to water down the supply and service agreement after privatisation;
- the purchaser of The Stationery Office should accept the principles set out in the supply and service agreement; and
- there should be no increase in charges (in real terms) above those applicable in 1996 and that the House should be credited with a proportionate share of future savings arising from technological advances.

Source: letter from the Speaker to the Chancellor of the Duchy of Lancaster of 28 November 1995

4.11 Both Houses had already, prior to privatisation, concluded supply and service agreements to enable Parliament to be provided with printing and publishing services more effectively. Officials of both Houses told us that they considered that the pre-existence of these agreements was very helpful to the process. They considered that if the Cabinet Office (OPS) had tried to sell The Stationery Office without such agreements the process would have been much more difficult, particularly given timetable constraints.

4.12 Before the agreements were converted into contracts both Houses had the opportunity to renegotiate on aspects which concerned them. (This was a privilege not granted to other customers who were not given the opportunity to alter the terms of existing agreements.)

4.13 We found that seven of the eight principal concerns expressed in the Speaker's letter to the Chancellor had been met through the contracts established. The one exception was the concern that The Stationery Office should provide substantial continuity in the staffing and management of the relevant sections of the business after privatisation, and adequate training for new staff, where it was found impossible to satisfy this aim in a contractual form. Nevertheless, it remains in The Stationery Office's best interests to ensure that this concern is met. Officials of the Houses have told us that they have been satisfied that staffing standards and continuity have been maintained. The senior management of The Stationery Office have told us that the staffing and management of their Parliamentary business will remain a high priority.

4.14 The House Officials who are also responsible for monitoring the Parliamentary contracts have told us that while it is too early to come to a clear view about service quality there does not appear to have been any overall reduction in this since privatisation and some of the concerns which Officials had about the service prior to the sale have not been realised. They consider that this was partly due to the close attention they had paid to the contract negotiation prior to sale which had resulted in clauses being included in the contracts which met worries such as those expressed in the Speaker's letter.

4.15 House Officials were also pleased to have negotiated contracts of over three years duration which provide Parliament with some certainty that the business of the Houses will not be adversely affected by the new arrangements. The House Authorities can, under the terms of the contracts, extend them by up to two years. Prior to their expiry, the contracts will be subject to a normal competitive tender process.

Other customers

4.16 We examined the way other, non-Parliamentary customers of Her Majesty's Stationery Office were treated and asked them whether they were satisfied with the sale process. We also interviewed representatives from the following Government Departments or agencies :

- Benefits Agency;
- Customs and Excise;
- the former Department of the Environment;
- Inland Revenue;
- Ministry of Agriculture, Fisheries and Food;
- Northern Ireland Office (Government Purchasing Agency).

4.17 Some customers (for example, the Inland Revenue) had already market-tested a major proportion of their work prior to the commencement of the privatisation process which had resulted in work, traditionally performed by Her Majesty's Stationery Office, being lost to other suppliers before privatisation. In other departments (for example, the former Department of the Environment) market-testing was not at such an advanced state with the result that Her Majesty's Stationery Office had retained a greater proportion of their business.

4.18 The Cabinet Office (OPS) asked Her Majesty's Stationery Office to draw up contracts with their existing customers which took into account the impact of European Community Supply Services Directives upon the provision of services to public bodies. The contracts entered into therefore fulfilled the following conditions:

- the contracts mirrored as far as possible the pre-existing administrative arrangements;
- the contracts covered only existing types or categories of work; and
- the contractual terms were kept to a minimum (eg. most contracts with non-Parliamentary customers are about 18 months in length).

4.19 The Cabinet Office (OPS) consider that the privatisation will expose The Stationery Office to a wider market and that, in due course, all contracts held by Government Departments with The Stationery Office will be subject to competitive tender on their expiry.

4.20 The customers interviewed by us were content that the contracts put in place had enabled them to maintain the previous arrangements which had already been concluded, in many cases following competitive tendering procedures. The customers said that they had chosen to formalise these agreements in their own interests and that no pressure had been put on them by Her Majesty's Stationery Office or by the Cabinet Office (OPS) to do so.

4.21 A number of customers told us that in the immediate post-sale period they had experienced some operational problems with the new privatised company. These were caused mostly by the disappearance of previous working level contacts either because staff had been moved within The Stationery Office or they had left the organisation as part of the large redundancy programme implemented following the sale. Customers believed, however, that this was a temporary problem and that The Stationery Office has been generally successful in re-establishing and improving good customer relations after the immediate post-sale period.

4.22 One customer (the Government Purchasing Agency in Northern Ireland) told us that one concern prior to privatisation had been that, should The Stationery Office be broken up and certain parts sold to trade buyers, they might face a quasi-monopoly supplier in certain markets. Nevertheless, customers were content that this had not happened and that The Stationery Office appears to be committed to maintaining the major elements of the business.

Length of contracts

4.23 We examined whether the length of the contracts awarded had an effect on the value for money achieved in the sale. It is usual in trade sales for the length of contracts to have some effect on proceeds and the vendor will wish to conclude contracts as long as possible because that will lead to a higher price being obtained. The purchasers would clearly have preferred longer contracts because this gives them secure income flows post-sale but they realised from the Information Memorandum and subsequent bid documentation that the contracts were not negotiable and bid on that basis. Although the short length of some of the contracts may have reduced proceeds from the sale itself we consider that it would not have been right to extend these contracts to enhance proceeds, because to have done so would have forced customers to enter into lengthy contracts which may not have provided value for money. In this sale the contracts were based on existing agreements which had been concluded, often after a process of competitive tender, with no reference to the privatisation process and conditions were not subject to alterations either by The Stationery Office or by the customers.

4.24 Moreover, customers were under no obligation or pressure to convert their agreements into contracts and could choose to do so based upon their view of their own interests. We consider that the pre-sale arrangements did not threaten the value for money achieved by customers since they were free to refuse to formalise their contracts if they so chose and the contracts were not extended beyond their pre-existing length.

Glossary

Benchmark Valuation	A pre-sale valuation of a business prepared by or on behalf of the vendor before any bids have been received
Completion Accounts	Accounts compiled at the end of a sale to agree the value of assets upon which final consideration will be paid
Completion Date	The date on which the sale was actually effected (30 September 1996)
Crown Copyright	The intellectual rights in documents and electronic material held by the Crown
Data Room	A site where prospective purchasers have access to documents relating to the sale of the business
Due Diligence	A process by which preferred bidders can verify the facts and assumptions that they have used as the basis upon which to bid
Final Bid	The second-stage bid for The Stationery Office made by the four shortlisted bidders
Financial Buyer	A financial institution or consortium of financial institutions who wish to purchase a business
Indicative Bid	An initial bid for The Stationery Office which was not binding and was based on the information contained in the Information Memorandum
Information Memorandum	A formal selling document supplied to prospective purchasers which includes financial and other information about the company to be sold
Long Form Report	A report prepared by a firm of accountants which sets out in detail financial and other information about the business to be sold. This was made available to the four shortlisted bidders
National Loans Fund	Government fund administered by HM Treasury which provides loans for public sector entities
Net Assets	The Balance Sheet assets of a company less its liabilities
Parliamentary Copyright	The intellectual rights in documents and electronic material belonging to Parliament
Preferred Bidder	The bidder who is selected by the vendor as being the party to whom it intends to sell the business, subject to the completion of negotiations and legal arrangements
Pre-Qualification	The selection of suitable applicants to be invited to submit indicative bids for The Stationery Office
Privatisation	Sale to the private sector of a company or business previously owned by the State
Profit Clawback	Provisions, usually limited in duration, in the terms of the sale enabling the vendor to receive a proportion of any subsequent profit made by the purchaser after sale
Reporting Accountants	Accountants employed by the vendor prior to sale to produce an independent and detailed "Long Form Report" on the business to be sold. This report is given to all shortlisted bidders.

continued …

Sale and Purchase Agreement	The formal legal document signed by the vendor and the purchaser under which terms The Stationery Office was sold
Trade Buyer	A prospective purchaser who already owns businesses similar to those operated by The Stationery Office
Trade Sale	A sale of an entity to another business
Trading Fund	An activity of Government which has its own balance sheet and profit and loss account and which prepares its own accounts separately from other Government Departments
Working Capital	Those net current assets of a business (consisting of stock, debtors and cash) which that business requires to generate income.

Appendix 1

Methodology used by the National Audit Office

1 The National Audit Office examined how the Cabinet Office (OPS) achieved the following objectives relating to the sale of Her Majesty's Stationery Office:

- to implement the privatisation so as to maximise value for money for the taxpayer;
- to ensure that staff are treated fairly and that their rights are respected in the sale process;
- to ensure that the needs of Parliament and other existing customers are satisfied, as appropriate, by contracts or other suitable arrangements for the provision of services; and
- to complete the privatisation as soon as is reasonably practicable.

Main aspects of the National Audit Office Methodology

2 The main aspects of the methodology used were:

- the collection of information relating to the sale and to the Cabinet Office (OPS)'s handling of the sale process;
- interviewing parties who had a substantial interest in the sales process including all four shortlisted bidders, trade unions, eight customers of Her Majesty's Stationery Office including officials from both Houses of Parliament, the Chairman and Chief Executive of The Stationery Office and management from Residuary HMSO;
- examination of the valuation methodology used by Coopers & Lybrand and the Cabinet Office (OPS);
- examining with Cabinet Office (OPS) officials the key aspects of how they handled the sales process; and

- evaluating the evidence obtained from interviews and from documentary sources.

The evaluation of the information collected

3 The approach adopted was to assess how the major decisions made by the Cabinet Office (OPS) in their conduct of the sale process impacted on the achievement of their objectives. Methods for evaluating the information which had been collected included:

- an assessment of whether the decisions taken by the Cabinet Office (OPS) maximised the likely achievement of their objectives;
- an assessment of whether decisions were taken against a background of appropriate information and after taking appropriate advice;
- consideration of whether the Cabinet Office (OPS) had taken appropriate account of all their objectives; and
- consideration of whether the Cabinet Office (OPS) had familiarised themselves with the strengths and weaknesses of Her Majesty's Stationery Office at an early enough stage.

Appendix 2

Liabilities retained by the Cabinet Office (OPS)

Liability	Estimated Value £		Description
Benefits Agency	436,000		Alleged failure to deliver printed forms and related items to required standards
Siba Systems Ltd	-		Claim for alleged breach of Public Procurement rules - but claim was dropped in April 1997
Konica Ltd	179,000		Undercharging for photocopier rental
Radio Communications Agency	100,000		Payments under leases for photocopiers damaged in the Docklands bomb in February 1996
Employees	614,000		Those suffering from industrial injury or occupational disease existing at 30 September 1996
COMIND Ltd	135,000 40,000	(settled) (not settled)	Disputes over the publishing of future works by The Stationery Office (currently subject to arbitration)
Employees and third parties	Not possible to estimate		The Cabinet Office (OPS) indemnified The Stationery Office against any claims which might be made before 30 September 1998, relating to the period before the sale, by employees and third parties, or for acts of default or omission by Her Majesty's Stationery Office
Re-assignment option concerning Sovereign House	97,500	p.a. rent until 2011 plus estimated £1 million cost of repairs	Sale agreement gave The Stationery Office the right to re-assign the leases of Sovereign House in Norwich and Britannia House in London to the Cabinet Office (OPS). The re-assignment option was exercised in December 1996 in respect of Sovereign House. The Cabinet Office (OPS) therefore became liable for the cost of repairs and for rent obligations.
Potential re-assignment of Britannia House lease to Cabinet Office (OPS).	66,348 46,000	annual rental plus annual service charge	For Britannia House the Stationery Office can return the lease to the Cabinet Office (OPS) and limit its liability in respect of dilapidations at any time until 14 September 1999

continued …

Liability	Estimated Value		Description
	£		
Catherine Soultanovich Ltd	50,000	(plus costs)	Commission relating to stationery contract with Uztoshkitob.
Connect Business Systems	142,000		In relation to incorrect publication of a notice in the London Gazette.
The Stationery Office	16,000		Legal costs for arbitration in COMIND claims.
Belfast employees of Her Majesty's Stationery Office	Not possible to estimate		Exposure to asbestos.

This Appendix shows the estimated liabilities retained by the Cabinet Office (OPS) after The Stationery Office was sold.

Source: Her Majesty's Stationery Office Trading Fund Accounts 1996 and the Cabinet Office (OPS)

Appendix 3

The Cabinet Office (OPS)'s advisers on the sale

Adviser	Description of tasks	Fees
Coopers & Lybrand	Financial Adviser Advise on bidding process; produce the Information Memorandum; carry out benchmark valuation; evaluate indicative bids; recommend shortlist; assist in due diligence; evaluate final bids; advise in negotiations and recommend winning bidder.	£696,000
Binder Hamlyn	Reporting Accountants Produce long form report and give accounting advice.	£223,000
Field Fisher Waterhouse	Legal Advisers Produce legal documentation for sale, verify Information Memorandum, advise on the novation of contracts and the application of EC law. Develop arrangements for Residuary HMSO and produce all necessary legal documentation. Also advise on bids and related issues.	£802,000
Government Property Lawyers	Advise on property law	£56,000
Government Actuary's Department	Advise on pension issues	£51,000