NAO
NATIONAL AUDIT OFFICE

Report by the
Comptroller and Auditor General

# The Sale of PSA Projects

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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
29 October 1997

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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# Preface

In March 1995, the Comptroller and Auditor General published an interim report on the sale of PSA Projects to Tarmac Construction Limited (HC306 of Session 1994-95). This report noted that the purchaser was required to submit a completion statement within seven months of the sale; and that any dispute on agreeing the adjustment to the sale price in the light of the statement would be referred to an independent expert. The interim report noted that PSA Services and Tarmac were unable to agree on the adjustments; and that the Department were seeking, through legal action, to enforce referral to an independent expert. Until a settlement was reached, the National Audit Office were unable to conclude on the outcome of the sale. Now that the independent expert has announced his decision, on 20 December 1996, the National Audit Office are able to make their final report on this sale.

# Executive summary

**1** PSA Services, formerly part of the Department of the Environment (the Department[1]), provided Government departments with a wide range of building and property related services through three organisations: PSA Projects, PSA Building Management and PSA International. This report deals with the sale of PSA Projects who provided design and project management services for major construction schemes together with surveying and specialist advisory functions.

**2** The sale took place within a wider objective to transfer all of PSA Services's activities to the private sector as soon as possible while:

- protecting the interests of the taxpayer;
- consulting client departments and providing a continuous service; and
- protecting staff interests - in particular their pension and severance entitlements.

Ministers stated that they would prefer a sale unless closure was cheaper.

**3** Achieving a sale depended on the Department being able to make progress towards transforming PSA Projects into a commercial organisation which was a major task.

## Outcome of the sale

**4** **The Department sold PSA Projects to Tarmac Construction Limited (Tarmac) in December 1992, although the final price was not agreed until December 1996 due to a dispute over the value of the net assets transferred with the business.** The Department initially paid Tarmac £60.2 million as compensation for future losses, risk, net debts and to provide funds for investment and working capital. In addition, the Department subsequently paid £39.5 million in post sale redundancy costs, and recovered £55 million in trade debts that were excluded from the sale. The Department also guaranteed the redundancy

1 On 16 June 1997 the Department of the Environment merged with the Department of Transport to form the Department of the Environment, Transport and the Regions.

entitlements of those staff who transferred permanently with PSA Projects for a period of five years after the sale if Tarmac become insolvent. Should such entitlements mature, this guarantee carries a further potential cost of around £10.3 million. In view of Tarmac's underlying financial strength and as the guarantee expires in December 1997 the Department do not expect the guarantee to be called. The cost of untying and selling PSA Projects is summarised in Figure 1 (paragraphs 3.1, 3.2, 3.4, 3.5 and Figure 9).

**The cost to PSA Services of untying and selling PSA Projects**

**Figure 1**

**Outcome of the sale compared with the estimated cost of closure**

| | Payments £m | (Receipts) £m | Net Total £m |
|---|---|---|---|
| Payment to Tarmac | 60.2 | | |
| Department's share of post sale redundancy costs | 39.5 | | |
| Compensation in lieu of notice[1] | 4.1 | | |
| Adjustment for difference between the estimated and actual value of net assets[2] | | (19.9) | |
| Interest thereon[3] | | (2.6) | |
| **Cost of sale** | 103.8 | (22.5) | **81.3** |
| **Estimated Direct cost of closure** | | **£89m to £114m** | |

| **Other costs and receipts** | Payments £m | (Receipts) £m | Net Total £m |
|---|---|---|---|
| Realisation of trade debtors excluded from the sale[4] | | (55.0) | |
| Advisers' fees and other sale costs[5] | 7.6 | | |
| Pre-sale redundancy costs driven by the untying programme | 34.4 | | |
| **Other net receipts** | 42.0 | (55.0) | **(13.0)** |
| Contingency liability in the event of the purchaser becoming insolvent by 31 December 1997 | 10.3 | | |

Notes:
1. Most seconded staff were made redundant on their return to PSA Services. They were entitled to 6 months notice or compensation in lieu.
2. The recovery arising from the settlement of the dispute between Tarmac and the Department over the value of net assets.
3. Interest of £2.6 million was payable on the £14.84 million deposited by Tarmac in an escrow account.
4. Trade debts were almost entirely due from other Government departments and thus do not represent an inflow of funds to the Exchequer.
5. These costs are excluded from the comparison with the cost of closure as they occurred prior to July 1992 - when the evaluation of bids was carried out (Appendix 8, Table 2).

Source: PSA Services and the National Audit Office

**5** The sale agreement required PSA Projects to be sold with net assets of £2.8 million. To achieve this, the Department made a cash injection of £13.3 million following their estimate of the net asset position at exchange of contracts. To protect the taxpayer's interest this cash injection was subject to adjustment following a review of PSA Projects's net asset position at the point of sale. For this purpose Tarmac were required to submit a completion statement within seven months of the sale. The Department's original intention was to complete the review and agree any necessary adjustments for the difference between the estimated and actual value of net assets by 30 September 1993 (paragraphs 3.1 and 3.3).

**6** **It took four years for the parties to agree the completion statement following court action and the appointment of an independent expert, who valued net assets at £22.7 million, which was £19.9 million greater than the estimated value of net assets at the point of sale. Tarmac were therefore required to refund £19.9 million to the Department (paragraph 3.25).**

## The sale process

**7** **The sale price arose out of a competitive, widely marketed trade sale. Short-listed bidders told us that the Department evaluated their bids in a fair and open manner.** Although the Department made some progress in transforming PSA Projects into a commercial organisation, the amounts paid to Tarmac reflected the risks to bidders arising from: PSA Projects's declining fee income; the absence of audited commercial accounts and robust forecasts of future profitability; contract records which did not meet commercial standards; the valuation of contracts which were not in accordance with standard accounting practice; the need to shed further staff, despite a significant pre-sale redundancy programme which cost the Department £34.4 million; and the need for further improvements to both productivity and unit costs (paragraphs 1.9 - 1.14 and 2.24).

## The achievement of sale objectives

**8** The Department estimated that the direct cost of closing PSA Projects was between £89 million and £114 million. Figure 1 shows that, **at a cost of around £81 million, the Department achieved their objective of selling PSA Projects for less than the estimated cost of closure**. However, the undervaluing of net assets by £19.9 million shows that there was considerable uncertainty surrounding the financial history of PSA Projects and of its future prospects at the time of sale. **While the undervaluation of PSA Projects's assets was significant,**

**it is not possible to estimate with any precision the extent to which greater certainty on this aspect would have had an impact on the outcome of the sale and the costs to the taxpayer (paragraphs 4.1 and 4.7).**

**9** Disputes over final adjustments in complex sales are not uncommon, although four years is a long time to reach a settlement. The difficulties in reaching agreement were caused mainly by ambiguities in the accounting principles to be used. **The size of the eventual adjustment, £19.9 million, casts doubt over the Department's control and valuation of the business (paragraph 4.5)**.

**10** Although the sale agreement did not provide for interest on amounts in dispute the Department received interest on the sum deposited by Tarmac in the escrow account. However, the remaining £5 million paid by Tarmac to the Department did not attract interest. Consequently, Tarmac had the use of these funds interest free for four years (paragraph 4.6).

**11** To protect the interests of taxpayers, staff and clients any resale of PSA Projects in the first five years is subject to the Department's agreement, although this is not to be unreasonably withheld or delayed. The Department consider that resale is unlikely before December 1997 as Tarmac are not permitted to transfer their obligations for redundancy payments under the sale agreement to a third party (paragraph 4.11).

**12** The administrative costs of the sale, of £7.6 million, reflected the work needed to prepare the business for sale and provide support to its management (paragraphs 3.26 - 3.31).

**13** **Major client departments were consulted and provided with a continuous service following the sale**. Potential conflicts of interest, where Tarmac would be both contractor and project manager, were dealt with satisfactorily (paragraphs 4.13 - 4.15).

**14** **Employees' terms and conditions of employment are protected by the Transfer of Undertakings (Protection of Employment) Regulations 1981 and the European Acquired Rights Directive.** The purchaser adopted the Department's suggested pension scheme, which was broadly comparable to the Principal Civil Service Pension Scheme, and staff redundancy entitlements were guaranteed by both the Department and the purchaser. The Department's legal advisers confirmed that the Department had complied with all relevant legislation (paragraphs 4.16 - 4.19).

## Recommendations

**15** We recommend that:

### Recommendation 1

When assets are offered for sale care should be taken to provide the best possible information on the financial position and history of the assets; including a clear statement of the accounting principles underlying the valuation of all assets and liabilities at the point of sale and the provision of audited accounts. Their absence in this case may well have increased the perception of risk among buyers and hence limited their number and the size of their bids. Certainly the ambiguities regarding the valuation of assets contributed to the time and cost of the four year dispute about the completion statement.

### Recommendation 2

There are lessons to be learned from this sale which departments should take into account when planning future trade sales:

- the risk of underestimating the additional resources needed to make a traditional public sector body sufficiently commercial to achieve value for money on sale;

- the need for additional specialist advice or a second opinion on key sale provisions where substantial sums may be at stake;

- the need for sale agreements to provide for the payment of interest on settlements where there is a protracted dispute; and

- the need to consider, as was done in this case, innovative schemes for risk and redundancy sharing which stimulate competition and limit the Government's liabilities.

# Part 1: Background and preparation for sale

**1.1** The Property Services Agency was established to provide, manage and maintain the buildings and property used by Government departments. In the 1980s, responsibility for these functions was progressively devolved to user departments and, in April 1988, civil departments assumed full financial responsibility for major new construction works and became free to put out to competitive tender new project management and design commissions. The Department recognised that the introduction of competitive tendering would have a significant effect on PSA Services's business and lead to increased redundancy, restructuring and other costs. However, while the benefits of market testing could not be quantified, the Government believed that any additional costs would be more than offset by the savings that market testing would bring.

**1.2** Later in 1988, the Government announced that, from April 1990, these arrangements would be extended to include all civil and defence works activities. The Government also announced that those parts of the Property Services Agency responsible for providing works and estate services were to be restructured to form PSA Services; a part of the Department of the Environment (the Department). PSA Services was to become a commercially run trading fund from April 1993.

**1.3** Before these changes took effect the Government announced, in October 1989, that the activities which formed PSA Services would be privatised as soon as the necessary arrangements, including the introduction of commercial accounts and any necessary restructuring of the organisation, had been completed. The Department considered that the earliest practical date for privatisation lay in the second half of 1992. The Property Services Agency and Crown Suppliers Act 1990 provided the statutory authority for these proposals.

**1.4** PSA Services provided Government departments with a wide range of building and property related services through three organisations: PSA Projects, PSA Building Management and PSA International (Appendix 1). This report deals with the sale of PSA Projects who provided design and project management services for major construction schemes together with surveying and specialist advisory functions. The sale of PSA Building Management, who provided Government departments with building and estate management services, was the subject of a separate National Audit Office report (HC 130 1995-96). PSA International, which provided departments with property related services overseas, was closed during 1993.

## Objectives of the sale

**1.5** The sale took place within a wider objective to transfer all of PSA Services's activities to the private sector as soon as possible while:

- protecting the interests of the taxpayer;
- consulting client departments and providing a continuing service; and
- protecting staff interests and, in particular, their pension and severance entitlements.

**1.6** No further specific objectives were initially set for the transfer of PSA Services's activities to the private sector, although Ministers later stated that sale would be preferred provided closure was not a cheaper option. Key dates in the sale process are given at Appendix 2.

## Scope of the National Audit Office examination

**1.7** We examined:

- how the Department carried out the sale (Part 2);
- the outcome and administration of the sale (Part 3); and
- whether the sale objectives were achieved (Part 4).

**1.8** Our work included an examination of Departmental papers and discussions with officials, their principal external advisers (Appendix 3) and the short-listed bidders. The report contains an assessment of the main costs to PSA Services of the decision to untie departments from them and introduce competition into the services provided by PSA Projects. It does not, however, address the wider benefits of untying to other Government departments and Agencies. Pannell Kerr Forster, Chartered Accountants, acted as technical consultants to the National Audit Office.

## Preparations for sale

**1.9** Transforming PSA Projects into a commercial and saleable organisation was a major task, requiring progress to be made in:

- reducing staff numbers from over 2,400 to an estimated long-term core of about 900;
- increasing productivity by about 10 per cent and reducing unit costs by between 20 per cent and 30 per cent;
- improving PSA Projects's public image and reputation with some of their clients;
- introducing new working practices to change from a bureaucratic to a commercial culture; and
- producing commercial accounts for the first time.

**1.10** By the end of May 1992, when PSA Services launched the sale competition and issued the sale memorandum, they had:

- prepared commercial accounts for the first time in 1991-92. But the Department's accountants, KPMG Peat Marwick, were unable to give an audit opinion because opening balances could not be verified and the contract accounting records did not meet standard accounting practices;
- introduced a new system of contract files in March 1991, but a year later there remained deficiencies in the quality of the records;
- reduced staff numbers from 2,400 to about 2,000. By November 1992 the number had reduced further to 1,417 at a cost of £34.4 million in redundancy payments; and
- achieved some reduction in costs, but the scale and nature of the changes they were undergoing meant that profitability and productivity levels were still below those achieved by the market. The task was made more difficult by the recession in the building industry; the Department estimated that during the pre-sale period commercial fee rates had fallen by 50-60 per cent.

## Profitability

**1.11** Demonstrable improvements in profitability were highly desirable to a successful sale competition. Figure 2 shows that from 1992-93 PSA Projects were forecasting significant improvements in their annual profitability, mainly by reducing unit costs and improved productivity.

Profit forecasts for PSA Projects

**Figure 2**

| | Actual (Unaudited) 1991-92 £m | Projection 1992-93 £m | Projection 1993-94 £m | Projection 1994-95 £m |
|---|---|---|---|---|
| Net Surplus / (Deficit) before tax | (4.5) | 2.5 | 4.9 | 4.6 |
| Total Income | 190.3 | 152.5 | 82.9 | 62.9 |

## Contract records

**1.12** By July 1992, when bidders were reviewing the contract files, KPMG Peat Marwick concluded that there was sufficient information to enable bidders to form a reasonable judgement as to the risks and rewards of current contracts and PSA Projects's future prospects. They considered that an additional one or two years track record would have been an advantage, but that waiting a further three to six months would have been of only marginal benefit.

**1.13** While recognising the progress that had been made, the short-listed bidders considered that the contract files still did not fully meet commercial standards at the time of their inspection because:

- PSA Projects's contract costing system did not properly match income and expenditure, thereby casting doubt on the forecast profit or loss to completion on individual contracts; and

- in a few instances basic data, such as regular progress reports or contractor details, were missing, although these would not affect the commercial viability of the contracts concerned.

**1.14** Bidders told us that as a result of these factors they had to take a more prudent view of the value of PSA Projects than might otherwise have been the case.

## Future workload

**1.15** Some of the potential bidders felt that they would be taking a considerable risk in acquiring an uncompetitive business, particularly as it had a poor reputation with some of its clients and a declining workload.

**1.16** To offset the expected loss of work from traditional customers due to competitive tendering and reduced capital programmes, PSA Projects were given ministerial permission to seek new customers in the private sector and in the wider public sector, provided that the capital value of the contracts sought were in excess of £1 million. This was to avoid competition with PSA Services's building management businesses who undertook low value works on behalf of departments. The Department and their advisers did not consider, however, that this restriction had a material impact on PSA Projects's success or prospects; although they considered that it limited their ability to gain experience in new markets prior to the sale.

**1.17** In order to achieve some security of income, and enhance PSA Projects's attractiveness to potential purchasers, the Department negotiated a minimum level of further design commissions with the Ministry of Defence and Property Holdings. The agreement guaranteed fee income of £11 million from 1992-93 to 1994-95 - less than PSA Projects would have expected to win from these clients in open competition. Other departments declined to offer similar agreements. Bidders told the National Audit Office that this level of guaranteed income did not have a material effect on their offers.

## Employee issues

**1.18** Potential bidders expressed concern at the possibility of receiving staff who had been transferred against their will and of having a significantly over staffed business. The Department judged that there would be insufficient staff commitment to the sale process and the risk of delay and even industrial action if staff faced compulsory transfer at the date of sale. At that time the Department forecast that there would be only long term jobs for about half of the work force. The Secretary of State therefore offered staff the choice of whether or not to transfer permanently with PSA Projects. Staff not willing to transfer permanently

would face redundancy, if not selected for secondment, or after their period of secondment ended unless they sought alternative jobs in the Civil Service and suitable posts could be found.

**1.19** Staff transferring to the purchaser had their existing terms and conditions of service, other than pensions, protected under the Transfer of Undertakings (Protection of Employment) Regulations 1981 and the European Community's Acquired Rights Directive. Employees were, therefore, legally entitled to retain their existing terms and conditions of service on transfer to the successful purchaser. The Department's legal advisers, Field Fisher Waterhouse, confirmed that the Department had complied with all relevant legislation.

**1.20** The costs of matching Civil Service entitlements were likely to be expensive, as private sector severance entitlements are typically smaller than those in the Civil Service, although generally well in excess of the statutory minimum. The Government Actuary's Department estimated that the statutory minimum cost of making all PSA Projects' s staff redundant was £3.3 million which compared with an estimated redundancy cost under Civil Service terms and conditions of £65.4 million.

**1.21** The transfer of Undertakings (Protection of Employment) Regulations 1981 do not preserve for staff an entitlement to the same pension rights in their new employment but, to avoid the risk that a case for constructive dismissal might be made against the transferring Department, the Department made it a condition of the sale that bidders offered a pension scheme which was broadly comparable with the Principal Civil Service Pension Scheme. If the purchaser could not do so, staff would need to be compensated. The Department developed a pension scheme, in consultation with the Government Actuary and the Trade Unions, which they made available to bidders. This scheme was broadly comparable to the Principal Civil Service Pension Scheme and was adopted by the purchaser.

**1.22** The recommended scheme has a number of measures to protect its funds. The assets backing employees' pensions are to be held separately from the purchaser's business assets. Investment in the purchaser's shares is limited to five per cent of the fund's assets and there is equal employee and management representation on the pensions fund board.

# Part 2: The sale process

## The timing of the sale

**2.1** Coopers and Lybrand, the Department's advisers, considered that the earliest practical date for sale would be in the second half of 1992 - after the introduction of commercial accounts and new contract costing systems. A sale before that date would have given PSA Projects insufficient time to produce the information needed by bidders to assess the business's potential value and the associated risks.

**2.2** Potential bidders indicated that they would prefer an early sale while the order book and committed workload were still robust. This would give them the opportunity to win new business and make the considerable productivity and efficiency improvements required in a way that suited them.

**2.3** Following the introduction of untying, some 92 per cent by value of PSA Projects's contracts were won by single tender negotiation while they were in the public sector. Coopers and Lybrand estimated that, because of the absence of competition and PSA Projects's uncompetitive unit costs and poor productivity, a sale postponed to 1993-94 could increase works costs to Government by up to £9 million.

**2.4** The Department were aware that a later sale could, in theory, lead to higher proceeds if PSA Projects succeeded in reducing their unit costs to private sector levels. The investment needed would, however, be substantial, given the high staff redundancy entitlements together with the need for staff training, new management information systems, external consultancy assistance and financial support. As the investment would not necessarily produce an organisation that matched the eventual purchaser's requirements, the sums expended might not be recovered through increased sale proceeds. In addition, given the anticipated shrinkage in PSA Projects's order book, there was no certainty that a profitable business could be created in the public sector.

**2.5** The Department were also concerned that continued uncertainty over PSA Projects's future would further deter customers and make it difficult to motivate and retain staff. For these reasons the Department considered that, despite the recession, the Government would minimise the costs of the disposal through an early sale, and that much of the necessary restructuring and reorganisation would therefore be left to the purchaser.

## The method of sale

**2.6** PSA Projects's poor trading prospects, the absence of audited commercial accounts and a competitive trading record, ruled out a public flotation. The Department decided that a widely marketed trade sale, of the whole of PSA Projects, was the most appropriate method of disposal. However, the Department retained the option to sell individual parts of PSA Projects to different bidders to provide flexibility and a fall-back position if a sale of the whole business failed.

## Management buy out

**2.7** Coopers and Lybrand advised the Department that it was unlikely that a management buy out would be successful because of the commercial inexperience of PSA Projects's senior management, the lack of assets against which to secure any borrowings, the absence of a commercial track record and the uncertainty of future cash flows and profitability.

**2.8** This advice from Coopers and Lybrand was not available to the PSA Projects Board, who had indicated, in April 1991, that they would, in principle, be interested in a buy out. The Department made it clear that any such bid would be treated on a par with other bids and that the team would have to put substantial sums of money at risk. Following discussions with the Department and their financial advisers, the Board decided not to proceed.

## Contractor manager

**2.9** The Department considered the appointment of a contractor manager in July 1991, following an approach by Pell Frischmann Consulting Engineers Limited. They proposed to manage PSA Projects for a period of five years, at the end of which they would purchase the business.

**2.10** The Department decided not to proceed with this option because:

- it did not constitute a full privatisation within the timescale envisaged by Ministers;

- it would have involved five years of management fees without any guarantee of added value to the business; and
- it would involve costly auditing and policing costs.

**2.11** Coopers and Lybrand considered that a clean break - whereby the Department's financial interest in the business ceased at the date of the sale - was unlikely to be achieved at a cost less than closure because of the scale of the risk which a buyer of PSA Projects would bear. The Department therefore decided to offer bidders two innovative risk and redundancy sharing schemes to limit their exposure and, therefore, to reduce the amounts required from the Department. Both schemes were likely to attract smaller more risk-averse firms to bid, thereby increasing the effective competition.

## Redundancy cost sharing

**2.12** The Department recognised that, as PSA Projects's workload was forecast to continue diminishing until 1994-95, prospective purchasers would take a cautious view on future redundancy costs. The Department therefore offered bidders a redundancy cost-sharing scheme which sought to reduce their exposure to this risk. Details of the scheme are given in Appendix 4. Short-listed bidders confirmed that this scheme had a positive impact on the way in which they viewed the sale. All the bidders opted for this scheme which they reflected in their bids.

## Risk sharing

**2.13** Under the sale arrangements the purchaser would be contractually committed to completing all existing work even if it was loss making. The Department recognised, therefore, that the lack of a commercial track record, and the inexperience of contract managers in forecasting future profit and loss might lead some bidders to attach particular importance to a risk-sharing arrangement. The Department developed a scheme, which provided for the sharing of any future variations in forecast income and direct costs on existing contracts between the vendor and the buyer. Details of this scheme are given in Appendix 5. However, the Department considered that there would be substantial practical problems in policing and administering such a scheme due to the difficulty of measuring profit on long-term contracts for PSA Projects's design services. The Department did not consider the scheme to be essential to protect value in the sale and therefore told bidders that they would prefer them not to make use of this scheme. Nevertheless two of the three final bidders, W S Atkins Ltd and Pell Frischmann Ltd, adopted this scheme, although the winning bidder, Tarmac Construction Limited, did not.

**2.14** The Department considered extending the risk-sharing agreement to reflect the profits or losses made on new work for a limited period post sale. They had initially concluded that the purchaser should be responsible for post sale trading risks on new contracts and that a profit sharing arrangement was inappropriate due to the risk of future losses. Three of the short-listed bidders threatened to withdraw from the competition unless the Department accepted more of the financial risk post sale. The Department resisted these demands as they:

- would have further undermined the aim of transferring as much of the trading risk as possible to the purchaser;
- would have added further complexity to an already complex offer structure;
- might weaken the incentive on the purchaser to maximise profits post sale; and
- would provide the purchaser with an incentive to place new work won elsewhere within his group, thereby maximising the Department's contribution to post-sale redundancy costs.

**2.15** After further discussions with the bidders, Coopers and Lybrand advised that extending the risk-sharing scheme to new work was unlikely to result in a significant improvement in the immediate offers. It would also involve significant auditing costs, and was unattractive because of the risk of further losses. In the event, only one of the bidders withdrew from the competition. If it had been impossible to maintain sufficient competition, however, the Department would have been prepared to look again at whether such schemes would have been acceptable.

## Valuation

**2.16** A previous Committee of Public Accounts recommended that benchmark valuations should be prepared, in advance of the sale, against which to compare the bids received (First Report, Session 1991-92, paragraph 7(ii), HC 51). The Department concluded that the appropriate benchmark was the estimated cost of closure because of:

- Ministers' view that PSA Projects had no long-term future in the public sector;
- the forecast decline in PSA Projects's income;
- the significant liability for future redundancies;
- uncertainty over the long term size of PSA Projects; and
- the need for post sale restructuring.

**2.17** Coopers and Lybrand developed a financial model of the direct cost of closing PSA Projects, based principally upon projected severance costs and future trading losses. This showed that the most likely direct cost of closure would be £101 million representing redundancy costs of £52 million (present value) and losses on existing contracts of £49 million. However, they recognised that the key components of this calculation, income projections, fee earner productivity, the time lag between the completion of work by fee earners and their subsequent redundancy, and the rate at which support staff could be found alternative employment, were difficult to forecast precisely. They therefore examined the effect on the cost of closure of changes in the underlying assumptions of these costs and estimated that the actual direct cost of closure was likely to lie between £89 million and £114 million.

**2.18** In addition to the direct costs of closure there were also potentially significant disruption costs, which would be borne by client departments and be difficult to quantify with precision. For example, PSA Projects estimated, that, for every one per cent increase in current works costs arising from additional contractors' claims, the cost of closure would increase by approximately £16 million.

## Marketing

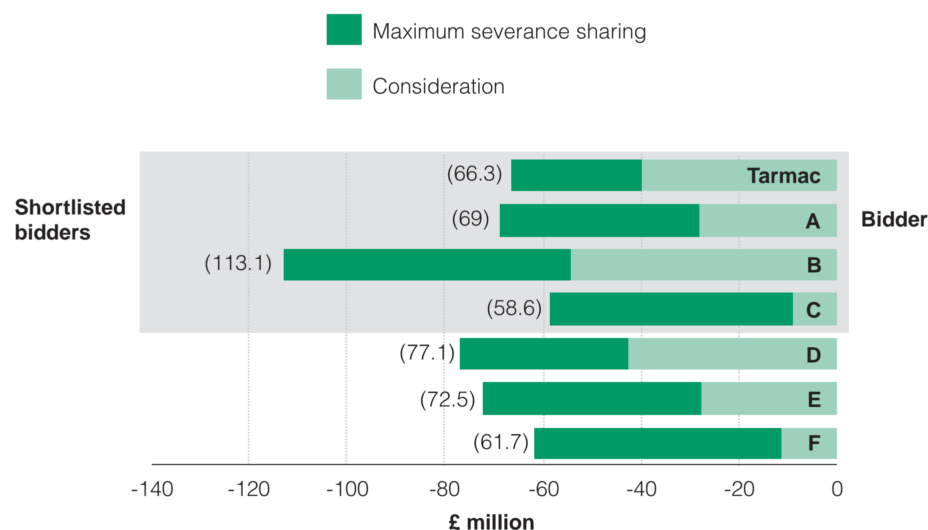
**2.19** Responsibility for marketing the sale lay with Coopers and Lybrand. To gauge the likely level of interest they surveyed the market on several occasions between 1990 and 1992. In January 1992, Tarmac submitted an unsolicited bid which the Department could not accept as PSA Projects had to be sold by competitive tender to meet the requirements of public accountability.

**2.20** This bid, which required a payment of £24.1 million by the Department, cannot be compared to later bids as it included a profit-sharing formula and excluded a working capital adjustment which was to be calculated at a later date. It was also made before the risk and redundancy-sharing arrangements had been finalised and did not include any provision for the staff choice exercise.

**2.21** In May 1992 the Department launched the sale competition with the publication of an Information Memorandum and advertisements in the Financial Times, The Times and The European. The launch received widespread media coverage. A total of 90 companies, including five overseas firms, were sent a copy of the Information Memorandum. The Department received seven initial bids which were reduced to a short list of four - details of which are at Figure 3.

**Preliminary bids**

**Figure 3**




**Key to Bidders:**

A: W S Atkins Limited
B: Pell Frischmann Limited
C: Carl Bro Limited
D: Scott Wilson Kirkpatrick Consortium
E: CMW Limited
F: Stimpson Willis

Notes:
1. Excludes the cost of risk sharing proposals.
2. Maximum severance sharing cost is contingent upon the long-term core size of the business.

Source: Coopers & Lybrand evaluations

**2.22** The criteria used to evaluate both the initial and final bids are given in Figure 4 below :

**Bid evaluation criteria**

**Figure 4**

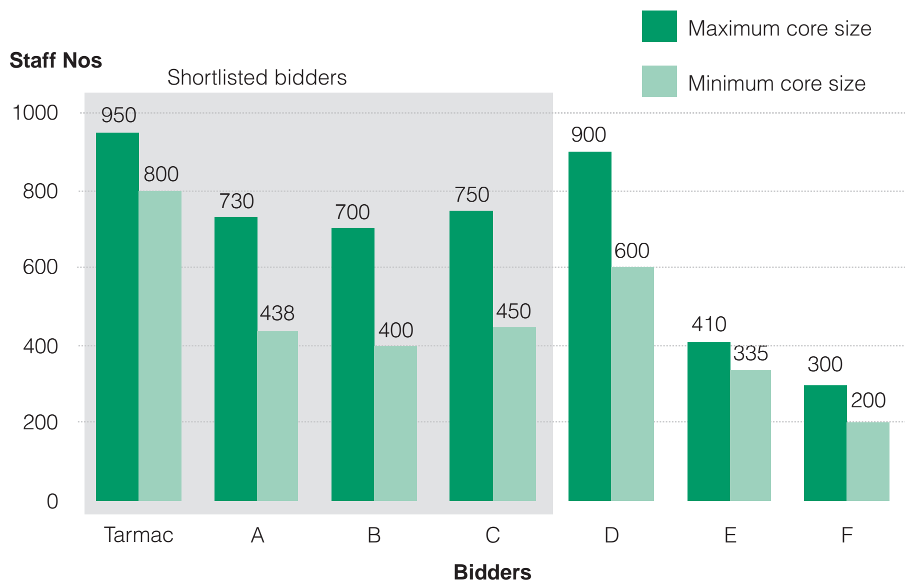
- The financial value of offers under various staff choice/core size scenarios;
- The bidders' financial status;
- The envisaged scale of PSA Projects and the credibility of plans;
- The bidders' commitment to developing PSA Projects;
- Bidders' intentions towards staff;
- Secondment and pension arrangements;
- The impact on continuity of service to clients.

Source: Coopers and Lybrand evaluation of final bids

**2.23** The financial elements of the preliminary bids are shown in Figure 3. The long-term staffing requirement (the core size) projected by bidders was a key consideration, as this was the basis upon which the Department's liability for redundancy costs was based (Figure 5).

**Core sizes stated in preliminary bids**

**Figure 5**




**Key to Bidders:**

A: W S Atkins Limited
B: Pell Frischmann Limited
C: Carl Bro Limited
D: Scott Wilson Kirkpatrick Consortium
E: CMW Limited
F: Stimpson Willis

The differing perceptions of bidders on the long term core size was one of the most important factors in evaluating bids.

Source: Coopers & Lybrand evaluations

## Negotiations with bidders

**2.24** The four short-listed bidders were satisfied that the sale process was handled in a fair, open and constructive manner by both the Department and their advisers. The Department accepted the recommendations of their advisers, Coopers and Lybrand, who analysed both the preliminary and final bids independently.

**2.25** Two companies, who submitted preliminary bids, were not short-listed as the Department considered that they were too small to manage PSA Projects's transition to a viable business. A third was rejected because of the way the bidder intended to divide staff and contracts between consortium members and renegotiate staff terms and conditions. Of the four short-listed bidders one, Carl Bro Limited, declined to make a final bid as they came to the conclusion that the financial risks were too great for a business of their size.

**2.26** To provide a basis against which negotiations could begin the Department asked the bidders for a detailed breakdown of their bid. The Department recognised that, in the final negotiations, they would have to concentrate upon the total amount payable and its relationship to any conditions attaching to the bid. Thus, trade-offs between these could not be ruled out.

**2.27** The movements in the sale price between the submission of preliminary and final bids are summarised in Figure 6.

**Figure 6**

**Financial summary of preliminary and opening final bids**

| *Bidders* | *Tarmac Construction Limited* | | *W S Atkins Limited* | | *Pell Frischmann Limited* | |
|---|---|---|---|---|---|---|
| | **Cost £ million** | **Core Size No. staff** | **Cost £ million** | **Core Size No. staff** | **Cost £ million** | **Core Size No. staff** |
| **Preliminary bid** | (60-66) | 800-950 | (52-69) | 438-730 | (103-117) | 400-700 |
| **Final bid:** | | | | | | |
| ■ consideration | (45.0) | | (54.0)[1] | | (56.0)[1] | |
| ■ severance cap | (17.5) | | (38.9)[2] | | (42.0) | |
| **Total** | (62.5) | 1,000 | (92.9) | 700 | (98.0) | 400-700 |

Notes: 1. These bids also included a risk sharing proposal.
2. Estimated by the National Audit Office.

The movements in the sale price between preliminary and final bids.

Source: Coopers and Lybrand's analysis and the NAO's own analysis

**2.28** These movements in the WS Atkins bid were due to:

- PSA Projects's worsening trading position; and

- the bidders' more pessimistic view of PSA Projects's prospects and future profitability once they had been given the opportunity to examine PSA Projects in more depth.

**2.29** In the course of final negotiations, bidders improved their offers by withdrawing conditions attached to their opening final bids. These improvements included:

- withdrawing the right to be included on government tendering lists for five years post sale;

- extending the scope of the severance sharing scheme to cover secondees as well as transferred staff;

- reducing the minimum number of staff opting for transfer from 1,200 to between 600 and 700; and

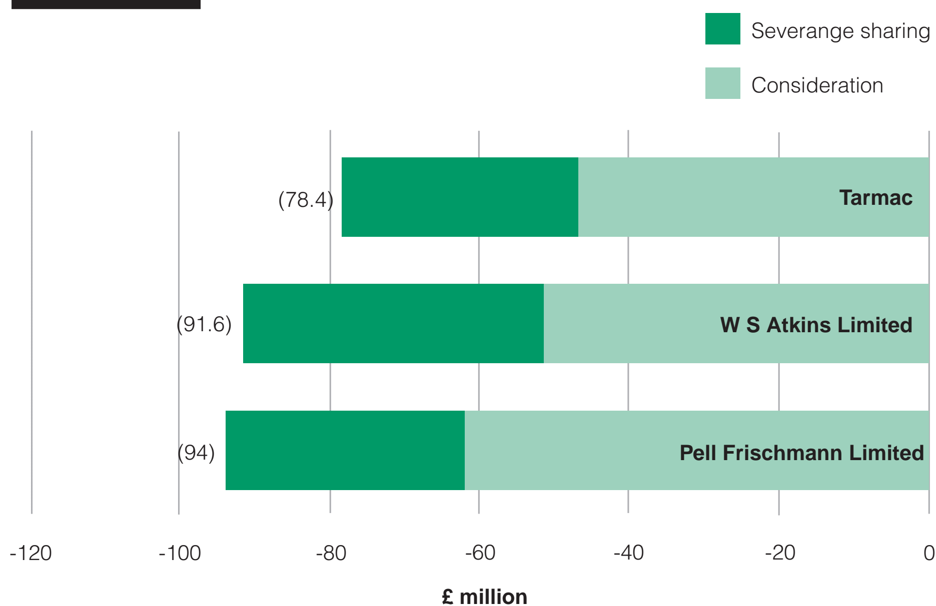
- limiting the Department's total redundancy liability.

**2.30** In September 1992, the Department identified Tarmac as their preferred choice from the final bidders, based on 900 staff transferring, which represented the mid-point of PSA Projects's estimate of the likely number of transferees (Figure 7). The Tarmac bid represented the most financially attractive offer if more than 600 employees agreed to permanent transfer and because their assessment of a sustainable core size for PSA Projects was higher than that of their rivals; in addition they did not ask for a risk sharing scheme. Finally, as the largest firm bidding they offered a substantial business that was able to provide continuity of service to clients, greater long-term employment prospects for staff, and the financial robustness necessary to ensure that Government guarantees to staff would not be called.

**2.31** The Department estimated that, if 900 staff agreed to transfer, the total payments to Tarmac, after post-tender adjustments, would be between £87 million and £90 million. This compared favourably with the most likely costs of closure - between £89 million and £114 million (paragraph 2.17). The offer was dependent, however, on at least 650 employees transferring with PSA Projects. PSA Projects's senior management estimated that between 800 and 1,000 staff would opt for

**Selection of preferred bidder**

**Figure 7**




Notes: The final offers have been standardised for the purposes of evaluation and based upon the transfer of 900 staff which represented the mid point of PSA Projects's estimate of the likely number of transferees.

Source: Coopers & Lybrand evaluations

On the assumption that 900 stafff would transfer, the Tarmac bid was the most financiallly advantageous.

permanent transfer. In the event, 694 staff elected to transfer permanently to Tarmac. Figure 8 shows the effect of this on the bids and demonstrates that Tarmac's offer remained the most attractive.

**2.32** Between the identification of Tarmac as the preferred bidder in September 1992 and the exchange of contracts in October 1992 the Department advised Tarmac of a number of changes in the information previously given which might adversely affect their valuation of PSA Projects. This led to an increase of £4.6 million in the consideration payable. These late concessions did not, however, affect Tarmac's place as the preferred bidder and the Department considered that the other bidders would be likely to seek similar compensation when informed of the changes.

**Comparison of final bids at preferred bidder stage and following results of staff choice**

**Figure 8**

| *Bidders* | *Tarmac Construction Limited* | | *W S Atkins Limited* | | *Pell Frischmann Limited* | |
|---|---|---|---|---|---|---|
| | **Cost £ million** | **Staff numbers** | **Cost £ million** | **Staff numbers** | **Cost £ million** | **Staff numbers** |
| Preferred stage - 900 staff[1] | 78.4 | 900 | 91.6 | 900 | 94.0 | 900 |
| Following staff choice exercise - 694 staff[2] | 100.7 | 694 | 105.2[3] | 694 | 104.4[3] | 694 |

Notes:
1. Final bids were standardised for assessment at the preferred bidder stage, September 1992, on the basis of 900 staff agreeing to transfer with PSA Projects.
2. The value of the adjusted final bids is based on the actual numbers of staff who agreed to transfer to Tarmac in November 1992. The outcome of this staff choice exercise would, however, have been different for each bidder.
3. There remained a number of outstanding issues on these final bids that might have had an impact on the final price negotiable.

At the preferred bidder stage, the Tarmac bid was significantly more attractive than the remaining bidders on the assumption that 900 staff would agree to transfer permanently with the business. In the event, 694 staff agreed to transfer, but Tarmac remained the best offer but by a reduced margin.

Source: Coopers and Lybrand bid evaluation documents

# Part 3: The outcome and administration of the sale

## The terms of the sale

**3.1** The Department completed the sale of PSA Projects to Tarmac on 1 December 1992. The Department paid Tarmac £44.4 million as compensation for future losses and commercial risk and to provide for a pension fund contribution, investment and working capital. The Department also made a cash injection of £13.3 million of which £10.5 million was retained by Tarmac to compensate them for the estimated net liabilities transferred with the business. They repaid the remaining £2.8 million to the Department, to reflect the net asset position of the business at the point of sale, as agreed at that time. The negative consideration therefore totalled £54.9 million.

**3.2** To prevent the purchaser from discounting his bid to take account of potential bad debts, the Department excluded trade debtors worth £55 million from the sale. The Department recovered these by March 1995. The decision to exclude trade debtors from the sale influenced the size of the cash injection.

**3.3** This injection was based on an estimate made at exchange of contracts of what the net asset position would be at the completion of the sale two months later. The sale agreement placed an obligation on Tarmac to produce a completion statement within seven months of the sale showing the actual net asset position at that time. The consideration paid to Tarmac would then be adjusted, after a review of the completion statement by accountants appointed by the Department, by an amount equal to the difference between the estimated and actual value of net assets.

**3.4** The Department agreed to an additional payment to Tarmac if, on the first anniversary of the sale, the number of staff transferring with the business was less than 850. This provision resulted in a further £4.5 million being paid to Tarmac in December 1993. This was subsequently adjusted to £4.4 million following a review of the number of locally engaged staff in Hong Kong who transferred with the business to Tarmac. Finally, the Department paid a further £880,000 to reimburse the company for the cost of increasing the opening value of the pension fund to reflect the difference in average retirement ages between the PSA Projects's staff and those generally applicable in the Tarmac Group. The amounts paid to Tarmac are summarised in Figure 9.

**Summary of the payments made to Tarmac Construction Limited**

**Figure 9**

| | | £ million |
|---|---|---|
| **December 1992** | Compensation for future losses, commercial risk, pension fund contribution, investment and working capital | 44.4 |
| | | 13.3 |
| Cash injection to bring estimated net assets to £2.8 million | | |
| | | (2.8) |
| Less sale price | | **54.9** |
| **December 1993** | Compensation for the number of staff transferees being below 850 | 4.4 |
| **September 1994** | Staff pension fund contribution | 0.9 |
| | Total price payable to Tarmac prior to adjustment following the outcome of the completion statement review | **60.2** |

## Liability for future redundancies

**3.5** The Department's liability for redundancy costs lasts for five years from the date of sale and is capped at £39.5 million. This cap relates to all seconded staff and up to 165 staff who transferred permanently to Tarmac, for whom total redundancy liabilities at sale were estimated at £32.9 million. By March 1997 the Department had spent the full £39.5 million on redundancy payments and a further £4.1 million on compensation in lieu of notice.

**3.6** The Department have, in addition, guaranteed the redundancy entitlement of staff who transferred with PSA Projects for five years from the completion of the sale if Tarmac Construction Limited go into liquidation and are unable to meet their obligations. In December 1992 the value of this contingent liability was estimated at £17 million. It is covered by a guarantee by the parent company, Tarmac Plc, indemnifying the Department for any costs incurred in discharging the guarantee to staff. By December 1996, the value of the contingent liability had fallen to £10.3 million because of reducing staff numbers.

## Future workload

**3.7** The sale agreement guaranteed a minimum level of future design commissions, at negotiated prices, from the Ministry of Defence and Property Holdings. These were expected to generate £11 million of fee income over the three years to 31 March 1995.

## The dispute over the final settlement

**3.8** The procedures to be used for compiling the completion statement, which would disclose the actual net asset position at the point of sale (paragraph 3.3) were set out in a schedule to the sale agreement. The Department with their accountancy advisers, KPMG Peat Marwick and their solicitors, Field Fisher Waterhouse prepared this schedule. The sale agreement required auditors appointed by the Department to review the completion statement and to propose and agree any adjustments within three months of its submission to the Department. KPMG Peat Marwick, the Department's reporting accountants, were unable to act for the Department in this matter as they were the auditors of the Tarmac Group. The Department therefore appointed Ernst & Young, in November 1992, following competition, to review the completion statement.

**3.9** Shortly after their appointment, Ernst & Young advised that the accounting principles which were set out in the schedule to the sale agreement could be interpreted in two different ways; one of which Tarmac could use to their advantage. The Department decided against seeking an amendment to the sale agreement as this might have alerted Tarmac to the weakness of the Department's position and have provided Tarmac with an opportunity to re-negotiate other aspects of the sale agreement. Instead, PSA Projects's staff prepared clarification notes which provided a more detailed statement of the accounting practices which were to be followed in the preparation of the completion statement. Tarmac accepted the clarification notes prior to completion of the sale. In April 1994, the Department's counsel raised serious reservations about the clarity of the schedule to the sale agreement and considered that the clarification notes were open to misinterpretation. It was also unclear to him as to whether Tarmac were bound by these notes.

## The completion statement submitted by Tarmac and the Department's proposed adjustments

**3.10** In June 1993, Tarmac submitted a completion statement which proposed a further payment of £3.2 million from the Department (Appendix 6). However, Ernst & Young pointed out that Tarmac's claim had not taken account of the Department's pre-completion cash injection of £13.3 million (paragraph 3.1). Tarmac later agreed that this was an error on their part. Adjusting for this omission would have resulted in Tarmac refunding the Department £10.1 million.

**3.11** Ernst & Young's review of the completion statement concluded that Tarmac's valuation of work-in-progress and deferred income had not followed the principles set out in the schedule to the sale agreement and the clarification notes. In September 1993, Ernst & Young presented their proposed adjustments, which had been prepared in accordance with their interpretation of the principles of the sale agreement schedule. This showed that Tarmac should refund £23.4 million to the Department.

## Differences between Tarmac and the Department

**3.12** The main differences between the two parties concerned the methods for valuing work-in-progress[1] and deferred income[2]. There were three key areas of disagreement:

- the treatment of post-completion date events, such as the retrospective authorisation of expenditure on projects;
- the impact of the final invoice run and its effect on work-in-progress; and
- the treatment of profit on sub-contracted work.

(1) Work-in-progress: costs incurred and recoverable from clients, but not invoiced at the point of sale.

(2) Deferred income: amounts invoiced at the point of sale which were in excess of costs incurred. This covers advances obtained from clients, profit and instances when invoicing was ahead of progress.

**3.13** The implications of these differences are summarised in Appendix 7. Tarmac considered that the Department could not claim for costs incurred but not invoiced at the point of sale, unless the client had formally authorised such costs in writing. They also maintained that the Department were not entitled to a share of profits on partially completed contracts at the point of sale. The Department took a contrary view on both points. To estimate the likely effect of these differences, and to support their case, the Department re-calculated work-in-progress and deferred income on the 200 largest contracts; and reviewed the remaining 800 contracts on a broader basis.

**3.14** Tarmac subsequently informed the Department, in November 1993, that they wished to withdraw their completion statement. They believed that a closer investigation of the contentious issues indicated that they might be entitled to a further payment from the Department, rather than have to refund £23.4 million of the sale consideration (paragraph 3.11). The Department rejected this request but agreed that, in the interests of reaching a settlement, Tarmac should carry out further work; on the understanding that it did not imply their agreement to the withdrawal of Tarmac's completion statement.

**3.15** Given the nature and extent of the differences between the two parties, Tarmac agreed to pay £14.84 million into an interest bearing escrow account in January 1994, although the original terms of the sale agreement did not provide for interest on sums in dispute. This included £10.3 million in recognition of the Department's view that, pending resolution of the dispute, at least this amount was due; and a further £4.54 million that the Department had initially paid Tarmac in respect of staff transferees (paragraph 3.4). The purpose of this account was to guarantee either side automatic access to funds should the final settlement be decided in their favour. The Department would receive interest on any sums paid to them up to £14.84 million. Any payment to Tarmac would not attract interest.

**3.16** Between November 1993 and August 1994 Tarmac revised their methodology for the valuation of deferred income and work-in-progress, the two main areas of contention, and recalculated their position. At the end of February 1994, Tarmac presented a revised completion statement which, if accepted, would have required a payment from the Department of £23.1 million. Ernst & Young advised Tarmac that, in their opinion, the methodology used to prepare this revised statement was not in accordance with the relevant schedule of the sale agreement. In August 1994, Tarmac presented a further revised completion statement which concluded that they should receive a payment of £20.9 million. The Department did not accept the revised statement. The various claims made by each side are set out in Appendix 6.

## The appointment of the Independent Expert

**3.17** The sale agreement specified that, in the event that the two parties were unable to agree the net asset position disclosed by the completion statement, they would jointly appoint an independent expert whose judgement would be binding, unless it could be proved that the expert had made material manifest error. By August 1994 the differences between the two sides had grown to £44.3 million and, although both parties were still in discussion over the revised completion statement, the Department proposed to Tarmac that the case be referred to an independent expert.

**3.18** Negotiations between Tarmac and the Department over the independent expert's terms of reference failed because of a difference of opinion over the status of the clarification notes and the need for the expert to provide the reasoning behind his conclusions. Tarmac argued that the independent expert should disregard the clarification notes until their legal status had been determined and that he should provide the reasoning behind his conclusion. The Department took the opposite view; in December 1994, the Department issued a writ against Tarmac requiring them jointly to instruct an independent expert in accordance with the relevant provisions of schedule 4 of the sale agreement which dealt with the preparation of the completion statement.

**3.19** The High Court ruled in March 1995 that the clarification notes did not vary the sale agreement and that Tarmac were not contractually bound by them. However, the Court also ruled that it was for the independent expert to decide the relevance of the clarification notes. The judgement also contained an order that the two parties should jointly instruct Touche Ross to act as the independent expert. Tarmac's costs, of £64,000, were awarded against the Department.

**3.20** Consequently, the Department and Tarmac appointed a senior partner of Touche Ross as the independent expert in October 1995. The appointment was on a single tender basis as Touche Ross was the only firm acceptable to both parties and had been named as the expert to be appointed in the High Court judgement. The Department told us that the expert was not, however, aware that no other bidder was involved prior to submitting his fee proposals, which were subsequently reduced through negotiation. The schedule to the sale agreement specified that the expert's fees were to be shared equally between the parties. The jointly agreed terms of reference required the expert to rule on each of the disputed matters and to calculate the consequential adjustments to the completion statement that were attributable to each item. To reduce the possibility of legal

challenge, the independent expert would not provide the reasoning behind his decisions; which would be binding on both parties in the absence of material manifest error on the part of the independent expert.

## The independent expert process

**3.21** The independent expert's terms of reference required each side to present three written submissions. After the final submissions the expert had discretion to request clarification from both sides and, if required, undertake new work. The expert had an unspecified time period after the third submissions to form his opinion. In November 1995, the Department estimated that the expert would complete his work by June 1996 - three months after the final submissions.

**3.22** Tarmac and the Department made final submissions to the independent expert at the end of March 1996. The Department's submission showed that they expected to receive a payment of £22.5 million, whereas Tarmac claimed that they should receive £6.6 million (Appendix 6). Figure 10 shows the final outcome on the three balance sheet figures that were in dispute.

**3.23** Due to difficulties in interpreting the complex and detailed data contained in the submissions the expert found it necessary to raise 86 formal requests for further detailed information. The requests were issued in batches between 21 March and 3 October 1996, with a three to four week total response time to each.

**3.24** In August 1996, both the Department and Tarmac were concerned at the time being taken by the independent expert to reach a decision. Following a joint approach to the independent expert, both parties were assured that a decision would be made by the end of 1996. Ultimately, the expert recalculated sums attributable to over 1,000 contracts in progress at December 1992.

## The outcome

**3.25** On 20 December 1996 the independent expert valued net assets at £22.7 million, which was £19.9 million greater than the estimated value of net assets at the point of sale. Tarmac were therefore required to refund £19.9 million to the Department. The Department received the £14.84 million from the escrow account and interest of £2.6 million on this amount. They have also received the balance of £5.1 million from Tarmac but no interest was payable on this sum. The independent expert's completion statement (Figure 10) indicated that the Department's key arguments had been upheld in all material aspects.

**The final submissions made by the Department and Tarmac compared with the decisions made by the independent expert**

**Figure 10**

| Balance Sheet Item | Department's calculation £'000 | Tarmac's calculation £'000 | Independent Expert's decision £'000 |
|---|---|---|---|
| **Assets** | | | |
| *Agreed Figures:* | | | |
| Fixed Assets; Stock; Other Debtors; and Cash | 15,584 | 15,584 | 15,584 |
| *Disputed Figures:* | | | |
| Work-in-Progress | 31,936 | 16,683 | 31,345 |
| **Creditors** | | | |
| *Agreed Figures:* | | | |
| Trade Creditors; Accrued Time Charges; Travel and Subsistence | (11,499) | (11,499) | (11,499) |
| *Disputed Figures:* | | | |
| Other Creditors; | (7,856) | (9,553) | (8,136) |
| Deferred Income | (2,915) | (14,996) | (4,573) |
| **Net Assets** | **25,250** | **(3,781)** | **22,721**[1] |

Note: 1. The final cash adjustment is calculated by deducting net assets at sale of £2.8 million (paragraph 3.1) from the net asset figure of £22.7 million calculated by the independent expert.

The independent expert ruled that Tarmac should refund £19.9 million to the Department.

Source: Final submission by the Department and Tarmac and the independant expert's completion statement

## The cost and administration of the sale

**3.26** We confirmed that the actions taken by the Department complied with the recommendations made by the Committee of Public Accounts on earlier sales. The Department's management of the sale was consistent with Treasury guidance on the handling of trade sales and of management buy outs by departments.

**3.27** We reviewed the costs which the Department incurred in achieving the sale. These included the cost of the Privatisation Unit - which worked on the sale of both PSA Projects and of PSA Building Management simultaneously - and the cost of obtaining advice of benefit to both sales. The Department allocated such costs in proportion to the fee turnover of each business. On this basis, the total direct costs of the sale are estimated at £45.3 million, and up to a further £39.5 million

committed to severance payments for staff not required in the long term (Appendix 8 Tables 1, 2 and 3). The costs of the sale do not include the costs of restructuring the business and introducing commercial accounts as these were incurred as a result of the earlier decision to commercialise PSA Services.

**3.28** The cash injections, severance-sharing costs and payments to the pension fund all resulted from the negotiations with the successful bidder. Pre-sale redundancy costs of £34.4 million were lower than expected, as the number of applications accepted for voluntary redundancy were below those anticipated. The costs of the Privatisation Unit, £437,000, were 30 percent below budget and reflected difficulties in attracting suitable staff.

**3.29** Total administrative costs of £7.6 million, including advisers' fees of £6.7 million (Appendix 8 Table 2), reflected the difficulties involved in preparing PSA Projects for sale and the need to provide support to their management. It is not possible to compare forecast advisers' fees with actual costs incurred as separate budgets for the PSA Projects and PSA Building Management sales were not prepared.

**3.30** However, expenditure on advisers' fees covering both sales exceeded the budget of £1.7 million by 14 per cent in 1991-92 and by 36 per cent (£6.1 million) in 1992-93. The Department regarded capped fees as inappropriate because of the uncertainty over the nature and timetable of each sale. Instead, the initial budgets were deliberately set at the minimum feasible cost and advisers were required to justify increases in these as the sales progressed.

**3.31** The Department incurred costs of £1.3 million in dealing with the dispute over the completion statement and a further £203,000 on accountancy advice between 1 December 1992 and 1 October 1993 in dealing with the initial completion statement.

# Part 4: The achievement of sale objectives

## i) The taxpayer's interest

### Preparations for sale

**4.1** Making progress in the transformation of PSA Projects into a commercial organisation was essential to a successful sale and required effective and experienced management. PSA Projects's senior management did not have sufficient commercial experience to manage this transformation although they bought in some staff, with relevant experience, on a fixed term basis. Despite their efforts in the two years preceding the sale, PSA Projects were unsuccessful in putting their contracts on to a full commercial footing and valuing their workload - the business's main asset - in accordance with accepted accounting standards. This increased the uncertainty of the value of the business to the bidders and contributed to the problems in determining the value of net assets at the point of sale. The scale of the understatement of assets, £19.9 million, suggests poor management and control of the business and a failure to manage, successfully, the change to a commercial organisation.

**4.2** The Department judged that they could not defer the sale to allow them to achieve further progress towards commercialisation. The absence of a commercial valuation of PSA Projects's workload may, however, have affected not only the value of net assets but also the projections of future profitability which were crucial to the maximisation of the sale price. Attributable profits on long term contracts were not recognised at appropriate stages of the contract, as required by professional accounting standards. While this would not affect the final outturn profits and losses on contracts, it would affect their allocations to particular years and, therefore, their post-sale valuation. Given the complexity and number of contracts in existence at the point of sale, around 1000, it was not possible for the National Audit Office to estimate the effect of the understatement of net assets on forecast profitability.

### The sale price

**4.3** The Department sought to minimise this risk through the use of a sale competition to push bidders to the upper end of their valuation range and maximise the price that could be achieved. The final settlement between Tarmac and the Department therefore arose out of a sale competition and was the best of

the three final bids received. From their discussions with bidders, and the movements in their offers secured over the final three weeks, the Department considered the competition to have been strong and to have produced a commercially negotiated settlement. Nevertheless, the poor image PSA Projects had with some of its clients, the uncertainty of its financial position and history, the absence of audited accounts and of a proven track record in forecasting future profits and growth, due to the need for an early sale (paragraphs 2.2 to 2.5) will have increased the perception of risk amongst potential buyers, and might have limited their number and reduced the prospects for a more competitive sale.

**4.4** Some of the unsuccessful bidders told us that, given the scale of the financial risks and the quality of the financial information available to them, they had been obliged to make a conservative valuation of PSA Projects to safeguard their existing businesses. Bidders also told the National Audit Office that the guaranteed future work agreements and the risk sharing agreements (paragraphs 1.15 to 1.17 and 2.13 to 2.15) were not sufficient fully to offset the financial risks associated with the sale. If the true level of future profitability and net assets at the point of sale had been known prior to the sale competition, it might have improved the competition and the level of consideration paid to secure a sale. However, it is not possible to say if this would have been so, nor by how much. The Department also pointed out that, given the unavoidable immaturity of the PSA Projects's business, bidders would have highly discounted any future profitability.

## The dispute over the completion statement

**4.5** Disputes over final adjustments in sales such as these are not uncommon, although four years is a long time to reach a settlement. Nevertheless, the Department and their advisers, Ernst & Young, achieved a satisfactory outcome, which vindicated the stance they had maintained from the outset. However, given the absence of audited commercial accounts, the existence of contract records which did not meet commercial standards, and the impact that the valuation of these contracts would have on the final adjustments to the sale price, we would have expected there to have been tight drafting to prevent ambiguity in the accounting principles concerning the compilation of the completion statement and the verification of net assets.

**4.6** The amounts deposited by Tarmac in the escrow account, £14.84 million attracted a commercial rate of interest, £2.6 million, which was paid to the Department once the independent expert's decision was implemented. However, the balance of the amount paid by Tarmac to the Department, £5.06 million, did not attract interest. As the Department had no legal entitlement to interest they did

not pursue this with Tarmac. Thus, the four years taken to conclude negotiations over the net asset position at the point of sale mean that Tarmac had the use of these funds for a considerable period.

## Comparison with the cost of closure

**4.7** At the point of sale, the forecast cost of sale was around £101 million, which is in the mid range of the Coopers and Lybrand's estimate of the direct cost of closing PSA Projects (£89 million to £114 million). In addition, there were indirect costs of closure that could not be predicted with certainty but which were estimated at £16 million for each one per cent increase in works costs arising from additional contractors' claims. The Department's decision to sell in mid 1992 was, therefore, consistent with their prime financial objective to sell or close whichever was the cheaper option. The final cost, at around £81 million, vindicates this decision.

## Taxation

**4.8** The Department obtained advice from the Inland Revenue that the sums paid to the purchaser would be free from taxation and made this known to all financial bidders so as to obtain the benefits of competition on the price sought by bidders.

**4.9** The Department, with the agreement of the Treasury, considered that the calculation of the costs of sale should be limited to the direct consequences of the Government's decision to sell and should not extend to decisions by the privatised business about the conduct of their business after sale completion. Similarly, the Department considered that the same limitation should apply in assessing the costs of closure. On completion of the sale, the privatised business was required, like any other, to pay tax in accordance with the normal tax rules. This means that Tarmac are able to offset expenditure on the privatised business made with the sale consideration against their total tax liability.

## Clawback

**4.10** Clawback on property was not necessary as all property was held on leases at market rentals which would revert to the Government once buildings were vacated. All rights to intellectual property were retained by the Crown which gave Tarmac a non-exclusive licence for £1 to exploit them and retain any income arising. The Department regarded clawback as inappropriate for these items since

they relate mostly to plans, drawings and manuals which were needed by PSA Projects in furtherance of their regular business, and were unlikely to generate significant windfall gains.

**4.11** There is no mechanism to allow the taxpayer to share in the proceeds from a resale of PSA Projects. The Department consider that the taxpayers' and clients' interests are adequately protected by non-transferrable parent company guarantees given by the Tarmac Group. These require the purchaser to perform their obligations under the sale agreements and to re-imburse the Government's costs in the event of a call on the guarantee to meet the redundancy entitlements of transferred staff. The benefits of the severance sharing scheme are also non-transferable to a third party and the loss of these would be an additional disincentive against resale in the first five years post sale. Furthermore, the sale agreement requires the Department's consent to any resale of PSA Projects, although this should not be unreasonably withheld or delayed.

### PSA Projects post sale ties with Black and Veatch

**4.12** In October 1993, Tarmac re-launched PSA Projects as TBV Consult, part of TBV Professional Services. TBV Professional Services was wholly owned by Tarmac Construction Limited, although Black and Veatch, an American consultancy, planned to take a 50 per cent interest in this in January 1996. In the event, Black and Veatch withdrew and the company is now known as Tarmac Professional Services; which is wholly owned by Tarmac. Tarmac consulted the Department about these changes.

## ii) Consultation with clients and the provision of a continuous service

**4.13** The National Audit Office confirmed with PSA Projects's largest clients that they had been consulted on those aspects of the sale in which they had a material interest and had received a continuing service.

**4.14** The short-listed bidders' intentions for the business formed an integral part of the Department's assessment criteria. They concluded that each bidder intended to develop PSA Projects as a going concern. The sale agreements required the purchaser to fulfil all PSA Projects's existing liabilities and obligations. The parent company also guaranteed Tarmac's performance of its obligations under the sale agreement.

**4.15** To ensure that potential conflicts of interest were avoided, the Department reviewed all large contracts where Tarmac would be both the project manager and major contractor. For those projects close to completion, responsibility for project management was passed to the sponsoring department with support from the privatised PSA Projects's business. In other cases, conflicts of interest were avoided by ensuring that departments were advised by independent quantity surveyors.

## iii) Protecting staff pension and severance entitlements

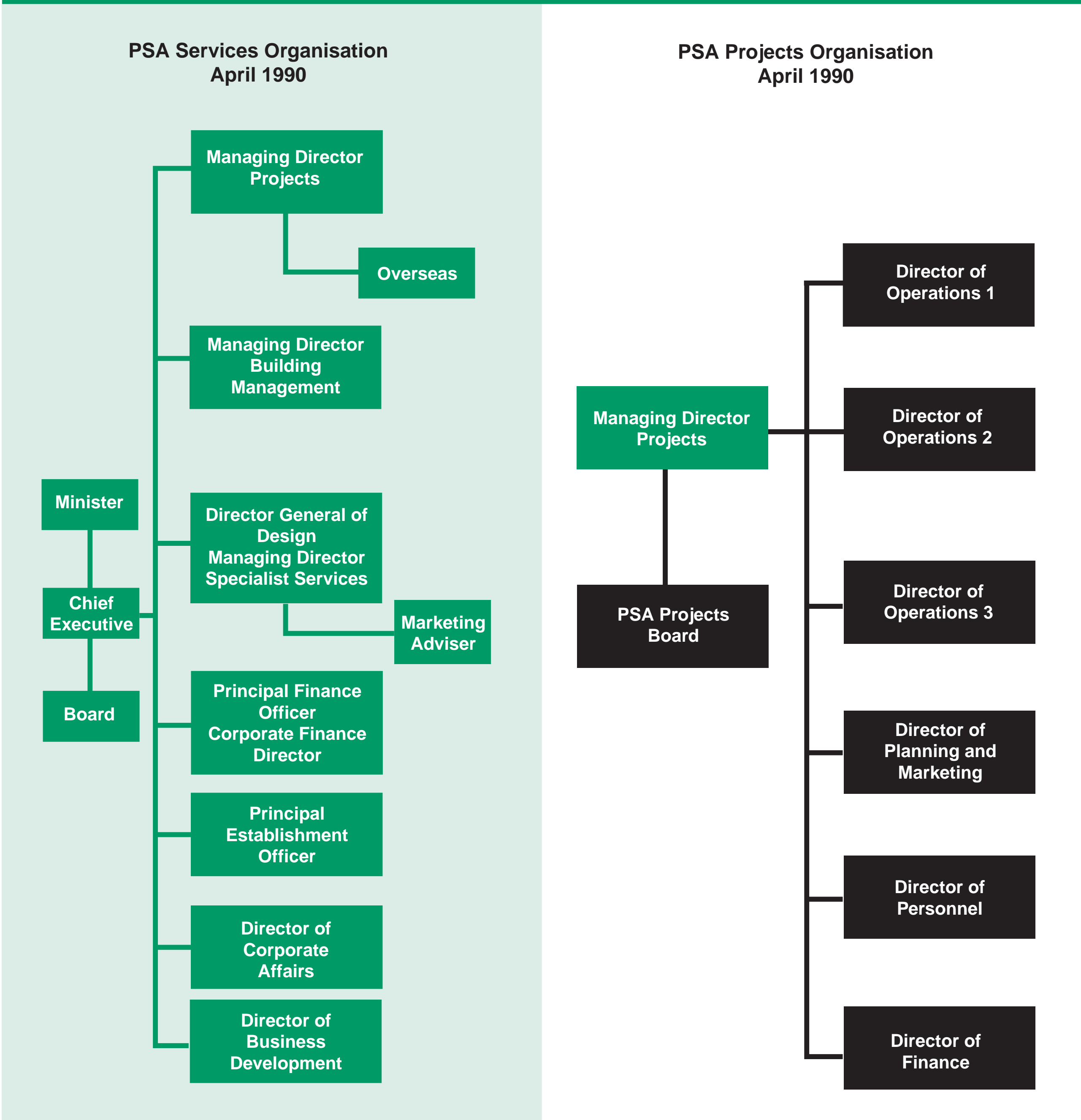
**4.16** Tarmac have accepted staff terms and conditions of employment, given assurances that staff severance entitlements will be protected and adopted the pension scheme made available to them as being automatically broadly comparable to the Principal Civil Service Pension Scheme. The 10 per cent minimum employer contribution to the scheme was removed, although Tarmac have given an assurance that this will not adversely affect their viability as the company's usual contribution commitment will be 17 per cent.

**4.17** The Tarmac bid required a minimum of 650 permanent staff agreeing to transfer with PSA Projects to provide a pool of staff from which to select long term employees. PSA Senior Management estimated that between 800 and 1,000 staff would transfer permanently. In the event, 694 permanent staff agreed to transfer. The Department estimated that, had PSA Projects's forecast of the number of employees willing to transfer been realized, the cost of the sale would have been reduced by between £10 million and £15 million.

**4.18** The Department attributed the disappointing result to: the attractiveness of the redundancy terms; concern about joining the private sector; over-optimism about the prospects for alternative employment elsewhere in the Civil Service; and the lack of positive endorsement by some senior and middle ranking managers, nearing the end of their careers, who failed to counter speculation and unbalanced concerns about security of jobs and staff entitlements post sale. Tarmac believe that some staff came to regret their decision to opt for secondment; under the terms of the sale scheme, they are likely to be made redundant at an average cost to the taxpayer of some £44,800 each.

**4.19** The Department consider that the staff choice exercise was essential to secure staff commitment to both the sale and the eventual purchaser and believe that everything possible was done to protect staff interests and enable them to make an informed choice.

# Appendix 1: Organisation chart of PSA Projects




From April 1990 parts of the former Property Services Agency were restructured to form PSA Services. PSA Projects provided project management and design for major construction work.

In October 1990 PSA Services separated into three main commercial activities: PSA Projects, which incorporated PSA Specialist Services; PSA Building Management and PSA International (formerly PSA Overseas).

# Appendix 2: Key dates in the sale of PSA Projects

| | | |
|---|---|---|
| **1988** | ***May*** | Secretary of State announced that the Property Services Agency (the Agency) were to become a commercial organisation without a tied Government customer base. |
| **1989** | ***October*** | The Secretary of State announced that the Agency's commercial activities were to be privatised. |
| **1990** | ***April*** | The Agency separated into Property Holdings and the four operating divisions of PSA Services (the Department). The Privatisation Unit was established. |
| | ***May*** | Coopers and Lybrand were appointed to advise on the transfer of the Department to the private sector. |
| | ***June*** | Property Services Agency and Crown Suppliers Bill received Royal Assent |
| | ***October*** | The Department were separated into three main commercial activities, PSA Projects (incorporating PSA Specialist Services), PSA Building Management and PSA International. Coopers and Lybrand recommended that PSA Projects and PSA Building Management should be sold separately. |
| **1991** | ***April*** | Coopers and Lybrand evaluated the costs of closure of PSA Projects. |
| | ***December*** | Coopers and Lybrand's final report recommended sale as soon as possible after the General Election (April 1992). |
| **1992** | ***January*** | The Department received Tarmac's unsolicited bid. |
| | ***May*** | Sale competition launched. |
| | ***September*** | The Department received the final bids. |
| | ***October*** | Contracts exchanged with Tarmac. |
| | ***November*** | The Department appointed Ernst & Young as accountants to review the completion statement. |
| | ***December*** | Completion of sale. PSA Projects carried out a final invoice run to ensure that all identified debtors were billed at the completion date. |
| **1993** | ***June*** | Tarmac presented their initial completion statement requiring a further payment of £3 million from the Department. |
| | ***September*** | Ernst & Young presented a report which included an adjusted completion statement showing that Tarmac should repay the Government £23.4 million. |
| | ***November*** | Tarmac advised the Department of their wish to withdraw their initial completion statement. The Department refused, but agreed to Tarmac undertaking further work. |
| **1994** | ***January*** | Tarmac established an escrow account containing £14.84 million. |
| | ***February*** | Tarmac presented their second completion statement claiming that they were owed £23.1 million. |
| | ***May to November*** | The Department obtained counsel's advice. Further attempts to convince Tarmac of the Department's arguments were unsuccessful. |
| | ***August*** | Tarmac revised their second completion statement and claimed they were due a payment of £20.9 million. |
| | ***December*** | The Department issued a writ against Tarmac requiring them jointly to appoint an independent expert in accordance with the sale agreement. |

continued ...

| | | |
|---|---|---|
| **1995** | ***February*** | High Court Hearing. |
| | ***March*** | Mr Justice Colman ruled that the clarification notes did not represent an amendment to the sale agreement but could be shown to the independent expert. He also ruled that Touche Ross be appointed the independent expert. |
| | ***April to July*** | The Department and Tarmac held a series of negotiations to attempt to narrow the differences between their claims and to agree terms of reference for the independent expert. |
| | ***October*** | Touche Ross appointed as the independent expert. |
| | ***December*** | The Department and Tarmac made their first submissions to the independent expert. |
| **1996** | ***March*** | Further submissions to the independent expert. Third and final submissions. The Department claimed that they should receive payment of £22.45 million; Tarmac claimed they should receive a further payment of £6.58 million. |
| | ***March to December*** | The independent expert undertook his analysis of each side's claim. |
| | ***December*** | The independent expert announced on 20 December that he had valued net assets at £22.7 million at the point of sale, which was £19.9 million higher than the estimated value at the point of sale. Tarmac were therefore required to refund £19.9 million to the Department. |

# Appendix 3: List of advisers to PSA Services Privatisation and Strategy Directorate

## Financial advisers

| | |
|---|---|
| Coopers and Lybrand | Main financial and marketing advisers |
| KPMG Peat Marwick | Reporting accountants and tax advisers |
| Kleinwort Benson | Secondary advisers |
| Ernst & Young | Completion statement accountants. |

## Legal advisers

| | |
|---|---|
| Field Fisher Waterhouse | Advisers on main sale agreement and property. |

## Other

| | |
|---|---|
| Bain Clarkson | Insurance advisers |
| Government Actuary's Department | Actuarial advisers |

# Appendix 4: Details of the Redundancy Sharing Scheme

**1** Under this scheme, the Department would bear all redundancy costs of those employees in excess of the purchaser's estimate of the maximum number of employees to be retained in PSA Projects (The Government Band). The purchaser would be responsible for all redundancy costs once his estimate of the minimum number of staff needed had been reached (The Purchaser Band). The difference between the Government and Purchaser bands was the Shared Band where redundancy costs would be shared between both parties.

**2** Redundant staff would fall into the Government Band first, then the Shared Band and finally the Purchaser Band. Estimates of maximum and minimum staff numbers and the Department's share of the costs falling in the Shared Band were to be determined by the bidding process. Bidders were also asked to specify maximum amounts payable by the Department under both the Government and the Shared Bands. In the event, the Shared Band was not used and the maximum Government liability was capped at £39.5 million.

**3** **Illustration**: Assume that an organisation employs 2,000 staff. A bidder proposed that the maximum sustainable size is 1,000 staff and the minimum sustainable size is 500 staff. The average cost of making each person redundant is £5,000. Costs in the shared band are to be split 60 per cent to the Department and 40 per cent to the purchaser. The following table shows the impact of various core sizes after five years. For simplicity it is assumed that the Government Band and Shared Band caps are not exceeded.

**Worked example of the redundancy sharing scheme**

| *Actual core size* | *Payment by Government* | *Payment by purchaser* |
|---|---|---|
| 750 | **Government band:**<br>Present workforce (2,000) - maximum core size (1,000) x average redundancy cost (£5,000) = £5,000,000 | **Shared band:**<br>Maximum core size (1,000) - actual core size (750) x average redundancy cost (£5,000) x purchaser's share (40%) = £500,000 |
| | **Shared band:**<br>Maximum core size (1,000) - actual core size (750) x average redundancy cost (£5,000) x Department's share (60%) = £750,000 | **Purchaser band:**<br>Nil |
| | **Total:** £5,750,000 | **Total:** £500,000 |
| 400 | **Government band :**<br>Present workforce (2,000) - maximum core size (1,000) x average redundancy cost (£5,000)= £5,000,000 | **Shared band :**<br>Maximum core size (1,000) - minimum core size (500) x average redundancy costs (£5,000) x purchaser's share (40%) = £1,000,000 |
| | **Shared band :**<br>Maximum core size (1,000) - minimum core size (500) x average redundancy cost (£5,000) x Department's share (60%) = £1,500,000 | **Purchaser band :**<br>Minimum core size (500) - actual core size (400) x average redundancy cost (£5,000) = £500,000 |
| | **Total :** £6,500,000 | **Total:** £1,500,000 |

Source: Coopers and Lybrand December 1991 report, the 'Offer Format and Sale Questionnaire' and the 'Sale Memorandum'

# Appendix 5: Details of the Risk Sharing Scheme

**1** The risk sharing agreement offered to potential purchasers was to last for three years from the date of completion. At the end of this period, the cumulative difference between the forecast and actual income on 92 of the largest existing contracts and the forecast and actual direct costs incurred on these contracts would be calculated. The Department would then compensate the purchaser for negative variance up to a preset limit (the cap). If there was a positive variance on these contracts then a payment would be made by the purchaser to the Department up to the same limit.

**2** Bidders were to specify in their offers the level at which the cap should be set, although the Department stated that this should not exceed 75 per cent of the difference between forecasts and actuals. Final settlement was dependent on the production of independently audited contract records.

**3** Illustration: The following table illustrates how the risk sharing scheme would have worked based on two different outcomes. In both cases this assumes that the gross margin on the major current contracts projected prior to the sale is £100 and the proportion of any variance accruing to Government proposed by the bidder is 25 per cent subject to a cap of £20.

**Example of the risk sharing scheme**

| *Actual Gross Margin* | *Payment to Government* | *Payment to Purchaser* |
|---|---|---|
| £200 | Lower of:<br><br>i) 25% of the excess of the actual (£200) over the forecast (£100) = £25<br><br>ii) Cap = £20<br><br>**Payment = £20** | <br><br><br><br><br><br>**Payment = £ Nil** |
| £80 | <br><br><br><br><br><br>**Payment = £ Nil** | Lower of:<br><br>i) 25% of the shortfall of the actual (£80) and the forecast (£100) = £5<br><br>ii) Cap = £20<br><br>**Payment = £5** |

Source: Coopers and Lybrand 1991 report: 'The Offer Format and Sale Questionnaire' and the 'Sale Memorandum'

# Appendix 6: The cash adjustments claimed by PSA Services and Tarmac

| Date | Department claim payment from Tarmac £ | Tarmac claim payment from the Department £ | Difference £ |
|---|---|---|---|
| **30 June 1993** Tarmac submit initial completion statement. | | 3,174,662 | |
| **30 September 1993** Department present adjusted completion statement. | 23,416,514 | | 26,591,176 |
| **28 February 1994** Tarmac present their second completion statement | | 23,058,896(1) | 46,475,410 |
| **8 August 1994** Tarmac revise their second completion statement | | 20,902,222(1) | 44,318,736 |
| **20 December 1995** First submissions to the independent expert | 22,425,990 | 8,777,377 | 31,203,367 |
| **7 March 1996** Second submissions to the independent expert | 21,069,824 | N/A(2) | 29,847,201 |
| **27 March 1996** Third and final submissions to the independent expert | 22,450,516 | 6,581,047 | 29,031,563 |

Notes: 1. The Department took the view that Tarmac's revised completion statements of February and August 1994 did not formally update their initial Completion Statement which was submitted in June 1993.

2. Tarmac's second submission to the expert did not include a revised completion statement.

Source: National Audit Office analysis of Departmental papers

# Appendix 7: The key items of dispute during the compilation of the Completion Statement

## The issues below represent the three key arguments between the Department and Tarmac

### Issue 1: The treatment of post-completion date events

The sale agreement was silent on whether post-completion date events should be taken into account in the preparation of the completion statement.

**PSA Projects's** normal practice was to have expenditure levels approved before costs were incurred. To avoid holding up projects unreasonably, formal authorisation often occurred after the event. The Department argued that work-in-progress should include costs incurred before the sale, but which were not formally authorised until between January and September 1993 - when the post-sale adjustment process was expected to be completed.

**Tarmac** claimed that post completion date events were neither considered in the accounting practices of PSA Projects nor regarded in the negotiation of their offer. Their stance was that all expenditure should have been formally approved and invoiced by the sale date and, as such, post-completion events were not relevant to the calculation of work-in-progress or deferred income.

#### Illustrative example:

| | |
|---|---|
| Approved sales value of contract: | £10,000,000 |
| Invoices raised at completion date: | £ 9,500,000 |
| Costs incurred at completion date: | £10,500,000 |
| Estimated completion of contract: | 99.5% |

After completion, the Department approved a revised sales value of the contract of £11,500,000.

Tarmac would value work-in-progress as **NIL** on the grounds that none of the excess costs had been approved and thus were not invoiceable at the completion date.

The Department would value work-in-progress as follows:

| | |
|---|---|
| Total costs of contract: | £10,500,000 / 99.5% = £10,552,763 |
| Profitability of contract: | (£11,500,000 - £10,552,763) / £11,500,000 = 8.2% |

Costs invoiced at completion date: £9,500,000 x (100-8.2) / 100 = £8,721,000

Therefore, work-in-progress (defined as costs incurred and recoverable, but not invoiced): £10,500,000 - £8,721,000 = £1,779,000

## Issue 2: Impact of the final invoice run on the valuation of work-in-progress

**The Department claimed** that work-in-progress should include PSA Projects's management fees where it could be shown that the fees had not been invoiced.

**Tarmac claimed** that PSA Projects's management fees should not be included in work-in-progress on the grounds that they would have been included in the final invoice run and thus eliminated from work-in-progress. On projects where a final invoice run was not carried out, the fee costs booked to that project since the billing date were treated as work-in-progress.

### Illustrative example:

| | |
|---|---|
| Approved sales value of contract: | £6,000,000 |
| Invoices raised at completion date: | £3,500,000 |
| Costs incurred at completion date: | £3,600,000 |
| Estimated completion of contract: | 66.67% |

An invoice of £100,000 was processed in the final invoice run, taking the total invoicing on the contract to: £3,600,000.

Tarmac would value work-in-progress as **NIL** on the grounds that since an invoice had been included in the final invoice run it should be presumed that all costs incurred to the completion date had been recovered.

The Department would use the same methodology for the valuation of work-in-progress as used in Issue 1:

| | |
|---|---|
| Total costs of contract: | £3,600,000 / 66.67% = £5,399,730 |
| Profitability of contract: | (£6,000,000 - £5,399,730) / £6,000,000 = 10% |
| Costs invoiced after final invoice run : | £3,600,000 x (100-10) / 100 = £3,240,000 |

Therefore, work-in-progress = £3,600,000 - £3,240,000 = **£360,000**

## Issue 3: The treatment of profit on sub-contractor elements of contracts

**The Department** claimed that invoicing for services provided by sub-contractors took into account the profit or loss on these sub-contracts. These profits or losses needed to be taken into account when valuing work-in-progress or deferred income. Thus for contracts where the value of invoices raised for sub-contracted work exceeded costs incurred, the difference was most likely to represent a combination of profit earned and deferred income.

**Tarmac claimed** that sub-contracted work was always invoiced at cost, and that PSA Projects did not make a profit or loss on this element of their contracts. Therefore, where the value of invoices raised exceeded costs incurred at that date, the difference should be considered as deferred income.

### Illustrative example

| | |
|---|---|
| Approved sales value of sub-contract: | £1,000,000 |
| Expected final cost: | £ 900,000 |
| Gross profit margin on contract: | 10% |
| Estimated completion of contract: | 50% |
| Invoices raised at date of sale: | £500,000 |
| Cost incurred: | £450,000 |

Tarmac would value the £50,000 difference between invoices raised and costs incurred as deferred income. The Department would consider this as profit and value deferred income as **NIL**.

# Appendix 8: Financial Summary of the sale of PSA Projects

**Table 1:** **The price paid to Tarmac**

| | £m |
|---|---|
| **Payments to Tarmac on 1 December 1992** | |
| Price per sale agreement (paragraph 3.1) | 44.4 |
| Cash injection to make estimated net assets equal £2.8 million (paragraph 3.1) | 13.3 |
| Less: sale receipts (paragraph 3.1) | (2.8) |
| ***Net payment to Tarmac on sale*** | **54.9** |
| ***Additional Payments*** | |
| December 1993: Compensation for fewer than 850 permanent staff transferred to PSA Projects (paragraph 3.4) | 4.4 |
| September 1994: Additional Pension Fund Contribution | 0.9 |
| ***Total payments to Tarmac prior to completion settlement*** | **60.2** |
| December 1996: Refund following completion balance sheet review (paragraph 3.25) | (19.9) |
| December 1996: Interest payable by Tarmac on completion settlement | (2.6) |
| ***Total payments to Tarmac*** | **37.7** |

**Table 2: Administration costs of the sale competition**

| | £m |
|---|---|
| **Advisers' fees** | 6.7 |

| | £000 |
|---|---|
| Main sale advisers | 2,528 |
| Secondary advisers | 108 |
| Reporting accountants | 1,184 |
| Legal advisers | 1,302 |
| Insurance advisers | 3 |
| Actuarial advisers | 70 |
| Completion statement accountants | 1,331 |
| Independent Expert | 174 |
| | 6,700 |

| | £m |
|---|---|
| Privatisation Unit Cost | 0.4 |
| Long Form Report costs borne by PSA Projects | 0.5 |
| **Total direct costs of the sale** | **7.6** |

**Table 3: Government funded redundancy costs**

| | £m |
|---|---|
| Redundancy payments for staff agreeing to retire prior to 1 December 1992 | 34.4 |
| Maximum contingent post sale severance sharing liability | 39.5 |
| Compensation in lieu of notice | 4.1 |
| **Maximum redundancy liability** | **78.0m** |

**Table 4: Liabilities now transferred to Tarmac or avoided because of the achievement of the sale**

| | £m (Estimated) |
|---|---|
| ■ Contingent severance liability in excess of the Government's liability capped at £39.5m | 10.3 |
| ■ Trading losses that would have been incurred under closure | 49.0 |
| ***Total*** | **59.3** |
| ■ Indirect costs of disruption, etc that would have occurred in the event of closure | unquantified |

Sources: PSA Services's financial records, sale agreements and privatisation unit files.