

House of Commons
Committee of Public Accounts

**ROYAL MINT TRADING
FUND 2001–02 ACCOUNTS**

Fourteenth Report of Session 2002–03

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FUND 2001–02 ACCOUNTS**

Fourteenth Report of Session 2002–03

*Report, together with
Proceedings of the Committee, Minutes of
Evidence and Appendices*

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Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine “the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit” (Standing Order No. 148).

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Ms Angela Eagle MP (*Labour, Wallasey*) was also a Member of the Committee during the period of this inquiry.

Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No. 148. These are available on the Internet via www.parliament.uk.

Publications

The reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) can be accessed via internet via www.parliament.uk. A list of reports of the Committee in the present parliament is at the back of this Report.

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Footnotes

In the footnotes of this Report, references to oral evidence are indicated by ‘Q’ or ‘Qq’ followed by the question number; references to the written evidence are indicated by the page number as in ‘Ev’.

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FOURTEENTH REPORT

The Committee of Public Accounts has agreed to the following Report:

ROYAL MINT TRADING FUND 2001–02 ACCOUNTS

INTRODUCTION AND LIST OF CONCLUSIONS AND RECOMMENDATIONS

1. The Royal Mint is an executive agency and has operated as a Trading Fund since 1 April 1975. The Treasury exercises oversight of the Royal Mint and makes payment to it under contract for the manufacture and distribution to banks of UK circulating coins. The Royal Mint also competes against its overseas counterparts and private sector commercial organisations in the world-wide markets for circulating coinage contracts, collector coins and medals.¹

2. The Committee, on the basis of a Report by the Comptroller and Auditor General, took evidence from the Royal Mint and the Treasury on:

- the deteriorating financial performance of the Royal Mint in recent years;
- the control weaknesses that gave rise to thefts of banknotes from the Royal Mint in 1997 and 2001;
- the allegations of improper payments by the Royal Mint; and
- the applicability of ‘Crown immunity’ to the Royal Mint.

3. Our key conclusions are:

- The profitability of the Royal Mint has continued to decline, culminating in an operating loss of £6.5 million in 2001–02, in spite of the previous Deputy Master’s statement in July 2001 that the decline in the Royal Mint’s financial performance had been arrested and reversed. The Royal Mint’s management needs to take a firm grip on costs and productivity, in order to restore its trading operation to overall profitability.
- The Royal Mint’s decision to embark on a £25 million expansion programme in 1996–97 was seriously flawed. Their ‘euro strategy’ was naïve, failed to achieve its objectives and has resulted in the need for a restructuring exercise costing a further £12 million and involving 220 redundancies.
- As a result of the lax attitude of the Royal Mint’s management to basic financial controls and physical security, two thefts of banknotes occurred. The Royal Mint failed to learn lessons from the first theft, and its Accounting Officer will need to show that controls are now tight enough to prevent any further recurrence.
- Allegations that the Royal Mint made improper payments are now the subject of an investigation by the Serious Fraud Office (SFO) to establish whether criminal offences may have been committed. The new Deputy Master has acted promptly and appropriately in investigating these allegations, and will need to deal vigorously with associated shortcomings in management and corporate governance. As a publicly-owned commercial enterprise, the Royal Mint has an obligation to maintain the highest ethical standards in conducting its business.

¹ C&AG’s Report, *Royal Mint Trading Fund Accounts 2001–02* (HC 1181, Session 2001–02), para 1

4. Other important conclusions and recommendations are:

The deteriorating financial performance of the Royal Mint in recent years

- (i) The Royal Mint expected that it would win 20% of the contracts for production of euro blanks, but only secured 5% of this market, partly because of its inability quickly to meet the tighter technical tolerances specified in the euro contracts.
- (ii) The Royal Mint provided evidence that no cross-subsidy exists between the Treasury's UK coinage contract with the Royal Mint and its overseas contracts for coins, blank and collector coins. There is however a lack of transparency in the reporting of the Royal Mint's financial performance in its Annual Report and Accounts. The Royal Mint and the Treasury should consider carefully what additional information on its financial performance can be included in its future Annual Reports and Accounts.

Weaknesses that gave rise to thefts of banknotes in 1997 and 2001

- (iii) The control weaknesses and failings exposed by the first theft of banknotes in 1997 were not addressed by the Royal Mint, thereby creating the circumstances in which the second, larger theft could take place. No disciplinary action was taken against staff responsible for storage and security arrangements. The Royal Mint needs to overhaul its operating controls and physical security measures to prevent any further recurrence.

The applicability of 'Crown Immunity' to the Royal Mint

- (iv) The Health and Safety Executive's investigation into the circumstances which led to the death of a Royal Mint employee in June 2001 found the Royal Mint to have been at fault. It is unacceptable that the Mint should hide behind Crown immunity in such circumstances. The Treasury should review the applicability of this principle to a commercial operation such as the Royal Mint.

THE DETERIORATING FINANCIAL PERFORMANCE OF THE ROYAL MINT IN RECENT YEARS

5. As a Trading Fund, the Royal Mint operates on commercial lines and is required under the Government Trading Funds Act 1975 to achieve financial break-even, taking one year with another. Whilst an operating loss may be incurred in any one financial year, this loss should be made good in subsequent years.²

6. Over the past decade, the Royal Mint's trading performance has gradually declined, as shown in **Figure 1**, from a peak operating profit of £15.6 million in 1993–94 to its first trading loss of £493,000 in 2000–01.³ The then Deputy Master of the Royal Mint stated in that year's Annual Report that "although the bottom-line performance for the full year was disappointing, the decline in the Mint's overall financial performance during the previous two years was arrested and reversed in the second half of 2000–01".⁴ However, in 2001–02 the Royal Mint recorded an operating loss (before a £12 million exceptional charge for restructuring costs) of £6.473 million.⁵

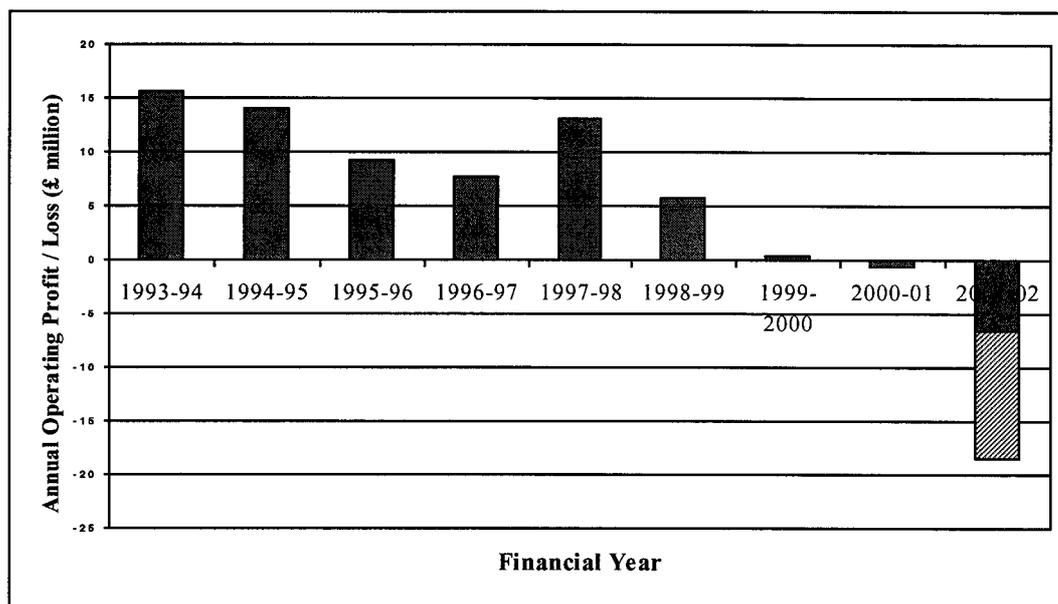
² C&AG's Report, para 2

³ *ibid*, para 5

⁴ *ibid*, para 6

⁵ *ibid*, para 7

Figure 1: Royal Mint annual operating results, 1993–94 to 2001–02



Note: The shaded bar in the 2001–02 column represents a £12 million exceptional provision for restructuring costs.

Source: *C&AG's Report, Table 1*

7. The Royal Mint told us that its management had engaged in a £25 million expansion programme in 1997–98, £9 million of which was used to refurbish plant and the remaining £16 million to expand capacity.⁶ This was designed to enable the Royal Mint to take advantage of the introduction of new coins for the twelve nation states which participated in the launch of the euro on 1 January 2002.⁷

8. The Royal Mint did not achieve its ambitious target of securing 20% of the contracts for euro blanks, instead securing just 5%.⁸ It was slower than its competitors in achieving the technical tolerance levels specified in the contracts for production of euro blanks and had not appreciated that these stricter levels meant that European coins would be more difficult to produce than UK coin products.⁹

9. The turnover of the Royal Mint fell from £111.9 million in 1997–98 to just £79.7 million in 2001–02, and its reported ratio of operating profit to sales declined from plus 11.7% to minus 23.2% over the same period,¹⁰ as shown in **Figure 2**. The Royal Mint has now embarked on a £12 million restructuring programme, involving some 220 redundancies, designed to reduce its production capacity and cost base, and to improve efficiency.¹¹

⁶ Q 91

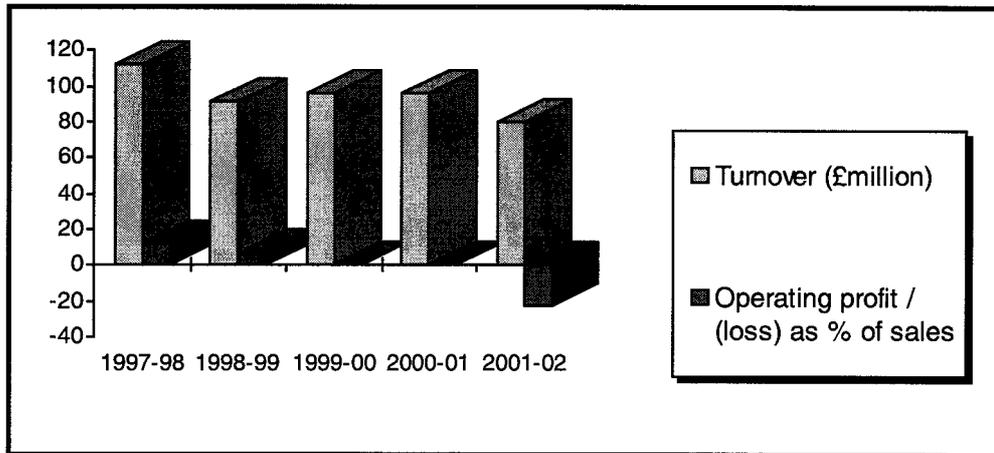
⁷ Q 10; C&AG's Report, paras 11, 15–16

⁸ C&AG's Report, paras 18–19

⁹ Qq 154, 170–175

¹⁰ C&AG's Report, p5

¹¹ *ibid*, paras 23–25

Figure 2: Royal Mint Turnover and Profit ratios, 1997–98 to 2001–02

Source: *Royal Mint 2001–02 Annual Report, page 5 (HC 1182, Session 2001–02)*

10. Although the 2001–02 annual report and accounts of the Royal Mint shows sales revenues analysed between UK and overseas sales, no further details on revenues, costs of sales or profit margins are set out in the document to allow the reader to determine whether or not any element of cross subsidy exists between the two streams of business. The Deputy Master told us that such information is considered commercially sensitive by the Royal Mint and could be detrimental to its business if made public.¹²

11. At the Committee's request, the Royal Mint therefore submitted further written evidence to us on 27 January 2003 to enable us to establish whether or not the UK taxpayer was subsidising the Royal Mint's overseas coinage and collector coin contracts via the Treasury's UK Coinage Contract with the Royal Mint.¹³ That note was examined by the Comptroller and Auditor General, who reported to us that he was content that it fairly reflected the Royal Mint's trading position over the periods disclosed (that is, from 1997–98 to 2001–02) in respect of its British and overseas markets.¹⁴

12. The Royal Mint secured a positive contribution to its fixed operating costs from its overseas circulating coin and blank sales in each of the years 1997–98 to 2001–02. Overseas sales of euro coins and blanks had also shown a positive contribution in each of those five years.¹⁵ We were assured that the Royal Mint had not used income from UK coin issues to cross subsidise prices for overseas euro orders, although the technical and quality difficulties experienced by the Royal Mint in meeting those orders had reduced the overall level of contribution achieved.¹⁶ Crucially, the Royal Mint's operating profit and financial performance would have been significantly worse if it had not secured these levels of overseas work, since the additional contribution generated had offset fixed costs that could not be avoided in the short to medium term.¹⁷

¹² Q 156

¹³ Q 140; Ev 19–22

¹⁴ Ev 25

¹⁵ Ev 20, para 12

¹⁶ Ev 21, para 16

¹⁷ Ev 21, paras 22–23

WEAKNESSES THAT GAVE RISE TO THEFTS OF BANKNOTES IN 1997 AND 2001

13. The Royal Mint operates a high-security plant guarded by Ministry of Defence Police, with controls such as random searches and metal detectors to ensure that coins are not taken into or out the premises without authorisation. However, £25,680 in brand new £20 banknotes was stolen from a safe at the Royal Mint at some point between April and December 2001.¹⁸ The Royal Mint also informed us that a similar theft of £5,000 in banknotes had occurred five years previously.¹⁹

14. Although an investigation of the 2001 theft by the MoD Police has not led to an arrest, the Royal Mint and the MoD Police identified a range of control weaknesses within the Royal Mint that had contributed to the loss, as shown in **Figure 3**.²⁰

Figure 3: Factors contributing to the 2001 banknote theft

1.	Neither of the two keys to the safe containing the banknotes was held securely.
2.	The safe was poorly located within the gold store, being located away from the supervisor.
3.	Although within a secure area, the safe was generally opened at the start of the day and left open and unattended until the end of the day.
4.	As well as Royal Mint employees, certain contractors working on the site had access to the area where the safe was located.
5.	No periodic stock checks of the contents of the safe were made between February and December 2001.
6.	The decision to order and store the total expected production run at the outset, rather than drawing down smaller consignments from the Bank of England as required during production exposed the Royal Mint to higher risk and greater potential loss.
7.	Whilst the Royal Mint is highly vigilant in addressing the risk of coin theft from the Llantrisant site, its control procedures (such as metal detectors) were not designed to combat the risk of thefts of other items such as banknotes.

Source: *C&AG's Report, para 37*

15. The Royal Mint admitted that its control procedures had been inadequate as its focus had been on the risks of coin theft, rather than banknotes.²¹ It also conceded that those procedures were themselves not adhered to for much of 2001, during a major refurbishment of the packaging area where the safe containing the banknotes was located.²²

16. Responsibility for the physical security of the banknotes held in the safe rested with the relevant departmental manager.²³ The Deputy Master explained to us that he had decided not to take disciplinary action in respect of the 2001 theft, because of the inadequacies of the operating procedures and also in view of that manager's unblemished health and absenteeism record during his 26 years of employment by the Royal Mint.²⁴

¹⁸ C&AG's Report, paras 30–32

¹⁹ Q 23

²⁰ C&AG's Report, para 37

²¹ Qq 24, 26, 45

²² Qq 19–20, 44

²³ Q 18

²⁴ Q 45

17. The Royal Mint's internal auditors had not alerted management to the security risks associated with the control weaknesses because their audit work did not address these issues and focussed instead on the manufacturing control systems.²⁵ Their last review of security controls had been undertaken in July 2001 but, with management's agreement, such audits were limited to reviewing whether the principal control procedures operated by the Royal Mint had operated satisfactorily and were limited to discussion and review of supporting documentation.²⁶

18. In the light of these thefts, the Royal Mint has since conducted a review of its physical security procedures and introduced revised arrangements, including the installation of video cameras in the area around the safe.²⁷

THE ALLEGATIONS OF IMPROPER PAYMENTS BY THE ROYAL MINT

19. In May 2002, the Deputy Master was alerted to allegations that over several years to April 1999 the Royal Mint had been involved in the making of improper payments. Having alerted Treasury Ministers, he conducted an internal investigation and submitted a report on his findings to the Financial Secretary to the Treasury on 25 June 2002. The Financial Secretary wrote to both the Chairman of this Committee and also the Comptroller and Auditor General on 1 July 2002, notifying them of her decision that the Deputy Master should notify the Serious Fraud Office of the allegations and provide it with a copy of his report.²⁸ The investigation by the Serious Fraud Office is continuing and we may decide to return to this issue after that investigation is completed and any subsequent legal actions concluded.

20. In July 2002, the Treasury agreed with the Deputy Master that, in the light of his findings and the circumstances of the banknote theft, an independent review of the Royal Mint's internal financial control systems should be commissioned.²⁹ Grant Thornton was appointed to conduct this review and submitted its report³⁰ to the Financial Secretary to the Treasury on 24 September 2002.

21. The Grant Thornton report contained 70 recommendations designed to secure improvements in the Royal Mint's overall corporate governance arrangements and in the operation of its internal financial controls, together with an Action Plan which incorporated the responses of the Royal Mint's Management to each point.³¹ The Deputy Master intended to ensure that all of these recommendations would be addressed by 31 December 2002 at the latest.³² In responding to a Parliamentary Question on 23 January 2003, the Financial Secretary to the Treasury said that action in respect of 67 of the 70 recommendations had been completed. Of the remainder, two would be complete by 31 March 2003 and one (relating to IT system access controls) had been found to be impractical.³³

THE APPLICABILITY OF 'CROWN IMMUNITY' TO THE ROYAL MINT

22. On 28 June 2001, an accident at the Royal Mint resulted in the death of an employee. A 6.5 tonne bell annealing furnace became detached from the hook of an overhead crane whilst being transported between locations in the production department and fell four

²⁵ Qq 48–49

²⁶ Memorandum received, not printed

²⁷ C&AG's Report, para 38; Qq 38, 47

²⁸ C&AG's Report, paras 40–45

²⁹ *ibid*, para 46

³⁰ Report by Grant Thornton, *Financial Systems Review of the Royal Mint*

³¹ C&AG's Report, paras 49–53

³² *ibid*, para 55

³³ HC Deb, 23 January 2003, col 432W

metres to the floor, striking the employee and causing fatal injuries. A subsequent investigation by the Health and Safety Executive (HSE), which received the full co-operation of the Royal Mint, determined that the furnace had not been properly attached and secured to the crane lifting hook. The HSE found that the Royal Mint had failed to perform a suitable and efficient assessment of the risks posed by the crane operation and that not all employees involved in the process could be shown from written records to have received sufficient training and instruction.³⁴

23. The Royal Mint told us that it had undertaken a range of measures to address the specific findings of the HSE, which had since confirmed that it was content with the action taken.³⁵ The Deputy Master had also given particular attention to improving health and safety standards and staff awareness throughout the plant in the months since the accident.³⁶

24. We sought to establish whether the fact that the Royal Mint enjoys the protection of Crown immunity had contributed to the weaknesses and failings in health and safety procedures uncovered by the HSE investigation. Crown immunity means that bodies such as the Royal Mint cannot be prosecuted for offences either created by statute or of the common law. In the case of health and safety legislation, whilst the law applies to the Royal Mint, the results of HSE investigations—as in this case—can only result in Crown censure. Whilst Crown immunity does not grant protection to individuals from prosecution, in this instance the HSE and Police investigations concluded that no Mint director or employee should face prosecution.

25. Crown immunity does not provide protection from civil claims. The Royal Mint has written to the representatives of the deceased employee to confirm its admission of liability and asked them to provide details of the quantum of their claim, which will be considered sympathetically by the Royal Mint.³⁷ The Deputy Master gave us an absolute assurance that the applicability of Crown immunity to the Royal Mint in no way impacted on the attitude of the organisation to the importance of compliance with health and safety legislation.³⁸

26. In a note submitted to the Committee following our evidence session, HM Treasury officials stated that the Government's position on Crown immunity remains as set out by Lord Falconer in his response to a Parliamentary Question by Lord Kennet, given on 4 November 1999.³⁹ However, recent consultation papers on corporate killing and health and safety have proposed modifications of immunity. In the light of responses to that consultation, officials have analysed the options and advice is to be put to Ministers.⁴⁰ Although recommendations on policy lie outside the remit of this Committee, we were told by the Deputy Master that he personally would have no problem if a policy decision were to be taken by the Government to remove Crown immunity from the Royal Mint.⁴¹

³⁴ Q 78; Ev 23–24

³⁵ Ev 24, para 16

³⁶ Qq 3–4

³⁷ Qq 7, 177; Ev 22, Appendix 2, para 3; Ev 25, Appendix 3, para 18

³⁸ Q 4

³⁹ HC Deb, 4 November 1999, col 98W

⁴⁰ Ev 22–23, Appendix 2, paras 4–5

⁴¹ Qq 108–109

MINUTES OF PROCEEDINGS OF
THE COMMITTEE OF PUBLIC ACCOUNTS

SESSION 2001–02

WEDNESDAY 23 OCTOBER 2002

Members present:

Mr Richard Bacon	Mr Nigel Jones
Mr Ian Davidson	Mr David Rendel
Angela Eagle	Mr Gerry Steinberg
Mr George Howarth	Jon Trickett
Mr Brian Jenkins	Mr Alan Williams

In the absence of the Chairman, Mr Alan Williams was called to the Chair.

Sir John Bourn KCB, Comptroller and Auditor General, was further examined.

The Committee deliberated.

Mr Brian Glicksman, Treasury Officer of Accounts, was further examined.

The Comptroller and Auditor General's Report on Royal Mint Trading Fund 2001-02 Accounts (HC 1181), was considered.

Mr Gerald Sheehan, Deputy Master and Comptroller (Chief Executive), Royal Mint, was examined (HC 1184-i).

Ordered, That, for the remainder of the evidence to be taken this day, the Committee meet in private.—(*The Chairman*).

The witnesses were further examined.

* * * * *

[Adjourned until Monday 28 October at Four o'clock.

* * * * *

SESSION 2002–03

MONDAY 31 MARCH 2003

Members present:

Mr Edward Leigh, in the Chair

Geraint Davies	Mr Gerry Steinberg
Mr Nick Gibb	Jon Trickett
Mr David Rendel	Mr Alan Williams

Sir John Bourn KCB, Comptroller and Auditor General, was further examined.

The Committee deliberated.

Mr Brian Glicksman, Treasury Officer of Accounts, was further examined.

* * * * *

Draft Report (Royal Mint Trading Fund 2001–02 Accounts), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 3 read and agreed to.

Paragraph 4 postponed.

Paragraphs 5 to 26 read and agreed to.

Postponed paragraph 4 read and agreed to.

Resolved, That the Report, as amended, be the Fourteenth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

* * * * *

[Adjourned until Wednesday 2 April at half past Three o'clock.]

MINUTES OF EVIDENCE

TAKEN BEFORE THE COMMITTEE OF PUBLIC ACCOUNTS

WEDNESDAY 23 OCTOBER 2002

Members present:

Mr Ian Davidson	Mr David Rendel
Angela Eagle	Mr Gerry Steinberg
Mr George Howarth	Jon Trickett
Mr Brian Jenkins	Mr Alan Williams
Mr Nigel Jones	

In the absence of the Chairman, Mr Alan Williams was called to the Chair.

SIR JOHN BOURN KCB, Comptroller and Auditor General, further examined.

MR BRIAN GLICKSMAN, Treasury Officer of Accounts, further examined.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL: ROYAL MINT TRADING FUND: 2001-02 ACCOUNTS

Memorandum submitted by the Royal Mint

PAC HEARING 23 OCTOBER 2002: THE ROYAL MINT

The Committee will be aware that the Report of the Comptroller and Auditor General (C&AG) makes reference to the theft of banknotes from the Royal Mint (paragraphs 30 to 38 refer).

As part of my preparations for the PAC hearing, information came to my attention on Friday 18 October about a previous loss of banknotes. I investigated immediately.

The detail is that on 29 October 1997 a consignment of banknotes was transferred from the Bank of England Printing Works to our office in London. On 5 November the consignment was transferred to our factory in Llantrisant. The consignment included 1,500 £10 banknotes (serial numbers HM50 000001 to HM50 001500) which were to be used to create a special, limited edition banknote and coin collectors' set. By early December the first 1,001 banknotes had been packed. However, the balance (£4,990 face value) could not be found when they were required for packing in mid-December.

The Ministry of Defence Police were informed about the loss and carried out extensive enquiries, but with negative results. The facts suggested a theft had occurred within the Despatch Area of the Proof Coin Unit at Llantrisant.

I apologise to the Committee and the C&AG for not bringing these matters to their earlier attention. I can only reiterate, as reported by the C&AG, that I have made improvements to our physical security arrangements and working practices.

In accordance with the normal convention, I am copying this note to the C&AG.

Gerald Sheehan
Accounting Officer (Deputy Master and Comptroller)
Royal Mint

22 October 2002

Memorandum submitted by the Birmingham Mint

The Birmingham Mint (BM) is a privately owned company and Britain's only Mint with significant coin manufacturing capacity other than the Royal Mint. Based in inner city Birmingham and employing 180 people, we have been engaged in the manufacture and sale of coins, coin blanks, tokens and medals for over 200 years.

The BM is looking to the Public Accounts Committee to examine carefully the Royal Mint's Annual Report and Accounts 2001-02 with a view to assessing whether:

1. its performance, strategy and plan are consistent with providing good value for the public purse in a competitive market;
2. were it not for government backing, it could survive as a going concern;
3. the Chancellor's financial objectives set for the period April 2001 to March 2006 are sufficiently challenging and, if so, are attainable without further monopoly support.

23 October 2002]

[Continued

BACKGROUND

In recent years the Royal Mint has been given more commercial freedom by the Treasury and encouraged to work in partnership with the private sector.

In embracing an increasingly commercial remit, there is concern the Royal Mint has not acted in a way that is appropriate for a public body and that it may be abusing a monopoly position. It currently enjoys, according to our understanding, sole supplier status to The Treasury for the manufacture and distribution of UK circulating coins. This is despite BM's strong belief that—had it been offered the opportunity—it could have competed for a significant part of the contract at lower cost.

In the period 1997–98, the Royal Mint embarked on a Capital Investment Programme that has resulted in significant excess capacity. As a result, its costs are too high and compare unfavourably with those of BM. (see table below, A Comparison of The Royal Mint and The Birmingham Mint Cost Structure, sources C&AG's Report on Royal Mint Annual Report and BM Management Accounts).

Moreover, with much of its overall fixed costs covered by its Treasury contract, the Royal Mint is able to sell in overseas markets at prices which we believe are uneconomic on a proper allocation basis, and with which BM has great difficulty competing.

Not only does this have implications for our company and employees, but most relevant to your inquiry, it does not offer good value to the taxpayer as public subsidy is being used to support coin production which, we contend, we could produce more efficiently.

This issue now threatens the future of our business and we would like to draw your attention to the following specifics.

ENDING OF CONSORTIUM AGREEMENT WITH THE ROYAL MINT

In July 2001, BM was unilaterally cut out of a 40 year Consortium Agreement with the Royal Mint, which applied to business and contracts that the two organisations were able to win from non-EU markets.

This decision has serious implications for the future of BM. As the Royal Mint “fronted” the consortium with overseas customers, BM is now at a considerable disadvantage when seeking new business with clients whose relationship previously was with The Royal Mint.

BM has—as a last resort and following repeated attempts to negotiate and obtain greater transparency of information from The Royal Mint—taken legal action for breach of contract arising out of the Royal Mint's actions under the agreement. This claim is referenced in paragraph 39 of the C&AG's Report. We would have preferred a constructive dialogue.

All the BM asks is to compete on a level playing field with The Royal Mint. To this end, we believe there are some important issues that need to be raised.

KEY QUESTIONS TO RAISE

- What scrutiny was there of the sales revenue and profit forecasts to justify The Royal Mint £25 million capital expenditure as part of a modernisation plan in 1997–98?
- Was consideration given to subcontracting or splitting manufacture of UK coinage with external contractors or competitors such as the Birmingham Mint?
- Why did the Royal Mint then set such an ambitious target of winning 20% of total contracts for euro blanks? Was this because of the pressure to increase sales (see paragraphs 11–18 of C&AG's Report) to justify capital expenditure? How did this impact on its relationship with the BM?
- Is the Royal Mint able to price down its overseas contracts by virtue of the fact that much of its fixed costs are covered by its Treasury contract?
- The Committee might also wish to ask which comparable organisations were used as benchmarks in the benchmarking exercise referred to in the Chief Executive's Report (page 3, Royal Mint Annual Report 2001–02)
- “The Corporate Plan calls for a substantial reduction in the production capacity of the Mint” (paragraph 24, C&AG's Report). Will this entail any assets acquired in the past five years being taken out of production?
- The “Ministerial Target” average rate of return on net assets is described on page 5 as 11% “within the five-year period 1 April 2001 to 31 March 2006”. The C&AG's Report (paragraph 9) states that for the same period “the Mint is required to achieve a rate of return of 11% in at least one of these five financial years.” This could be literally understood as only one of these years. What is the target?

23 October 2002]

[Continued

- It is reported that the “guaranteed minimum order volumes” from the APCS “aided forward planning” (page 7, Royal Mint Annual Report 2001–02). Why then, in view of the 17% decline in turnover, are stock levels unchanged at £49 million, which represents more than seven months sales value? Even after deducting the £16.5 million precious metal held for 3rd parties, this represents five months sales, compared to four months for 2000–01. Much of the increase appears to be UK circulating coin (see paragraph 22, C&AG’s Report).
- In paragraph 12 of the C&AG’s Report, it is stated that productivity rose by 27% between 1996–97 and 2000–01. How is this productivity measured?
- The PAC may also wish to probe areas mentioned in the Royal Mint Annual Report 2001–02 such as:
 - The reference on page 22 to “liquidity risks following recent trading deficits”.
 - The reference on page 31 to “lack of outside insurance for fire, explosion, common law, third party, theft and similar risks.” Is there a commercial charge to the RM?
 - The reference on page 36 to material transactions with the MOD and the Home Office—what was the nature and extent of these and were they put out to competitive tender? Was the contract with the Department for Media, Culture and Sport put out to tender?

**A COMPARISON OF THE ROYAL MINT AND THE BIRMINGHAM MINT
COST STRUCTURE (2000 AND 2001)**

	Year	<i>Birmingham Mint</i>		<i>Royal Mint</i>	
		2000	2001	2000–01	2001–02
£’000					
Turnover		18,263	34,036	96,241	79,672
Raw materials and consumables		–8,829	–17,918	–46,014	–36,986
Stock/w-i-p adj		227	–210	3,910	2,164
Gross Margin		9,661	15,908	54,137	44,850
	%	52.90%	46.74%	56.25%	56.29%
Staff Costs		–4,611	–5,770	–30,594	–28,255
	% Gross Margin	47.73%	36.27%	56.51%	63.00%
Other Costs		–4,260	–4,910	–24,036	–23,068
	% Gross Margin	44.09%	30.86%	44.40%	51.43%
Operating Profit/Loss		790	5,228	–493	–6473

Sources: C&AG’s Report and BM Management Accounts

22 October 2002

Examination of Witness

MR GERALD SHEEHAN, Deputy Master and Comptroller (Chief Executive), Royal Mint, examined.

Mr Williams

1. We are here today to consider the NAO Report on the Royal Mint Trading Fund 2001–02 and their accounts. We welcome you, Mr Gerald Sheehan, as our witness. It is your first visit here. I am sure you wish it had been the third, but it has to happen some time. Can I explain to everyone that the Committee process will be slightly varied today because there are allegations of improper payments that have been made in pursuit of contracts. This has led to a formal investigation which is still going on by the Serious Fraud Office. What we will be doing is dealing with other aspects of the Report and then at the end of that section we will go into closed session when I am afraid all our visitors will have to leave. Mr Sheehan, I know that you have inherited the situation you find yourself in but what we are confronted with is a loss of £6 million, an expansion of capacity by 50% at the very time when the world market for coins and discs

was shrinking, the theft of £25,000 that was not discovered for over a year and now we have learned yesterday about the theft of another £5,000 five years ago. There have been the allegations that I have referred to of improper conduct and in very recent times we have had the tragic loss of life of one of your workforce. There are obviously very many questions we will wish to ask you. Before I start on details can I ask you two points that may hopefully be an oversight? Your Report and your accounts are required to be distributed to MPs but we did not get them and we received them very late. Also, they are required to be printed by the Stationery Office and that was not fulfilled. Can you explain how that arose?

(*Mr Sheehan*) Because of the nature of the Report and the issues within it and some of the issues you have already mentioned, we delayed the input of our results this year in line with and agreed with the

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MR GERALD SHEEHAN

[Continued

[Mr Williams Cont]

National Audit Office. In the context of the Stationery Office producing our Report, I was not aware of that. I am aware that we are very keen to reduce our costs so we may well have done it that way. If that was an oversight I can only apologise.¹

2. But it was an oversight, no deliberate intent?

(Mr Sheehan) Absolutely.

3. Okay, that is fine. I am sure you will make sure it does not happen again. Before we go on to the financial matters, there is the sad matter of the death of one of your employees. I was very disturbed to find, as I am sure the Committee was when it read the background briefings from the C&AG, that the Health and Safety Executive found that the Mint had been responsible for the death of one of its staff in an industrial accident, but the presiding officer at the hearing said that but for Crown immunity there was a realistic prospect of conviction in the courts. That is very serious indeed. Can you give us one good reason why the Mint should have this Crown protection that it has?

(Mr Sheehan) Can I say first that this tragedy—and it was very much a tragedy—was felt very much by all the workforce in the Mint and is still felt and our sympathy still goes out very much to the family. In the case of the Crown immunity, my understanding is that this is a policy issue. I find it quite difficult to comment on this particular point. The important point and the key issue for me is that we have to have health and safety standards within the Mint which are absolutely paramount and at the top of the agenda. The work that we have been doing over the last six to nine months has focused very clearly upon improving safety standards throughout the Mint. We have structured to a large extent the health and safety team and made them far more focused. We are focusing very clearly on risk assessment and safe working procedures, and our accident performance is improving.

4. Do you think they might have been more focused already had they been aware that they were not protected by Crown immunity?

(Mr Sheehan) Absolutely not. This is a key priority for us in the Mint and whether we are fined or not is not a factor which we must take into account in looking at our accident record and performance.

5. Obviously you cannot comment on policy. Can you give me any operational reason why Crown immunity should be extended to you? You are just a production plant. Why should you have Crown immunity?

(Mr Sheehan) It is a policy issue. I cannot think of any other reason at this stage. I am not used to this particular situation, coming from a private sector environment, but apart from the policy issue, which I really cannot comment upon, I would not be able to comment any further.

6. Since the presiding officer felt that there was a realistic prospect of conviction, can we take it for granted therefore that there has been disciplinary action internally as a result of this incident, since culpability lies within your organisation?

(Mr Sheehan) We have looked at the whole aspect of this. As you are aware, I was not there at the time. It was felt that there was no requirement in this instance for that action to be taken. There were a number of issues surrounding the event and what we had to do was review the whole of the safety procedures in this area. We did have generic procedures that covered the handling of equipment of this nature, using overhead cranes. The failing that we had was that we did not have a risk assessment specifically for this type of kit, and obviously since the event we have corrected that.

7. So the Health and Safety Executive found you responsible, the presiding officer at a hearing felt there was a reasonable prospect of a conviction, but apparently the circumstances that led to those conclusions do not even merit a disciplinary act on your part as management?

(Mr Sheehan) The other point I would make is that the Health and Safety Executive also made it very clear that there was no individual culpability and it is possible to prosecute individuals in the Mint as it is in other parts of business but that was not the action that the Health and Safety Executive deemed necessary.

8. It is a sensitive issue to raise so soon after the event, but does the Crown immunity in any way prejudice the compensation to which the victim's family would be entitled?

(Mr Sheehan) Absolutely not. We have done everything we can to help the family within the guidelines that we have used. We have done everything we possibly can.

9. Your loss of six million: why did you increase your capacity by 50% at the very time when there was already surplus capacity in the world market in production terms and the world market, if anything, was declining? Why a 50% increase?

(Mr Sheehan) I have to go back five years to paint the picture then of the market. The situation was very clear then. With the introduction of the euro to the Euro 12 there were some very great opportunities in terms of the market place. The anticipation was something in excess of 50 billion coins over a three-year period, which is something like a 30% increase. It was clear that the Mint management saw an opportunity to take a significant market share of this particular market, particularly in the case of plated material where there was a lot of expertise within the Mint and a lot of the focus of the investment at the time was directed at the introduction of more copper plating plants to take advantage of this market opportunity.

10. Where did you read a market increase of 50% when everyone else says that there was over-capacity?

(Mr Sheehan) It was very clear that for a three-year period from that period on there would be a spike in the market associated with the introduction of euro coins and of the £25 million about £16 million was directed at the capital investment to attract a share of that market. The other £9 million was aimed at improving the overall Mint plant and equipment which was becoming a bit tired. In going for the

¹ Note by witness: The Report and Accounts were published by the Stationery Office. Ref Ev 19

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[Continued

[Mr Williams Cont]

investment to attract the market share we did not achieve anything like we anticipated we would achieve.

11. There was a major planning error in fact and a costly planning error and 200 people are losing their jobs now, I understand.

(Mr Sheehan) I cannot relate the 200 people to the capital investment, sir, because they are two separate issues.

12. Just to the market conditions?

(Mr Sheehan) The market conditions now are very different from what they were anticipated to be five years ago. The situation we have now is that we have passed the euro peak. A lot of people like us invested in new plant and equipment. We have something like 30% over-capacity—

13. The euro peak, with respect, would not account for a 50% increase, and it would be a once-and-for-all increase to get the initial stock of coins in circulation. You do not plan long term investment on a short term production possibility in one market, do you?

(Mr Sheehan) That was the three to four year period of opportunity with the euro. At the time there was a clear move in other parts of the world, in other countries, to move their product, their coin, from a homogeneous, non-ferrous product to plated material, so there was a clear move in that direction and people could see the opportunities, particularly in copper-plated material.

14. Can I move on to the theft of the £25,000? First of all, you are an ultra-secure plant, you even have army protection, and yet we find that the safe was left open all day during working hours and that in the safe there were passwords or something or other. What passwords were in there?

(Mr Sheehan) There are two safes. The one you are alluding to has passwords. It is nothing to do with this particular theft. The second safe which has passwords does not contain anything in bank notes. The bank note safe, the one you are alluding to, was left open and that was obviously an incorrect procedure, very much so.

15. For a year?

(Mr Sheehan) It was left open during the day hours. It was obviously locked out of working hours.

16. Yes, but for how many years? Was that standard practice?

(Mr Sheehan) The procedures were very clear, that the safe should not be left open.

17. But who left it open?

(Mr Sheehan) The person in charge—

18. Who was in charge? Office, not name. What was the office of the person in charge?

(Mr Sheehan) It was the departmental manager at the time. The circumstances that we had were that it was likely that this theft occurred between the April and October period in our view.

19. And it took you over a year to find it.

(Mr Sheehan) It took us until December, you are quite right, to find it. At the time there was a significant investment taking place in the packaging area. People were under pressure, there were lots of

contractors being used at that time and there were clear failings in applying our procedures. There is no doubt about that.

20. But what does what is going on in the packaging area have to do with closing a safe?

(Mr Sheehan) This is all in the same area. I cannot defend the situation because the procedures were not being applied.

21. Is it not even worse if it is all in the same area that you have contractors and their workers and so on all circulating there, and you just left the safe open? Was the safe with the passwords open as well?

(Mr Sheehan) This was in a totally different part of the plant.

22. That is not the point.

(Mr Sheehan) I cannot comment on whether that safe was open at any time. I can comment that in the light of the Grant Thornton internal review we have now corrected that other problem.

23. My understanding from the National Audit Office is that passwords were at risk. Perhaps you will consider that again. That was a relatively recent occurrence and then yesterday I get a phone call from the clerk to say that we have been notified that you have found that another £5,000 had walked about five years earlier. I assume that five years earlier the safe was still left open and that you did not have all this extra activity in the packaging area, so how did that happen and how is it that no-one knew about it?

(Mr Sheehan) This came to light on Friday evening when I was carrying out further investigations on the whole issue of procedural control in the Mint in the light of the issues that we had. It is a very different issue. This was of bank notes that were being delivered from the Bank of England to our London office and then on to Llantrisant. It is a different matter, still a procedural control issue, without question, and unacceptable.

24. How did it take five years to discover? You have internal audits and so on. How did you not know about it?

(Mr Sheehan) I think it is necessary for me to explain the focus of the Mint in terms of procedural control and security control. Our focus has been very clearly upon the avoidance of theft of coin. We produce coin and that has been our clear focus. To put that in perspective and to demonstrate that it is fairly effective, since 1989 there have been four attempted thefts of coin. We have dismissed three of those people and the fourth person resigned prior to any disciplinary procedure.

25. But, with respect, there is a limited amount of value you can carry out in coin unless you are carrying it in a transporter or something. You can fill your pockets with coins and it is still petty cash. Fill your pockets with bank notes and it is a fair amount of money. Where is your sense of proportion?

(Mr Sheehan) Absolutely. What we have had to do very clearly is to review the whole procedural issues within The Mint in terms of security and we have taken the appropriate action to make sure that we can minimise the possibility of this happening again.

26. You have only been there 30 years. Not you, the Mint has only been there 30 years. So you are getting around to looking at these things, are you?

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[Continued

[Mr Williams Cont]

(Mr Sheehan) I think the focus was on coin and that was a mistake and we accept that.

Mr Williams: Rather belatedly.

Mr Rendel

27. Perhaps I can start off on the whole of the investment that you made which the Chairman was referring to just now. I think he is quite right to mention that it does seem rather strange that a one-off demand, the peak in demand, led to this huge investment. You did mention one or two other things. Was a business plan produced concerning this investment and, if so, how quickly did it show that the investment would be paid off?

(Mr Sheehan) This plan was produced in terms of the most likely scenario. We are talking about a pay-back, I believe, within four years for the three plants.

28. So it was going to be paid back after the end of the euro peak?

(Mr Sheehan) The demand for coin in the euro was likely to be in the three to four year period, three full years and one partial year, so the logic was to pay back on that basis.

29. But you were still expecting some of the pay-back to take place after that? You are expecting to take on quite a lot more business in order to pay back that sum, let alone make a profit on it afterwards?

(Mr Sheehan) The anticipation was that other countries would move to particularly copper plated material and to some extent nickel plated material.

30. Why has that not happened?

(Mr Sheehan) It has happened to some extent but the market dynamics and the over-capacity have more than offset the benefits of that.

31. Was that over-capacity taken into account when you drew up that business plan?

(Mr Sheehan) I do not believe that we were aware in 1997 of the quite expansive plans that private sector blank producers in particular and some mints had in anticipation of the euro demand, so I do not think it was taken into account.

32. What efforts at the time were made, apart from the plating issue, to identify other sources of revenue, other business that you might be going to be able to take on if you made this investment?

(Mr Sheehan) Again, the plan was clearly looking at the overseas market outside Europe, understanding that some countries were looking for re-coinage business, and that is a significant opportunity, and that they were looking to convert from homogeneous material to plating material. That is not guaranteed but there was certainly a clear move in that direction.

33. Have you identified particular contracts that you were going to win, or you thought in general you were likely to be able to win?

(Mr Sheehan) We had identified particular countries that were moving that way but not a specific contract.

34. Can I turn to the theft and perhaps come back if I have time to some more general questions afterwards? Can you explain why the £20 notes were taken into storage 14 months before they were

needed? That seems to be in a sense a cash flow problem, does it not? You are increasing your working capital quite a lot by just having those notes in storage without needing them for 14 months.

(Mr Sheehan) This is very clearly one of the lessons that we have learned from the new procedure. The actual total was £40,000 and we had used just under £15,000 of the total, so there was £25,000 left and I agree that that was one of the lessons we have learned.

35. It was not left; it disappeared.

(Mr Sheehan) The £25,000 disappeared. We had actually used £15,000 as part of the plan.

36. Would you have used more if there had been more left? When you started production there was only £15,000 left in the safe anyway.

(Mr Sheehan) The plan was to use them all over an extended period. The issue we have had, and we have learned from, is that we should not hold anything like that amount of money and just have it delivered on a more regular basis.

37. There are two points here. It is not only when you took in the money but also how much did you eventually use? You expected to use £40,000 worth of these notes in these presentation packs. As it happened there was only £15,000 left when you started production. Did you get in another £25,000 to replace the £25,000 that was lost and did you sell £40,000 worth of packs?

(Mr Sheehan) I cannot confirm the total amount that we sold but we anticipated using the £40,000 and I am not sure, although I can confirm this later, that we took more in.

38. Anyway, you found £15,000 was left of the £40,000. I understand that your policy now is only to bring in the money as you need it in line with production, but that still does not explain the fact that it is not only a question of bringing it in as you produced it but of how long in advance you got it in to begin with. It is not only that you got the whole lot in. The first bit you got in 14 months in advance. Why on earth did you get any of it in at that stage?

(Mr Sheehan) Again, I admit very openly that this was a mistake on our part. Since we have reviewed this we have very clearly changed the procedures. We have done a number of things. We have re-positioned the safe to make it far more clear and open in that sense. We have put in video cameras. We now have a three-key system. One of those keys is held by the MoD police and cannot be opened without them being there, and we have limited the amount of money that comes in.

39. I think in October 2000 you took the money into the safe. Were you expecting at that stage to start production of these packs at about that time or did you, even in October 2000, know that you were not actually going to start production of these presentation packs until December 2001, which is when you did start production?

(Mr Sheehan) The money was brought in in October. As I indicated, we used £15,000 of that. My belief is that that was associated with the run-up to the Christmas period and the time for packing, etc.

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[Continued

[Mr Rendel Cont]

40. Hang on a minute. As I understand it, you did not start production of any of these packs until December 2001. Is that wrong?

(*Mr Sheehan*) No. My belief, and again I confirm that I was not there, is that we used £15,000 worth from October 2000 onwards, but the problem occurred between April and October 2001.

41. I thought there was £15,000 left in the safe in December 2001. Paragraph 32 says: "... on 13 December 2001 a stock check of the contents of this safe prior to the commencement of the production run for the presentation packs revealed that 1,284 notes were missing and only £14,320 . . . remained", so it looks as if prior to production, starting in December 2001,—

(*Mr Sheehan*) You are absolutely right.

42. I go back to the first question. Did you know in October 2000 that you were not going to start production until December 2001?

(*Mr Sheehan*) I cannot comment on that. I can confirm that in a separate note if I may.²

43. But certainly if that was known it seems to me a quite extraordinary position that you should have taken in the money 14 months in advance of needing it, and it does lead one to wonder whether somebody actually wanted that money in place a long time in advance because somebody had their eyes on it.

(*Mr Sheehan*) I can confirm that the use of bank notes has been in place since about 1990, so there has been a rotation of bank notes through the period and they are used as part of these packs on a regular basis.

44. You had some stock control regulations in place, some procedures, but they apparently did not include a stock take over quite a long period of time. When you knew that there were going to be contractors in the area why were these stock controls not at that point made a great deal more stringent, which one would have expected?

(*Mr Sheehan*) That is exactly what should have happened. The circumstances were that the individuals concerned were under a fair bit of pressure to complete the work in the area because the packaging refurbishment area was a necessity for storing extra stock, and the focus went off the stock procedural controls and that was obviously a mistake.

45. Has anything happened to the man or woman who took that decision? There were lax controls at the very time when the danger was at its highest.

(*Mr Sheehan*) I looked at this situation. The procedures were not good enough, without question, and have since been reinforced. The individual concerned had been an employee in the Mint for 26 years. He had an unblemished record in terms of health/absenteeism and, weighing up the pressures and the issues that we had and the fact that the procedures were not good enough, I felt it inappropriate to discipline him. In fact, the situation occurred not long after this event that the individual has been away from work with ill health, with a stress-related problem and depression, and has now taken early retirement.

46. Can you tell me please why it took as long as four months, from December 2001 when the problem was discovered until April 2002, for the MoD police report to be produced? That seems a long time for what was clearly a serious problem which needed urgent action.

(*Mr Sheehan*) The MoD report was a protracted investigation which involved the outside police as well because we wanted to keep it low key in the hope that we could find the notes and find the theft and the person who had taken them, so there was a very protracted investigation which involved the external police as well.

47. What steps were taken during the investigation to prevent anything of a similar sort happening again?

(*Mr Sheehan*) We immediately instituted the new procedures. We reviewed them when I was aware of it and we introduced those new procedures.

48. You have an internal audit section, I understand, or at least you employ internal auditors on a contract basis. Was any action taken against any of them for having failed to notice the fact that there was this horrendously obvious open situation with money lying in an open safe?

(*Mr Sheehan*) The internal audit section did not flag this up, to be quite honest.

49. The question is, why did they not?

(*Mr Sheehan*) The issue was that I do not believe that the audit was focused on these particular issues. It was focused on the Mint as a manufacturing entity looking specifically at the control from a manufacturing perspective—the control of stock, the hedging policy, etc. That is again a lesson that we have very clearly learned, that some of the internal audit must be focused on some of these issues.

50. When was the last internal audit done of the security situation in what I believe is called the Collector Coin Division's gold store?

(*Mr Sheehan*) We have an internal audit on security, I believe, every three years. I cannot say exactly the year it was done. It is every three years.

Mr Rendel: It would be interesting, Chairman, to know when that was last done before all the problems came to light, because if these are people employed on contract and they had done anything like a relatively recent security audit of that area at a time when the safe was being kept open during the day, and there is some evidence I think that the safe had been kept open during the day for some time before this matter came to light, then clearly it seems to me that they failed rather badly in their duties. I would have thought this might be worth considering when you are renewing the contract.

Mr Williams

51. Before we go on, do you have any colleagues with you from the Mint and are they able to provide the answer?

(*Mr Sheehan*) I have two colleagues with me. I am not sure that they are particularly expert in this field, and I suspect that they would not know the answer.

² Confidential note provided, not printed.

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MR GERALD SHEEHAN

[Continued

[Mr Williams Cont]

52. In that case you will let us have an urgent note on it.

(Mr Sheehan) Certainly.³

Mr Rendel

53. I have to say, Chairman, as somebody who has been an internal auditor of a large multinational in the past, I am surprised that internal audit have failed to pick this up in good time. It seems to me that they have let you down really rather badly.

(Mr Sheehan) I can only comment that my belief is that this incident occurred between April and October. I have no evidence to suggest that the safe being left open was something that happened well before that as well.

54. So the safe was only left open during the time when these contractors were in?

(Mr Sheehan) I cannot comment on that because there was no evidence to confirm one way or the other, but certainly it was left open in that period, yes.

55. Again, it seems quite extraordinary that somebody should have made things easier for potential theft at the very moment when the danger of potential theft became the greatest.

(Mr Sheehan) I think it was open by default because of the nature of the work that was ongoing in that particular area.

56. Can we turn back to the more general points? On page 38 in paragraph 10 there is a note that there was a change of contract by the Treasury which led to a reduction in turnover. How much of the reduction in your profit has been because of a change of terms in what the Treasury was paying you?

(Mr Sheehan) If I compare it since the 1994–95 period to date, then the actual impact upon the profitability of the Mint from that period to now is something like £2.8 million.

57. Given that we are probably not the nearest mint to a lot of the overseas markets, what is the proportion of transport costs as a proportion of your sales revenue? Presumably if you are transporting heavy coins all over the world it must cost quite a bit.

(Mr Sheehan) I cannot give you the exact number but, bearing in mind the high value of these products, it is a relatively small percentage.

58. A high value of the products but not necessarily a high profit margin on the products, which is the important point. It is transport costs against the profit margin which is important.

(Mr Sheehan) I think we have to consider the whole situation in terms of the Mint and its position in the international market because we have a capital intensive industry with high fixed costs and the Mint must attract overseas volumes to achieve a good return.

59. Precisely, and in Wales presumably you do have a difficulty with competing with some of the international producers because your transport costs are inevitably going to be higher if you are producing euros for Germany than, say, a mint in Germany or France.

(Mr Sheehan) In the case of euros, yes, but this is very much an international market and the key competitors that we have are, for example, in Canada, in Germany, in Chile, in South Africa. They have the same issues that we have in trying to deliver to a wide range of countries. The transport factor is not a major issue and we do not have a major disadvantage in that respect if you consider that we are delivering typically, last year, 200 currencies to 55 countries.

Mr Rendel: I am surprised, but thank you.

Mr Davidson

60. When you were speaking earlier on, Mr Sheehan, about the facts of the notes you mentioned, if I picked you up correctly there had been four attempted thefts of coins which had resulted in three dismissals and one person had resigned before disciplinary action was taken. Did I hear that correctly?

(Mr Sheehan) That is correct.

61. Can I ask whether or not any prosecutions were considered and what the amounts involved were?

(Mr Sheehan) This was in fact trying to take out a very small number of coins through the security and the MoD police, of which we have 30, picked them up. It was not the value of the coins per se; it was the fact that they were taking them out.

62. Would you know if people were being successful in stealing coins on a regular basis?

(Mr Sheehan) Our stock control procedures suggest that we do not have a major problem. I can tell you that we have picked up one or two other issues. We have one issue at the moment with an alleged theft and it is going through the disciplinary procedures. There was one other issue that we flagged up as well as these four people in January 1998 where there was an issue of £250 which was never completely solved, whether it was a theft issue or a procedural control issue.

63. Had the people that you caught got away with it, would it have been picked up or would somebody just run the machine a bit longer and print off some more?

(Mr Sheehan) We have 30 MoD police on site. We have a very focused search system. We actually did about 18,900 searches last year of individuals and about 9,000 searches of cars, so it has been fairly focused. We also have locker searches. We did about 900 of those. That, combined with the MoD presence there and the fact that we do not have a stock control problem in coin, gives me the comfort that we do not have a particular problem in this area.

64. When you say you do not have a stock control problem in coin that is capable of being interpreted in a number of different ways. Would you notice if somebody had managed to get away with, say, several handfuls of coin? It would become immediately apparent that you were coins short?

(Mr Sheehan) If it were several handfuls it may not become immediately apparent, but when we did our stock reconciliation checks, which take place on a weekly, monthly, quarterly, annual basis, we would have picked it up.

³ Confidential note provided, not printed.

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MR GERALD SHEEHAN

[Continued

[Mr Davidson Cont]

65. Can I turn to the question of coining the euro? You got 5% of the euro market. Do I take it then that if Britain joined the euro 95% of our euro coins would be imported?

(Mr Sheehan) The situation we have there is that in terms of the euro production in the 1997–98 period and from there on we were on a very big learning curve in terms of the quality of the product and the tolerances that were required. We did not get it right in those years very clearly and as a consequence we did not achieve the market share that we had anticipated. The situation now is very different in that we do have the quality assurance standards to meet the requirements of the euro and we are producing euros now and have done consistently over the last few years very successfully. If the UK moved in that direction we have very clear plans in place, dependent on the volume requirement and on the timescale, to meet the Treasury requirements if they gave us those orders.

66. You make the not unreasonable point that you were on a learning curve with producing the euro, but presumably this was not unique to yourselves since nobody else had been producing them before. Everybody else was on the same learning curve as you were and you aimed for 20% and you got 5%. If it comes to the situation that Britain joins the euro what percentage would you be aiming for and how can we believe that you would achieve that percentage?

(Mr Sheehan) If the policy decision was to ensure that the Mint supplied all the coins, dependent on the volume and the timescale (and they are still under discussion) we would be in a position to produce them all.

67. I understand that but surely this would have to go out to EU open competition. There would be no guarantee that you would get them all, would there, because that would be contrary to EU procurement legislation?

(Mr Sheehan) The situation, certainly with the euro, from the government mint perspective in continental Europe was that they had the orders from their particular government. If that is a policy decision then we would obviously adhere to that.

68. Just so that I am clear about that, every company in Europe that had a mint did its own and you were bidding for the euros for those that did not have their own mint?

(Mr Sheehan) Or for euro blanks, ie, the unstruck coins.

69. I am still a bit unclear. Why should you get 100% of the British order, yet you were able to bid for a share of the euro blank orders from other countries?

(Mr Sheehan) Because there are certain countries that do not have mints, as you have already indicated, and there was a requirement, because of the very high volume of coin needed over a relatively short timescale and the fact that other mints did not have the capacity to produce blanks.⁴

70. So you only got a share of the orders in those countries which did not have their own capacity to produce blanks?

(Mr Sheehan) Or did not have the capacity to produce their full complement.

71. So you feel confident that, irrespective of cost, if a political decision is taken that we in Britain should produce all our own coins, then you will get that order and you will be able to produce them?

(Mr Sheehan) If the Treasury wish me to make 100% of the coin then I have plans in place to achieve that, dependent upon volume and timescale.

72. At the moment am I right in thinking that there is a euro mountain of coins produced surplus to requirements within the EU?

(Mr Sheehan) There is a general view that there was a cautious approach to the volume that was required in various euro countries and that generally there is somewhere between 25% and 30% excess production. That is true for certain countries but not necessarily for others. In the light of that the Euro Coin and Notes Working Group was looking at, if this did happen, what the requirement would be for the UK.

73. So there is in fact, according to the section on page 9, a euro mountain at the moment with some countries having more than 12 months' stock of coins in their vaults. You must regard yourself as unfortunate that you are not covered by the common agricultural policy; otherwise you would be getting paid to produce even more euro coins that nobody wants to use them, but I will leave that for the moment. Can I come back to the question of the death of the member of staff? I am a bit perplexed at the point where you say that no disciplinary action was taken. Surely if the Health and Safety Executive felt that a prosecution had a very good chance of succeeding there must have been some blame associated to yourselves as an organisation and presumably within that there must have been some blame associated to particular members of either management or staff.

(Mr Sheehan) The situation we had was that there were safe working procedures in place of a generic nature which applied to this particular piece of kit. This was a specialist piece of kit that in truth required a specialist procedure in terms of safe working and handling and we did not have that. In hindsight we should have that but we did have safe working procedures in place and we were actively pursuing a wide range of risk assessments and safe working procedures throughout this particular area and other areas of the Mint.

Mr Williams

74. You said you did not have it in place. Someone must have been responsible for putting it in place. Whose responsibility was that?

(Mr Sheehan) The question was, was there a requirement for a specialist safe working procedure in this area and that was the debate. In hindsight, and it is easy in hindsight, it was very clear that we needed that specialist safe working procedure.

75. Was it an individual decision or a collective decision?

⁴ Note by witness: Only one of the Euro currency countries does not have its own mint. Ref answer to Q 152.

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MR GERALD SHEEHAN

[Continued

[Mr Williams Cont]

(Mr Sheehan) In terms of risk assessment and safe working procedures it was looked at in the context of the Mint as a whole and we prioritised certain areas. There are certain areas of the plant which are extremely safety critical in terms of the area of annealing, plating and pickling, for example, and our efforts were very much focused in that area.

76. Did the manufacturer provide any safety guidance and was that guidance observed?

(Mr Sheehan) The manufacturer provided the safety guidance. In one instance there was a failing on our part in that we did not adhere to that particular guidance.

77. Was that contributory to the accident?

(Mr Sheehan) We do not believe so.

78. Did the Health and Safety Executive think it might be?

(Mr Sheehan) No. They mentioned the fact that this was an issue but I think the problem was specifically that there was no specialist procedure in place.

Mr Williams: I would like to have a very full note on the background to this. I am not at all happy about this and I think it is outrageous that Crown immunity protects you from proper investigation.⁵

Mr Jones

79. I have just been scanning through the Annual Report and you have some wonderful coins there, including the sixpence and the half new penny but there is no sign of the euro. Why did you exclude the euro from your accounts?

(Mr Sheehan) Not for any particular reason. We took advice from our design experts and after fairly healthy discussion on this subject we concluded this. There was no particular reason.

80. Can I refer you to table 1 on page 37 of the Report where there is a pretty dramatic drop-off in the annual operating results, particularly from 1992-93 to 2001-02, with a bit of a blip in 1997-98 which is explained by a rise in collectors' sales. I know you were not there but could you give us a history as to why it was that action was not taken earlier to arrest this pretty steep decline?

(Mr Sheehan) If I try and put myself in the position of the management team perhaps two or three years ago, the situation they had was that it was clear that the euro peak would eventually come and would pass and there would be some possible capacity issues. There was a question mark over the other markets and the opportunities in other markets, particularly in terms of the copper plated and nickel plated material, and whether that would to some extent offset the euro peak. There was also the question mark about the euro in the UK. The dilemma that they had was to assess the cost/benefit analysis of investing a significant amount of money in redundancies, early retirements, etc, against a backcloth of potentially losing money, and whether that would give a good return for that investment. It was a dilemma and I can understand the dilemma to some extent. What we did, and this started before my

time but I accelerated the process, was to look at the whole aspect of our competitive position. We benchmarked ourselves against a number of key good players throughout the world and by February of this year we concluded that we did have a major issue in terms of our competitive position in terms of cost for the various products that we made. On that basis, and on the basis that the market conditions were even more difficult than the previous management team had anticipated two or three years ago, it was clear to me that decisive action had to be taken. By the end of February I had concluded that. I wrote my report in the context of the corporate plan, submitted that to the Economic Secretary and very quickly, at the end of March, she confirmed that I could move ahead with this restructuring. This is paramount and vital for the Mint in my view, not just in terms of taking 220 jobs out of the organisation but a fundamental change in working practices and flexibility with a target of being in the top quartile in terms of performance, which is absolutely vital for us in my view.

81. Are you now kitted up to meet the challenges of the future? There are another 10 or so countries who may be joining the European Union and I guess a lot of those will want to join the euro eventually. Are you exploring market opportunities there and have you got the right equipment to see you through the next few years?

(Mr Sheehan) We have the right equipment, without question. What we have to achieve now is clear accountability within the Mint to deliver, particularly in terms of customer service, and that is a key focus for us.

82. You mentioned in the Report, paragraph 18, that you aimed for 20% of the euro coins and ended up with 5%, a lot of euro blanks. Why was that 20% target set? How was it assessed that it would be possible for a country which is not actually joining the currency to end up with a fifth of the business? Would that not be a bit unrealistic?

(Mr Sheehan) The situation that we had was that we were the main exporter of coin in the world. The emphasis very much in the lower denominations was on copper plated material and the investment was very much focused in that particular area. We were anticipating that we would get a very significant share of that particular market in the light of our track record and in light of the kit that we had invested in.

83. Are you allowing the team who made those estimates to continue to estimate the amount of new business that you might get from other aspiring countries?

(Mr Sheehan) My philosophy in the context of markets and financial achievements is one of caution and I have applied that caution within the Mint. I can tell you that we have had difficulties over the last few years, which is very clear, but I can tell you that in the first six months of this year we are more than achieving our target position.

84. Was the 20% incautious?

(Mr Sheehan) It is so simple in hindsight to say it was ambitious. Based on the facts at the time and the information that the people had it was a challenging target.

⁵ Ev 23-25

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MR GERALD SHEEHAN

[Continued

[Mr Jones Cont]

85. Do you think that there was any political decision among the other countries who were joining the euro to exclude the Royal Mint from part of the work that you were aiming for?

(Mr Sheehan) That has not been a proposition that has been made to me.

86. So it was just done on quality, price and ability to deliver?

(Mr Sheehan) In my view.

87. Can I move you on to the theft? Paragraph 32 says that 1,284 notes were missing. It seems a curious number of notes to disappear. Do you think that these were being stolen in dribs and drabs over a period of time rather than just one lifting of a chunk of money?

(Mr Sheehan) That is certainly a possibility but I genuinely cannot tell you that one way or the other.

88. Is the police investigation ongoing?

(Mr Sheehan) The external police investigation is still ongoing, yes.

89. Are you able to say anything about the previous theft of £5,000? Is an investigation still going on into that?

(Mr Sheehan) No. That has been concluded. The view of the MoD police at the time that the most likely event was that there was a theft and that has not been pursued after that event.

90. Do you know of any further thefts?

(Mr Sheehan) I can tell you that there are other issues. I have alluded to some of them already. We talked about the coin. There is one other particular issue related to bank notes which occurred at about the same time where there was an MoD police investigation. This was linked to bank notes and coin. The conclusion of the MoD police at the time was that they could not conclude whether this was a theft or whether there was a lack of procedural control. The issue for me, and this is something I identified fairly early on in the Mint, is that we have to address the issues of procedural control and stock control. That is a key focus for us.

Angela Eagle

91. In 1997–98 the then management team got £25 million to restructure the business, did they not, and they spent it on increasing capacity at a time when that was perhaps something to do with the euros, from 18,000 tonnes to 27,000 tonnes. That is a big increase. Why so large?

(Mr Sheehan) This is a very capital intensive industry and if you are going to invest it costs a lot of money. Of the £25 million £9 million was associated clearly with plant refurbishment as opposed to capacity expansion and £16 million was associated with expansion and that was clearly identified as a market opportunity, particularly with the euro, but also with the changes in the market place. This is a cyclical industry. The demand does move year on year and can vary considerably.

92. Let me just stop you there. Twenty five million was spent in 1997–98 to significantly increase the capacity. You have now come back and asked for £12 million to reduce it.

(Mr Sheehan) We are not currently reducing capacity. The decision to reduce capacity from a 20-shift operation to a 15-shift operation was made during 2001 and that was completed by the end of the calendar year 2001.

93. You are reducing capacity by getting rid of between 200 and 220 people, are you not?

(Mr Sheehan) I am hoping to improve productivity considerably. I am hoping to attract more market share by being more competitive.

94. Let me take you through this, Mr Sheehan. The Government gave you £25 million to restructure, not you personally but the Mint, in 1997–98. Capacity was vastly increased but the cost base was vastly increased, and now we are having to give you £12 million so that you can reduce capacity.

(Mr Sheehan) The situation we have at the moment in terms of the market and in terms of our competitive position is very clear. We have to restructure. We have to reduce our cost base. We have to address the fundamentals within the business and the market now compared to three or four years ago is very different. We have to face up to this.

95. Why was this not anticipated when the 25 million was given to you in 1997–98?

(Mr Sheehan) Because I believe the market fundamentals then were different. There was the opportunity with the euro. There were clear opportunities in terms of the coinage orders during that period and there was a move to plating products. Not all of that has come to fruition but we are well set for the future.

96. The euro opportunity was totally wasted. Winning 5% when you had hoped to win 20 of the largest recoinage that has happened for many a long year is not really a very good performance, is it?

(Mr Sheehan) It is not a good performance and everybody in the Mint who was involved accepts it is not a good performance. We have learned our lessons. We have learned very clearly that we have to achieve the quality standards in much shorter timescales. It is a very big lesson and we have learned it.

97. You completely missed the boat on the euro, did you not, with all that extra investment?

(Mr Sheehan) We did not achieve the market share that we anticipated.

98. I would say you completely missed the boat. There was a big wasted opportunity there, was there not? In other words, that restructuring of money was effectively wasted.

(Mr Sheehan) In the context of kit, we have some of the best kit in the world. We do have some real opportunities for the future. We are going through this restructuring. We are very much on course in that restructuring. In fact, we are further ahead than we anticipated at this stage in the year. I believe we are well set for the future. The key focus now is upon improved flexibility in working practices and meeting customer service standards.

99. All these figures are in the Report. With this extra 25 million—and perhaps there was a misreading of the world situation—you ended up with a 5% increase in turnover and a 15% increase in

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MR GERALD SHEEHAN

[Continued

[Angela Eagle Cont]

the cost base. Part of what you are now doing with the 12 million that you have asked the Treasury for is to reduce your cost base, is it not?

(Mr Sheehan) To reduce our cost base, but with an expectation—

100. You used the 25 million to put it up.

(Mr Sheehan) To reduce our cost base in terms of manning levels, in terms of fixed costs in other areas, but with a clear focus on achieving extra volume and extra market share by having that much better cost base.

101. In paragraph 22, productivity per employee, with your £25 million of money to invest in 1997, fell by 16%. How can you invest and have productivity fall like that?

(Mr Sheehan) In the early years, we saw a very significant increase in productivity of 27% on a tonnes per man year basis. The market then changed considerably, as I have tried to describe, and the decision was made not to take the action in terms of the employment levels. Post the competitive benchmarking exercise, it was very clear to me that we had to take those decisions.

102. How would you look at it, as somebody who was perhaps in private banking wondering whether to invest an amount of money to help a company invest, if their previous record was to squander £25 million of restructuring money in the way the Mint has, when they came back to ask for another 12 million?

(Mr Sheehan) I think I would look at the overall picture in terms of profitability over the period. I think I would try to understand the market dynamics which had caused this particular problem and I would be questioning the management team very thoroughly on what their strategy is to get out of the problem.

103. What has happened to the management team that made this series of disastrous investment decisions in the mid-1990s? Are they all still working at the Mint?

(Mr Sheehan) I have restructured the executive team to clarify accountability, which I believe is a problem. One position has been removed so we have reduced the numbers by one. That has given me the opportunity to focus the key executives in terms of accountability so there is no ambiguity in their job. This is a key priority for me, to make people clearly accountable for performance in the Mint.

104. That is admirable but it does not actually answer my question, with all due respect. The group of individuals who made these disastrous investment decisions and completely failed to deliver the euro business as they themselves presumably had anticipated they would: are they all still in your management team?

(Mr Sheehan) The director of circulating coin production has been in his position for two and a half years. That was after the event. The person prior to that, I believe, retired. The sales director has been in position since 1996. The key job which was director of circulating coin production—the person has been changed two and a half years ago.

105. You are happy that the people who made these decisions have been properly called to account for them and they are now not in a position where they can make a series of similar disastrous decisions with public money?

(Mr Sheehan) I am very happy that they understand the circumstances surrounding the decision making and the problems that we had. I am very happy and clear that they are now focused and accountable for delivering to ensure that we achieve what we need to achieve. I can tell you again that we are, in the first six months of this year, very much on line.

106. I note from the Report that, because of the over-capacity created by this huge investment you made in 1997–98, you have been able to stockpile circulating UK coins. You now have 240 million pieces extra. That is 34% more than you used to store. Is that correct?

(Mr Sheehan) It was correct at the time but I am not a great believer in holding high stocks.

107. Is that wise, given your experience with bank notes?

(Mr Sheehan) I think I tried to demonstrate that our controls in the coin area are very effective. I accept the problems with bank notes. I am not a great believer of holding high stocks in this particular area. In fact, the stocks have come down progressively and, as of yesterday, they are now running at 594 million which is significantly lower than the end of the year number.

108. I would like a simple answer to this final question on Crown immunity: would you personally be happy if Crown immunity was lifted from the Royal Mint tomorrow?

(Mr Sheehan) The issue of crown immunity is not an issue for me at all.

109. I am asking your opinion. Would you personally be happy if Crown immunity were lifted from the establishment that you are now in control of tomorrow?

(Mr Sheehan) If that is a policy decision by the government, I have no problem with that policy decision.

Jon Trickett

110. Given the fact that there is a possibility we might go into the euro, is it possible that we are getting our stock levels to a level where some of the coinage that you have minted will never be used?

(Mr Sheehan) The plan that we have clearly suggests a requirement for current UK coin over a period of time during the production of the euro if that happens, so there is no chance of that at all.

111. Is there a possibility that you continue to mint sterling and continue to have historically high stock levels and at some point or another we will get into a position where some of the cash which you are holding would not be used, should we go into the euro? Is that something which you have considered?

(Mr Sheehan) We have considered that and plans are designed to minimise that possibility.

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MR GERALD SHEEHAN

[Continued

[Jon Trickett Cont]

112. Is it not the case that you are running production levels at a higher level than strictly necessary, given the fact that stock levels have risen, and in a way your bottom line is artificially improved by the fact that you put money into stock rather than reducing production to keep stock at normal levels?

(Mr Sheehan) The stock levels for the end of this financial year will be lower than they were at the end of the last financial year.

113. I am using the phrase “historic levels” and the reason why is that, like you, I have worked in the private sector and I know that many businesses will look very carefully at work in progress and stock levels in order to ensure that the bottom line figure, the profit or loss level, is not quite as bad as it might otherwise be. The fact of the matter is your operation—perhaps not you individually—has continued to produce sterling at a higher level than is actually strictly necessary according to historic levels, I think, in order to show less of a loss than would otherwise have been the case. That would be normal business practice, would it not, in the private sector, to do that kind of thing?

(Mr Sheehan) You come from the private sector, like me, and you know that it can be unhealthy to hold too high stocks. The areas of stocks that we have are in raw materials—that is metal and scrap particularly—and in coin. We are addressing both those issues and by the end of this year the raw material stocks will be significantly lower than the start of the year, as will the UK coin stocks.

114. I am going to assume that you did not answer my question because you chose not to answer it. My assertion that businesses in a position which are in trouble, as you are or have been until the last few months, deliberately look at stock and work in progress levels to assist them with disguising the true state of the business. I assume that you did not answer that question because that is in fact true.

(Mr Sheehan) I thought I had answered the question in the context of my objective, which is to reduce stock levels.

115. That is not what I am asking you. I will move on. I think people round the table can see that you are not addressing the question which I am putting to you. I want to move away from stock and ask about the state monopoly which you have. You are a monopoly supplier at the moment, partly because the Treasury makes you a monopoly supplier and partly because you dismissed your contractors. We have had a note from Birmingham making various, fairly interesting statements. Before I ask you about that, I want to understand the euro. Paragraph 16 refers to the European procurement roles. Are you really proposing that the government and this committee might endorse the proposition that you should continue to have a monopoly, given the way that you have performed as a business in the last year or two?

(Mr Sheehan) This is very much again a policy decision. Mints through Europe have a similar relationship with their government and have that under consideration but if the Treasury require me to produce the coin of the realm and have a monopoly in that that is their decision. It is very much a policy decision.

116. European procurement rules would allow you to operate a monopoly if the Treasury determined?

(Mr Sheehan) In terms of European procurement rules, there is a questionable debate about whether they apply to coinage.⁶

117. It is a questionable situation in law. When you were asked a question earlier about the issue of sterling, transferring into the euro, you said you were capable of producing all the coinage. I do not know how many coins are in circulation at any one time in the UK but if we move from sterling to the euro clearly that is going to be a huge great peak of activity. You said yes, you could produce all the coins but then you added a conditional clause and I wrote it down. You said, “Depending on the amount of coinage and the time within which we are required to produce the euro.” Are you really proposing that you should have the monopoly supply in relation to the introduction of the euro into the UK, should that happen?

(Mr Sheehan) Again, this is very much a policy decision. I have plans in place, dependent upon the volume requirements and the timescale which would meet the Treasury requirements. Again, it is subject to policy.

118. I want to move on slightly. Given the fact that you have lost money in producing coins, both sterling and the euro, is it not the case that the British taxpayer has subsidised the euro which has been in circulation in the rest of Europe? What you are doing by announcing a loss means the taxpayer is subsidising the euro which is in circulation elsewhere in Europe.

(Mr Sheehan) We have a very limited euro market, as you know.

119. 5% of all coins, and you made a loss on that, did you not?

(Mr Sheehan) We competed actively for that market. It was a competitive tender arrangement and we did not achieve the profitability that we anticipated.

120. You lost money. The fact of the matter is that that bill is now being picked up by the taxpayer. While some of us are sceptical about going into the euro or not, at least we will have a choice. What the Mint has done effectively is ensure that the British taxpayer subsidises European use of the euro which we ourselves have not yet agreed to go into. Is that not the case?

(Mr Sheehan) The situation with the Mint is that, as you know, we are an agency. If we have problems in terms of profitability, we have a facility for borrowing money that we pay back at a commercial rate. That is not an ongoing situation and hence the action that I have announced that has to take place to correct the situation.

⁶ Note by witness: The manufacture and issue of coinage is a state function of the Crown, and the Royal Mint is the particular emanation of the Crown responsible for performing that function. Although an agreement exists between the Mint and the Treasury (as the Department with overall responsibility for the economy and financial affairs) as to the arrangements for coinage production, the manufacture and issue remains a Crown activity, which is effectively performed by the Crown itself.

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MR GERALD SHEEHAN

[Continued

[Jon Trickett Cont]

121. I am going to try to take you on to productivity because I think there is some deliberate mis-wording in the Report. I want to ask you about that in a second or two. On the question of the euro, which I believe we are subsidising, frankly, because of the incompetence of your management, probably before you arrived, I want to see whether you have any further reflections in relation to the point I am making and whether you can actually identify whether the losses which were incurred fell more heavily upon the euro than they did on sterling. In other words, the unit costs of production relative to the sale price which you were selling the service at, what the differential was, and whether the losses were more incurred by euro production or more by sterling production.

(*Mr Sheehan*) I have to try and split the two markets. In the case of the coin contract, we have what I consider to be a challenging contract.

122. Is that for the euro or for sterling?

(*Mr Sheehan*) This is for sterling. It should become more and more challenging over the period. In fact, if you analyse it without adjusting for volume, the cost per unit this year compared to 1993–94 is about 70%, so it is that much lower. In the case of the euro, this was very much a competitive market where other suppliers, blank producers like us, coin producers like us, competed. It was a very healthy, competitive market. Unfortunately, we only achieved 5%.

123. The question I am asking is, in terms of the bottom line figure of £6 million or £7 million, whatever you actually lost, was that loss incurred by the euro or was it mostly incurred by failing to meet the prices which you had sold to the Treasury—if you like, the sterling?

(*Mr Sheehan*) In the context of the overall sales turnover in overseas coin, the euro was a very small percentage. The issues were of an international nature in terms of competition, not just the euro situation.

124. You are not going to answer my question. I think I have asked you three times. Are you able to find the amount of money that was lost in producing the euro?

(*Mr Sheehan*) Our plans are very clear: to recover our profitability and get back on course.

125. We are talking about accounts which you have produced late, by the way, which show a loss and I think we are entitled to ask you where was that loss incurred in terms of your productive activities. One of the things you do is produce euros which you bid against other producers elsewhere. You won 5%. I want to know how much you lost on that contract.

(*Mr Sheehan*) The losses were incurred primarily in the overseas markets and I would not differentiate in this forum between the euro market and other international markets.

126. The British taxpayer, broadly speaking, has been subsidising coin production in the euro and in other coins as well as a result of the losses which were incurred?

(*Mr Sheehan*) The current market situation is very clear. There is over-capacity. It is a flat market and people have to compete in that flat market. The dynamics are such that there is less volume available

to compete for and the margins, the selling prices, are very tight. The situation we have now is that we have to compete in these markets. If we did not compete and we did not achieve the volumes from international markets, the Mint would be publishing worse profitability than it is now.

127. Is it right that the British taxpayer should subsidise you for lost leaders in foreign currency, taking work from the private sector who would not receive any subsidy from anywhere? Is that morally correct and is it *vires*? Are you within your legal powers to do that?

(*Mr Sheehan*) The British taxpayer is not subsidising us. I would reiterate if we did not compete in the international market and achieve volumes then we would be in a worse situation. The actions that we are taking are clearly designed to correct the profitability problem.

128. The Birmingham Mint say that their unit costs or the price at which they would sell to the Treasury, presumably, is less than you are selling at. Is that the case?

(*Mr Sheehan*) I have no idea.

129. Why not?

(*Mr Sheehan*) I do not know what their unit costs are.

130. Until quite recently, they were your subcontractors, were they not?

(*Mr Sheehan*) We are not party to their unit costs.

131. I said the sale price to you.

(*Mr Sheehan*) You asked me about unit costs.

132. No. I corrected myself. What I said was the price at which they are selling to you. Is that higher or lower than your costs of production?

(*Mr Sheehan*) This is a totally different market in different products. We are talking about an arrangement that we had with the Birmingham Mint in overseas markets, not for UK coin, and they are very different products.

133. Let me just repeat the question. The Birmingham Mint have sent a note to all Members of this Committee asserting that they can provide coin cheaper than you are, but they have been excluded because you have used your monopoly supplier position. Is that statement correct?

(*Mr Sheehan*) I cannot comment upon their unit costs, as I have indicated, because I do not know their unit costs.

134. I am not asking you about unit costs now, am I?

(*Mr Sheehan*) We have a challenging contract with the Treasury which has continued to decrease on a year on year basis. Ignoring volume, it is about 70% of what it was in 1993–94.

135. Our exchanges are quite unsatisfactory because you have addressed very few of the points I have made. Although I am becoming impatient with this exchange, I want to try one further line of questioning. In paragraph 12, we learn that a significant amount of money, £25 million, has been spent on re-equipping the capital plant in the Mint. It says in the last sentence there that the productivity of the Mint's employees had risen by 27%. Do you stand by that statement?

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MR GERALD SHEEHAN

[Continued

[Jon Trickett Cont]

(*Mr Sheehan*) In terms of the measure of productivity that we had, which is the amount of production divided by the number of employees, yes, I do.

136. Why did staff costs go up by 28% and turnover only by 5%? It strikes me that if employees' productivity is higher by 27%, there would certainly be an increase in turnover beyond the 28% increase in staff costs, since the sales figure is directly related to the productivity of the employee costs. How can I make sense of this table three?

(*Mr Sheehan*) The situation we have is that there was a 27% increase in productivity over a period where we increased our shift patterns from 15 to 20 shifts and increased volumes. The increased volume more than offset the increased numbers. Then, the situation changed and by the end of last year we had to reduce our shift patterns because of the nature of the market. Unfortunately, we did not reduce the numbers accordingly.

137. Table three is the period of time which paragraph 12 is referring to, broadly speaking. Turnover increased by 5% but staff costs increased by 28%. It is impossible to reconcile the statement that that table three is not out. How is it possible to reconcile the statement that productivity increased by 27%; yet turnover only increased by 5% and staff costs have increased by 28%?

(*Mr Sheehan*) Can I refer you to the dates which I think are particularly important? The 27% increase referred to in paragraph 12 is the increase from 18,000 tonnes in 1996–97 to 1999–2000 and that is where the increase in productivity occurred that is not directly related to staff costs. Table three refers to the period 1996–97 to 2000–01.

138. That is simply not true. The sentence says that the productivity increased by 27% from 1996 to 2001. That is the last clause in the final sentence of paragraph 12.

(*Mr Sheehan*) The volume went up by some 50% from 18,000 to 27,000 tonnes so the 50% increase offset the increased staff levels.

139. The volume of production increased by 27% but the sale value increased by 5% so you were producing 27% more coinage but only getting 5% more income.

(*Mr Sheehan*) That was the nature of the market we had in that period. Hence the need to take the action we have taken.

Mr Williams

140. You work in the steel industry which is highly competitive and yet you do not seem to know the profitability of individual markets or individual contracts.

(*Mr Sheehan*) I do not think it is appropriate that we discuss specific contracts. The euro contracts were many and varied over the period and I do not think it is appropriate to select those or differentiate between those and other international contracts throughout the world.

Mr Williams: In that case, you can put in a confidential note to us. We want to know clearly whether there is cross-subsidy between the British market and the overseas market. I will expect the

National Audit Office to look over those figures with you to make sure that they are properly presented. I want them within the next two weeks.⁷

Mr Howarth

141. You have been very gamely defending things that happened before you had any responsibility at the Mint but would it not be fair to say, if you are really going to be honest about it, that the period probably since the middle of the 1990s could be characterised in management terms as being sluggish, short sighted and complacent?

(*Mr Sheehan*) I can perhaps modify the words slightly, if I may, in that they were certainly ambitious in terms of their investment plans.

142. The use of the word "ambitious" in conjunction with the three adjectives I have just used is not modifying it; it is completely disagreeing with it.

(*Mr Sheehan*) Ambitious in the sense that they clearly identify the market opportunities and can see that in future years those market opportunities could well increase outside Europe and were prepared to invest heavily to achieve good returns. The events of circumstance and the fact that we did not achieve the levels of market share that we anticipated and the fact that the international market has deteriorated far more significantly over the period than they anticipated, those two factors together, have to a large extent caused the problems.

143. Let us examine the question of sluggishness a little more. You just had a very interesting exchange on the question of productivity and, to be honest, at the end of that exchange I am more confused than I was at the beginning. How would you define productivity?

(*Mr Sheehan*) Productivity classically is defined in some form as tonnes per man year or tonnes per man hour or some version like that, typically.

144. Using that typical measure, how would you illustrate the levels of productivity at the Mint over, say, a period since 1995?

(*Mr Sheehan*) I can illustrate it by saying that levels of productivity went up from 1996–97 to 2000–01 by 27% against a backdrop of significantly high volume sold and some increase in manning levels and then deteriorated because the market itself, the volume sold in the subsequent year, reduced significantly. The numbers did not reduce in line with those reductions in volume. In my personal view, that type of measure is not necessarily the correct measure for the Mint because you have to look at this business as a manufacturing business in terms of cost, not purely in terms of productivity.

145. In the period you refer to you had basically more people producing less.

(*Mr Sheehan*) Yes, in the last year.

146. Clearly, there is a record in the quite recent past of a decline in actual productivity. You talk about the way you intend to remedy that. Let us move on to the question of being short sighted. It seems to me that what has happened over a period of

⁷ Ev 19–22

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MR GERALD SHEEHAN

[Continued

[Mr Howarth Cont]

time is that you invested on the assumption that you were going to get a share of the euro market that failed to materialise. You used the word “ambitious” to describe that but surely there must be some prudential part of decision making and investments like that? Surely it must have been foreseeable that there was no absolute guarantee that you were going to get that share of the market and yet the levels of investment are quite significant. Again, would you not agree that, rather than ambitious, perhaps the best way to describe it is short sighted?

(*Mr Sheehan*) No. Bearing in mind the circumstances at the time and the market opportunities that prevailed, I still believe that the decision to invest was absolutely the right decision. The problem was that, because of the circumstances that I described, we did not get the market here that we anticipated.

147. How can it be right if that was the outcome?

(*Mr Sheehan*) Because there were other factors that were not taken into account at the time in terms of the difficulty in producing the tolerances of these coins and the significant investment that other producers, particularly private sector producers, had put in which caused the significant extra capacity which had to be utilised.

148. You are from the private sector and you know that in those sorts of circumstances you have not only to look at what the potential market is; you have to look at what the competition in the market is, your capacity as a business not only to produce but to produce to the required standard. All of those factors must come into it and yet it seems to me none of those factors was properly taken account of and yet you still believe it was an ambitious thing to do. It seems to me to have been short sighted and perhaps negligent in management terms.

(*Mr Sheehan*) The Mint at the time very clearly had an excellent track record in the international market in terms of its sales. It had a very good reputation in the international market. The investment was designed to link with that, very clearly, in terms of what it could achieve.

149. I am beginning to wonder whether we are talking a different language here. However, I will move on. On the other issue of complacency, if you look at the health and safety problem, particularly the tragic death, and the question of the losses or thefts, it seems to me they both illustrate a sense of complacency. This is the way we have always done things; it seems to work; there is not a problem here and something terrible or very unfortunate happens in the case of the thefts involved. Clearly, there were failures in both cases in procedures which you have hopefully put right. Again, we are talking about during that period of time. Does that not indicate there was a high level of complacency? What was revealing was that you said a few moments ago that the Mint had a very good track record. It has been very successful over a long period of time. Is there a sense in which, because of that, people were resting on their laurels and things started to go wrong?

(*Mr Sheehan*) I do not accept that in terms of our accident performance. If we go back to 1993–94 compared to last year, our loss and accident rate was only 75% of that on a comparable basis, which is a

significant improvement. Generally, the accident performance within the Mint is in line with that of the manufacturing industry. We do have a strong focus. I would like to focus on what we are doing to correct the situation generally. That is important to me because we have learned some lessons and it is important that we understand the lessons and learn from them. Some of the things that we are doing and have done are particularly addressing your concerns, because we have set up a very strong risk management committee. We have given them very clear terms of reference which are very effective, in my view. We have addressed the health and safety issues in terms of accountability. We now have restructured the health and safety team. We have a senior manager specifically responsible for that area, a manager who is totally committed to this particular area. We have reviewed the internal accounting systems which address some of the stock issues, of which you are very aware, and I am comfortable that we are well in line there with. Of the 70 recommendations in the Grant Thornton Report, we have now completed 47 and we are well on line to meeting the requirements for the end of this year. We have addressed some of the other issues in the Grant Thornton Report in terms of the audit committee, which is obviously very important as well. The key issue is that we have a focused senior management team and they are clearly accountable. I can measure them clearly on their performance over the next period. If I have any problems, I will address those problems.

150. To return to the question of productivity and the performance of the workforce, you talk about having introduced more flexibility. Presumably that involves things like multi-skilling and so on. What I find quite staggering in that regard is that there is quite a big manufacturing sector in my own constituency and many, many years ago I worked in the manufacturing sector. Ten years ago or 15 years ago even in some parts of the industries in my area, they were bringing these sorts of things in anyway. Do you not think you have been very slow to bring in these modern ways of managing manufacturing plants?

(*Mr Sheehan*) The principles of team working and flexibility started in the Mint about four years ago. We have made good progress over that period. I am looking to go further in terms of integration of craft teams into the workforce, in terms of more innovative working arrangements, annual hours, for example, and these are particularly important because these are designed to address the cyclical nature of the business in which we work, both in circulating coin and collector coin. The key focus in this business has to be customer service. We have to have the flexibility of the workforce to achieve that. It is not just the numbers that we are taking out; it is the complete addressing of the working practices and some other difficult decisions as well. We have imposed a pay freeze this year. We are taking away some of the other benefits which are inappropriate for the manufacturing industry. This has been difficult for us over the last six to nine months, but we are making good progress.

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MR GERALD SHEEHAN

[Continued

[Mr Howarth Cont]

151. We are going to have to beg to differ about what all these mean because it has been a sluggish, short sighted and complacent business. However, it does seem that no heads have rolled. Mistakes have been made; wrong investment decisions have been made. Also, procedures have been inadequate and yet, when you are asked as to whether anybody has left, one person may have taken early retirement no doubt with a fairly generous package to go with it. Do you not think it would have been a bitter had you been a bit more ruthless with some of the people that you inherited?

(*Mr Sheehan*) Perhaps I have not been as clear as I should have been in terms of the changes that we have made. We are taking 220 people out of the system. We are in advance of our plans there. This clearly addresses the issues from top to bottom without question. If I take the area of concern of stock control, the bank note and packaging area, we now have five new managers over the last six to nine months in key management positions, three line managers, one in planning and despatch and another manager in the area of warehousing. This is fairly radical action in this area. It is a much younger management team. It is a far more focused and accountable management team and I expect them to deliver.

Mr Jenkins

152. You know that the rigours of the market place are not applicable in some sectors. All we have is this committee or committees like ours to ensure that rigours are imposed upon some of the public sector. We have to ask questions as to whether we are getting value for money in that sector. Towards the end, you are starting, I feel, to recognise the greater need to hold your hands up and say, "Yes, we were wrong. We took our eye off the ball. We were lousy." We have situations where the Report says, in the finance department, the safe containing such items as blank cheques and bank receipts and the system password was left open during working hours. This is a sloppiness that would not be tolerated in most privately run companies. Companies that do not get their act together go out of business. We have to ask ourselves why should you remain in business. From some of the answers you have given, my reply would be you have no right to remain in business because I do not think you were briefed to come before this committee as well as you should have been. It was fairly obvious before you came to this committee that money that went missing from the safe would be enquired about. When Mr Rendel asked you about the £40,000, when it was missing, and did you send for more, you said, "I do not know." Why was the money there for so long before it was needed? "I do not know." When was the last security audit conducted? "I do not know." I suggest you should have known. Next time, maybe you will take the time to prepare yourself and get that team behind you, who are supposed to be briefing you, in place. When your neck is on the line, you should ensure that somebody else takes the stick as well. I am sure you will after this point. I have worked in industry and I understand what productivity is about. Productivity is a term we use to assess the ratio between output

and the inputs used to generate that output. You can have a reduced output but as long as the input falls faster your productivity is going up, as you well appreciate. Most countries in Europe have their own means to turn out the euro. What is the percentage of countries in the euro zone that do not have their own mint?

(*Mr Sheehan*) the only one I am aware of is Luxembourg. Holland provides them with their coins. The issue we have is not necessarily that they do not have a mint but they do not have the capacity to produce the full output. Hence, there was the reliance upon other producers. A lot of mints do not have blank production facilities, so they buy in blanks to produce the coin.

153. Is it the blanks that you supply?

(*Mr Sheehan*) Blanks and, to some extent, coins to meet the requirements of a particular country.

154. We were totally unaware of what requirement was laid down for a coin because the Mint has been making coins for a while around the world and they know what tolerances are required. Why were you taken so unaware with the actual tolerances?

(*Mr Sheehan*) The tolerance requirements were quite strict for most countries. There was some variation from country to country but mostly the tolerances were very strict and more difficult than we anticipated to produce. That was a major problem.

155. That is amazing. Most countries will have their own mint constantly?

(*Mr Sheehan*) It depends on the demand that is required. The situation we have now is that some countries invested heavily in new coining presses to meet the demands and now those coining presses are redundant. This is a factor within the market place itself.

156. We have a breakdown between our own production and export production. Jon Trickett pressed you on the percentage of your profit or loss that comes from the export side. I understand you do not make a loss on the Treasury side, the Treasury contract. Is that true?

(*Mr Sheehan*) We do not disclose details of profit and loss in any particular market, certainly not in an open forum.

157. I do not mind you making a loss if we got the right price and the Treasury would make that profit and that is passed on back to the taxpayers. In this scenario, profit and loss is merely a figure that we use to evaluate against other suppliers, is it not?

(*Mr Sheehan*) As you said, you have been in the private sector. I am sure you are very clear that on occasions, particularly in difficult markets, the strategy that you employ is to achieve a contribution to fixed costs, not necessarily a profit. That can be a short to medium term goal and that is a better solution for a particular business than not making the product in totality, because the profitability is better overall by doing that. That is not a long term solution. We have to solve the problem in terms of the cost structure.

158. I am well aware of marginal cost price and how to implement it. When I quickly made a decision to cut those products, I had to search round for a product that would pay its full price. We did survive

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[Continued

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on marginal cost pricing. Can you tell me why the Treasury should deal with you if they can get the product from another supplier, cheaper?

(*Mr Sheehan*) The Treasury have given us a challenging contract which has reduced progressively over the years. I believe we supply them with a very good service and a very good quality of product. It is very much a policy decision and that policy decision is applicable throughout Europe. I believe they get a good deal.

159. The Treasury actually does give you a subsidy to some degree because it pays via the contract to supply coins. If the price is higher than what they could achieve in the open market, that is a subsidy to your production and that production could be used to undercut other suppliers in the export field. You did indicate that the price in the world market is so competitive that we have to use that subsidy. We have to do marginal cost pricing and we have to pare it to the bone. If I can buy those coins in the world market cheaper than you can supply at home, why do I not buy them on the world market and save money?

(*Mr Sheehan*) I believe we supply the Treasury with an excellent service in terms of quality and product. It is a challenging contract and it has continued to decrease generally, year on year.

160. Have you any intention of introducing some sort of performance related pay?

(*Mr Sheehan*) I am a believer in incentivising the workforce. In one particular area where we had to address that recently, that is starting to show some success. I have had discussions with the non-executive chairmen on this subject and I believe it would be appropriate. There is a profit sharing scheme at the moment but obviously when you are not making money you do not pay out on a profit share scheme.

161. That is the incentive to start making money so you get the bonus.

(*Mr Sheehan*) I concur.

162. You had £594 million in coin stock.

(*Mr Sheehan*) 594 million coins.

163. It is that value that we keep referring to, high value product. You make tokens like any other token producer. I suggest that maybe you should put a whole through the middle of some of those tokens. You might have adequate coin to pay some of the management for their performance over the last few years. Would I be wrong?

(*Mr Sheehan*) I find it difficult to answer that question, to be quite honest.

Mr Williams

164. Does the management have performance pay?

(*Mr Sheehan*) They are part of the profit share scheme.

165. Have they had any benefits recently?

(*Mr Sheehan*) Absolutely none.

166. Incentivising, a wage freeze and the removal of benefits sound a rather original way of incentivising. Were these negotiated with the workforce?

(*Mr Sheehan*) In the context of all the changes that took place, there was a list of changes in terms of working practices that we needed to achieve in terms of manning reductions, in terms of the pay pause, in terms of the removal of some of these benefits. We had a consultation period of 90 days from the end of March to the end of June before we enacted, so there was full consultation on the subject. I hope that the majority of the workforce feel it was a necessity, not a choice, in that sense.

167. Does 90 days' consultation mean 90 days of just letting them talk or did you adopt any of the changes they suggested?

(*Mr Sheehan*) I think during that period I gave about 24 presentations. I think there were about 36 in total. There was a very animated discussion after almost all of those presentations and we certainly took on board some of their points.

168. Do you expect any further redundancies in the foreseeable future Are you anticipating any?

(*Mr Sheehan*) If we achieve what we can achieve—I do believe we have a good workforce—and achieve the productivity levels and the service levels, then at this stage I believe we have done enough. What I cannot guarantee, and I do not think anyone can guarantee in this type of market, is the state of the market and the trends in the market. We have to be able to react quickly to positives and negatives in the market place. Hence the need for a highly flexible workforce.

169. Following on some of the questions Angela asked, your investment as very substantial. Were you buying, if that is an appropriate term in this industry, state of the art equipment?

(*Mr Sheehan*) Yes, very much so.

170. In that case, why is it that other countries did not have problems achieving the targets required by the euro and you did?

(*Mr Sheehan*) Everybody had problems to a greater or lesser extent.

171. But you seem to have had more because you lost more of the market.

(*Mr Sheehan*) Yes, that is quite true.

172. Did your predecessors choose the wrong machinery and equipment?

(*Mr Sheehan*) This is fairly standard, state of the art machinery, so there was no fundamental difference between this and other players. Other players made different decisions.

173. In that case, why could they get the tolerances with the same equipment or similar equipment that you could not?

(*Mr Sheehan*) Everybody had issues in terms of achieving tolerance levels. We were slower than others and that is not acceptable.

174. What made you slower?

(*Mr Sheehan*) It is difficult for me to say because I was not there but I believe it was associated with us understanding very clearly the UK coin market and our ability to produce there and perhaps not understanding that the European coins were far more strict in their tolerance levels and more difficult to produce than the UK coin products.

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[Continued

[Mr Williams Cont]

175. For people who are specialists in this field, that seems to be a rather substantial oversight, does it not?

(Mr Sheehan) I would not have been happy at the time, I have to say.

176. You do seem to be rather addicted to the relationship with your present auditors. There does not seem to be much evidence of your seeking alternatives. We have found in the past that such relationships can be over-cosy. Do you think that your way of appointing your internal auditor is adequate?

(Mr Sheehan) We accept the points that Grant Thornton have made very clearly. Of the 47 actions that we have already taken, one is to agree through the Audit Committee to put the internal audit out to tender next year. The internal auditor, in my view, having looked at it from a purely manufacturing perspective, has done an excellent job. The mistakes that we have made together have been that we have not addressed necessarily some of the public sector issues that we should have addressed.

177. Going back to the issue of Crown immunity, how far is this just a status quo situation that no one has ever sought to change because it has always been

there? Has there been any assessment of a necessity for Crown immunity? If you cannot answer on the spur of the moment, let us have a document.

(Mr Glicksman) I would be happy to do that. In general, the question of Crown immunity has been under review in the past and there have been steps to remove Crown immunity in a number of areas. I do not know in detail about this particular area of the health and safety legislation but I would be happy to put in a note for you.⁸

178. When you put in a note, will you also put in two notes, with a note to whoever is responsible that we have expressed our concern at the situation we find at the Mint and its workforce as a result of Crown immunity. We would hope to see it reviewed urgently.

(Mr Glicksman) Yes, I will do that.

Mr Williams: We look forward to your note. That is the end of the open session. I now have to ask everyone other than the committee and witnesses to leave.

⁸ Ev 22–23

APPENDIX 1

Supplementary memorandum submitted by the Royal Mint

ARRANGEMENTS FOR THE PRINTING, LAYING AND DISTRIBUTION OF THE 2001–02 ANNUAL REPORT AND ACCOUNTS OF THE ROYAL MINT

1. In his opening remarks at the Committee's evidence session on 23 October 2002, the Chairman to the PAC commented: "Your report and accounts are required to be distributed to MPs but we did not get them and we received them very late. Also, they are required to be printed by the Stationery Office and that was not fulfilled".

2. I have now had an opportunity to investigate the Chairman's concerns in detail and thought I should write to provide the Committee with a fuller explanation.

3. The Royal Mint's Annual Report and Accounts for 2001–02 were laid before both Houses by the Comptroller and Auditor General on the afternoon of 15 October 2002. This was the date on which Parliament returned after the Summer Recess, and hence was the earliest opportunity for the document to be laid. In previous years, the Royal Mint's Annual Report and Accounts have been laid in July before the Summer Recess. However, the time-scales involved in the preparation of the C&AG's Report on the 2001–02 accounts meant that, exceptionally, this could not be achieved this year.

4. As regards the distribution of copies to members, I understand that the NAO obtained from the Royal Mint 25 copies of the Annual Report and Accounts for distribution via the Committee Clerk to PAC Members and others. I regret that, because of the interest generated by the impending PAC hearing, it appears that insufficient additional copies were made available by the Royal Mint to meet Members' immediate requirements and I offer my sincere apologies for the inconvenience that this has undoubtedly caused.

5. Finally, on the use of the Stationery Office for the printing of the document, I enclose for the Committee's information copies of letters exchanged between the Clerk of the Journals and the Royal Mint (**not printed**). Whilst it transpires that the Royal Mint had in fact complied with the requirement to use the Stationery Office, we had failed to include their publishing imprint on the title page. Again, this is an oversight for which I can only apologise and provide an assurance that this will not recur.

Gerald Sheehan
Deputy Master and Chief Executive
The Royal Mint

14 November 2002

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QUESTION NO 140—CROSS SUBSIDY ISSUES

1. Your Committee asked that I provide a note explaining “whether there is a cross-subsidy between the British market and the overseas market”. The request was made in the specific context of the Royal Mint’s UK and overseas circulating coin and blank business; suggestions that the Royal Mint had been subsidising overseas euro coin production; and suggestions that the Royal Mint had been unfairly competing in the market place. This note addresses those concerns.

2. The Committee asked that the Comptroller and Auditor General should examine this note prior to its submission to the Committee and a copy has been passed to Sir John Bourn for that purpose.

BACKGROUND

3. As highlighted in paragraph 13 of the Report by the Comptroller and Auditor General (included in the Royal Mint’s Annual Report for 2001–02), coin manufacture is a capital intensive industry that tends to carry a high proportion of fixed and semi-fixed costs, which vary little with customer demand. Consequently, the Royal Mint relies on order volume to achieve an acceptable unit cost structure.

4. In line with market demands, action was taken in 2001 to reduce plant capacity and associated operating costs through reducing shift patterns. More recently a fundamental restructuring programme has been initiated involving a significant number of redundancies (about 220).

THE CURRENT MARKET PLACE

5. The world market for coins and blanks is highly competitive. Quality and reliability of delivery are key factors, but cost to the customer is the determining factor in most tenders. The global industry has increased capacity, and growth in competition is noticeable from Europe, Korea and Chile.

6. The decision of the first wave euro countries to join the new euro currency system prompted many producers—including the Royal Mint—to increase their production capacity. Exceptionally high demand was forecast for the three-year lead up period to E-Day (1 January 2002), followed by a further one or two year period of high demand to meet the overall replacement programme. There was also the possibility that “second wave” countries might decide to join the euro currency system. Thus there was a general expectation of several years of profitable business sufficient to justify an industry-wide expansion of capacity.

7. By September 2001 the first wave countries (including the late entrant, Greece) forecast that overall 52 billion coins would be required for E-Day. In the event production by E-Day was close to forecasts, but demand was much lower. On 1 January 2002 only 37.6 billion coins had been issued.

8. There is some evidence to suggest that demand for euro coins is now increasing, but it is difficult to predict future demand patterns. However, it is clear that the peak demand has been met and that future requirements will be much lower than expected. As a result there is over capacity in the industry worldwide, and the industry is in a period of rationalisation with some companies leaving the market and others reducing their effective capacity.

RECENT TENDERS

9. Set out at confidential Annex 1 (**not printed**) is a summary of the invitations to tender received during the last 12 months. Where known, details of who won the tenders are provided and details about the competitor prices quoted. In many instances tender prices are not disclosed by customers and, where they are, it is often on a strictly confidential basis. The annex (**not printed**) demonstrates the competitive nature to the market place.

TRADING PERFORMANCE

10. Set out at confidential Annex 2 (**not printed**) are details of the Royal Mint’s trading performance for the last five year period (1997–98 to 2001–02), together with details for each individual year. Euro coins were not sold prior to this period.

11. Contribution before direct labour is defined as sales income less those costs (metal, bought in semi-process materials, commissions, freight, packaging, utilities, wastage, and other consumables) that would have been avoided if the orders had not been taken on. However, much of the direct labour cost could not in the short term have been avoided without significant loss of production flexibility (and one-off redundancy costs). Therefore, it could be argued that these direct labour costs should be included as fixed costs. Nevertheless, “contribution after direct labour” is a prudent definition of contribution.

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OVERSEAS CIRCULATING COINS AND BLANKS

12. As can be seen from confidential Annex 2 (**not printed**), the Royal Mint secured a positive contribution to its fixed operating costs from its overseas circulating coin and blank sales in each of the last five years. Overseas sales of euro coins and blanks have also shown a positive contribution in each of the last five years.

13. On a number of occasions competitors have quoted prices that have been much lower than that of the Royal Mint. The Royal Mint has neither followed a strategy of “unfair” pricing nor specifically targeted any competitor in the market place. There has been a need to respond to the prevailing market conditions in order to secure business and achieve a contribution to fixed operating costs.

14. Margins on overseas sales of circulating coins and blanks have been steadily falling due to competition and over capacity in the marketplace, but have remained positive.

15. The bulk of euro orders have been for copper plated blanks. The most recent euro order was for coin and thus a direct comparison can be made to UK coin prices. The price per tonne secured on this euro order was higher than the average price charged for UK copper plated coins in 2002–03, and confidential details are at Annex 3 (**not printed**).

16. The Royal Mint has obtained euro orders at price levels designed to give a reasonable contribution and has not used income from UK coin issues to cross subsidise prices for overseas euro orders. However, the Mint did encounter technical and quality difficulties in producing a number of euro orders. The resolution of these difficulties took longer than anticipated and involved considerable cost and R&D effort which reduced the actual level of contribution although it remained positive overall.

COLLECTOR COIN

17. Overseas and UK sales of collector coin and related items have been made at broadly similar prices in all markets and have generated significant positive contribution. The actual price charged in a particular market takes account of the relative costs associated with selling in that market and any differences in local market conditions.

TREASURY UK COIN AGREEMENT

18. Under the terms of its agreement with HM Treasury, the Royal Mint charges the Treasury a given price for coins issued on their behalf to the UK banks. It is not possible, therefore, to provide an exact, equivalent price for UK blanks and compare this with overseas orders. The current agreement with the Treasury is for a five-year period ending in 2005.

19. The Agreement is challenging. The graph at confidential Annex 4 (**not printed**) compares the average prices secured since 1993–94 for UK coin from HM Treasury compared to prices secured on overseas sales of coins and blanks.

20. The prices which can be secured on overseas orders are very volatile, but have fallen dramatically in the last two years by some 18%. On average over the last 9-year period, the prices charged to HM Treasury and secured on overseas sales have both fallen by around 30%.

STRATEGY

21. The production and staffing levels at which the Royal Mint has been operating over the last 18 months has meant that there has been significant capacity over and above that required for normal UK coin production. However, the Royal Mint needs to maintain a minimum capacity level sufficient to meet potential demand, which has historically been volatile and difficult to forecast.

22. In this situation the Royal Mint’s strategy has been to secure overseas orders at sales values greater than the variable costs incurred in producing those orders. The additional contribution generated has offset the fixed costs that could not be avoided in the short to medium term. Had the additional contribution not been generated then the losses of the Royal Mint (and, therefore, the taxpayer) would have been greater.

23. The Royal Mint’s operating profit and financial performance would have been significantly worse if it had not secured the level of overseas work that it did during this period. Indeed, in the Royal Mint’s view, the overseas business is subsidising the UK business because it spreads the burden of fixed costs which would otherwise be allocated solely against UK coins.

24. If the Royal Mint focused solely on the production of UK circulating coin, this would require a fundamental change to its operating base. Two options could be taken:

- (Reduce shift patterns further and increase the cost base significantly).
- (Close certain plant in its entirety and reduce manpower further by approximately 40% with associated redundancy and related costs of around £18 million).

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[Continued

25. Both these options are indefensible at least in the short to medium term, and the strategy of competing for overseas business is sound. This conclusion is supported by the Royal Mint's performance in the first half of 2002–03 where an unaudited operating profit was secured. The level of profitability was in excess of the Corporate Plan forecast and the Royal Mint is currently on schedule to achieve—or better—its annual Plan target.

THE FUTURE

26. The planned restructuring programme and associated cost reductions will be achieved by 31 March 2003. This is designed to make the Royal Mint more competitive and profitable. It is difficult to forecast what action may be taken by competitors, and some predatory pricing is possible. However, the Mint is taking action to make further efficiencies and cost reductions in order to compete on a global scale.

CONCLUSION

27. Overseas orders have over the years contributed to the Royal Mint's profitability and thus reduced the burden on the Exchequer.

28. The Royal Mint has obtained euro orders at price levels designed to give a reasonable contribution and has not used income from UK coin issues to cross subsidise prices for overseas euro orders.

29. The Royal Mint has neither followed a strategy of “unfair” pricing nor specifically targeted any other competitor in the market place.

30. In the prevailing market conditions the Mint's aim has been to reduce capacity and costs in order to compete in a fiercely competitive international market place and to lay the foundations for sustained profitability.

31. *I have no objection to this note being put into the public domain, but the attached annexes (not printed) are not for public disclosure because of their commercially confidential nature.*

Gerald Sheehan
Chief Executive
The Royal Mint

22 January 2003

APPENDIX 2

Supplementary memorandum submitted by HM Treasury

CROWN IMMUNITY FROM PROSECUTION

The Public Accounts Committee asked HM Treasury for a note on the Government's policy towards the Crown's immunity from prosecution in the context of the tragic fatality at the Royal Mint (on which the Mint have submitted a separate note).

What is “Crown immunity”?

Crown immunity means that emanations of the Crown are not susceptible to prosecution for offences either created by statute or of the common law. It is more difficult to define precisely what is meant by an “emanation of the Crown”, but it is clear that ministers and their departments are included. Crown immunity is today primarily an issue of the criminal law. The Crown Proceedings Act 1947 substantially reduced the Crown's immunity from civil proceedings.

It is important to be clear about what Crown immunity does not protect the executive from. It does not afford any protection from investigation, for example by the Health and Safety Executive in the Royal Mint context. In the case of legislation relating to food and health and safety, the law applies to the Crown, but the Crown cannot be prosecuted under it. Instead a system of Crown censure and Crown notices is used, publicising the inspectors' findings. The HSE investigation into the Mint resulted in Crown censure. Crown immunity also does not grant protection to individuals from prosecution. In the Mint case, a thorough investigation by Police and HSE concluded that no Director or Manager could be prosecuted. Crown immunity also does not give protection from a civil claim. In this particular case the Mint has already written to the representatives of the deceased to confirm admission of liability and asking them to provide details of the quantum of their claim (a schedule of dependency).

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[Continued

Future policy on Crown immunity

The Government's position on Crown immunity remains as set out by Lord Falconer in his response from a Parliamentary Question laid by Lord Kennet, given on 4 November 1999. The Crown's immunity from criminal prosecution has been eroded in certain specific areas. The 1988 Road Traffic Offenders Act introduced a system of "nominated defendants" for the Crown who could be prosecuted and fined on behalf of the Crown. The Food Safety Act 1990 stops short of criminal liability but permits the Court to declare acts or omissions of the Crown as unlawful. Similar provisions appear in the Environmental Protection Act 1990, the Environment Act 1995, the Chemical Weapons Act 1996 and the Transport Act 2000. In an alternative approach, National Health Service authorities as Crown corporate bodies were immune from prosecution. This immunity has been removed in stages since the mid-1980s.

The Government has recently given consideration to the general issue of the state's immunity from criminal proceedings. Recent consultation papers (on corporate killing and health and safety) have proposed modifications of immunity. In the light of responses to that consultation, officials have analysed the options and advice is to be put to Ministers.

HM Treasury

December 2002

APPENDIX 3

Further supplementary memorandum submitted by the Royal Mint

QUESTION 78—FATAL ACCIDENT

Your Committee asked for a very full note on the background to the accident, which sadly resulted in the death of Mr John Wynne on 28 June 2001.

BACKGROUND

1. An Ebner Bell Annealing furnace is situated at the east end of the Blank Production Department of the Royal Mint. It was manufactured and installed in 1998 by Ebner, a specialist furnace Company based in Austria. The fatality was caused by the bell annealing furnace being detached from the hook of the overhead crane whilst being transported from the storage to the working position. The furnace struck Mr Wynne causing fatal injuries.

2. The bell annealer consists of a base onto which coils and material are stacked vertically. An inner cover, which is lowered onto the base, encloses the stack. A heating bell measuring approximately four metres high and weighing approximately 6.5 tonnes is lowered over the inner cover and sealed onto the base. The inner cover and heating bell are lifted into position using a 7.5 tonne safe working load ("SWL"), 25 metre span, Morris electric overhead travelling ("EOT") crane. An operator using a remote radio control operates the crane from ground level.

3. The heating bell is fitted with a single lifting point consisting of a 65 millimetres diameter pin welded into cross members on top of the bell. The cross members also act as horizontal guides to lead the crane hook into engagement with the lifting point. The lifting point is equipped with a location indicator to show when the crane hook is correctly engaged on the pin.

4. The indicator consists of a horizontal hinged steel plate with a bell crank at right angles to the plate connected to a wire rope. The rope passes across the top and down the side of the bell to a red painted telltale weight acting in a vertical guide tube. When the point of the hook is passed over the lifting pin to the correct position it is directly under the free end of the hinged plate. As the hook is raised to engage with the pin, the point comes into contact with the free end of the hinged plate. The plate and bell crank rotate about the hinge pulling the wire rope horizontally and lifting the telltale weight so that it disappears from view into the guide tube.

THE INCIDENT

5. On 28 June 2001, the heating bell was being moved from its storage location using the EOT crane to position it over the inner cover on the furnace base. As the heating bell approached the furnace base, it became detached from the crane hook and fell approximately four metres to the floor, coming to rest on its side against a barrier at the side of the gangway in front of the furnace. Mr Wynne, who was not operating the crane, was struck and received fatal injuries.

6. An immediate investigation was undertaken, and a report prepared by the HM Specialist Inspector of Health & Safety.

23 October 2002]

[Continued

7. When investigating the circumstances giving rise to the incident, it was possible to see the engagement of the hook clearly, but the indicator was not travelling its full length. This was caused by the hinged plate flap being distorted, but even so, and despite the user manual containing warnings to ensure that the hook engaged indicator shows that the crane hook is properly engaged, the operatives did not use the indicator.

8. It must be noted that there was a previous incident in September 2000 when the heating bell had become detached from the crane hook. The HSE agreed that the circumstances differed to those of the incident of June 2001. However, the HSE did conclude that the loss of control of a load such as the furnace was clearly an incident with potentially fatal consequences, and one which could reasonably have been expected to initiate a thorough assessment of the operation. They also concluded that whilst some investigation did take place, a suitable and efficient assessment of the risks posed by the operation was not made.

9. The report concluded that, if the lifting pin was properly engaged with the crane hook, it would not be possible for the heating bell to become detached. However, the probable explanation for this accident was that the crane hook was not properly engaged with the lifting pin of the heating bell. The heating bell was probably lifted with the lifting pin balancing on the point of the crane hook. The heating bell remained balanced on the hook while it was being transported from the storage to the working position and, when the crane hook was raised to the top hoist limit to lift the heating bell over the inner cover guide posts, the heating bell fell from the point of the crane hook, the guide bracket on the bottom of the heating bell struck the top of the inner cover, causing the bell to tilt sideways and then fall to the floor on its side coming to rest against the barrier on the other side of the gangway.

10. Numerous detailed discussions took place between the Project Engineers, Technical Services, the Health & Safety Department, and representatives of Ebner with regard to the operation of the furnace and the most appropriate and safe method of lifting it. However, it is accepted that the Mint did not formally record a suitable and sufficient risk assessment.

11. Furthermore, a number of personnel had received training (90% having achieved NVQ Level 2), and were highly experienced, not only in relation to lifting operations but also in relation to the operation of the Ebner furnace. Nevertheless, it is accepted that not all employees involved in the process can be shown from written records to have received sufficient instruction. It is also accepted that there was a need to improve the audit trail, such that documentary proof of the depth of job skills is readily available.

12. It is accepted that some operatives exhibited a lack of knowledge of the function of the location indicator and that, because it was used infrequently, there should have been time-based maintenance of the indicator.

13. There is no suggestion by the HSE that financial considerations played any part in the accident.

14. Indeed, there has been a significant investment in training and the health and safety structure prior to, and since, this tragic incident. Priority has been given to the areas now classified as a COMAH site.

15. The Mint co-operated fully with the HSE in the course of their investigation.

SUMMARY OF ACTIONS

16. Further steps were taken as follows:

16.1 A full review of the operation of the Bell Annealer Furnace and Risk Assessment was undertaken and safe working procedures reviewed and up-dated.

16.2 Those with responsibility for operating the Bell Annealer Furnace have undertaken Knowledge Competency Assessments.

16.3 A Hazards & Operability Study ("HAZOP Study") has been undertaken in relation to the operation and maintenance of the Bell Annealer Furnace.

16.4 The Blank Production Department has also undertaken a review of Risk Assessments throughout the Department.

16.5 A Bell Annealing sub-group has been set up to review periodically the process to ensure that all issues and remedial actions identified have been implemented.

16.6 In addition, a platform has been constructed around the annealing furnace area to assist the operators to visually confirm that the hoist is located correctly. This is the safest option because the location indicator is prone to damage despite regular maintenance.

16.7 The HSE has confirmed that they are satisfied with the action taken.

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[Continued

GENERAL COMMENTS

17. Whilst the Treasury Officer of Accounts will be responding separately to the question of Crown Immunity generally, some of the specific comments below may aid a clearer understanding of the procedure in this case.

17.1 Crown Immunity does not afford any protection from investigation by the HSE. Moreover, the Royal Mint asked the HSE to lead the investigation into this incident and ensured full co-operation by affording total access to all areas, employees and records.

17.2 Crown Immunity does not grant any protection from prosecution for any Director or Manager. After a thorough investigation, initially by the Police and thereafter by the HSE, it was concluded that no individual should be the subject of a prosecution.

17.3 The Mint invited the family of the employee, his union and their legal advisors to attend the Crown Censure Hearing so that there would not be any “behind closed doors” aspect to the investigation by the HSE and/or their findings.

18. Whilst understandably due to their grief, the family has refused the direct support of the Royal Mint’s Welfare Department, they have received substantial financial support via the Mint. This immediate assistance will be supplemented by a Civil Claim which will undoubtedly be initiated and which the Mint will consider sympathetically.

19. This was a tragic accident for which the Royal Mint accepted responsibility at a very early stage. The circumstances surrounding the incident have been thoroughly investigated by the authorities and measures have been implemented to ensure there can be no repetition.

20. The Mint has a serious commitment to Health & Safety which is evidenced not only by the improvement in its accident record which has seen the number of accidents reduced year-on-year for the last four years but also by its increased resourcing of Health & Safety matters.

21. This commitment to resource in all aspects of Health & Safety, and the improvements to the accident record of the Royal Mint, are acknowledged by the HSE.

Gerald Sheehan
Chief Executive
The Royal Mint

27 November 2002

APPENDIX 4

Letter to the Chairman of the Committee from the Comptroller and Auditor General

PAC HEARING ON THE 2001–02 ROYAL MINT TRADING FUND ACCOUNTS: SUPPLEMENTARY EVIDENCE BY THE ROYAL MINT (Q140)

At its hearing on 23 October 2002, the Committee asked the Deputy Master of the Royal Mint to provide a note on whether a cross-subsidy exists between the Royal Mint’s British and overseas markets (Q140 refers). The acting Committee Chairman also asked that the note should be scrutinised by the National Audit Office prior to its submission.

The Royal Mint submitted its note on 28 January (including in Annexes 1 to 4 detailed financial information that has been provided to the Committee on a confidential basis), and my staff have concluded their review of its contents. The National Audit Office was assisted in this work by accountants of KPMG, who have supported my audit of the Royal Mint since 2000–01. Appended to this letter is a copy of the report dated 23 January 2003 that KPMG have made to me, setting out the scope of their work and the results of their detailed testing of the financial information contained in the Deputy Master’s note.

Based on the results of the detailed review by KPMG and the work undertaken by my own staff, I am content that the Deputy Master’s note fairly reflects the Royal Mint’s trading position over the periods disclosed in respect of its British and overseas markets.

Sir John Bourn KCB
Comptroller and Auditor General

3 February 2003

REPORTS BY THE COMMITTEE OF PUBLIC ACCOUNTS
SESSION 2002–03

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1	Collecting the Television Licence Fee (HC 118)	18/12/02
	Government Reply (Cm 5770)	06/03/03
2	Dealing with pollution from ships (HC 119)	09/01/03
	Government Reply (Cm 5770)	06/03/03
3	Tobacco Smuggling (HC 143)	10/01/03
	Government Reply (Cm 5770)	06/03/03
4	Private Finance Initiative: redevelopment of MOD Main Building (HC 298)	30/01/03
	Government Reply (Cm 5789)	10/04/03
5	The 2001 outbreak of Foot and Mouth Disease (HC 487)	14/03/03
6	Ministry of Defence: Exercise Saif Sareea II (HC 502)	12/03/03
7	Excess Votes 2001–02 (HC 503)	19/03/03
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9	The Office for National Statistics: outsourcing the 2001 Census (HC 543) . .	26/03/03
10	Individual Learning Accounts (HC 544)	04/04/03
11	NHS Emergency Planning (HC 545)	16/04/03
12	Tackling Pensioner Poverty: encouraging take-up of entitlements (HC 565) .	09/04/03
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14	Royal Mint Trading Fund 2001–02 Accounts (HC 588)	17/04/03



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