

TITLE OF REPORT: ONGOING FINANCIAL AND OPERATIONAL VIABILITY OF CONTRACTORS

REPORT OF THE HEAD OF FINANCE, PERFORMANCE & ASSET MANAGEMENT

1. SUMMARY

- 1.1 As requested at the June meeting, to provide the Committee with information on what actions the Council is taking to protect itself from the impact of contractor failure.
- 1.2 To summarise the internal audit that was carried out in to this area, actions that have been taken in respect of this and remaining actions to be taken.
- 1.3 To highlight that this is an area where actions that are put in place need to be proportionate to the risk and that there will always be a risk of contractor failure. This risk is increasing as we continually ask our contractors to deliver better value for money. The current economic climate also increases the risk of business failure.

2. RECOMMENDATIONS

- 2.1 That the Committee notes this report.

3. REASONS FOR RECOMMENDATIONS

- 3.1 The committee considers Shared Internal Audit Service (SIAS) reports and the level of assurance this provides. This includes, but is not limited to, high priority recommendations.
- 3.2 The committee monitors the effective development and operation of risk management, agree actions (where appropriate) and make recommendations to Cabinet.

4. ALTERNATIVE OPTIONS CONSIDERED

- 4.1 There are no alternative options that are applicable.

5. CONSULTATION WITH RELEVANT MEMBERS AND EXTERNAL ORGANISATIONS

- 5.1 SIAS have reviewed this report in relation to audit findings and actions undertaken in relation to them.

6. FORWARD PLAN

- 6.1 This report does not contain a recommendation on a key decision and has not been referred to in the Forward Plan.

7. BACKGROUND

- 7.1 Coin Co International PLC (CCI) were contracted to collect, process and bank cash from the Council's 23 car parks. In November 2014, we learned that they had entered administration and ceased to carry out the contracted activity. This resulted in

problems with recovering the collection boxes and keys to the car parking payment machines. Parking services staff were then used to empty the payment machines until a new contractor was engaged.

- 7.2 SIAS were asked to include an audit of this area in their plan for 2015/16 to identify lessons that could be learnt and appropriate mitigating actions. The report was agreed and issued in November 2015. The audit provided moderate assurance and made 4 recommendations (3 medium and 1 merits attention).
- 7.3 Since then there have been two further contactors that have gone in to administration. In March 2016 we were notified of the receivership of LightBrigade Media Corporation Limited (LightBrigade), the exhibition fit out contractor for the Hitchin Museum project. SSP the main contractor for Hitchin Splash Park went in to administration following completion of the works, but were then not able to carry out required remedial works.

8. AUDIT RECOMMENDATIONS AND MANAGEMENT ACTION

- 8.1 SIAS reports identify areas where controls could be improved and makes general recommendations. The relevant NHDC manager details the specific actions that they will take and target dates. The SIAS auditor will review this response and if they are satisfied they will issue this as a final report.
- 8.2 The first recommendation related to identifying business critical activities and what monitoring of those contractors would take place to review financial and operational viability when the contract is awarded and throughout the life of the contract. The Council's contracts have now been analysed and assessed as being either core or non-core. The core contracts cover significant areas of business (e.g. waste collection), as well as contracts where there could be a significant impact on business continuity in the event of provider failure (e.g. now includes car park cash collection).
- 8.3 Contractors that deliver core contracts are now automatically added to 'CreditSafe' updates. 'CreditSafe' provides credit checking reports on companies that includes risk tracking reports that provide an automatic e-mail if there is a change in circumstances. Our contract for this service means that we can receive these reports for a significant number of companies at no additional cost. Whilst these reports are a useful tool, they may not be able to react quickly enough to changing business circumstances (particularly for small businesses).
- 8.4 Parent company guarantees and performance bonds can also be sought for core contracts. Both of these would only be applicable at the contracting stage. A parent company guarantee is only relevant where the tenderer is part of a group, which tends to only apply to larger companies. The guarantee would require the parent to step in and fulfil the contract, and provide any relevant financial compensation. For such companies, even if there was a risk of liquidation, they would tend to find ways to fulfil the contract anyway (e.g. due to value of reputation, value of assets in the company). Even if such a company was to enter administration, the administration would look to continue to fulfil contracts so that it can be sold on as a going concern. A performance bond is like an insurance policy that is taken out by the contractor that would provide a pay-out to the Council should the contractor not be able to deliver the contract. These bonds cost money and therefore that cost would be passed on to the Council as part of the contract price. They also only provide compensation and the Council would still have to find a way to undertake the contacted activities. Both of the above would tend to favour larger companies, and therefore may act against the use of local SMEs (small and medium sized enterprises).
- 8.5 The second recommendation continued the theme of what was included in the first one, and recommended that we have a protocol that covers:
- The value of setting up and receiving company alerts (e.g. 'CreditSafe' and 'Google Alerts')

- Management of the contract including records required, action plans and risk monitoring
 - Escalation routes if contractor viability risks are identified
 - Making use of shared learning
- 8.6 In addition to the 'CreditSafe' checks referenced previously, there will be a 'CreditSafe' check of all tenderers during the tender decision process. Adverse findings from this will be reviewed and may lead to a tenderer not being selected for a contract. This will be done on a case by case basis, and will also reflect relative risk. There may be instances where all the tenderers have a low 'CreditSafe' score. This can be the case where the work is of a specialist nature and requires high up-front investment. In these instances a decision is then taken as to whether it is better to accept the risk and award the contract or to rerun the tender. SMEs tend to have worse credit scores than larger organisations so there is a balance with encouraging local SMEs against the potential risk of supplier failure. In some situations we will also review the credit rating and viability of sub-contractors. This could highlight risks from the failure of a sub-contractor having a knock-on impact on the main contractor. It could also highlight opportunities where a sub-contractor could step in and deliver a contract should the main contractor fail.
- 8.7 For core contracts, the contract manager signs up to 'Google Alerts'. This provides a regular summary of the news stories relating to a company. This can be a useful indicator, but for larger companies may lead to too much information being received, and smaller companies may not even be reported on.
- 8.8 Contract (service) managers are the ones that are best placed to monitor contractors, and this is reflected in guidance. We are currently developing a contract management guide that will provide guidance and instruction in relation to this area. Contract managers are responsible for having regular contact meetings. They should use this alongside local intelligence as a risk indicator of provider viability. For example, the following are likely to be significant signs of increased risk:
- Poor performance (e.g. performance indicators)
 - Declining performance
 - Departure of key staff
 - Complaints from sub-contractors, or them seeking direct payment
 - Requests for faster payments
- 8.9 The Contract and Procurement Group is an officer group that includes those that are responsible for managing significant contracts, alongside specialist procurement and legal support. This group is developing the contract management guide. The principles of good contract management are frequently discussed at the group, and therefore are already being applied to the significant contracts. The purpose of the guide is therefore to disseminate this knowledge to all contract managers. This group also shares lessons that have been learnt, including those from provider failure.
- 8.10 When a risk of contractor viability is identified, this needs to be escalated to the Head of Legal, relevant Head of Service and Head of Finance, Performance and Asset Management. This requirement has been raised at the Contract and Procurement Group, but needs to be formalised through the contract management guide. Even when a risk is identified, it can be difficult to know what action to take. Providing support to the contractor can help them through a difficult period and provide time to consider exit strategies that allow service continuity. However this could also increase the level of financial risk that the Council is exposed to. For example, withholding payment to a contractor could reduce financial risk, but also perpetuates the risk of business failure.
- 8.11 The third recommendation focused on knowing what to do if a contractor ceases to deliver services.

- 8.12 Contract Managers have tended to focus on the impact of major events (e.g. severe weather) and how the contractor would deal with these. There has been less of a focus on what would happen if the contractor ceased operating and was therefore unable to fulfil the contracted activities. This has started to be considered more within Business Impact Assessment (BIA) processes and then Business Continuity Plans (BCPs). Further work will be undertaken to review this in more detail with Service Managers. This will assess contracts (or areas within contracts) where there would be a significant impact on the service our customers receive if they were not provided. It will then look at what can be done to mitigate this.
- 8.13 As part of the contracting process, tenderers are required to provide a BCP evaluation. This makes sure that they consider business continuity as part of the delivery of the contract, and gives us assurance that they have done this.
- 8.14 The fourth recommendation was around contract monitoring and setting up alerts. This was a 'merits attention' recommendation and is covered by the comments made above in relation to the other recommendations.

9. LEGAL IMPLICATIONS

- 9.1 No legal implications arise from this report. The Committee's role as set out in the Constitution includes considering Shared Internal Audit Service (SIAS) reports and the level of assurance this provides. This includes, but is not limited to, high priority recommendations. The Committee also monitors the effective development and operation of risk management, and can agree actions (where appropriate) and make recommendations to Cabinet.

10. FINANCIAL IMPLICATIONS

- 10.1 The actions contained within this report are delivered through existing resources. The Contracting and Procurement Officer group are working on a contract management guide.
- 10.2 The requirement for Parent Company Guarantees and Performance Bonds (as referenced in 8.4) needs to be proportionate, as they are likely to lead to increased costs for the contractor which will be passed on to the Council through an increased contract price.
- 10.3 As part of the need to make savings, Contract Managers continue to seek better value for money from our contractors. Contractors will try to be more efficient and also may reduce their profit margin to be able to win contracts. Effective procurement and contract management will mean that we look to pass on the risks of delivering efficiencies on to the contractor. All of this combines to increase the risk of business failure.

11. RISK IMPLICATIONS

- 11.1 These are covered in the body of the report. This report is focused on balancing the risk of supplier failure with the costs of monitoring.

12. EQUALITIES IMPLICATIONS

- 12.1 The Equality Act 2010 came into force on the 1st October 2010, a major piece of legislation. The Act also created a new Public Sector Equality Duty, which came into force on the 5th April 2011. There is a General duty, described in 12.2, that public bodies must meet, underpinned by more specific duties which are designed to help meet them.

- 12.2 In line with the Public Sector Equality Duty, public bodies must, in the exercise of its functions, give **due regard** to the need to eliminate discrimination, harassment, victimisation, to advance equality of opportunity and foster good relations between those who share a protected characteristic and those who do not.
- 12.3 Contract and procurement legislation requires equality during the contracting and decision process, as well as setting a requirement for contractors to deliver on equality during the provision of the contract.

13. SOCIAL VALUE IMPLICATIONS

- 13.1 As the recommendations made in this report do not constitute a public service contract, the measurement of 'social value' as required by the Public Services (Social Value) Act 2012 need not be applied, although equalities implications and opportunities are identified in the relevant section at paragraph 12.
- 13.2 Contract regulations include provisions for ensuring that social value requirements are met.

14. HUMAN RESOURCE IMPLICATIONS

- 14.1 There are no direct Human Resource implications arising from this report

15. APPENDICES

- 15.1 Appendix A – Audit report - Ongoing Financial and Operational Viability of Contractors, issued November 2015.

16. CONTACT OFFICERS

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17. BACKGROUND PAPERS

- 17.1 None.