

# Pecyn Dogfennau Cyhoeddus

## Pwyllgor Archwilio

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Man Cyfarfod  
**Ystafell Bwyllgor A - Neuadd y Sir,  
Llandrindod, Powys**

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Dyddiad y Cyfarfod  
**Dydd Mercher, 7 Awst 2019**

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Amser y Cyfarfod  
**10.00 am**

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Neuadd Y Sir  
Llandrindod  
Powys  
LD1 5LG

I gael rhagor o wybodaeth cysylltwch â  
**Lisa Richards**  
01597 826371  
lisa.richards@powys.gov.uk

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Mae croeso i'r rhai sy'n cymryd rhan ddefnyddio'r Gymraeg. Os hoffech chi siarad Cymraeg yn y cyfarfod, gofynnwn i chi roi gwybod i ni erbyn hanner dydd ddau ddiwrnod cyn y cyfarfod

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### AGENDA

<b>1.</b>	<b>YMDDIHEURIADAU</b>
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Derbyn ymddiheuriadau am absenoldeb.

<b>2.</b>	<b>DATGANIADAU O DDIDDORDEB</b>
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Derbyn datganiadau o ddiddordeb gan Aelodau.

<b>3.</b>	<b>DATGANIAD O CHWIPIAU PLAID</b>
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Derbyn datganiadau ynglyn â gwaharddiad chwip plaid a gyflwynwyd i Aelod mewn perthynas â'r cyfarfod yn unol ag Adran 78 (3) Mesur Llywodraeth Leol 2001.

(D.S: atgoffir yr Aelodau, dan Adran 78, na all Aelodau sydd wedi derbyn gwaharddiad chwip plaid bleidleisio ar fater gerbron y Pwyllgor.

<b>4.</b>	<b>COFNODION</b>
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Awdurdodi'r Cadeirydd i lofnodi cofnodion y cyfarfod blaenorol.  
(Tudalennau 1 - 2)

<b>5.</b>	<b>PROSES AU CAFFAEL</b>
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Ystyried prosesau caffael gan gyfeirio'n benodol at Dawnus a Jistcourt.  
(Tudalennau 3 - 78)

<b>6.</b>	<b>RHAGLEN WAITH</b>
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Ystyried y blaenraglen waith ac os dylid cynnwys unrhyw eitemau ychwanegol.  
(Tudalennau 79 - 80)

**MINUTES OF A MEETING OF THE AUDIT COMMITTEE HELD AT COMMITTEE ROOM A - COUNTY HALL, LLANDRINDOD WELLS, POWYS ON THURSDAY, 16 MAY 2019**

**PRESENT**

County Councillors JG Morris (Chair), M J Jones, K Laurie-Parry, K Lewis, N Morrison, WD Powell, D A Thomas, R G Thomas, T J Van-Rees, A Williams, J M Williams and R Williams and Mr J Brautigam

In attendance: None

Cabinet Portfolio Holders In Attendance: None

Officers: Wyn Richards, Scrutiny Manager and Lisa Richards, Scrutiny Officer

Other Officers In Attendance: None

<b>1.</b>	<b>ELECTION OF CHAIR</b>
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**RESOLVED** that County Councillor J G Morris be elected Chair for the ensuing year.

<b>2.</b>	<b>ELECTION OF VICE CHAIR</b>
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**RESOLVED** that Mr J Brautigam be elected Vice Chair for the ensuing year.

<b>3.</b>	<b>APOLOGIES</b>
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There were no apologies for absence.

<b>4.</b>	<b>INTERNAL AUDIT WORKING GROUP</b>
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**RESOLVED** that County Councillors J G Morris, W D Powell, R G Thomas, A Williams and Mr J Brautigam be elected to the Internal Audit Working Group.

**County Councillor JG Morris (Chair)**

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# Dawnus Chronology<sup>5</sup>

<b>SEWSCAP Framework run by RCT &amp; later Cardiff commenced</b>	May 2015
<b>Mini competition using Constructionline</b>	Through 2015/16
<b>Dawnus 2014 accounts published</b>	21 <sup>st</sup> Oct 2015
Cash £7.0m      Net assets £1.0m	
<b>Dawnus 2015 accounts published</b>	1 <sup>st</sup> Oct 2016
Cash £4,8      Net assets £11.1m	
<b>Debentures issued to HSBC 13 &amp; 14 (incl. chattels mortgage)</b>	August 2017
<b>Dawnus 2016 accounts published</b>	3rd Oct 2017
Cash £8.1m      Net assets £5.9m	
<b>Dawnus Year end 2017.</b>	31 <sup>st</sup> Dec 2017
<b>Internal PCC financial analysis</b>	Feb 2017
<b>Issue of further Debentures to HSBC and WG</b>	
15, 16, 17, 18, 19, 20.	16 <sup>th</sup> & 27 <sup>th</sup> March 2018
<b>Dawnus 2017 accounts passed by their board</b>	27 <sup>th</sup> June 2018
Cash £0      Net assets £11.1	
Sometime between Jan and June 2017 accounts adjusted – reduced turnover and profit to loss	
<b>Partly or wholly released from charge</b>	
Debentures 13 – 20 incl.	2 <sup>nd</sup> July 2018
<b>School contracts signed</b>	July 2018
<b>Dawnus 2017 Accounts published at Companies House</b>	24 <sup>th</sup> Sept 2018
<b>Appointment of Administrator</b>	April 2019

Mae'r dudalen hon wedi'i gadael yn wag yn fwriadol

## **Dawnus Questions**

### **Background**

The procurement of all 21<sup>st</sup> Century Schools is undertaken through the South East Wales 21<sup>st</sup> Century Schools Construction Framework (SEWSCAP). The framework is a collaboration between 15 local authorities (and other public sector organisations in Wales) and though initially established in the South the benefits of its use were clear to Powys who have been utilising it for their schools for as long 6-8 years.

The framework includes for value lots with multiple contractors under each lot which are determined by value so that contractors and smaller contractors can apply for membership on the framework on a competitive basis to accord with their size and capability.

At the point of framework procurement all the terms and conditions of contract are set and agreed as are the policy requirements determined by Welsh legislation, or Welsh Government requirements under grant conditions. The framework is also a skills academy as determined and monitored by the construction Industry Training Board which requires each partner to sign up and deliver requirements such as apprenticeships, work experience, work with colleges and schools. This would include appropriate clauses for Community benefits local sourcing and (now) code of practice for ethical employment in the supply chain.

The usual prequalification checks including financial experience and capability are undertaken at the point of procurement of the framework but thereafter each authority is encouraged to undertake their own due diligence of companies bidding for their contracts at the point of this procurement. The companies are all experienced school construction companies and includes a mix of small medium and large contractors across the lots.

Each value lot includes multiple contractors which allows each local authority to undertake their own competitive 'mini-competition'. And to undertake the necessary due diligence at that point

### **Answers to Questions**

#### **An internal assessment of Dawnus finances was commissioned in February 2018 - why?**

This was undertaken as part of the normal procurement process and due diligence prior to the award of any contract to any contractors and in this case prior to a stage 1 design contract for Bro Hyddgen school in Machynlleth. Tender value £14.4m, at that stage we were only contracting for the stage 1 element of the contract which is essentially professional services elements (Design/ Costing Planning etc)

#### **When did this work commence and when did it finish? Was a report submitted?**

The assessment was undertaken at the point of procurement during the evaluation stage, it was undertaken diligently so that the evaluation process for the technical stage could be undertaken.

A tender report was produced upon award of this stage 1 of the design and build tender and signed off by Gareth Jones prior to awarding the tender.

For information, the schools are tendered on a 2-stage design and build contract. Stage 1 (design) contract is awarded shortly after award of the tender with Stage 2 (build) awarded once the designs are complete and costs agreed.

Appraisal Information and was completed on 15<sup>th</sup> February 2018

Date of Report – 26<sup>th</sup> March 2018

Date of issue of intention to award letters (commencement of the standstill period) – 26<sup>th</sup> March 2018

Date of Award – 6<sup>th</sup> April 2018

**Were the terms of reference for this assessment confined to Dawnus Construction or was the wider Group also considered?**

In February 2018 the assessment was confined to Construction Holding only

These requirements are set with the prequalification criteria and applied to all contractors bidding for school tender.

Further group accounts were assessed in July 2018 prior to the award of the second stage of the contractor at Salop Road Welshpool. The holding and the group were considered and assessed at this time.

Rumours began to emerge around the financial position of Dawnus, at this point the group accounts for 2017 and construction accounts for 2017 were requested and assessed to add to the 2016 assessment carried out previously. The issues were brought to David Powell's attention prior to the award of the £7.7m stage 2 (build) contract for Salop Road. Further information was requested by way of 1<sup>st</sup> quarter management accounts for both the Group and Construction arm and were assessed prior to David Powell agreeing to continue with the award of stage 2 for Salop Road.

**What if any tailored systems/software do you use and what data is required?**

**To which years did the data inputted apply?**

Financial Appraisals are carried out using our own design spreadsheet assessment tool which is populated with relevant information accounts from the contractors to provide an understanding of the financial position of the company(s). The assessment is largely based on the usual standard accounting ratios and is in line with the credit companies approach.

February 2018 assessment was based on the accounts for 31<sup>st</sup> December 2016 and 2015

The July 2018 assessment included the 31<sup>st</sup> December 2017 accounts

**Were you made aware of the changes to the accounts reducing turnover and profits that was made to the accounts of Dawnus Construction according to the Chairman's report after year end but before their publication in June? Given this change which version of the unpublished information on 2017 accounts was provided and for what companies?**

We weren't aware of the changes but the Council did appraise the latest accounts which would have encompassed any previous changes.

In July 2018 when the 2017 accounts were available the Council considered the Group and the holding companies accounts. These were the latest edition (June publication) of the accounts and signed off by their Board.



**In particular were you aware of the closing (Dec 2017) cash, debtors and creditors values for Dawnus Construction, published final version? If so, what other information led you to give approval to their suitability for the schools contracts? If not, was it requested?**

The July 2018 appraisal undertaken was based on the December 2017 figures, Despite the changes in some of the figures the overall appraisal result was still satisfactory albeit with a reduced maximum contract value

**Companies House data shows that a chattels mortgage was issued to Dawnus Construction in August 2017. Were you aware of this and did it play any part in your assessment? If not, why not?**

The Council would not be aware of this particular borrowing. However all borrowings listed in the companies accounts form part of the appraisal and the July 2018 appraisal was based on 2017 account and the borrowing in August 2017 would have been included in these accounts.

**The Portfolio holder for finance has said that the first quarter management accounts was also examined. Were these figures for Dawnus Construction or other parts or all of the Dawnus Group? What aspects of the accounts were covered by these figures?**

In July 2018 we received management account for the first quarter 2018 for the Dawnus Construction Holding Company. A profit and loss account and a balance sheet were provided.

**Several further secured loans were given to Dawnus Construction in March 2018, including a chattels mortgage on behalf of the Wales government. This is within Q1 were you made aware of this by Dawnus.**

No

**Were you aware that the Wales Government had also issued a secured loan to Dawnus International at the same time.**

We were not made aware of this.

**If you were aware of the loans, were you also aware of the repayment arrangements apparently agreed with the Welsh Government (as implied in their response to Russell George Q3) which entailed the sale of much of their equipment and other assets in June.**

The Council was not made aware of such loans.

**All of these loans were registered at Companies House. Were Dawnus companies put on a tracker on the CH website? If not, why not? Is such a precaution not standard practice?**

The Council did not have a tracker on Dawnus via companies house. In February 2018 and July 2018 we have appraised their accounts and there was not a significant concern which would lead us to place a tracker on the company. The Council understood also that Welsh Government were financially supporting the company though we were not aware what form that was.

Mae'r dudalen hon wedi'i gadael yn wag yn fwriadol

## Vetting Prior to Procurement

We have agreed that the purpose of the special August meeting of the audit committee would be to appraise the vetting procedures and methods used in order to identify any weaknesses and propose potential improvements. That said, we cannot ignore the fact that there have been two significant apparent failures – Dawnus and Jistcourt. In both cases we do not know if it was a failure or shortcoming of the system used or of the data inputted into it. As you know we have already put some questions to officers specific to the Dawnus failure but the answers received raise further questions, (I have attached a copy of their response for your convenience). Putting these together with further questions arising from the Jistcourt situation, I think the meeting should explore the following and I think it would be fair and constructive to give the service advance notice of our challenge.

- Dawnus

The vetting for Dawnus commenced in Feb 2018 prior to awarding the stage 1 contract for Bro Hyddgen school. The work was completed in February, report produced at the end of March and contract awarded in April. That assessment was made using the Dawnus Construction Holdings accounts for 2015 & 2016. There would have been no reason to reject the tender using that data. The response states that rumours about Dawnus viability reached the council in or just prior to July 2018 *'at this point the group accounts for 2017 and construction accounts for 2017 were requested and assessed to add to the 2016 assessment carried out previously.'*

The 2017 accounts reflect the fact that at the end of that year Dawnus had involved consultants, its banks and the Welsh Government to advise and assist in their cash flow problems. Those accounts show a bank balance of zero, creditors at £52m (some 24 weeks of cost of sales) and an apparently liquid position maintained by an equally massive £58m of debtors – much of which a recent report from the administrator appears to have been overvalued. We will need to establish:

- How the spreadsheet dealt with the extra year (2017) - the response states that it was 'included'.
- Why such dismal figures when taken in isolation were apparently mitigated by the Q1 results requested and submitted also in July, there were, after all, rumours which should have prompted extra vigilance. We need to see those figures before the meeting, not the least because the bank and WG loans were made in that quarter.
- By what criteria, to quote the 26<sup>th</sup> March report from the portfolioholder, did the assessment of the 2017 and 2018 (Q1) accounts show 'good financial health with just a small reduction in the maximum contract value'.
- The Chattels mortgage taken out in 2017 was relatively small, however, the security for the March 2018 loans at some £7m were significant and should have been declared. I have not yet had a response on the issue of obligatory disclosure clauses.

- Jistcourt

There is very little information available on Jistcourt. The latest accounts registered at Companies House is for the year ending 30<sup>th</sup> June 2017. The accounts for the 2018 year are overdue. However, the records do show that two secured loans were taken out by the company one in 2016 from Finance Wales and another from the Development Bank of

Wales in September 2018. The latter was at 9% presumably recognising the high risk to the loan. In a section of the directors report titled 'Going Concern' various current liabilities were discussed totalling £1.6m, the relevant paragraph ends:

*The majority shareholder has provided a letter of support confirming that they will, if necessary, waive further repayments and/or support to the Group to assist the working capital of the Group for a period of no less than 12 months from the date of signing of these accounts.*

That period would have ended in March 2019. On that basis the directors felt able to adopt the going concern basis in preparing the financial statements.

Also shown is the resignation of the finance director and contracts director replaced, it would appear by family members. Also, somewhat curiously the financial year was shortened from the 30<sup>th</sup> June to 29<sup>th</sup> June! We therefore need, preferably before the meeting:

- an account of the data received for Jistcourt similar to that supplied for Dawnus.
  - The circumstances surrounding the award of the contract without the bond being in place.
- General

I am totally mystified that investigation of Companies House records which include details of accounts, charges and directors is not an integral part of the due diligence vetting process. The last paragraph of the Dawnus note give me particular concern:

*The Council did not have a tracker on Dawnus via companies house. In February 2018 and July 2018 we have appraised their accounts and there was not a significant concern which would lead us to place a tracker on the company. The Council understood also that Welsh Government were financially supporting the company though we were not aware what form that was.*

In July 2018 officers had heard rumours of financial problems, also they were aware of the WG support, surely, in those circumstances, every information channel should be explored.

We shall also have to understand:

- The calculations made by the spreadsheet tool in order to assess its limitations since, on the face of it, some rather curious results have emerged particularly in the case of Dawnus. In particular, how the maximum contract value is calculated.
- The role of the SEWSCAP2 framework manager and why, given his responsibility to ensure that contractors continue to meet framework standards, no warnings were apparently received.
- The timing and scope of the Constructionline investigation.

Your comments, additions/deletions would be appreciated.

John



Mae'r dudalen hon wedi'i gadael yn wag yn fwriadol

**CYNGOR SIR POWYS COUNTY COUNCIL**

**AUDIT COMMITTEE**

**7<sup>th</sup> August 2019**

**REPORT AUTHOR: Jane Thomas, Head of Financial Services**

**SUBJECT: Undertaking Economic and Financial Standing (EFS)  
Procedures in Procurement**

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**REPORT FOR: Information**

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**1 Purpose**

- 1.1 The purpose of this report is to provide additional details to Audit Committee of the Economic and Financial Standing Assessments that were undertaken for Dawnus Ltd and Jistcourt Ltd which led to the awards of contracts for schools and Housing projects for the Council

**2 Introduction**

- 2.1 The reports seeks to show how the EFS procedures are undertaken in general together some specific elements related to the construction projects for schools and housing and also some shortcomings of any process applied to these assessments. Responses have also been provided at the end of the report have been provided to the specific questions raised by Audit Committee (Appendix 1) .

**3 Economic and Financial Standing Assessments**

- 3.1 Economic and Financial standing assessments as a principle is a process to a assess bidder's ability and capacity to undertake a contract alongside other criteria obtained as part of any procurement.
- 3.2 The criteria and information we assess against has to be specified upfront in any process and the Council will be unable to change or vary the criteria once bids or prequalification data is received. The questions asked and the evaluation criteria from recent tenders are included as Appendix 4
- 3.3 All assessments of bidders must be fair, proportionate, contract specific, flexible and not be overly risk averse whilst ensuring protection of public money and compliance with procurement law. The assessment should also avoid discrimination of small and medium enterprises.
- 3.4 The assessment is considered as part of the overall selection criteria. It may not on its own reflect a bidder's ability to deliver and other criteria should be considered including references from other clients, value of contracts currently undertaken, track

record and the type of organisations bidding (e.g whether part of a wider group of companies)

- 3.5 The public announcement of a change in circumstances may also be relevant for consideration. For instance in the case of Jistcourt Ltd, in May this year they announced that they were opening an office in Bristol because of their expansion plans which if considered alongside the specified assessment would give a more rounded picture of the current operation and direction of the company
- 3.6 The assessment is carried out for any major or high risk contracts by the Council by its financial team utilising criteria they have provided and have published in tender or prequalification documentation and this may also require companies to produce further information to support their accounts.
- 3.7 The set criteria have been utilised on many occasions and for many of Powys's contracts.
- 3.8 The EFS process is recognised to have some shortcomings. For example, information on a bidder's profitability, cash flow, liquidity and solvency and therefore its EFS and capacity can change. Financial assessments are also dependant on backward facing information which even in a period of downturn can subsequently (and quickly) improve or deteriorate without any client visibility and is very difficult to monitor until subsequent published information is available. The recommendations below are some consideration which may be possible to implement for any future high risk project.
- 3.9 Prequalification processes are undertaken for any procurement before tenders are issued or alongside or at the same time as a tender process. The prequalification envelope includes mandatory criteria (such as criminal offences, fraud etc) which are pass fail type criteria, technical and capability criteria and financial criteria including insurances and financial standing of the companies concerned. If a company fails on any mandatory question or fails on the financial then the companies will not be invited to the second stage unless further mitigation is provided. This was not the case for either Dawnus or Jistcourt at the time of assessments.
- 3.10 The process applied are in accordance with usual prequalification processes and in accordance with Welsh Government supplier qualification questions (SQUID) guidance used by many other public sector buying organisations in Wales.
- 3.11 The SEWSCAP framework which operated on behalf of 15 local authorities in Wales and provides a flexible framework for appointment of school contractors according to the value of each school. It provides for a speedy means of engaging contractors in accordance with our specific requirements and important contractual terms and conditions, some elements of pricing added value and community benefits have already been agreed. The way the SEWSCAP2 framework operated for financial vetting was that the financial checks were undertaken when appointments were first made to the framework but local authorities were expected to undertake their own due diligence/ prequalification at the point of any subsequent mini-competition for a project build. This has and was undertaken by Powys Council and because the procurement and construction process were two stage for Schools (stage 1 design development and costing, stage 2 Construction) the due diligence undertaken again before the construction element of the contract was commenced and after design had been undertaken. There was some anecdotal and rumour that there were issues at Dawnus but no information available publicly and the SEWSCAP team were also unaware of any difficulties.



- 3.12 The full financial assessment was also carried out for the Bowling Green Contract
- 3.13 Performance Bonds are a useful tool and obtained at contract award for an agreed percentage of the total contract, They provide some compensation if the supplier proven to have defaulted and some incentive for suppliers to ensure they carryout the contract efficiently and on time and an additional incentive on the supplier to perform well. However they are not obtained until contracts have been awarded and required within 7 to 14 days of award. The Bond market however in some case is requiring contractors to demonstrate a competed construction contract before providing the bond

#### **4 Considerations and Recommendations**

- 4.1 A new Policy Guidance Note has been issued by the government 'Assessing the Economic and Financial Standing of Suppliers' (Appendix 2) which will be used to review current practice and approach for the Council
- 4.2 As a result of the experiences in these two incidents the Council will be considering whether to include ongoing monitoring processes for all of its major or high risk contracts. This is not currently undertaken at present and requires access to forward information and predictions if available as well as ongoing published result as anniversary of publications occur. This is most likely best delivered via and electronic portal via a specialist provider such as Dunn and Bradstreet or Equifax.
- 4.3 Finance and Commercial Services are currently reviewing whether any market and company health analytic companies or providers who are able to electronically monitor changes or financial distress events, can provide these services to the Council. and provide alerts to the Council so that it can make decisions or put in place appropriate mitigation.
- 4.4 The Council will be considering whether it can include terms in its contract which may require providers to provide annual confirmation of compliance and notify the Council of any defined changes classed as financial distress factors (which would need to be specified) and consideration of the use of other tools and sureties to provide assurances to the Council on the financial health of all of its key suppliers.
- 5 The Council may also need to review it procurement documentation to ensure that any changes to the approaches are incorporated into pass/ fail mechanisms within documentation.

<b>Recommendation:</b>	<b>Reason for Recommendation:</b>
<b>That Audit Committee notes the contents of the report.</b>	<b>To review the process for Economic and Financial Standing Assessment to provide the necessary assurance that new providers and current strategic/major suppliers have the financial Health to deliver its services and projects</b>

Contact Officer Name:	Tel:	Email:
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## Responses to the Specific Questions Raised

### Question 1

- *Dawnus*

*The vetting for Dawnus commenced in Feb 2018 prior to awarding the stage 1 contract for Bro Hyddgen school. The work was completed in February, report produced at the end of March and contract awarded in April. That assessment was made using the Dawnus Construction Holdings accounts for 2015 & 2016. There would have been no reason to reject the tender using that data. The response states that rumours about Dawnus viability reached the council in or just prior to July 2018 ‘at this point the group accounts for 2017 and construction accounts for 2017 were requested and assessed to add to the 2016 assessment carried out previously.’*

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- *How the spreadsheet dealt with the extra year (2017) - the response states that it was ‘included’.*
- *Why such dismal figures when taken in isolation were apparently mitigated by the Q1 results requested and submitted also in July, there were, after all, rumours which should have prompted extra vigilance. We need to see those figures before the meeting, not the least because the bank and WG loans were made in that quarter.*
- *By what criteria, to quote the 26<sup>th</sup> March report from the portfolio holder, did the assessment of the 2017 and 2018 (Q1) accounts show ‘good financial health with just a small reduction in the maximum contract value’.*
- *The Chattels mortgage taken out in 2017 was relatively small, however, the security for the March 2018 loans at some £7m were significant and should have been declared. I have not yet had a response on the issue of obligatory disclosure clauses.*

### Response

Further response will be tabled prior to or at the Audit Committee

### Question 2

- *Jistcourt*

*There is very little information available on Jistcourt. The latest accounts registered at Companies House is for the year ending 30<sup>th</sup> June 2017. The*

accounts for the 2018 year are overdue. However, the records do show that two secured loans were taken out by the company one in 2016 from Finance Wales and another from the Development Bank of Wales in September 2018. The latter was at 9% presumably recognising the high risk to the loan. In a section of the directors' report titled 'Going Concern' various current liabilities were discussed totalling £1.6m, the relevant paragraph ends:

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- *an account of the data received for Jistcourt similar to that supplied for Dawnus.*

The tender process required bidders to be Constructionline registered with assessed work categories and category notation values relevant to the value of the contract. The Council reserved the right to request company accounts and to carry out a credit check and further financial analysis.

Jistcourt passed the requirement for both Constructionline work categories and notation values in excess of that required for the contract. As final due diligence prior to award, the Council requested their latest audited full accounts for year ending June 2018. The bidder was unable to provide audited accounts at this time due to the accounts being with the auditors, but were able to provide unaudited accounts. The resulting financial assessment of the 2 years worth of information available from these accounts resulted in the following assessment:

Financial Health - Strong  
Risk of Failure – Higher than average risk  
Maximum Contract Amount - £4.1 million

Following this assessment meetings advice was sought from senior managers on whether or not to proceed with the award of the contract. Following discussions, the award was agreed based on the following:

- The project was being ran under the Welsh Government's Innovative Housing Programme. The

Bowling Green had been designed on this basis and had a grant award of approximately £2 million. The grant terms stated that award was on the basis of entering into contract by the end of March 2019. Not awarding to the contractor would have meant losing this award, and potentially jeopardising the viability of the scheme.

- Unlike the contracts with Dawnus, where the contractor had been responsible for the initial designs, as well as construction, on the Bowling Green the designs had been developed by architects commissioned by the Council. It was seen that in the case of the contractor going into insolvency, it would be a more simple process to appoint a contractor to complete the construction of the building.
- The contract included for a performance bond of 10% of the total build cost, valued at £3.5 million. This was seen to give adequate protection to the Council in the event of the contractor going into administration.
- The contractor would be requested to put a Project Bank Account in place to give protection to local subcontractors in the event of the contractor becoming insolvent.

On the basis of the above points, senior managers agreed to proceed with the award of the contract to Jistcourt (South Wales) Ltd.

### *Question 3*

*The circumstances surrounding the award of the contract without the bond being in place.*

The Employers Requirements documents stated a requirement for a Bond of 10% of total contract value. It was very clear in the documentation that a Bond was expected to be put in place with the contract award, during the 12-week lead in period to commencement. Contractors are unable to obtain a bond until after a contract is awarded and in some cases until the Construction contract has been completed. There was a dependency on awarding the contract, securing the site and make a meaningful start on site to secure a £2million grant from Welsh Government. Following award the Contractor did not produce the Bond and was in breach of its obligations. They were continuing to assure the Council that the Bond would be put in place. They were aware that they could not submit any Applications for Payment until the Bond was provided. No Applications were received by the Council and no payments were made.

#### Question 4

##### General

*I am totally mystified that investigation of Companies House records which include details of accounts, charges and directors is not an integral part of the due diligence vetting process. The last paragraph of the Dawnus note give me particular concern:*

The Council did not have a tracker on Dawnus via companies house. In February 2018 and July 2018 we have appraised their accounts and there was not a significant concern which would lead us to place a tracker on the company. The Council understood also that Welsh Government were financially supporting the company though we were not aware what form that was.

#### Question 5

*In July 2018 officers had heard rumours of financial problems, also they were aware of the WG support, surely, in those circumstances, every information channel should be explored.*

*We shall also have to understand:*

*The calculations made by the spreadsheet tool in order to assess its limitations since, on the face of it, some rather curious results have emerged particularly in the case of Dawnus. In particular, how the maximum contract value is calculated.*

**Please see Appendix to follow**

#### Question 6

*The role of the SEWSCAP2 framework manager and why, given his responsibility to ensure that contractors continue to meet framework standards, no warnings were apparently received.*

*Was it SEWSCAP's responsibility to do ongoing checks?*

The framework managers undertake these checks at the point of appointment of the companies to the framework. For the SEWSCAP2 Framework. Authorities are advised to undertake their own due diligence and prequalification checks at the time of undertaking a mini competitions for a specific project. This was undertaken for Dawnus in accordance with previous information.

However we understand that under the new SEWSCAP3 the Framework Management will be providing this service and have the facility to undertake annual checks with 6 monthly checks on management accounts.

## Question 7

*The timing and scope of the Constructionline investigation.*

Carried out during the evaluation process, as part of the Qualification Assessment as a pass/fail.

The scope includes the Work Categories and Category Notation Values relevant to that which the contractors are being assessed against. For example, building schools and colleges, social housing. The Notation Values are calculated by looking at a contractor's financial ability and established track record for successfully delivering contracts in each work category to a certain value. This brings together the last reported annual turnover, net assets, and the average value of references obtained.

ASSESSING AND MONITORING THE ECONOMIC AND FINANCIAL STANDING OF  
SUPPLIERS - Government Policy Paper



**FINANCIAL AND ECONOMIC INFORMATION REQUESTED AT PREQUALIFICATION  
AND TENDER STAGE AND EVALIATION PROCESS**

**REVIEW INFORMATION OF JISTCOURT FINANCIAL STANDING (*COMMERCIALY  
CONFIDENTIAL INFORMATION REDACTED*)**



Government  
Commercial  
Function

# ASSESSING AND MONITORING THE ECONOMIC AND FINANCIAL STANDING OF SUPPLIERS

Guidance Note

July 2019

Tudalen 25



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# 1. Introduction

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## 1.1. Issue

- 1.1.1 Assessing and monitoring the economic and financial standing (EFS) of suppliers is about understanding the financial capacity of suppliers to perform a contract in order to safeguard the delivery of public services.
- 1.1.2 This Guidance Note provides advice on how to:
- assess the EFS of bidders during a procurement;
  - mitigate financial risks arising from the EFS of a bidder or changes to such standing; and
  - monitor the ongoing EFS of suppliers during the life of a contract.
- 1.1.3 The EFS of suppliers also forms part of maintaining a healthy market. This is explored separately in the [Outsourcing Playbook](#) as part of wider market and commercial strategy.

## 1.2. Dissemination

- 1.2.1 The contents of this Guidance Note are relevant to all Central Government Departments, their Executive Agencies and Non Departmental Public Bodies. Such bodies are asked to test this guidance over the next six months and feedback any comments or recommendations for improvement.

## 1.3. Timing and Scope

- 1.3.1 In due course this Guidance Note is expected to apply to all new procurements with an expected contract value exceeding the relevant public contracts regulation threshold. In applying the guidance however, bodies are likely to be asked to consider whether it is appropriate to their particular procurement and to adopt a 'Comply or Explain' approach.

## 1.4. Contact

- 1.4.1 Feedback on and enquiries about this Guidance Note should be directed to [project.santiago@cabinetoffice.gov.uk](mailto:project.santiago@cabinetoffice.gov.uk).



## 2. Assessing the Economic and Financial Standing of Bidders

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### 2.1. Background

- 2.1.1 There is a risk that a financially challenged supplier could adopt sub-optimal behaviours, fail to deliver aspects of a contract to a satisfactory standard, or fail to deliver a contract at all if it experiences financial distress or becomes insolvent. This could also occur as a result of financial challenge within a bidder's wider group or supply chain. A Contracting Authority may then incur additional time and cost in managing and re-procuring the contract or bringing it in-house, and any change of supplier may come at an increased price, particularly if short-term or interim arrangements are required. Poor delivery or failure may also have consequential effects, for example delays to the provision of important public works and/or risks to the quality and continuity of critical public services.
- 2.1.2 The purpose of assessing the EFS of bidders as part of a procurement is to assess their financial capacity to perform the contract.

### 2.2. Principles

- 2.2.1 All assessments of bidders' EFS should be proportionate, flexible, contract specific and not overly risk averse while ensuring protection of taxpayer value and safety and compliance with relevant procurement law.
- 2.2.2 All bidders, whatever their size and constitution, should be treated fairly and with appropriate diligence during the assessment of their EFS. No SMEs (Small and Medium sized Enterprises), public service mutuals or third sector organisations should be inadvertently disadvantaged.
- 2.2.3 EFS should only be considered as part of the overall selection criteria. It may not on its own reflect a bidder's ability to deliver.
- 2.2.4 Assessment of EFS must be transparent, objective and non-discriminatory. It should be based on a set of metrics and ratios appraised against pre-determined thresholds to provide a set of risk classifications for each bidder. Bidders should be able to see their risk classifications as they complete the financial assessment and, where relevant, given the opportunity to explain why different risk classifications may be more appropriate.

- 2.2.5 In many cases the assessment can be based on a standardised set of metrics and ratios. For certain contracts, however, additional or alternative metrics and ratios may be appropriate, in particular for procurements of more critical, complex works and services or for longer periods. Minimum financial thresholds should be appropriate and proportionate to the contract being procured.
- 2.2.6 The assessment of a bidder's EFS should be conducted by staff with a financial background, calling on specialist in-house or external expertise as necessary.
- 2.2.7 Suppliers' financial information may be available through the Supplier Registration Service (where it is being used to complete the Selection Questionnaire), which may reduce the burden on bidders and Contracting Authorities.

## 2.3. Financial testing

### ***Contract categorisation***

- 2.3.1 In order to determine what constitutes a proportionate assessment of EFS Contracting Authorities should, prior to commencing a procurement, determine the categorisation of the potential contract based upon its criticality. This should then drive the level of EFS required from bidders and any associated requirement for financial assessment subject matter expertise.
- 2.3.2 Cabinet Office has developed a [Contract Tiering Tool](#) to measure criticality. The Tool takes into account various criteria, including the potential impact of service failure, the speed and ease of switching suppliers and the contract value. Contracting Authorities should use this to categorise potential contracts between 'Gold' (most critical), 'Silver' and 'Bronze' (least critical) contracts. Contracting Authorities may also categorise other potential contracts as critical or 'Gold' contracts.
- 2.3.3 Once the potential contract has been categorised, it is then possible to determine the appropriate financial thresholds and level of financial analysis necessary. This Guidance Note provides advice on determining financial thresholds and adopts a 'tiering' approach to the financial analysis, depending on the categorisation of the potential contract.
- 2.3.4 Care should be taken when setting financial thresholds so as not to disadvantage SMEs (Small and Medium sized Enterprises) and the VCSE (Voluntary, Community and the Social Enterprise) sector. Thresholds should be proportionate to the requirement.

**Bronze contracts**

- 2.3.5 Bronze contracts are typically smaller, simpler contracts for non-critical works and services. In these cases it may be appropriate to carry out a more basic financial assessment.
- 2.3.6 As a starting point, Contracting Authorities may wish to use 'off-the-shelf' financial analyses and risk assessments from a credit scoring agency. Contracting Authorities should first set the credit score thresholds above which bidders are deemed to have sufficient EFS. As a minimum, this should be 25 for a Company Watch H score and 10 for a Dun & Bradstreet score. Where a bidder falls below the thresholds set, a more detailed assessment, including ratio analysis, should be undertaken; credit agency scores should not be used to exclude a bidder.

**Silver contracts**

- 2.3.7 Silver contracts are typically contracts for important but not critical works and services. In these cases a more detailed financial assessment is appropriate and minimum thresholds should be set accordingly.
- 2.3.8 This assessment should use the standard financial metrics and ratios set out in '*APPENDIX I – Standard Financial Ratios*' and the minimum thresholds in '*APPENDIX II – Interpreting standard financial metrics*'.

**Gold contracts**

- 2.3.9 Gold contracts are typically larger, longer contracts for complex or critical works and services. In these cases a very detailed financial assessment is appropriate; minimum thresholds should be set at the same level as for Silver contracts or higher.
- 2.3.10 The assessment should normally include as a minimum the standard financial metrics and ratios set out in '*APPENDIX I – Standard Financial Ratios*' and minimum thresholds in '*APPENDIX II – Interpreting standard financial metrics*'. Contracting Authorities should also consider whether to carry out additional analysis, for example the use of additional financial metrics, ratios and/or trend analysis. Contracting Authorities may also consider more demanding thresholds to be appropriate, taking into account the greater and/or more complex requirements of the contract.

**Decision tree**

- 2.3.11 A decision tree showing the route to determining the recommended approach to assessment of EFS is set out in '*APPENDIX III – Financial Assessment Flowcharts*'.

## 2.4. Demonstrating economic and financial standing

- 2.4.1 Proof of a bidder's EFS may be provided by one or more of the following<sup>1</sup>:
- appropriate statements from banks or, where appropriate, evidence of relevant professional risk indemnity insurance;
  - financial statements or extracts from the financial statements<sup>2</sup>, where appropriate (i.e. where publication of financial statements is required by law); and
  - a statement of the bidder's overall turnover and, where appropriate, of turnover in the area covered by the contract for a maximum of the last 3 financial years available.
- 2.4.2 Where these proofs are not appropriate in a particular case, the Contracting Authority may require the bidder to provide other information to prove its EFS.
- 2.4.3 Use of the information set out above to assess the EFS of the bidder is subject to various shortcomings. For example, information on a bidder's profitability, cash flow, liquidity and solvency (typically the most relevant criteria to assess EFS) is limited to historical and current information. Over time, however, a supplier's profitability, cash flow, liquidity and solvency and therefore its economic and financial capacity to deliver the contract can change.
- 2.4.4 It is therefore important that Contracting Authorities use the information available in such a way as to provide as accurate a picture as possible of the bidder's economic and financial capacity to deliver the contract.
- 2.4.5 When Contracting Authorities use financial metrics and ratios, they should set out bands for each metric or ratio at which a bidder would normally be classed high, medium or low risk. Bidders should be able to see their risk classifications as they complete their financial assessments and offer a written explanation as to why different risk classifications may be more appropriate. Examples of such explanations include but are not limited to:
- Improvements in a bidder's EFS due to the sale of a business or raising of additional capital since the last accounting reference date (but prior to the tender submission date);
  - Non-underlying charges or circumstances which are one-off in nature and not expected to repeat themselves; and
  - Adoption of new accounting policies.

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<sup>1</sup> Regulations 60 (6), (7) and (8), Public Contracts Regulations 2015

<sup>2</sup> Financial statements should be provided in English

- 2.4.6 A Contracting Authority should take such explanations into consideration in its assessment of a bidder's EFS. A Contracting Authority can share EFS assessments with another government body.
- 2.4.7 Where there has been a public announcement of an event or other change in circumstances affecting a bidder, a Contracting Authority may seek to calculate proforma ratios based on the event or change of circumstances. This should be considered in the light of circumstances at the time and would normally only be appropriate where updated figures are available from the bidder or a reputable independent source or can be estimated with reasonable certainty<sup>3</sup>. The Contracting Authority should explain how it has derived the proforma ratios and give a bidder the right to explain in writing why application of a different risk classification would be more appropriate before using the proforma ratios as a basis for its appraisal of EFS. Examples of changes in circumstances in which use of proforma ratios might be appropriate include but are not limited to:
- The announcement of an acquisition or a change of control;
  - The declaration or payment of large dividends or other distributions; and
  - Publicly announced interim or final results or profits warnings.
- 2.4.8 A Contracting Authority should specify in advance the thresholds at which it may eliminate a bidder from a procurement. Such thresholds may be linked to the risk rating on a single financial metric or ratio or to a combination of risk ratings across multiple financial metrics or metrics or ratios. Thresholds must be transparent, objective and proportionate to the requirement under procurement.
- 2.4.9 A Contracting Authority may allow bidders to proceed despite being classified overall as medium or high risk subject to agreeing a set of risk mitigations acceptable to the Contracting Authority. Such mitigations may include but should not be limited to:
- Enhanced contract management and financial monitoring procedures, which may include additional obligations or Financial Distress Events;
  - Restrictions on the bidder's business and/or its ability to make distributions or lend money to other group members if it wins the contract; or
  - The provision of a collateralised cash deposit, guarantee or performance bond.
- 2.4.10 A [Financial Viability Risk Assessment Tool](#) is available which can be completed by individual bidders. The model automatically calculates a series of financial ratios and, subject to the insertion of the desired individual ratios and thresholds, can generate potential risk bands by ratio for each bidder subject to override by the Contracting Authority as set out above. Input of information should be checked by the Contracting Authority back to the source material provided by the bidder.

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<sup>3</sup> *If an exact figure cannot be estimated but it can reasonably be ascertained to be above (or below) a particular amount and use of any figure above (or below) that amount would produce a similar outcome in the appraisal of EFS, the Authority may use that amount as the basis for the proforma.*

- 2.4.11 The bidder's EFS is assessed at the selection stage of a procurement but may be revisited if there are any concerns subsequently. It is good practice to monitor any changes to the EFS of bidders in the case of a long procurement.
- 2.4.12 In any event, immediately prior to contract award for Gold and Silver potential contracts, a Contracting Authority should confirm whether there has been any change to a bidder's EFS which would have resulted in its elimination if it had been known at the time of the original assessment. If such a change has occurred, a Contracting Authority should consider whether adequate risk mitigations (such as those set out in *Section 2.4 – 'Demonstrating economic and financial standing'* above) can be implemented. If the EFS of a winning bidder is considered to have deteriorated to such an extent as to pose an unacceptable risk to public services and/or public money, the contract should not be awarded to that bidder.

## 2.5. Financial information required from bidders

- 2.5.1 Contracting Authorities are encouraged to exercise flexibility when specifying the financial information they require from bidders.
- 2.5.2 Proof of a bidder's EFS should be in accordance with Public Contract Regulations 2015, Regulations 60(6) and (7). Standard information required from a bidder would normally comprise audited accounts for the past two years of trading (this may be extended to three years where the criticality of the potential contract requires use of trend analysis) and information on the structure and ownership of any group of which it is a member. Assessments should be based on the most recent audited accounts available even if these have not been filed. Bidders should be encouraged to provide narrative where appropriate to reduce the need for subsequent clarifications.
- 2.5.3 Where audited accounts are not available, other financial information that Contracting Authorities may use, in accordance with Regulation 60(7), to demonstrate a bidder's EFS includes but is not limited to:
- Parent or ultimate parent company audited accounts (if applicable);
  - Guarantees and bonds;
  - Bankers' statements and references;
  - Management accounts;
  - Financial projections (including cash flow forecasts) and order book pipeline;
  - Details and evidence of previous contracts, including contract values; and
  - Other evidence of capital availability.

- 2.5.4 Management accounts and financial projections should be supported at the minimum by written representations from the Boards and/or Chief Financial Officers of bidders and ideally by independent assurance. The acceptability of different forms of information and assurance will depend on the criticality of the potential contract; where the procurement is for a 'Gold' contract the appraisal should be supported by audited financial statements or independent support of the bidder's EFS.
- 2.5.5 A number of frequent bidders have registered with central information repositories such as the Supplier Registration Service. In order to reduce the burden on bidders, Contracting Authorities are encouraged to use central repositories, such as the Supplier Registration Service and Companies House, as sources of financial information on bidders. Contracting Authorities should check or seek confirmation from bidders, however, that the information is the most recent available and that it relates to the correct bidding entity, particularly in group situations.
- 2.5.6 Many companies have similar names or change their names. The standard Selection Questionnaire requires bidders to submit their company registration numbers (this may be from Companies House or an equivalent). You should check that the company registration number has been completed and if the bidder is a UK based company, check at Companies House that the number correlates to the company name that the bidder has provided.

## 2.6. Application to groups and guarantors

- 2.6.1 Where a bidder is a member of a group, it may benefit from the greater financial resources available to the group. Conversely, there is a risk that a parent could cause a bidding subsidiary to use its financial resources to support other members of the group or that the financial failure of another group member could trigger the financial failure of the potential supplier as a result of their inter-connectedness. As a result, where the procurement is for a Gold or Silver contract and the bidder is not the ultimate parent company<sup>4</sup> of the group, the bidder should ideally be supported by a guarantee from the ultimate parent company<sup>3</sup> of the group where this has sufficient EFS. At the selection stage a commitment from the ultimate parent company to provide such a guarantee if the bidder wins the procurement would normally be sufficient.
- 2.6.2 The assessment of the bidder's EFS should cover each of (a) the bidder and (b) any guarantor.

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<sup>4</sup> Unless the ultimate holding company acts as a pure investor and the bidder has no direct or indirect financial or other dependence on it in which case references to the ultimate parent company should be read as references to the highest parent company in the group which does not act as a pure investor.

## 2.7. Application to joint ventures and consortia

- 2.7.1 Where a Contracting Authority is considering a contract with a Joint Venture Company (JVC) or a Special Purpose Vehicle (SPV), which may have two or more major shareholders and which may not be adequately capitalised or have sufficient financial strength on its own to support the risks and obligations it will assume under the contract, the Contracting Authority should normally seek 'joint and several' guarantees from the major shareholders of the JVC or SPV. The purpose is to avoid a situation in which identified risks that the Contracting Authority has transferred to the supplier are effectively passed back to the Contracting Authority by virtue of the JVC or SPV having insufficient EFS on its own to support those risks. A commitment to provide such guarantees would normally be sufficient at selection stage.
- 2.7.2 If a Contracting Authority has accepted only 'proportionate' liability from each of the shareholders (i.e. 'several' rather than 'joint and several' guarantees), then it may not achieve full recovery if the JVC or SPV and one or more of the shareholders was to fail.
- 2.7.3 Similar considerations apply in the case of consortia. Where bidders rely on the EFS of specific consortium members within a bidding group, Contracting Authorities should normally seek joint and several guarantees from those particular members covering the liabilities of the entire bidding group; the assessment of EFS should then be based on those consortium members. A commitment to provide such guarantees would normally be sufficient at selection stage.

## 2.8. Application to key sub-contractors

- 2.8.1 In this paragraph, references to key sub-contractors means:
- (a) a sub-contractor that the bidder is relying on in order to meet the Contracting Authority's requirement for EFS; and/or
  - (b) a sub-contractor that the bidder proposes will deliver the whole or a substantial or critical part of the works or services.
- 2.8.2 The Cabinet Office standard Selection Questionnaire requires bidders to set out whether they will be using sub-contractors and to include the approximate percentage of the contractual obligations to be performed by each sub-contractor.
- 2.8.3 Where a bidder is relying on the financial status of a key sub-contractor in order to meet the requirement for EFS under a procurement, the Cabinet Office standard Selection Questionnaire requires Contracting Authorities to assess the EFS of that key sub-contractor in addition to the bidder. The bidder should also be required to prove to the Contracting Authority that it will have at its disposal the resources necessary, for example by producing a commitment by the key sub-contractor to that effect.



- 2.8.4 In addition, where a bidder is proposing to use key sub-contractors to deliver the whole or a substantial or critical part of the works or services under procurement, the Contracting Authority should also test the EFS of those key sub-contractors prior to contract award. The Contracting Authority should explain this, including how they will carry out the assessment, in the Selection Questionnaire or other procurement document. For example, the Contracting Authority may wish to apply the same tests, may adjust the thresholds pro-rata to represent the proportion of the works or services to be delivered by the key sub-contractor or may use a different test for key sub-contractors.
- 2.8.5 If the bidder is unable to demonstrate the EFS of a key sub-contractor, the Contracting Authority must require the bidder to replace the key sub-contractor.

## 2.9. Application to framework agreements and call-off agreements

- 2.9.1 Where a Contracting Authority is procuring a framework agreement, it should assess the EFS of bidders in a similar manner to the procurement of a standard contract. The Contracting Authority procuring the framework agreement should also monitor the ongoing EFS of suppliers on the framework agreement.
- 2.9.2 A Contracting Authority entering into a call off contract under a framework agreement should undertake its own financial assessment of the bidders' financial capacity to deliver against the requirements specific to the call-off contract.

## 2.10. Application to construction projects and other special cases

- 2.10.1 The financial assessment tests set out in this Guidance Note are designed to test the EFS of bidders at the selection stage of a procurement. They do not test the deliverability of bidders' proposed solutions which may need to be evaluated at the assessment stage. It is typical, in construction projects and other special cases, to ask bidders to provide financial models of their proposed solutions as part of their bids. The financial robustness of these models should then be tested in evaluating the deliverability of bidders' solutions. Such models could cover, for example, the amount of finance required, its sourcing and the ability to mitigate any adverse contingencies.

## 2.11. Use of credit ratings and credit scores

- 2.11.1 Credit ratings issued by major credit rating agencies (such as Moodys, Standard and Poors and Fitch) generally provide a good, but not infallible, indication of a bidder's EFS. A comparison of the credit ratings issued by different agencies is set out at Appendix IV; note in particular the difference between 'investment grade' and 'non-investment grade' (popularly known as junk). However, the cost of such ratings (which is paid by the companies being rated) means that they are generally limited to larger bidders.
- 2.11.2 Contracting Authorities should not use the lack of a credit rating or of a minimum credit rating as a reason to eliminate a bidder; other financial ratios should also be considered.
- 2.11.3 Credit ratings should be distinguished from the credit scores issued by credit scoring agencies such as Company Watch, Dun & Bradstreet and Experian. Credit scores are based on algorithms; while they provide a predictive indication, their usefulness is limited by their dependence on backwards-looking published financial information which can be out of date.

## 2.12. Support

- 2.12.1 Where they have questions or issues, Contracting Authorities are encouraged to consult with colleagues in the Complex Transactions Team ([cttbusinessoperations@cabinetoffice.gov.uk](mailto:cttbusinessoperations@cabinetoffice.gov.uk)) and/or Markets and Suppliers Team ([marketsandsuppliers@cabinetoffice.gov.uk](mailto:marketsandsuppliers@cabinetoffice.gov.uk)) in Cabinet Office and with other Contracting Authorities.

## 3. Mitigating Financial Risk

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### 3.1. Introduction

3.1.1 This section reviews ways to mitigate risks arising from a bidder's EFS which have been identified at the procurement stage. It also reviews ways to manage changes to a supplier's EFS which may occur over time during the life of the contract.

### 3.2. Insurance

3.2.1 **Employers' Liability Insurance** is generally required by law to cover employees and many insurers incorporate it into their business insurance policies.

3.2.2 **Public Liability Insurance** provides cover where a customer, contractor or member of the public is injured and the service provider is at fault. This is often combined with Employers' Liability Insurance.

3.2.3 **Professional Indemnity Insurance** is typically required to cover the provision of professional services such as financial services or IT consultancy. It may be required if advice is being provided to customers, if data belonging to a customer is being handled or the service provider is responsible for a customer's intellectual property.

3.2.4 **Levels of cover:** A Contracting Authority will typically wish to specify the level of insurance cover required; the Authority should therefore formulate its intentions before commencing a procurement.

3.2.5 A blanket approach to levels of cover should be avoided. The level of cover should be based on the risk inherent in the contract under procurement. Adopting a blanket approach can create unnecessary expense and friction for small businesses which do not trade regularly with the public sector.

3.2.6 Contracting Authorities should therefore be proportionate in their specification of insurance requirements having appropriate regard to the balance of risk and value for money in setting the level of cover required. Contracts should be considered on an individual basis.

3.2.7 Unless the employer is exempt, Employers' Liability Insurance minimum cover of £5m is fixed by law.

- 3.2.8 If at the bidder selection stage a bidder does not hold the level of insurance cover required, an undertaking to secure the cover if it should be awarded the contract should normally be sufficient. It is not necessary at the bidder selection stage to insist that the cover be in place.

### 3.3. Guarantees

- 3.3.1 Guarantees and bonds can be either performance or financial guarantees, or a hybrid of both. They only crystallise when a supplier has failed to perform or to pay a sum of money due to the Contracting Authority. As such, they provide a remedy once a supplier has failed to deliver the works or service rather than directly supporting performance of the contract.
- 3.3.2 Under a guarantee, another party (the guarantor) undertakes to fulfil the terms of the contract (a performance guarantee) and/or provide financial compensation to the Contracting Authority (a financial guarantee) if the contract is not fulfilled or a sum of money not paid.
- 3.3.3 Where a potential supplier's EFS appears lower than the thresholds required, Contracting Authorities should ask it to procure a guarantee from a guarantor with greater EFS or alternative means of support. It is important that any guarantor has adequate assets and is an entity of substance as a guarantee is only as good as the EFS of the entity providing it (see also *Section 2.6 'Application to groups and guarantors'* above). An assessment of the guarantor's EFS will need to be performed. Contracting Authorities should ensure that any guarantee will survive a change of control of the guarantor or that a mechanism exists to ensure that appropriate alternative arrangements are in place if necessary.
- 3.3.4 A guarantee can be provided by a member of the supplier's group or by a bank or insurance company. The latter would normally provide a financial guarantee where the guarantor agrees to indemnify the Contracting Authority against specific financial losses, liabilities and expenses incurred if the supplier defaults on its contractual obligations. These guarantees may be less advantageous, assuming the guarantor remains solvent, than a performance guarantee from the supplier's parent company or another company in the group which obliges the guarantor to perform the contract if the supplier fails to do so (which is what the Contracting Authority ultimately wants).

### 3.4. Bonds

- 3.4.1 The financial markets can provide a variety of alternative financial instruments to protect customers. Since these can be expensive and their cost is likely to be reflected in bidders' tenders, it is generally preferable to seek a parent company bond or guarantee first where this is available and credible.

- 3.4.2 A **performance bond** can provide some compensation if the supplier is proven to have defaulted on its obligations. It is usually provided at contract award, for an agreed percentage of the total contract value until its expiry date. A performance bond will not of itself ensure that contracts are carried out efficiently and to time, but it will be an additional incentive on the supplier to perform well.
- 3.4.3 **Conditional bonds** can usually only be called on (invoked) following a serious breach by the supplier (including becoming insolvent, which would normally allow the Contracting Authority to terminate the contract). These bonds provide a third-party incentive to the supplier not to default under a contract it has entered into. They also provide compensation to the Contracting Authority where there is a proven default. They may be required where there are identifiable risks of default by the supplier, subject to value for money considerations.
- 3.4.4 **On-demand bonds** include within their terms and conditions the trigger and mechanism for calling on them. These are expensive and therefore more onerous for the supplier; they should typically only be used for high risk and/or high value projects where the costs and/or consequences of default by the supplier are high. They can be called on at the sole discretion of the customer, i.e. there may be no need to establish that the contract has been breached; if the agreed conditions for calling are met, the payment must be made.
- 3.4.5 Contracting Authorities should seek professional advice on the best choice, use and drafting of bonds. In particular, they should be used proportionately; they are burdensome requirements for small value contracts and their costs are likely to be reflected in tenders. Performance bonds and sureties are often used in construction contracts where there is an active private market in the provision of such bonds and where performance can more easily be measured; they would not normally be used to support services contracts. Other common protection mechanisms used in construction projects include retention arrangements and project bank accounts.

## 3.5. Financial Distress Events

- 3.5.1 The Model Services Contract contains a set of standard Financial Distress Events or triggers. These should be included in all new critical and important contracts ('Gold' and 'Silver' contracts). Their purpose is to provide a Contracting Authority with an early warning signal of a supplier's possible future financial distress and give an Authority the time and opportunity to investigate and take further action if required.

- 3.5.2 The Model Services Contract also contains a list of Financial Distress Events based on the principal financial indicators or metrics used to assess bidders' EFS at the procurement stage. The more important of these metrics should normally be included in Gold and Silver contracts. Contracting Authorities should also consider whether to include any additional Financial Distress Events to reflect the particular circumstances of the requirement under procurement.
- 3.5.3 Financial Distress Events should generally be applied to each of (a) the supplier, (b) any guarantor, (c) any key sub-contractors and (d) 'monitored suppliers'. Monitored suppliers would normally be limited to key members of the supplier's group on which the supplier depends [financially or to provide a substantial or critical part of the works or services].
- 3.5.4 Suppliers of Gold and Silver contracts should be required to warrant to the Contracting Authority, on entering into a contract, that no Financial Distress Event or any matter which could cause a Financial Distress Event has occurred and/or is subsisting<sup>4</sup>. Standard wording is included in the Model Services Contract.
- 3.5.5 If a Financial Distress Event is triggered, a Contracting Authority should promptly discuss the position with the supplier. Subject to the detailed mechanism set out in the contract, where the supplier satisfies the Authority that it is a false alert and/or that it has the necessary plans in place to manage the situation, it is appropriate for the Authority not to pursue its full rights, subject to agreeing any enhanced monitoring or other conditions the Authority deems appropriate.
- 3.5.6 If a Contracting Authority remains concerned that the supplier could be entering financial distress, it should actively pursue the situation. See [Guidance on Corporate Financial Distress](#) for further assistance.

## 3.6. Other methods to mitigate financial risk

- 3.6.1 Risk mitigations should be proportionate to the risk identified and the inherent criticality of the contract.
- 3.6.2 **Contract management and monitoring procedures** should help ensure that contractual services are delivered in accordance with the terms and conditions of the contract. Active and thorough contract management is essential; monitoring reports provide the basis for deciding whether action should be taken if there is a specific performance issue. In many cases the contract will also contain specific financial (service credit) and non-financial (correction plan) remedies in the event of poor performance.

- 3.6.3 **Step-in rights** allow a Contracting Authority to take over some or all of a supplier's contractual obligations for a temporary period to rectify a problem (usually a major performance failure), after which control is returned to the supplier. A trigger could be where a failure by the supplier causes the Contracting Authority to be in breach of a statutory duty where the Contracting Authority has no option but to assume control of the service in order to remedy the statutory breach. A permanent replacement supplier cannot be appointed under these measures; that would require a fresh competition in accordance with applicable procurement law. The Model Services Contract contains standard step-in rights.
- 3.6.4 **Escrow arrangements** can be used, where appropriate, to protect critical software and technology assets. Escrow services are provided by neutral third party escrow and verification specialists. Risk is mitigated by ensuring the Contracting Authority has access to source code and other proprietary information needed to maintain technology should the service provider go out of business or fail to provide support. The trusted third party escrow specialist will securely hold the source code and release it under specific contractual conditions.
- 3.6.5 Whether an escrow arrangement is entered into and who bears the cost<sup>5</sup> is subject to agreement between the parties. Escrow arrangements should not be required for open source software since the source code would normally be provided with the software.
- 3.6.6 Suppliers of Gold (critical) contracts and certain other suppliers should be required to provide **resolution planning information** to allow Contracting Authorities to understand better the potential impact of a supplier's insolvency. This should enable Contracting Authorities to work more closely with suppliers to develop mitigations to protect short-term service continuity together with plans for the accelerated transfer of responsibility for service provision to protect longer-term service continuity. Further details are set out in [Resolution Planning guidance](#).

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<sup>5</sup> These arrangements normally attract charges/fees.

## 4. Monitoring the Economic and Financial Standing of Suppliers following Contract Award

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### 4.1. Background

- 4.1.1 The EFS of suppliers, and hence the risk of their financial failure, can deteriorate after procurement, either suddenly (for example because of the loss of a major contract) or over time. Where a supplier's EFS declines, there is often a heightened risk of a decline in performance under the contract. In the relatively rare case that a supplier becomes insolvent, there is a significant risk that services may be interrupted or terminated, whether because of a lack of liquidity to maintain them, loss of key staff or other reasons.
- 4.1.2 Early recognition of a supplier's declining EFS or the risk of its failure may help Contracting Authorities avert or be better prepared to deal with such under-performance or failure as it arises limiting the impact on potentially critical public works and services. Contracting Authorities should therefore monitor the EFS of their key suppliers.

### 4.2. Principles

- 4.2.1 Contracting Authorities should identify their key suppliers and monitor their EFS<sup>6</sup>.
- 4.2.2 Monitoring should reflect the criticality of the contract and, where appropriate, should cover not just the contractual Financial Distress Events (or their equivalent) but take a wider view of the supplier's business. The focus should primarily be on liquidity.
- 4.2.3 Where no Financial Distress Event has been notified, boards of suppliers of critical (Gold) contracts should provide formal annual confirmations that no Financial Distress Event or any matter which could cause a Financial Distress Event has occurred<sup>7</sup>.

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<sup>6</sup> The overall EFS of *Strategic Suppliers* to Government is monitored by the Cabinet Office Markets & Suppliers Team

<sup>7</sup> Standard wording is included in the Model Services Contract.



- 4.2.4 Where monitoring and follow-up suggests a raised level of concern, contract managers should ensure their contingency plans are up-to-date and consider whether any further action or enhanced monitoring is required.

### 4.3. Identifying and monitoring key suppliers

- 4.3.1 Contracting Authorities should identify their key contracts and suppliers using the [Contract Tiering Tool](#) which categorises contracts between ‘Gold’, ‘Silver’ and ‘Bronze’ based on their criticality. Key suppliers include all suppliers of critical (Gold) contracts or important (Silver) contracts. Contracting Authorities should also consider whether any other suppliers should also be regarded as key suppliers.
- 4.3.2 It can be difficult for Contract Managers involved in the day-to-day management and monitoring of service under a contract to stand back and appraise a supplier’s EFS; there is also a risk of ‘optimism bias’. Where practicable, an independent team or function should therefore undertake first level monitoring. Several Departments ask their Finance function to undertake this role.
- 4.3.3 The EFS of all suppliers of ‘Gold’ and ‘Silver’ contracts and any other key suppliers should be reviewed at least once per year. EFS should be a standing item on the agenda of supplier relationship meetings. Reviews should normally take place following publication of the supplier’s statutory accounts and, in the case of Gold contracts, receipt of the annual statement of compliance. In the case of publicly quoted suppliers interim reviews may also be appropriate following publication of interim results. Where the contract provides for more frequent (e.g. quarterly) testing of Financial Distress Events, the monitoring frequency should adopt the same pattern. Any key supplier considered to be at heightened risk of failure should be monitored more frequently.
- 4.3.4 Monitoring teams should establish ‘alert’ systems under which they are immediately informed, in respect of key suppliers, of:
- any stock exchange announcements (where suppliers are quoted);
  - press articles commenting on a supplier’s profitability or financial standing;
  - any movements in suppliers’ credit ratings (where suppliers have formal credit ratings); and
  - any drop in Dun & Bradstreet and/or Company Watch H scores below standard financial health levels (10 for D&B score and 25 for the H score).

- 4.3.5 The Markets & Suppliers Team in the Cabinet Office currently monitors the overall financial health of Strategic Suppliers to Government. Subject to observing any applicable confidentiality obligations, the Markets & Suppliers Team should regularly share information on the EFS of Strategic Suppliers with the relevant Contracting Authorities. For their part, Contracting Authorities should liaise closely with the Markets & Suppliers Team and make them aware of any relevant information they receive.

## 4.4. Coverage

- 4.4.1 Monitoring of key suppliers should cover not just the contractual Financial Distress Events but take a wider view of a supplier's business and financial health and the level of risk. Although suppliers can collapse suddenly and unexpectedly, declines in financial health typically occur over a longer period as a result of changes in the market and/or business performance which then lead to a longer-term solvency problem. It is therefore helpful to be aware of the wider business context and performance metrics, the trends over time and non-financial indicators.
- 4.4.2 Where a supplier is a member of a group of companies, financial monitoring should cover the supplier, any guarantor or monitored supplier specified in the contract and, if this is not the ultimate holding company, the ultimate holding company. Exceptions to this would be where the supplier and/or any guarantor have been deliberately ring-fenced, operationally and financially, from the remainder of the group or where the ultimate holding company acts as a pure investor (as in the case of a private equity investor for example) and the supplier and parent company guarantor have no other financial dependence on the ultimate parent company in which case references to the ultimate parent company should be read as references to the highest parent company of the ring-fenced entity or the highest parent company in the group which does not act as a pure investor.
- 4.4.3 The Contracting Authority should also take whatever steps are appropriate to monitor the EFS of key sub-contractors.

## 4.5. The importance of access to liquidity

4.5.1 In terms of immediate risk, lack of access to liquidity is the typical cause of financial failure. It is therefore important to understand a supplier's, or a supplier group's, funding strategy and the nature of any borrowing arrangements. Relevant questions include:

- Are its existing borrowing facilities committed or can they be withdrawn by the lender?
- When do the existing facilities mature and what plans does the supplier or its group have to repay or replace them (where maturing facilities need to be replaced, most companies start to do this at least 12 – 18 months prior to maturity)?
- How much borrowing headroom do the facilities provide against peak future borrowing requirements and how will the supplier manage any pinch points?
- Has the supplier or its group provided security to its lenders?
- How tightly drawn are the covenants in the facilities? How much covenant headroom is there?

4.5.2 Not all of this information is readily available in the public domain; some suppliers (particularly quoted suppliers) may be reluctant to provide details of covenants and headroom for example. Contracting Authorities should consider whether their reluctance to provide such information stems from genuine concerns over commercial confidentiality or potential issues in the supplier's financial position and prospects.

4.5.3 Set out in '*APPENDIX V – Potential indicators of future financial distress*' is a non-exhaustive list of potential indicators of future financial distress. Note that while the presence of an indicator may give rise to concern, it should not be assumed inevitably to lead to financial distress.

## 4.6. Access to forward looking information

4.6.1 The limitation of using published information is that it is backward-looking and can often be a year or more out of date. Monitoring should therefore include access to forward-looking information where possible. In the case of publicly quoted suppliers, the share price performance relative to its peers or a relevant stock market index can provide a useful indication of investor sentiment towards the company. The degree of shorting of a supplier's shares can also be useful; where this exceeds 5% of a supplier's issued share capital, it would suggest significant divergence in investors' views over the company's future profitability or financial position, possibly as a result of adverse information about its prospects leaking into the market.

- 4.6.2 In the case of private suppliers which are not members of a publicly quoted group, it may be appropriate to seek access to forward-looking information such as financial projections or a simplified business plan. Many suppliers will provide this information to their banks as a matter of course to support their credit lines so will have a standard pack available on request. Where a private supplier falls below key parameters (a Company Watch H score of 25 or a Dun and Bradstreet score of 10), reassurance should be sought from the supplier about its financial position and prospects.
- 4.6.3 Suppliers which are publicly quoted (or part of publicly quoted groups) are generally very reluctant to provide access to forward-looking information as such information may be price sensitive. Where analyst research reports are available, these provide a view on investors' expectations of a supplier's future performance (the most useful reports are typically those issued by a supplier's retained stockbroker). Note however that these can only ever represent a third-party view, that such reports are written without access to the supplier's internal budget and forecasts, that they cannot be relied upon and that they are written for the benefit of investors, not customers.
- 4.6.4 Contracting Authorities must take legal advice or consult Cabinet Office Markets & Suppliers Team ([marketsandsuppliers@cabinetoffice.gov.uk](mailto:marketsandsuppliers@cabinetoffice.gov.uk)) prior to accepting price sensitive information and becoming insiders because of the obligations that this status can create.

## 4.7. Annual confirmation of compliance

- 4.7.1 The Model Services Contract provides that Suppliers should promptly notify a Contracting Authority following the occurrence of a Financial Distress Event or any matter which could cause a Financial Distress Event. Where no Financial Distress Event or any matter which could cause a Financial Distress Event has been notified, boards of suppliers of critical (Gold) contracts should provide an annual confirmation in writing to the Contracting Authority that no Financial Distress Event or any matter which could cause a Financial Distress Event has occurred and/or is subsisting. Standard wording is included in the Model Services Contract.
- 4.7.2 Strategic Suppliers to Government and members of their groups should additionally be required to report by exception to the Cabinet Office Markets and Suppliers Team where they are unable to provide the confirmation. Standard wording is included in the Model Services Contract.

## 4.8. Follow up

- 4.8.1 Whether or not a review indicates any concerns, it should be discussed promptly with the contract manager. Any concerns should normally then be discussed with the supplier and reassurance sought; it is good practice to hold at least an annual meeting with key suppliers to discuss their financial health and strategy.
- 4.8.2 Where financial monitoring and follow-up suggest a raised or continuing level of concern, contract managers should ensure their contingency plans are up-to-date and consider whether any further action or enhanced monitoring is required. Any concerns and actions should be raised with a senior business owner at an early stage.

## 4.9. Information sources and support

- 4.9.1 A list of standard information sources is set out in '*APPENDIX VI – Tools and Information sources*' and a framework for the provision of external consultancy support is expected to be put in place later this year.
- 4.9.2 Subject to observing any confidentiality obligations, information and best practice should be shared between Contracting Authorities. The Markets and Suppliers Team in the Cabinet Office acts as a Centre of Excellence for Financial Monitoring; it is contactable on Team [marketsandsuppliers@cabinetoffice.gov.uk](mailto:marketsandsuppliers@cabinetoffice.gov.uk)<sup>8</sup>.
- 4.9.3 It is good practice to use an internal RAG rating system to monitor the EFS of key suppliers. Red ratings should normally be set at the levels of the Financial Distress Events in the relevant contract(s). Amber ratings should be set by individual Contracting Authorities.

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<sup>8</sup> A 'Best Practice' network is also planned.

## APPENDIX I – Standard Financial Ratios

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This Appendix provides guidance on the standard ratios and metrics that should be used when assessing the economic and financial standing (EFS) of bidders and suppliers.

1. **Terminology:** The terms referred to in this paper are those used by UK companies in their financial statements and are mostly available on the face of the Balance Sheet, Income Statement and Statements of Cash Flow. Where the entity is not a UK company, the corresponding items should be used even if the terminology is slightly different (for example a charity would refer to a surplus or deficit rather than a profit or loss).
2. **Groups:** Where the entity is the holding company of a group and prepares consolidated financial statements, the consolidated figures should be used.
3. **Foreign currency conversion:** In a procurement situation the Contracting Authority should specify what exchange rate to use to convert amounts denoted in foreign currency to Sterling. In some tests, where both the numerator and denominator are expressed in the same foreign currency, no conversion may be required. Where conversion is required, amounts should generally be converted either at current exchange rates (e.g. the rate prevailing at the date of issue of the Selection Questionnaire) or at the exchange rate in force at the relevant date for which the financial ratio or metric is being calculated.
4. **Treatment of non-underlying items:** Ratios should generally be based on the figures in the financial statements before adjusting for non-underlying items. Where this produces other than a low risk outcome, Contracting Authorities should permit adjustment for non-underlying items, subject to satisfying themselves that the items are material and out of the ordinary course, on the basis that this is likely to provide a better representation of underlying performance.

Subject to reserving the right to do so, a Contracting Authority may also adjust for non-underlying items which are material and out of the ordinary course where this would move the categorisation to a higher risk banding provided this is explained in the Selection Questionnaire or other procurement document, that it discloses the proposed adjustments to the bidder, allows the bidder adequate time to respond and appropriately considers any representations the bidder wishes to make.

5. **Accounting periods of other than 12 months:** Where metrics are measured for a period rather than at a specific date (for example, operating profit), they should generally be based on figures for periods of 12 months to allow for potential seasonality. Appropriate adjustments should be made where necessary. Contracting Authorities should discuss the basis of the adjustments with their Finance Teams.
6. **Post balance sheet events:** Bidders may draw attention to post balance sheet events in explaining why application of a different risk threshold may be more appropriate than that generated by the ratios. Similarly, Contracting Authorities may adjust for post balance sheet events in preparing proforma ratios (see *Paragraph 2.4.7*).
7. **Qualified accounts:** Where the Independent Auditor's Opinion on the entity's financial statements has been qualified (either due to not being able to obtain sufficient evidence or if the auditor concludes that the financial statements are not free from material misstatement) or if the Auditor's Opinion contains an emphasis of matter, Contracting Authorities should review the qualification or emphasis and decide how to proceed. Additional assurance may be required to confirm the entity's EFS. Particular care should be taken where the qualification or emphasis relates to whether the entity is a going concern.

The methodology for assessing EFS should be clearly described and any minimum financial requirements clearly stated in the Selection Questionnaire or other procurement document. Where bidders are asked to insert figures in a response or model, a copy of the underlying financial statements or other document supporting those figures should be sought so that they can be checked if required. A check should always be performed on the winning bidder. Where the procurement relates to a critical or important (Gold or Silver) contract, checks should be performed on all bidders at the bidder selection stage to avoid the risk of later damage and delay to the procurement.

The assessment should normally include as a minimum the standard financial metrics and ratios set out below. The list is not exhaustive and should be tailored to the particular requirement under procurement. Any ratios used should be transparent, objective, proportionate and non-discriminatory. Where a bidder's ratio score results in a High Risk classification, there is an opportunity within the Financial Viability Rating Assessment template for the bidder to provide explanations. If an alternative tool is used the same opportunities should be provided to bidders.

## Metric 1 – Turnover Ratio

*Turnover Ratio = Bidder Annual Revenue / Expected Annual Contract Value*

### **Definition**

Revenue should be shown on the face of the Income Statement in a standard set of financial statements. It should exclude the entity's share of the revenue of joint ventures or associates.

### **Interpretation**

The Turnover Ratio is used to understand how large the contract is compared to the annual revenue of a bidder for the contract. A larger number might suggest that the bidder can accommodate the contract more easily and be better able to deliver the contract.

### **Benchmark**

The Public Contract Regulations 2015 (Regulation 58.9) permit Contracting Authorities to require a minimum annual turnover of up to twice the estimated contract value (save where a higher figure can be justified by reference to the special risks attaching to the nature of the works, services or supplies). Turnover thresholds should be set at a reasonable level so as to provide assurance of the capacity of the bidder to deliver the goods and services required, without imposing inappropriate and unfair barriers to smaller, particularly social sector, suppliers. Bidders should normally not be eliminated on the basis of the Turnover Ratio alone.

The Turnover Ratio is not relevant to the procurement of multi-supplier frameworks.

### **Potential mitigations**

Where application of the test generates a ratio which would fall into the medium or high risk band, potential mitigations could include:

- Extension of the test to the bidder's wider group where the bidder is part of a group and the bidder is supported by a parent company guarantee; or
- Inclusion of new contracts won by the bidder since the publication of its financial results or the full impact of which is not reflected in the financial statements used for the assessment.



## Metric 2 –Operating Margin

$$\text{Operating Margin} = \text{Operating Profit} / \text{Revenue}$$

### Definition

The elements used to calculate the Operating Margin should be shown on the face of the Income Statement in a standard set of financial statements. Figures for Operating Profit and Revenue should exclude the entity's share of the results of joint ventures or associates. Where an entity has an operating loss (i.e. where the operating profit is negative), Operating Profit should generally be taken to be zero.

Since Operating Margin can vary, the test should normally be based on the higher of (a) the Operating Margin for the most recent accounting period and (b) the average Operating Margin for the last two accounting periods.

### Interpretation

Operating Margin is a measure of an entity's profitability. A higher ratio would normally suggest, other things being equal, that the entity's business is more sustainable and able to withstand any change in business and financial circumstances. Conversely, a low ratio may raise doubts over the sustainability of the business and hence the entity.

### Benchmark

See standard ratios by sector in '*APPENDIX II – Interpreting standard financial metrics*'.

### Potential mitigations

The Operating Margin may not be representative of a bidder's future profitability and hence sustainability. It may also not reflect a bidder's mission. Where application of the test generates a ratio which would fall into the medium or high risk band, potential mitigations could include:

- Adjustment for any one-off costs or expenses that unduly affected the Operating Margin for the period(s) under consideration and are unlikely to be repeated to the same extent in future years;
- Adjustment for profitable new business won or loss-making business closed since the publication of its financial results or the full impact of which is not reflected in the financial statements used for the assessment; or
- Recognition that the Operating Margin may not be an appropriate indicator of sustainability where, for example, the bidder is a charity or other non-profitmaking organisation with a mission to subsidise provision of services.

## Metric 3(A) – Free Cash Flow to Net Debt Ratio

(Metrics 3(A) and 3(B) are alternative measures. Metric 3(A) is more relevant to capital intensive sectors and Metric 3(B) to less capital intensive sectors.)

*Free Cash Flow to Net Debt Ratio = Free Cash Flow / Net Debt*

### Definition

*Free Cash Flow = Net cash flow from operating activities – Capital expenditure*

*Capital expenditure = Purchase of property, plant & equipment + Purchase of intangible assets*

*Net Debt = Bank overdrafts + Loans and borrowings + Finance leases + Deferred consideration payable – Cash and cash equivalents*

The majority of the elements used to calculate the Free Cash Flow to Net Debt Ratio should be shown on the face of the Statement of Cash Flows and the Balance Sheet in a standard set of financial statements.

- **Net cash flow from operating activities:** This should be stated after deduction of interest and tax paid.
- **Capital expenditure:** The elements of capital expenditure may be described slightly differently but will be found under '*Cash flows from investing activities*' in the Statement of Cash Flows; they should be limited to the purchase of fixed assets (including intangible assets) for the business and exclude acquisitions of other companies or businesses. The figure should be shown gross without any deduction for any proceeds of sale of fixed assets.
- **Net Debt:** The elements of Net Debt may also be described slightly differently and should be found either on the face of the Balance Sheet or in the relevant note to the financial statements. All interest bearing liabilities (other than retirement benefit obligations) should be treated as borrowings as should, where disclosed, any liabilities (less any assets) in respect of any hedges designated as linked to borrowings (but not non-designated hedges). Borrowings should also include balances owed to other group members.

Deferred consideration payable should be included in Net Debt despite typically being non-interest bearing.

Cash and cash equivalents should include short-term financial investments shown in current assets.

Where an entity has net cash (i.e. where application of the formula would produce a negative figure), the outcome of the test should be treated as 'Low Risk'.

## Interpretation

An entity's free cash flow represents the cash generated from its operations which is available for other purposes after ongoing capital expenditure. The Free Cash Flow to Net Debt Ratio effectively shows the proportion of its outstanding net debt (debt less cash), which it could pay off in a year if all its free cash flow went towards repaying debt and is a measure of the bidder's leverage. A high ratio would normally indicate, other things being equal, that an entity is better able to pay back its debt and/or may be able to take on more debt if necessary. Conversely, a low ratio may raise doubts over an entity's ability to service its existing debt.

## Benchmark

See standard ratios by sector in '*APPENDIX II – Interpreting standard financial metrics*'.

## Potential mitigations

A bidder's free cash flow for one year in isolation may not be representative of its future ability to generate cash. It may also have other means to service its debt or its debt may not be due for repayment for a significant period. Where application of the test generates a ratio which would fall into the medium or high risk band, potential mitigations could include:

- Adjustment for any one-off costs that unduly affected the free cash flow for the year under consideration and are unlikely to be repeated to the same extent in future years; or
- Adjustment for profitable new business won or loss-making business closed since the publication of its financial results or the full impact of which is not reflected in the financial statements used for the assessment; or
- Adjustment for exceptionally high capital expenditure which unduly depressed the free cash flow for the year under consideration and is unlikely to be required at the same level in future years; or
- A bidder's ability or plans to repay debt from sources other than the generation of free cash flow from operations, for example through the sale of an asset or business currently generating limited cash flow or through the use of parent company resources where the bidder is a member of a wider group; or
- Adjustment for elements of debt or deferred consideration which are only due for repayment in the long-term (for example beyond the maturity of the contract under procurement) or debt which is held with other companies in the same group which is not likely to be required to be repaid; or
- Adjustment for contingent deferred consideration to the extent that the liability is unlikely to crystallise in practice.

## Metric 3(B) – Net Debt to EBITDA Ratio

(Metrics 3(A) and 3(B) are alternative measures. Metric 3(A) is more relevant to capital intensive sectors and Metric 3(B) to less capital intensive sectors.)

*Net Debt to EBITDA ratio = Net Debt / EBITDA*

### Definition

*Net Debt = Bank overdrafts + Loans and borrowings + Finance leases + Deferred consideration payable – Cash and cash equivalents*

*EBITDA = Operating profit + Depreciation charge + Amortisation charge*

The majority of the elements used to calculate the Net Debt to EBITDA Ratio should be shown on the face of the Balance sheet, Income statement and Statement of Cash Flows in a standard set of financial statements but will otherwise be found in the notes to the financial statements.

- **Net Debt:** The elements of Net Debt may be described slightly differently and should be found either on the face of the Balance Sheet or in the relevant note to the financial statements. All interest bearing liabilities (other than retirement benefit obligations) should be included as borrowings as should, where disclosed, any liabilities (less any assets) in respect of any hedges designated as linked to borrowings (but not non-designated hedges). Borrowings should also include balances owed to other group members.

Deferred consideration payable should be included in Net Debt despite typically being non-interest bearing.

Cash and cash equivalents should include short-term financial investments shown in current assets.

Where an entity has net cash (i.e. where Net Debt is negative), the outcome of the test should be regarded as ‘*Low Risk*’.

- **EBITDA:** Operating profit should be shown on the face of the Income Statement and, for the purposes of this test, should include the entity’s share of the results of any joint ventures or associates.

The depreciation and amortisation charges for the period may be found on the face of the Statement of Cash Flows or in a Note to the Accounts.

Where EBITDA is negative, the outcome of the test should be regarded as '*High risk*' unless Net Debt is also negative in which case the outcome of the test should be regarded as '*Low Risk*'.

### **Interpretation**

An entity's EBITDA is a proxy for the cash flow it generates from its ongoing operations. The Net Debt to EBITDA Ratio is often used by lenders as a measure of an entity's ability to service its debt. A low ratio would normally indicate, other things being equal, that an entity is better able to pay back its debt and/or may be able to take on more debt if necessary. Conversely, a high ratio may raise doubts over an entity's ability to service its existing debt.

### **Benchmark**

See standard ratios by sector in '*APPENDIX II – Interpreting standard financial metrics*'.

### **Potential mitigations**

A bidder's EBITDA for one year in isolation may not be representative of its future ability to generate cash. It may also have other means to service its debt or its debt may not be due for repayment for a significant period. Where application of the test generates a ratio which would fall into the medium or high risk band, potential mitigations could include:

- Adjustment for any one-off costs that unduly affected EBITDA for the year under consideration and are unlikely to be repeated to the same extent in future years; or
- Adjustment for profitable new business won or loss-making business closed since the publication of its financial results or the full impact of which is not reflected in the financial statements used for the assessment; or
- A bidder's ability or plans to repay debt from sources other than the generation of cash flow from operations, for example through the sale of an asset or business currently generating limited cash flow or through the use of parent company resources where the bidder is a member of a wider group; or
- Adjustment for elements of debt or deferred consideration which are only due for repayment in the long-term (for example beyond the maturity of the contract under procurement) or debt which is held with other companies in the same group which is not likely to be required to be repaid.
- Adjustment for contingent deferred consideration to the extent that the liability is unlikely to crystallise in practice.

## Metric 4 – Net Debt + Net Pension Deficit to EBITDA Ratio

*Net Debt + Net Pension Deficit to EBITDA ratio = (Net Debt + Net Pension Deficit) / EBITDA*

### Definition

*Net Debt = Bank overdrafts + Loans and borrowings + Finance leases + Deferred consideration payable – Cash and cash equivalents*

*Net Pension Deficit = Retirement Benefit Obligations – Retirement Benefit Assets*

*EBITDA = Operating profit + Depreciation charge + Amortisation charge*

The majority of the elements used to calculate the Net Debt + Net Pension Deficit to EBITDA Ratio should be shown on the face of the Balance sheet, Income statement and Statement of Cash Flows in a standard set of financial statements but will otherwise be found in the notes to the financial statements.

- **Net Debt:** The elements of Net Debt may be described slightly differently and should be found either on the face of the Balance Sheet or in the relevant note to the financial statements. All interest bearing liabilities (other than retirement benefit obligations) should be included as borrowings as should, where disclosed, any liabilities (less any assets) in respect of any hedges designated as linked to borrowings (but not non-designated hedges). Borrowings should also include balances owed to other group members.

Deferred consideration payable should be included in Net Debt despite typically being non-interest bearing.

Cash and cash equivalents should include short-term financial investments shown in current assets.

- **Net Pension Deficit:** Retirement Benefit Obligations and Retirement Benefit Assets may be shown on the face of the Balance Sheet or in the notes to the financial statements. They may also be described as pension benefits / obligations, post-employment obligations or other similar terms.

Where calculation of Net Debt + Net Pension Deficit produces a negative figure, the outcome of the test should be regarded as '*Low Risk*'.

- **EBITDA:** Operating profit should be shown on the face of the Income Statement and, for the purposes of this test, should include the entity's share of the results of any joint ventures or associates.

The depreciation and amortisation charges for the period may be found on the face of the Statement of Cash Flows or in a Note to the Accounts.

Where EBITDA is negative, the outcome of the test should be regarded as '*High risk*' unless the Net Debt + Net Pension Deficit calculation also produces a negative figure in which case the outcome of the test should be regarded as '*Low risk*'.

### **Interpretation**

Pension deficits have some similarities to debt in that they represent obligations repayable over time on which interest accrues. An entity's EBITDA is a proxy for the cash flow it generates from its ongoing operations. The Net Debt + Net Pension Deficit to EBITDA Ratio measures the scale of an entity's debt and any pension deficit relative to the entity's size. A low ratio would normally indicate, other things being equal, that an entity is better able to pay back its debt and fund its pension fund deficit and/or may be able to take on more debt if necessary. Conversely, a high ratio may raise doubts over the sustainability of the entity.

### **Benchmark**

See standard ratios by sector in '*APPENDIX II – Interpreting standard financial metrics*'.

### **Potential mitigations**

A bidder's pension deficit may not need to be paid off for many years and may be overstated against its actuarial value. A bidder's EBITDA for one year in isolation may not be representative of its future ability to generate cash. It may also have other means to service its debt or pension deficit or its debt and pension deficit may not be due for repayment for a significant period. Where application of the test generates a ratio which would fall into the medium or high risk band, potential mitigations could include:

- Adjustment for any one-off costs that unduly affected EBITDA for the year under consideration and are unlikely to be repeated to the same extent in future years; or
- Adjustment for profitable new business won or loss-making business closed since the publication of its financial results or the full impact of which is not reflected in the financial statements used for the assessment; or
- A bidder's ability or plans to repay debt from sources other than the generation of cash flow from operations, for example through the sale of an asset or business currently generating limited cash flow or through the use of parent company resources where the bidder is a member of a wider group; or
- Adjustment for elements of debt, deferred consideration or pension deficit which are only due for repayment in the long-term (for example beyond the maturity of the contract under procurement) or debt which is held with other companies in the same group which is not likely to be required to be repaid; or
- Adjustment for contingent deferred consideration to the extent that the liability is unlikely to crystallise in practice; or
- Where the deficit in the most recent triennial valuation (as adjusted for subsequent deficit recovery payments) is significantly lower than that shown for accounting purposes.

## Metric 5 – Net Interest Paid Cover

*Net Interest Paid Cover = Earnings Before Interest and Tax / Net Interest Paid*

### Definition

*Earnings Before Interest and Tax = Operating profit*

*Net Interest Paid = Interest paid – Interest received*

Operating profit should be shown on the face of the Income Statement in a standard set of financial statements and, for the purposes of this test, should include the entity's share of the results of any joint ventures or associates. Where the entity has an operating loss (i.e. a negative operating profit), operating profit should generally be taken to be zero.

Interest received and interest paid should be shown on the face of the Cash Flow statement.

Where Net interest paid is negative (i.e. the entity has net interest received), the outcome of the test should be regarded as '*Low risk*'.

### Interpretation

The Net Interest Paid Cover measures how easily an entity can pay interest on its debt out of the profits it generates from its operations, and therefore provides a measure of the entity's solvency. A higher number would normally indicate, other things being equal, that the entity is better able to service interest on its debt, and/or is more likely to be able to borrow additional money if required. Conversely, a low figure may raise doubts over an entity's ability to service the interest on its existing debt.

### Benchmark

See standard ratios by sector in '*APPENDIX II – Interpreting standard financial metrics*'.

### Potential mitigations

A bidder's EBIT for one year in isolation may not be representative of its future EBIT. A bidder may also have plans to repay its debt from other sources reducing the level of future interest or the interest may be rolled up and not due for payment until a future date. Where application of the test generates a ratio which would fall into the medium or high risk band, potential mitigations could include:

- Adjustment for any one-off costs that unduly affected EBIT for the year under consideration and are unlikely to be repeated to the same extent in future years; or
- Adjustment for profitable new business won or loss-making business closed since the publication of its financial results or the full impact of which is not reflected in the accounts used for the assessment; or



- A bidder's plans to repay debt, for example through the sale of an asset or business currently generating limited profits or through the use of parent company resources where the bidder is a member of a wider group.

## Metric 6 – Acid Ratio

$$\text{Acid Ratio} = (\text{Current Assets} - \text{Inventories}) / \text{Current Liabilities}$$

### Definition

All elements that are used to calculate the Acid Ratio are available on the face of the Balance Sheet in a standard set of financial statements.

### Interpretation

The Acid Ratio provides a measure of an entity's ability to meet its short term liabilities. A high ratio would normally suggest, other things being equal, that it can more easily meet its liabilities as they fall due. Conversely, a low ratio may raise doubts over its ability to meet its liabilities as they fall due.

### Benchmark

See standard ratios by sector in '*APPENDIX II – Interpreting standard financial metrics*'.

### Potential mitigations

The Acid Ratio ignores inventories and focuses just on an entity's more liquid assets relative to its short-term liabilities. It ignores the availability of other sources of funding with which to pay short-term liabilities, the possibility that its inventory may be capable of swift realisation and an entity's ability to take credit from its suppliers. Where application of the test generates a ratio which would fall into the medium or high risk band, potential mitigations could include:

- A bidder's ability to raise cash through new borrowings, equity issuance, the sale of an asset or the use of parent company resources where the bidder is a member of a wider group;
- A bidder's stock turn, i.e. the speed with which it can sell its inventory to raise cash; and
- The nature of the bidder's short-term liabilities which may include creditors and accruals not immediately due for settlement.

## Metric 7 – Net Asset Value

*Net Asset Value = Net Assets*

### Definition

Net Assets are shown (but sometimes not labelled) on the face of the Balance sheet of a standard set of financial statements. Net Assets are sometimes called net worth or Shareholders' Funds. They represent the net assets available to the shareholders. Where an entity has a majority interest in another entity in which there are also minority or non-controlling interests (i.e. where it has a subsidiary partially owned by outside investors), Net Assets should be taken inclusive of minority or non-controlling interests (as if the entity owned 100% of the other entity).

### Interpretation

The Net Asset Value provides a basic view of whether an entity's assets exceed its liabilities. Where an entity has a negative Net Tangible Asset Value this may suggest the business and hence the entity is less sustainable in the event of any deterioration in performance.

### Benchmark

See standard ratios by sector in '*APPENDIX II – Interpreting standard financial metrics*'.

### Potential mitigations

The value of an entity's Net Assets provides a very basic assessment of its worth. Assets are stated at accounting values which may be substantially lower than their market values, particularly in the case of fixed assets. Many intangible assets may not be included at all.

The test provides no indication of an entity's ability to pay its creditors as they fall due, with no recognition of its ability to generate funds, of the funding available to an entity or of when liabilities are due for payment.

Where application of the test would suggest medium or high risk, potential mitigations could include:

- Considering the value of any intangible assets such as goodwill which have not been included in the balance sheet (although the value of purchased goodwill is included in balance sheets, the value of self-generated goodwill is not);
- Considering any other assets (for example property) which may have been included at an undervalue;
- Considering the ability of the entity to generate EBITDA sufficient to meet its liabilities as they fall due;
- Considering other sources of funding available to the entity.

Bidders should normally not be eliminated on the basis of the Net Asset Value test alone.

## Metric 8 – Group Exposure Ratio

*Group Exposure Ratio = Group Exposure / Gross Assets*

### Definition

*Group Exposure = Balances owed by Group Undertakings + Contingent liabilities assumed in support of Group Undertakings*

*Gross Assets = Fixed Assets + Current Assets*

**Group Exposure:** Balances owed by (i.e. receivable from) Group Undertakings are shown within Fixed assets or Current assets either on the face of the Balance Sheet or in the relevant notes to the financial statements. In many cases there may be no such balances, in particular where an entity is not a member of a group or is itself the ultimate holding company of the group.

Contingent liabilities assumed in support of Group Undertakings are shown in the Contingent Liabilities note in a standard set of financial statements. They include the value of guarantees and security given in support of the borrowings of other group companies, often as part of group borrowing arrangements. Where the contingent liabilities are capped, the capped figure should be taken as their value. Where no cap or maximum is specified, the outcome of the test should automatically be regarded as '*High risk*'.

In many cases an entity may not have assumed any contingent liabilities in support of Group Undertakings, in particular where an entity is not a member of a group or is itself the ultimate holding company of the group.

**Gross Assets:** Both Fixed assets and Current assets are shown on the face of the Balance Sheet

### Interpretation

This test is relevant to subsidiaries and controlled entities which may have exposures (actual or contingent) to wider group entities whose results are not reflected in the entity's own financial statements. The test is designed to establish whether an entity could withstand a significant adverse event elsewhere within the group of which it is a member; such an event could lead to the non-recovery of balances owed to it by other group members or to the crystallisation of a contingent liability linked to the wider group (e.g. a call under a guarantee).

Where Group Exposure represents a high or uncapped percentage of an entity's Gross Assets, this suggests the entity is more exposed to the performance or position of other entities within its wider group. Typical exposures arise where an entity is a member of a borrowing group the members of which have provided cross guarantees and/or security to the lender.

**Benchmark**

See standard ratios by sector in '*APPENDIX II – Interpreting standard financial metrics*'.

**Potential mitigations**

The value of an entity's Gross Assets may be a poor reflection of the size and value of the entity. Where application of the test would suggest medium or high risk, potential mitigations could include:

- A comparison of Group Exposure relative to the size of the bidder as measured by Revenue or Operating profit rather than Gross Assets; and
- Inclusion within Gross Assets of the value of any intangible assets such as goodwill which have not been included in the balance sheet (although the value of purchased goodwill is included in balance sheets, the value of self-generated goodwill is not).

Where an entity has uncapped exposure to wider group entities, the solution is often to seek a parent company guarantee. Other potential mitigations might include analysis of the EFS of those other group entities to which the entity is exposed to determine whether or not the risk of an exposure crystallising is limited (for example, an entity may be a member of a borrowing group and act as guarantor of its parent company's drawings under a debt facility but the facility itself is capped or is unlikely to be drawn down).

## APPENDIX II – Interpreting standard financial metrics

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The following table sets out how to interpret the results of standard financial assessments.

### **How to use the table**

Before you start:

1. Calculate the ratio based on the guidance in Appendix I.
2. Identify the criticality (ie Gold, Silver or Bronze) of the contract under procurement using the Contract Tiering Tool.
3. Identify the most suitable sector (in the first column) into which the services to be delivered under the contract fall.

Consulting the table:

4. Identify the metric you have calculated in the 2nd column.
5. Identify the relevant set of thresholds based on the contract criticality (ie Gold, Silver or Bronze).
6. Identify the threshold into which the calculation carried out in step 1 falls.
7. The column header identifies the level of risk the supplier represents based on the metric assessed.

**Interpreting standard financial metrics - Risk categories by Sector and Criticality of procurement**

The following table should be used to determine the level of risk associated with a bidder following the application of standard financial assessments.

Sector	Metric	Non-critical (Bronze) procurements			Important (Silver) or Critical (Gold) procurements		
		Low risk	Medium risk	High risk	Low risk	Medium risk	High risk
<b>All sectors (save where shown separately below)</b>	Metric 1 - Turnover Ratio	>2.0x <sup>1</sup>	1.5 - 2.0x	<1.5	>2.0x <sup>1</sup>	1.5 - 2.0x	<1.5
	Metric 2 - Operating Margin	N/A	N/A	N/A	>10%	5 - 10%	< 5%
	Metric 3(A) - Free Cash Flow / Net Debt	N/A	N/A	N/A	> 15%	5 - 15%	< 5%
	Metric 3(B) - Net Debt / EBITDA	< 2.5x	2.5 - 3.5x	> 3.5x	< 2.5x	2.5 - 3.5x	> 3.5x
	Metric 4 - Net Debt + Net Pension Deficit / EBITDA	N/A	N/A	N/A	< 4.0x	4.0 - 5.0x	>5.0x
	Metric 5 - Net Interest Paid Cover	> 4.0x	2.5 - 4.0x	< 2.5x	> 4.5x	3.0 - 4.5x	< 3.0x
	Metric 6 - Acid Ratio	> 0.8x	0.7 - 0.8x	< 0.7x	> 1.0x	0.8 - 1.0x	< 0.8x
	Metric 7 - Net Assets	> Nil	> Nil	> Nil	> Nil	> Nil	> Nil
	Metric 8 - Group Exposure Ratio	N/A	N/A	N/A	<25%	25 - 50%	> 50%
<b>Business Process Outsourcing</b>	Metric 2 - Operating Margin	> 8%	3 - 8%	<3%	> 10%	5 - 10%	< 5%
	Metric 3(A) - Free Cash Flow / Net Debt	N/A	N/A	N/A	N/A	N/A	N/A
	Metric 3(B) - Net Debt / EBITDA	< 2.5x	2.5 - 3.5x	> 3.5x	< 2.5x	2.5 - 3.5x	> 3.5x
	Metric 4 - Net Debt + Net Pension Deficit / EBITDA	N/A	N/A	N/A	< 4.0x	4.0 - 5.0x	>5.0x
<b>Facilities Management and Construction</b>	Metric 2 - Operating Margin	> 6%	3 - 6%	< 3%	> 7%	4 - 7%	< 4%
	Metric 3(A) - Free Cash Flow / Net Debt	N/A	N/A	N/A	N/A	N/A	N/A
	Metric 3(B) - Net Debt / EBITDA	< 1.0x	1.0 - 2.0x	> 2.0x	< 1.0x	1.0 - 2.0x	> 2.0x
	Metric 4 - Net Debt + Net Pension Deficit / EBITDA	N/A	N/A	N/A	< 2.5x	2.5 - 3.5x	>3.5x
<b>Information Technology and Telecoms</b>	Metric 2 - Operating Margin	N/A	N/A	N/A	> 10%	5 - 10%	< 5%
	Metric 3(A) - Free Cash Flow / Net Debt	N/A	N/A	N/A	N/A	N/A	N/A
	Metric 3(B) - Net Debt / EBITDA	< 3.0x	3.0 - 3.5x	> 3.5x	< 3.0x	3.0 - 3.5x	>3.5x
	Metric 4 - Net Debt + Net Pension Deficit / EBITDA	N/A	N/A	N/A	<4.5x	4.5 - 5.0x	>5.0x

**Notes:**

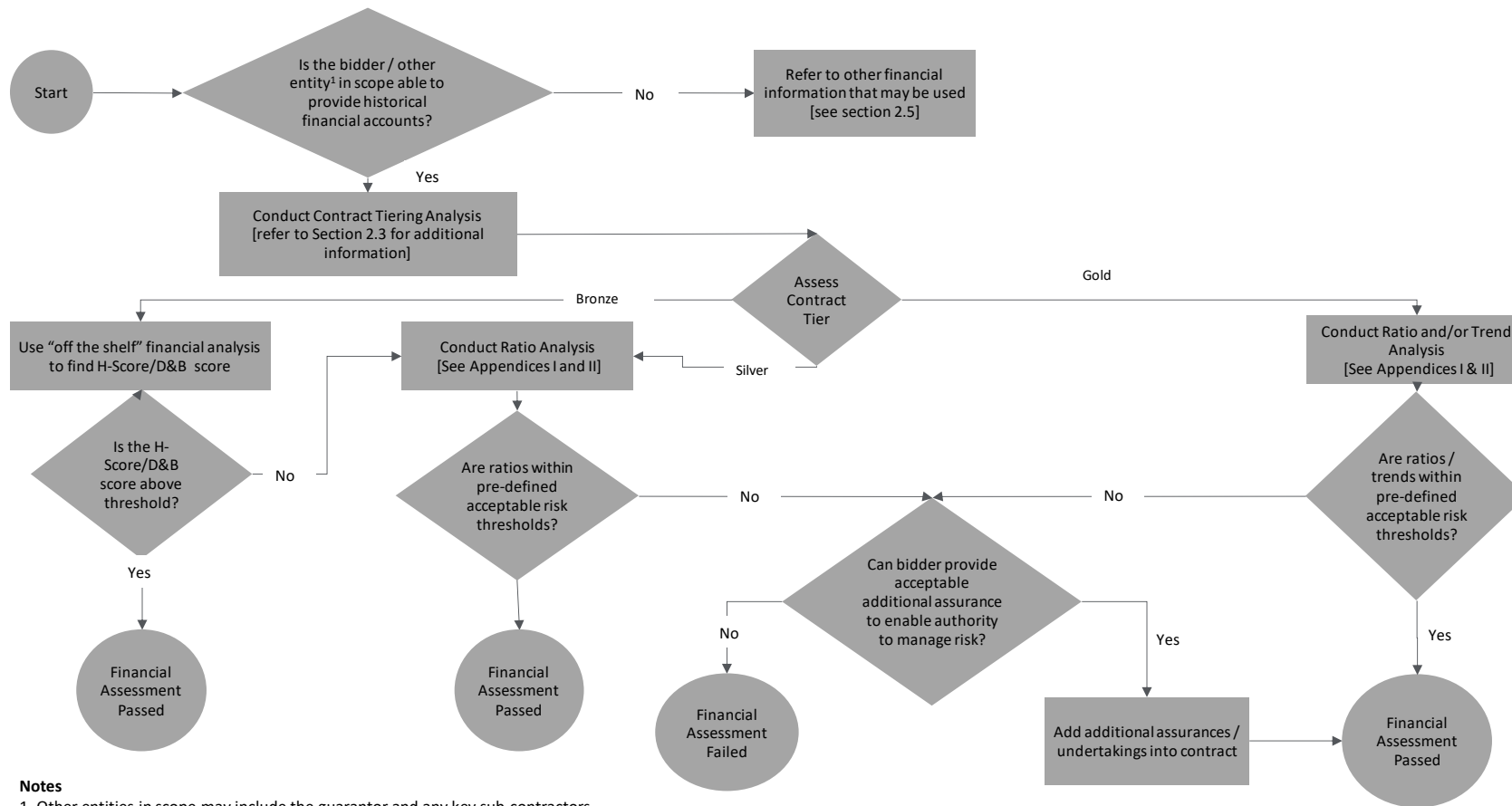
(1) Maximum threshold at which exclusion is permitted by procurement law

(2) The selection of ratios and thresholds should be tailored to the circumstances of the particular procurement. For example, for very short bronze contracts it may not be appropriate to apply a Net Debt / EBITDA ratio. For potential Gold contracts, however, more demanding thresholds may be appropriate. Contracting Authorities should consider what is appropriate to their particular procurement and adopt a 'Comply or Explain' approach.

# APPENDIX III – Financial Assessment Flowcharts

## Financial Testing Decision Tree Part 1 – Financial Assessment of Bidders

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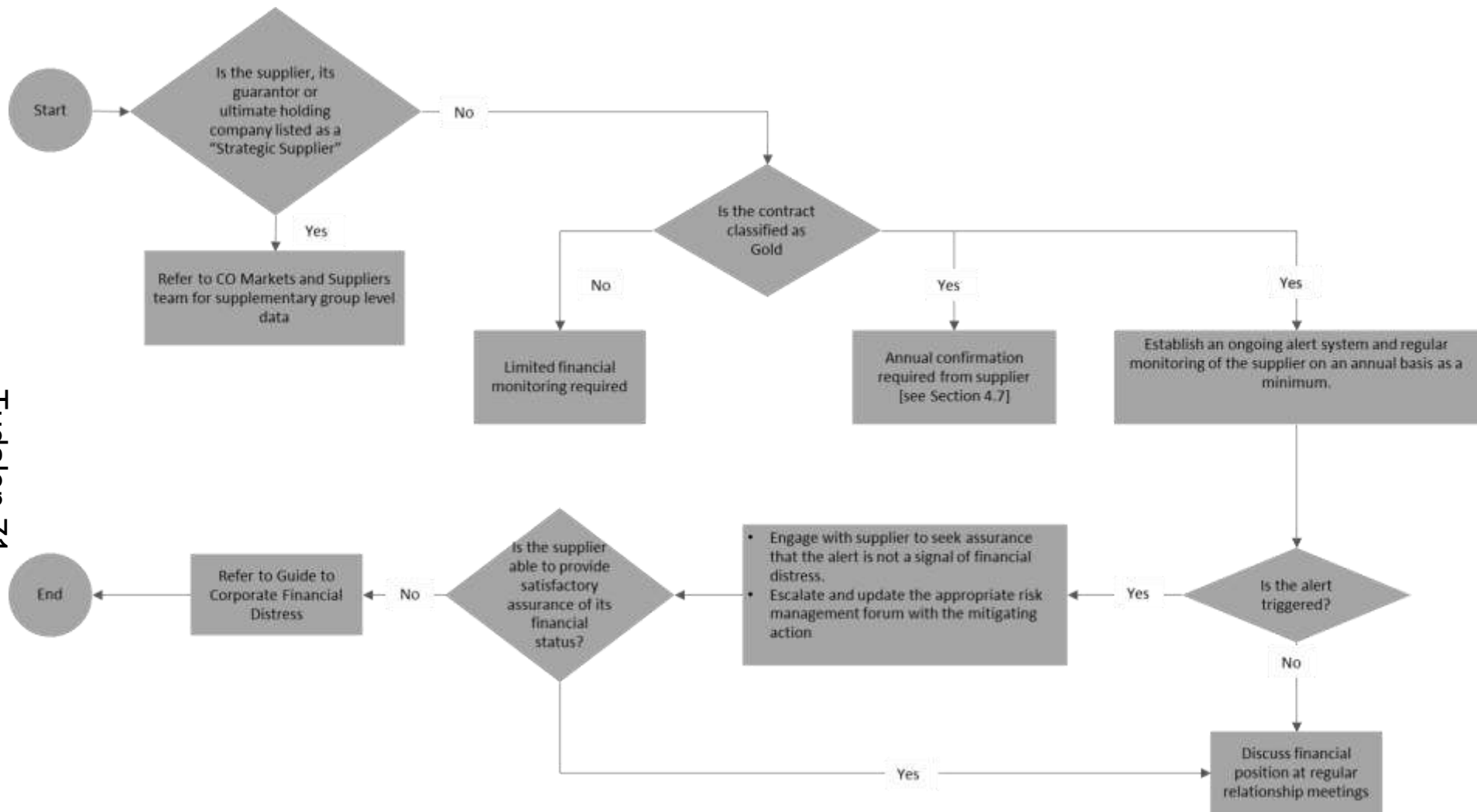
**Notes**

1. Other entities in scope may include the guarantor and any key sub-contractors



# Financial Testing Decision Tree Part 2 – In Contract Financial Monitoring

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# APPENDIX IV – Comparison of credit ratings issued by different rating agencies

Moody's		Standard & Poors		Fitch			
Long-term	Short-term	Long-term	Short-term	Long-term	Short-term		
Aaa	P-1	AAA	A-1+	AAA	F1+	Prime	
Aa1		AA+		AA+		High grade	
Aa2		AA		AA			
Aa3		AA-		AA-			
A1	P-2	A+	A-1	A+	F1	Upper medium grade	
A2		A		A			
A3		A-		A-		A-	F2
Baa1	P-3	BBB+	A-2	BBB+	F3	Lower medium grade	
Baa2		BBB		BBB			
Baa3		BBB-	A-3	BBB-			
Ba1	Not Prime	BB+	B	BB+	B	Non-investment grade speculative	
Ba2		BB		BB			
Ba3		BB-		BB-			
B1		B+		B+		Highly speculative	
B2		B		B			
B3		B-	B-				
Caa1		C	CCC+	C	CCC+	C	Substantial risks
Caa2			CCC		CCC		
Caa3			CCC-		CCC-		
Ca		C	CC	D	CC	D	Extremely speculative
	C		C		Default imminent		
C		RD	D	DDD	D	In default	
/		SD		DD			
/		D		D			

## APPENDIX V – Potential indicators of future financial distress

	<b>Financial</b>	<b>Non-financial</b>
<b>Business performance / Operating efficiency</b>	<ul style="list-style-type: none"> <li>● Adverse changes in the market / market structure</li> <li>● Declining revenues</li> <li>● Declining profit margins</li> <li>● Declining Return on Capital Employed</li> <li>● Declining cash conversion</li> <li>● Public profit warnings</li> <li>● Increases in creditor days / Delayed payments to suppliers</li> <li>● Decreases in debtor days</li> <li>● Declining stock turnover</li> </ul>	<ul style="list-style-type: none"> <li>● Unexpected resignations of key management / High employee turnover</li> <li>● Weak management or overly controlling CEO</li> <li>● Delayed filing of statutory accounts / late provision of management information</li> <li>● Competitor gossip / market intelligence</li> <li>● Regulatory action</li> <li>● Declining share price / Sudden share price falls / Significant shorting of shares</li> <li>● Major adverse announcements (e.g. major litigation, large contract losses, etc)</li> </ul>
<b>Liquidity / Solvency</b>	<ul style="list-style-type: none"> <li>● High / Rising net debt to EBITDA</li> <li>● Declining interest cover</li> <li>● High / Rising gearing</li> <li>● Deteriorating liquidity / Declining headroom</li> <li>● Lending covenant breaches</li> <li>● Increasing reliance on short-term or uncommitted debt</li> <li>● Use of non-standard financing markets</li> <li>● Going concern qualifications in published accounts</li> <li>● Requests for payments in advance</li> <li>● Invoice discounting / Factoring / Other means of raising short-term cash</li> <li>● Rising pension deficits</li> <li>● Rising contingent liabilities</li> <li>● Cuts in / Cancelled dividends</li> </ul>	<ul style="list-style-type: none"> <li>● Poor or deteriorating relationship with Lenders</li> <li>● Withdrawal of coverage of a supplier's debts by credit insurers</li> <li>● Falls in or withdrawal of credit ratings (or announcements of credit watch with negative implications) by major credit agencies</li> <li>● Company Watch H score falling below 25 / Dun and Bradstreet score falling below 10</li> </ul>

## APPENDIX VI – Tools and Information sources

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**Financial Viability Risk Assessment tool**

<https://www.gov.uk/government/publications/the-outsourcing-playbook>

**Outsourcing Playbook**

<https://www.gov.uk/government/publications/the-outsourcing-playbook>

**EU procurement Regulations** (for thresholds and reference to Regulation 60(7))

<https://www.ojec.com/directives.aspx>

**Supplier Registration Service**

<https://supplierregistration.cabinetoffice.gov.uk/>

**Companies House**

<https://www.gov.uk/government/organisations/companies-house>

**Contract Tiering Tool** (KHub account required)

[https://khub.net/group/gcf-community/group-library/-/document\\_library](https://khub.net/group/gcf-community/group-library/-/document_library)

**Company Watch**

<https://www.companywatch.net/>

**Dun & Bradstreet**

<https://www.dnb.co.uk/>

**Model Services Contract**

<https://www.gov.uk/government/publications/model-services-contract>



Mae'r dudalen hon wedi'i gadael yn wag yn fwriadol

As agreed at Scrutiny on 24<sup>th</sup> June, we can now give you a position statement and update on the Bowling Green scheme in Newtown. Powys County Council received notification that Begbies Traynor had been appointed as administrators for the construction firm Jistcourt on Thursday 27<sup>th</sup> June. The firm had won the contract to build 26 new flats on the Bowling Green site. The site has been secured and made safe.

Following a review of available procurement options, I can confirm that the Council's preferred route to market is a full retender of the scheme, to include Pre-Qualification Questionnaire (PQQ) and Invitation to Tender (ITT). We encourage local construction firms to tender for the work and if any have any queries over the process to please get in touch.

The estimated delay to the project is approximately six months to appoint a principal contractor and a further three months mobilisation for the contractor to commence on site.

Questions have been raised around the procurement process, which for the Bowling Green site in Newtown involved an assessment of the contractors experience, and suitability. This assessment included a requirement to demonstrate Constructionline Level 2 Silver registration, which incorporates a contractors financial ability and established track record for successfully delivering contracts to the anticipated value of the contract being awarded.

In addition to this, and prior to award of the contract, an assessment of Jistcourt's finances was undertaken by the Council as final due diligence.

Due to the contractual requirement for the principal contractor to put in a performance bond of 10% of the value of the total contracted works, and their failure to do so, the Council has made no payments to Jistcourt South Wales Ltd on this scheme. The expenditure figures that have been quoted (£695,000) are the costs incurred to get to this stage of the development process, and are not payments made to Jistcourt.

It has been confirmed by Welsh Government that the Innovative Housing Grant awarded to this scheme is secure and not at risk.

The Council continually reviews its processes for financial and tender analysis, particularly since the collapse of Dawnus and Jistcourt. Updated financial analysis based on a Pass/Fail basis is now being used. With ongoing concerns affecting the UK construction industry, the Council will continue to monitor the situation and how it assesses the suitability of companies to bid for Council contracts.

Mae'r dudalen hon wedi'i gadael yn wag yn fwriadol



# 6

Audit Committee Work Programme	
Date	Items for consideration
07/08/19	Procurement process
30/08/19	Seminar - final statement of accounts and AGS
06/09/19	Statement of Accounts 2018/19
	Annual Improvement Report - WAO
	Strategic Risk Management
	Business continuity
	Internal Audit - performance monitoring
	Treasury Management
19/12/19	Strategic Risk Management
	Corporate Director, Transformation - Risk Management
	Business continuity
	Internal Audit - performance monitoring
	Treasury Management
	Closure of Accounts

Mae'r dudalen hon wedi'i gadael yn wag yn fwriadol