

Committee:	Date:
Procurement Sub Committee	2 December 2019
Finance Committee	10 December 2019
Subject:	Public
Financial Appraisals for Procurement	
Report of:	For Decision
The Chamberlain	
Report author:	
Chris Bell, Commercial Director, Chamberlain's	

Summary

In 2015 Members resolved that the financial standing of companies bidding for all contracts over the Official Journal of the European Union (OJEU) services threshold (currently £181,302) and £400,000 for works should be undertaken to evaluate the risk of supplier failure during the term of a proposed contract. These assessments are undertaken by the Chamberlain's Corporate Treasury team within the Financial Services Division using a standard set of financial criteria.

The financial assessment has proved to be a blunt tool in addressing the risk of contract default; the main impact being to reduce the number of bidders and potentially therefore increase the price contracts are awarded at. Increasingly exceptions to the financial criteria are being made for low risk contracts where it is easy to change suppliers. Since 2015 the ability of the City Corporation to respond to supplier failure through the City Procurement team has increased significantly. Consequently, given this capacity, a change to the process was recommended as part of the Chamberlain's Fundamental Review Recommendations, reducing the level of financial assessment for low risk contracts. The change of process was considered and recommended for approval by the Resource Allocation Sub Committee's awayday and will be considered by Policy and Resources Committee in November 2019.

Members are now asked to consider the implementation of that recommendation. Specifically, Members are being asked to approve that the financial assessment procedure used for suppliers bidding for "low risk" contracts, above the OJEU services and the City Corporation's £400,000 works thresholds, is replaced by sole reliance on credit reference agencies.

For all other procurements, not classified as low risk, the City Corporation's standard financial criteria and assessment methodology will continue to apply.

Recommendations

Members are asked to:

- Note the informal recommendation by Resource Allocation Sub Committee of the Chamberlain's Fundamental Review recommendation for the use of a credit agency to provide financial checks for suppliers rather than in house- appraisal; and to receive a verbal update on whether the proposal has been ratified by Policy and Resources Committee.
- Approve from 1 January 2020 that the financial assessment criteria used for suppliers bidding for "low risk" procurements above the OJEU services and the City's £400,000 works thresholds is replaced by credit rating agency checks.

- Approve change to Part 2 of the Procurement Code and the Financial Appraisal Procedure Guide to include distinction between 'low risk' and 'not low risk'.

Main Report

Background

1. Public sector procurement is regulated by the Public Contracts Regulations 2015 (PCR 2015). In respect of the financial assessment of potential suppliers, Regulation 58 (7-8) of PCR 2015 states that 'with regard to economic and financial standing, contracting authorities may impose requirements ensuring that economic operators possess the necessary economic and financial capacity to perform the contract.'
2. PCR 2015 does not require a financial assessment to be undertaken and does not specify how an assessment should be conducted. It does state that organisations must be transparent when using ratios and the criteria should also be 'objective and non-discriminatory'.
3. In response to the requirements of PCR 2015, Finance Committee Members in July 2015, presented a report to the City Corporation's Finance Committee, approved a recommended methodology for assessing the risk to the City Corporation of supplier failure. This is the methodology used today.
4. Rule 35 of the City of London's Procurement Code 2015 requires all contracts over the Official Journal of the European Union (OJEU) services threshold (currently £181,302) and £400,000 for works should be undertaken to evaluate the risk of supplier failure during the term of a proposed contract
5. The current methodology allows the City Corporation to adjust 'pass thresholds' within certain financial ratios based on risk, the same level of scrutiny is applied irrespective of the impact of supplier failure on the City Corporation.

Current Position

6. The risk to the City Corporation of supplier financial failure has been managed through the current financial appraisal approach. However, the organisational resilience and the capacity to respond to such events has increased since 2015, as the City Procurement function has evolved.
7. In recognition of the ability of the City Procurement team to mobilise, at short notice, alternative suppliers of low risk goods and services with minimal business interruption, officers have identified an opportunity to amend the current financial appraisal methodology and seeks to place sole reliance on credit reference agency checks. This is to ensure that the level of financial scrutiny of potential suppliers is proportionate to the risk to the City Corporation given the mitigations available to manage the risk of supplier failure.
8. A variety of approaches to the economic and financial assessment of suppliers are used in other public bodies. There appear to be some commonalities of process, however, with the majority of those contacted making use of a credit

reference agency score at some point in the financial appraisal process. The results of the benchmarking are detailed in the appendix.

Possible Risks of Using Credit Reference Agency Checks

9. The use of credit reference agency (CRA) checks has been debated widely in public sector. Crown Commercial Service, for example, advise that they should not be used in place of an independent financial assessment. Several issues for consideration include:
 - CRA scores can be volatile as they are based in part on market speculation and reaction to internal and external events.
 - CRA checks as they can be unduly influenced by a small number of payment experiences which may not be representative of the business.
 - The algorithms used by credit agencies are proprietary and therefore it is not possible independently validate their conclusions.
 - Scores may differ based on the credit agency used to perform these checks.

Mitigation for Risks associated with CRAs

10. City Procurement believe that the benefits of open competition outweigh the risks outlined above and the City Procurement team will work closely with Category Boards, Members and the Financial Services Division to mitigate these where possible.
11. In practice this approach will only be adopted for low risk procurements and the use of CRAs does not appear inconsistent with the findings identified from the benchmarking exercise carried out in relation to other public sector procurement practice. CRAs would be used as an indication of financial suitability in the place of a full financial assessment.

Benefits of the use of CRAs

12. Where used, CRAs would allow for an easy and transparent way for bidders to 'self-certify' whether they have a suitable credit score. The expected result is an increased number of bidders benefitting the City Corporation commercially.
13. The use of CRAs would reduce pressure on both the Corporate Treasury Team and City Procurement streamlining the process and reducing the amount of clarifications needed during evaluation.

Recommendation

14. City Procurement propose a revision to the risk-based approach to categorise procurements into one of two categories: low risk and not low risk.

The proposed Enhanced Risk Assessment Framework:

Risk	Assessment
Low	Turnover Check and Credit Reference Agency Score Only
Not Low	Turnover Check and Credit Score Only, or; Full Standard Financial Appraisal Assessment as per the Financial Appraisal Procedure Guidance

15. The 'Low Risk' / 'Not Low Risk' rating would allow flexibility for Category Boards to choose the most appropriate due diligence which is proportionate to what is being purchased taking into consideration market factors and prior lessons learned. The City Corporation, however, will always have recourse to conduct a full financial appraisal if considered necessary. Guidance for setting the risk rating as 'low' or 'not low' is included in the appendix.
16. The risk rating and assessment would be included as part of the PT3/Stage 1 report that is signed off by Category Board/Members after recommendation by City Procurement and the stakeholder department.
17. This report, therefore, recommends an increase in the risk tolerance of the City Corporation to remove a full financial assessment on procurements deemed to be low risk and replace this with a credit reference agency score and turnover check. This report is not recommending a specific supplier or rating agency. The selection of a provider will be reviewed periodically by the Commercial Director in liaison with the City's Corporate Treasurer.
18. Lastly, it is recommended where the City Corporation contracts directly for goods or services with: other local authorities, the Police, Crown Prosecution Service, Greater London Authority, Clinical Commissioning Groups, National Health Service, Her Majesty's Prison Service, Fire Brigade or other public sector bodies no credit checks or financial appraisals are required. Such organisations are not currently subject to detailed financial scrutiny as they are underwritten by Central Government(s) and thus are deemed financially viable.
19. A proposal to use a credit agency to provide financial checks for suppliers rather than the in-house appraisal was submitted as part of the Chamberlain's Fundamental Review recommendations, considered and recommended by Resources Allocation Sub Committee, and ratified at Policy and Resources Committee in November 2019.

Conclusion

20. It is anticipated that removing the financial appraisal requirement from low risk procurement exercises will reduce pressure on both the Corporate Treasury Team and City Procurement, thereby streamlining lower risk procurements and increasing competition in tender exercises. As such, a recommendation to use credit agency checks in place of the in-house financial appraisal was submitted as part of the Chamberlain's Fundamental Review proposal. This paper seeks approval to change the process and enact the recommendation.

Appendix

- Additional Guidance for Financial Appraisals in Procurement

Background Papers

- Chamberlain's Financial Appraisals of Third-Party Entities, 21 July 2015

Chris Bell,

Commercial Director for City Procurement, Chamberlain's Department