

CITY OF LONDON
CHAMBERLAIN'S DEPARTMENT
INTERNAL AUDIT SECTION



CORPORATE
**REVIEW OF INSOLVENCY - FIRMS IN LIQUIDATION,
RECEIVERSHIP AND ADMINISTRATION**
FINAL REPORT

Date Issued: 2nd March 2016

Issued to:

John Barradell (Town Clerk and Chief Executive)
Peter Kane (Chamberlain)
Adrian Leppard (Commissioner of the CoL Police)
Peter Bennett (City Surveyor)
Michael Cogher (Comptroller and City Solicitor)

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Audit Fieldwork completed	25 th January 2016
Draft Report Issued	10 th February 2016
Management Response Received Agreeing Recommendations	1 st March 2016
Final Report Issued	2 nd March 2016

SECTION A: EXECUTIVE SUMMARY

Introduction

1. This review is being undertaken as part of the agreed 2015-16 internal audit plan and was last the subject of an Internal Audit review in 2006.
2. Since 2006, some 933 of the City's Suppliers (e.g. companies with whom the City of London procures goods, works or services) have been recorded on the City's Business Information System (CBIS) as having gone into administration, liquidation or receivership.

Insolvencies within the City of London Suppliers

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Totals
Administrations	10	13	28	15	50	64	30	11	12	23	256
Liquidations	17	48	74	40	124	188	48	44	30	36	649
Receiverships	<u>1</u>	<u>3</u>	<u>2</u>	<u>4</u>	<u>6</u>	<u>4</u>	<u>3</u>	<u>3</u>	<u>2</u>	<u>0</u>	28
Totals	28	64	104	59	180	256	81	58	44	59	933

3. [Construction News](#) reported in July 2015 that the number of construction firms experiencing financial distress (23,000) was up by 31% in the prior 12 months, which is roughly in accordance with the City's own data indicating an increase of 34% between 2014 and 2015.
4. With the City's level of expenditure and the current climate of austerity it is therefore increasingly important that robust procedures are in place setting out the steps to be taken when contractors, consultants and suppliers cease to trade. When this happens there is cause for concern because there is the risk of one or more of the following happening; staff time and therefore expense will be needed to appoint another firm; the new firm may cost more than the original; the project itself may be delayed and/or there could be a delay in regaining site possession, during which time the contractor or sub-contractors could strip the site of saleable assets already paid for. Further, consultancy cost could rise as a result of any of these factors, any of which could cause the project to go over the approved budget requiring additional expense and time in obtaining additional funding.
5. The systems in place must therefore be sound and those officers involved in the co-ordination of this process should be fully aware of the actions to be taken to minimise the risk of additional expense or delay to the completion of the project.

Audit Control Objectives

6. The purpose of this audit review was to give an assurance opinion to Chief Officers on the adequacy of corporate controls which are intended to mitigate risks to the City when firms go into administration, liquidation, or receivership.

Guidance and Co-ordination

7. This review has found that the previously published guidance directing officer actions has lapsed through various corporate changes and is no longer known to staff. We also found that the system needs improved co-ordination of the communication and recording of company details when insolvency applies.

Initial and On-going Financial Appraisals

8. We also found that there is a well-developed system in place within the Chamberlain's Corporate Treasurers Unit (CTU) for the financial appraisal of suppliers prior to contracts being entered into, and for the on-going monitoring of supplier accounts, where they have been assessed and are then used on contracts exceeding one year. Officers of the CTU carry out these evaluations in compliance with the detailed guidelines in place, along with a comprehensive list of specific checks and actions, to be carried out when financially appraising firms.

Recovery of Additional Costs

9. There is no specific assignment of responsibility for one officer, section or department to communicate with the CTU, contract managers and others so as to reconcile outstanding sums due to, or from, an insolvent firm, or whether a corporate right of set off needs to be employed.

Internal Audit Assurance Statement

Assurance Level	Description
Moderate Assurance	An adequate control framework is in place but there are weaknesses and/or a lack of compliance which may put some system objectives at risk.

Key Conclusion

10. The previously well embedded system for dealing with firms going into insolvency has deteriorated over recent years and now needs to be re-established under the directed control of one lead department or alternatively clearly establish roles and responsibilities that are fully understood by staff.

Recommendations	Red	Amber	Green	Total
Number Made:	0	3	0	3
Number Accepted:	0	3	0	3

SECTION B: AUDIT FINDINGS

Key Findings

Guidance

11. The current corporate Procurement Code ([Part Two](#)) at Rule 34 stipulates "In cases where a supplier become (or is about to become) insolvent and an insolvency practitioner becomes involved in the business, the City's standard form contracts allow the City to terminate the supplier's engagement. On occasion it may be that the insolvent supplier's business will be acquired by a third party as a going concern. In such cases the views of the Comptroller and City Solicitor's office must be sought as to whether a novation agreement will be required. The views of the Chamberlain's division must also be sought as regards conducting a due diligence exercise on the new owner of the business. City Procurement must therefore seek the advice of the Comptroller and City Solicitor's office when it becomes aware that suppliers have been acquired as identified above or where an approach has been made by a supplier to involve a third party in managing the contract. Contract Managers must also notify City Procurement if they become aware of their supplier being acquired so that the review can be undertaken by City Procurement and the Comptroller and City Solicitor's office."
12. Other rules/controls designed to minimise risks due to insolvencies were previously, defined within the Control of Projects Manual (CoPM) (Appendix 1) and in the "Procedures for Creditors in Liquidation" (Appendix 2). While compliance with the current Procurement Code is mandatory, continued compliance with the CoPM and the *Procedures for Creditors in Liquidation* is not. It was established that this previous more detailed guidance is now largely unknown to staff who have joined the City in recent years. Neither of these documents has been updated or replicated in the current suite of control documents.

Priority	Issue	Risk
Amber	There is currently a lack of detailed corporate guidance for officers to help co-ordinate their efforts when dealing with insolvencies.	The current lack of guidance is increasing the risk that additional recoverable costs may not be set off against other sums owed.
<p>Recommendation 1:</p> <p>The Chamberlain's Head of City Procurement should ensure that;</p> <p>(i) the insolvency guidance previously published in the Control of Projects Manual (Appendix 1), and the guidance applicable to the CBIS Payments and Data Team (Appendix 2), are updated to reflect modern communication practices as well as current departmental structures,</p> <p>(ii) this updated guidance is developed in consultation with the Comptroller and City Solicitor's Contracts and Litigation Sections, and those other departments as required, and</p> <p>(iii) this revised guidance is published in the Procurement Code to ensure a wide circulation amongst staff.</p> <p>(MK Ref: 01849)</p>		

Management Response and Action Plan

The recommendation is noted and will be actioned by the City Procurement Business Enablement team who will review the now out of date guidance, refresh it making sure it is widely consulted with appropriate areas of the Corporation (including Comptrollers) and provide new up to date guidance. Once this new process guidance is complete and approved, City Procurement will edit the City Procurement Code 2015 to make reference to the new guidance and processes.

Responsibility: Head of City Procurement, Policy and Compliance Officers

Target Implementation Date: Revised Guidance – April 2016, Procurement Code edits by June 2016.

Co-ordination

13. The co-ordination of this system is of considerable importance as it enables the speedy reaction to situations as they develop and both the communication and recording of insolvency details is integral to this process. The primary IT systems used for this updating/recording of a firm's status to one of insolvency is (i) KMX (Document Management System, controlled by the Comptroller and City Solicitor) and (ii) CBIS (Inactivation of Suppliers, controlled by the Payments and Data team).
14. When interviewed, officers were generally aware of the need to co-ordinate communication and actions with other officers, when they acquire information about a possible insolvency, but there is no longer a specific requirement for them to follow, other than in rule 34 of the Procurement Code referred to above, nor is there any direction as to how the information is to be shared and recorded.
15. This review therefore sought to verify the details recorded in respect of 16 of the City's Suppliers who were known to have gone into Administration, Liquidation or Receivership between 2006 and 2015. Of these 16 firms only one was found not to have had its status updated on either CBIS or KMX (Broadcast Support Services Ltd (BSS), City supplier number 31913). Of the remaining 15 firms, all were found to have been marked as Inactive on CBIS suspending further payments, but two of these, The Synergy Group Limited (Supplier Number 18985) and 16 Hoxton Square Limited (Supplier Number 25872) had no supporting notations in the "Supplier note" field to explain when each firm had been marked as inactive, whether this was the result of internal or external communications, nor any indication of the officer co-ordinating the reconciliation of amounts due from and owing to the firms.
16. Update of the CBIS "Supplier note" field is a primary control in this system as the

accessibility of CBIS across all departments assists in the co-ordination of a consistent corporate wide approach, by conveying key information to all CoL departments. This review therefore considered the use of the "Supplier note" field over the 933 firms identified as Insolvent between 2006 and 2015, finding that only 63% had some data entered in this field. Further scrutiny indicated that the use of this field has declined over the period from 89% in 2006, to 53% in 2015. Further, officers also confirmed that the previously maintained "Creditors in Liquidation" file, which had acted as the central register of Insolvent suppliers, is no longer being updated with detailed information about each insolvency.

Priority	Issue	Risk
Amber	There is insufficient information being recorded on CBIS when a supplier's status is changed to inactive as a result of insolvency.	Poor communication of information making efficiency less likely and the possible recovery of sums due less attainable.

Recommendation 2:

The Chamberlain's Head of City Procurement should instruct officers to complete the CBIS "Supplier note" field with information detailing:

- (i) the date and origin of information indicating the insolvency of a supplier,
- (ii) a uniform descriptor (e.g. LIQUIDATION) making data retrieval easier,
- (iii) the location of documents received in connection with any insolvency, and
- (iv) the identity of the officer making the amendment to this field

Consideration should also be given to introducing a monitoring process to check that the "Supplier note" field is being completed when appropriate.

(MK Ref: 01850)

Management Response and Action Plan

This is an accepted recommendation and will form part of the new guidance to be produced as per Recommendation 1.

The new guidance will make clear reference to the necessity for the Supplier details to be updated on CBIS and the information to be appended to the supplier record as outlined in i to iv above.

We will also produce a recommended monitoring process to be managed by City Procurement and the Chamberlain's CBIS team.

Responsibility: Head of City Procurement, Policy and Compliance Officers and the Senior Procurement Projects Officer.

Target Implementation Date: April 2016

Initial and On-going Financial Appraisals

17. The current corporate Procurement Code ([Part One](#)) at paragraph 36.1 stipulates that *"City Procurement are responsible in conjunction with the Chamberlain's Financial Division for ensuring that appropriate steps have been undertaken to appraise the financial standing of the contractor and any other risks for contracts with an estimated value over the EU threshold for supplies or services" (currently £172,514) "and valued £400,000 or more for works."* (Note the £172,514 threshold reference should be changed to £164,176 as of the 1st January 2016.)
18. We found that there is a well-developed process in place within the Chamberlain's Corporate Treasurers Unit (CTU) for the financial appraisal of suppliers. This service is generally requested prior to contracts being entered into, and for the on-going monitoring of Supplier Company Accounts where firms are being used on contracts, with a term exceeding one year, and/or their current Company Accounts are due to be renewed before expiration of the term.
19. CTU officers carry out these evaluations in compliance with the detailed guidelines in place, along with a comprehensive list of specific checks and actions, when financially appraising firms and establishing the "Contract" and/or "Workload" limits to be assigned to each firm. When a financial appraisal is completed officers write to the officer that requested the financial appraisal conveying the results of the appraisal.
20. Financial Appraisal results were reviewed in respect of 30 companies being considered for various contracts and framework agreements prior to their invitation to tender. Of these 30 firms, four were not approved for use due to concerns identified by the financial appraisal process, two firms were not approved for use as they were unable to submit their Full Company Accounts for scrutiny, and one firm who had initially submitted its Full Company Accounts, and been approved, was then identified by the on-going monitoring process and effectively 'rested' when it failed to submit current accounts some two months after they were due.
21. Various control documents were also reviewed in respect of firms subject to on-going appraisals in relation to (i) the Guildhall Catering Approved List, (ii) the ESPO Security Services Framework Agreement, and (iii) the LCP Major Works Framework Agreement. It was therefore verified that there is on-going financial appraisal of a further 42 firms previously approved for use on the City's contracts.

22. This review also requested the financial appraisal results of the firm BSS Ltd, referred to above, but found that the CTU had never been requested to carry out a financial appraisal of this firm. We therefore requested that the CTU carry out a financial appraisal of BSS Ltd based upon its last submitted company accounts for the year ending 31 March 2014 as if it had been considered for the CoLP Action & Know Fraud System and Associated Services. This financial appraisal highlighted various concerns regarding an over reliance upon a small number of clients and recognised pension liabilities, but nevertheless concluded that *"Based on these accounts, the company appeared financially satisfactory to undertake the contract against the City's normal criteria as they then applied (October 2014)"*.

Recovery of Additional Costs

23. In the past, notifications of insolvency were passed to the Comptroller and City Solicitor's Contracts or Litigation Sections to carry out a reconciliation considering the potential amounts owed to the City by the insolvent firm. This would involve the identification of contracts outstanding with the firm, consideration of any potential over/under payments on contracts, outstanding rents, outstanding rates etc. When this reconciliation was completed the Litigation Section would then consider whether or not to employ a 'right of set off' against any amounts still owed to the firm.
24. Interviews with staff indicate that this reconciliation exercise is no longer undertaken by the Comptroller and City Solicitor and we have been unable to confirm that it is actually being undertaken elsewhere.

Priority	Issue	Risk
Amber	It is currently uncertain which departmental team is responsible for the reconciliation of outstanding amounts owed to and from insolvent firms. We consider that given the current structure of the City Procurement Team, its responsibility in maintaining a corporate contracts register, and its ability to speedily identify those contracts and framework agreements in which particular firms are employed, this function would be best placed within City Procurement.	There is a risk that insufficient co-ordination of the reconciliation process could lead to a payment being made on one contract when amounts are still owed to the City on others.

Recommendation 3:

The Chamberlain's Head of City Procurement should clarify roles and responsibilities to ensure that the reconciliation process used to identify additional costs or amounts due to the City, as a consequence of a firms insolvency, is in future, undertaken by the City Procurement Team, and that any decision to exercise a right of set off against other amounts owed is taken after liaise with the Comptroller and City Solicitor's Assistant City Solicitor (Litigation and Contracts).

(MK Ref: 01851)

Management Response and Action Plan

City procurement will consult with Comptrollers over this area of responsibility and devise a clear process on who is responsible for which tasks to ensure the financial recovery process is effective.

Responsibility: Head of City Procurement, Policy and Compliance officers and Comptrollers Head of Contracts team.

Target Implementation Date: June 2016

APPENDIX 1: Past Corporate Requirements for Insolvency Risks

Following is an excerpt from CoL Control of Projects Manual - Appendix 12 (2010)

LIQUIDATION OF CONTRACTORS AND CONSULTANTS

Introduction

If a contractor ceases trading on a building or engineering contract there is a need for urgent action to be taken to secure appropriate sites and appoint a completion contractor as soon as possible. Settlements with failed contractors are required to be negotiated for the Corporation as a whole and one payment made to or from the relevant liquidator/receiver. It is therefore necessary for actions of the Corporation to be co-ordinated.

The following is a schedule of the main aspects to be considered when dealing with a contractor in liquidation. For more detailed guidance reference should be made to the publication "Insolvency of Building Contractors 2nd Edition" issued by the Society of Chief Quantity Surveyors in Local Government in September 1988.

Main procedures to be followed:-

1. Any rumours or unconfirmed reports that a contractor is suffering financial difficulties are to be reported to the Head of the Department who shall liaise with the Chamberlain (Financial Services Division) who shall then agree what action needs to be taken and if any other departments need to be informed.
2. Upon the failure of a consultant or contractor no further payments to the company are to be certified. The Chamberlain (Financial Services Division and Systems and Records Section) shall suspend all payments to the company until written approval has been received from the Comptroller and City Solicitor (Litigation Section). The company is not to be invited to tender for any further projects.
3. All outstanding contracts with the company should be immediately identified and any sites made secure. This will include the securing of any unfixed materials, plant and machinery etc. until ownership has been ascertained. Contractors can be appointed under emergency procedures to ensure sites are secure and are left in a safe condition if necessary. Details should be forwarded to the Chamberlain (Financial Services Division) and the Comptroller and City Solicitor (Litigation Section).
4. The Comptroller and City Solicitor (Litigation Section) shall represent the Corporation in dealings with the liquidator/receiver.
5. The Comptroller and City Solicitor (Litigation Section) should ascertain whether the liquidator/receiver intends to arrange for the completion of any outstanding projects and inform the technical departments and the Chamberlain (Financial Services Division) accordingly.

6. Outstanding works on projects are to be identified and revised specifications prepared if necessary.
7. Alternative contractors to complete outstanding projects should be appointed in accordance with chapter 6.
8. Details of any additional supervision and administration time spent on undertaking the completion contract must be recorded and details forwarded to the Comptroller and City Solicitor (Litigation Section) accordingly.
9. Upon completion of outstanding projects notional accounts are to be prepared indicating what the final costs would have been had the original contractor completed the project.

APPENDIX 2: Past Procedures for Creditors in Liquidation

These procedures must be followed when dealing with creditors who are in liquidation/administration/receivership.

1. Notification for freezing creditors which have gone into liquidation should come from Financial Services Division or Comptrollers & City Solicitors Department. A preliminary phone call may be made to the Payments Systems Section from the Financial Services Division or Comptrollers & City Solicitors Department to check for any outstanding payments. Confirmation, in the form of a memo, will follow.
2. The record can be frozen at the time of the phone call and a explanatory message should be inserted into the comment field on screen 771. E.g. 'IN LIQUIDATION'. If there is no record of the company on the system a new record should be created, which should be frozen immediately and a message inserted into the comment field on screen 771.
3. All requests and subsequent action taken on the creditors system by an administrator from the Payments Systems Section must be checked by another administrator from the Payments Systems Section.
4. Written requests for freezing creditors should be initialled and dated by an administrator from the Payments Systems Section and any action taken noted on the request. This should then be filed alphabetically in the 'Creditors in Liquidation' file. If the request to freeze the creditor was taken over the phone a screen print should be taken, which should also be signed and dated and a note of the person who requested the freeze should be made on this print. This should also be filed alphabetically in the 'Creditors in Liquidation' file, awaiting written confirmation.
5. The form contained at the front of the 'Creditors in Liquidation' file should be completed to keep a record of any action to freeze a creditor in liquidation. This should include Creditor No, Creditor Name, details of action taken, date of action, name of person who requested action, initials of person who amended system, initials of person who checked request and amendment and date confirmation memo received.
6. Notification to remove the block on frozen creditors in liquidation should only come from Financial Services Division or Comptroller & City Solicitors Department. This will come in the form of a phone call which will be followed up by a written confirmation. Under no circumstance must creditors be unfrozen following a request from creditor users.
7. Written requests for unfreezing creditors should be initialled and dated by an administrator from the Payments Systems Section and any action taken noted on the request. This should then be filed alphabetically in the 'Creditors in Liquidation' file. If the request to unfreeze the creditor was taken over the phone a screen print should be taken, which should also be signed and dated and a note of the person who requested the creditor to be unfrozen should be made on this print. This should be filed with the original request to freeze the creditor in the 'Creditors in Liquidation' file, awaiting written confirmation.
8. The form contained at the front of the 'Creditors in Liquidation' file should be completed to keep a record of any action undertaken on a creditor in liquidation.
9. When a creditor has gone into liquidation and the company name is amended to form a new company, the original creditor record should remain frozen and a new creditor record created with the new company name.

APPENDIX 3: AUDIT DEFINITIONS AND RESPONSIBILITIES

Assurance levels

Category	Definition
Nil Assurance 'Dark Red'	There are fundamental weaknesses in the control environment which jeopardise the achievement of system objectives and could lead to significant risk of error, fraud, loss or reputational damage being suffered.
Limited Assurance 'Red'	There are a number of significant control weaknesses and/or a lack of compliance which could put the achievement of system objectives at risk and result in error, fraud, loss or reputational damage.
Moderate Assurance 'Amber'	An adequate control framework is in place but there are weaknesses and/or a lack of compliance which may put some system objectives at risk.
Substantial Assurance 'Green'	There is a sound control environment with risks to system objectives being reasonably managed. Any deficiencies identified are not cause for major concern.

Recommendation Categorisations

Priority	Definition	Timescale for taking action
Red - 1	A serious issue for the attention of senior management and reporting to the appropriate Committee Chairman. Action should be initiated immediately to manage risk to an acceptable level	Less than 1 month or more urgently as appropriate
Amber - 2	A key issue where management action is required to manage exposure to significant risks, action should be initiated quickly to mitigate the risk.	Less than 3 months
Green - 3	An issue where action is desirable and should help to strengthen the overall control environment and mitigate risk.	Less than 6 months

Note:- These 'overall assurance level' and 'recommendation risk ratings' will be based upon auditor judgement at the conclusion of auditor fieldwork. They can be adjusted downwards where clear additional audit evidence is provided by management of controls operating up until the point of issuing the draft report.

What Happens Now?

The final report is to be distributed to the relevant Head of Department, relevant Heads of Service, and those involved with discharging the recommended action.

A synopsis of the audit report is provided to the Chamberlain, relevant Members, and the Audit & Risk Management Committee.

Any Questions?

If you have any questions about the audit report or any aspect of the audit process please contact Dan Doherty, Audit Manager on Ext 1299 or Anna Simmonds, Senior Audit Manager on 07972 004266, or via email to Anna.Simmonds@cityoflondon.gov.uk.