

Audit, Risk & Assurance Committee

Date	Monday 4 th December 2023
Report title	Financial Due Diligence checks on suppliers in response to Rail Package 1
Accountable Chief Executive/TfWM Director	Laura Shoaf, Chief Executive, West Midlands Combined Authority. Email: laura.shoaf@wmca.org.uk Tel: (0121) 214 7444
Accountable Employee	Linda Horne, Executive Director of Finance and Business Hub, West Midlands Combined Authority. Email: linda.horne@wmca.org.uk Tel: (0121) 214 7508
Report has been considered by	Linda Horne, Executive Director of Finance and Business Hub, Section 151 Officer

Recommendation(s) for action or decision:

The Audit, Risk & Assurance Committee is recommended to:

- (a) Note the financial due diligence process carried out when awarding contracts.
- (b) Note the ongoing financial checks and mitigations in place for future contract awards.

1. Purpose

- 1.1 To update ARAC on the financial due diligence procedures that were carried out at contract award for Buckingham Group Contracting Limited (BGLC) in June 2021.
- 1.2 To provide update on what procedures are in place to manage risk and keep an update on suppliers post contract award.
- 1.3 To update ARAC on the risk outlined in the WMCA Strategic Risk update which was presented to ARAC in October 2023.

2. Background

- 2.1 The New Stations Package 1 Full Business Case was approved at WMCA Board on 15th January 2021, with a total project budget of £55.84m being confirmed.
- 2.2 Following a compliant tendering process, the construction contract for Rail Package 1 was awarded to BGCL in June 2021.

- 2.3 BGCL submitted a notice to appoint administrator in August 2023, and formal appointment of an administrator, Grant Thornton UK LLP, was made on 4th September 2023.
- 2.4 On 4th September 2023, Kier Group Plc announced that it had agreed to acquire substantially all the rail assets from Buckingham Group Contracting Limited and their HS2 contract supplying Kier's HS2 joint venture, EKFB, for a total consideration of £9.6m.
- 2.5 WMCA Board were presented with a project update on New Stations Rail Package 1 on 13th October 2023 and were asked to note the insolvency and administration proceedings of the principal contractor for the New Stations Package 1 project, BGCL. In addition, were asked to note the decision made at WMRP Board on 28th September 2023 to novate the Package 1 main works contract to Kier Integrated Services Limited.

3. Financial Implications

- 3.1 A summary of financial due diligence checks on BGCL has been outlined below. The timeline of events leading up to the contract award in June 2021, and result of the financial checks and credit scores are also outlined in Appendix 1.
 - 3.1.1 As part of the procurement process leading up to the contract award, financial tests were carried out on 3 years financial statements using the standard WMCA financial due diligence template which is used for all new suppliers. In addition, credit checks were carried out.
 - 3.1.2 As part of the Package 1 award process, these checks were carried out on the 2017, 2018 and 2019 audited financial accounts. The output results passed all criteria. In addition, the credit safe report generated a score of 96-Grade A indicating very low risk.
 - 3.1.3 BGCL also submitted bids in the tender processes for both University Station and Rail Package 2. The same checks were carried out, in both separate processes with the same results, passing all test criteria.
- 3.2 It was noted that the financial difficulties that were experienced by BGCL which ultimately led to the company filing for administration were not within the rail division itself but were a result of other financial pressures within other aspects of the BGCL business, namely sport and leisure.
- 3.3 The rail division of BGCL was sold and acquired by Kier Group Plc for £9.6m. Prior to the recommendation to novate the construction contract to Kier Group Plc, which was approved at WMRP Board on 28th September 2023 and notified to WMCA Board in October 2023, appropriate financial checks were also carried out on Kier Group Plc and Kier Integrated Services Limited.
- 3.4 A summary of the results from the assurance checks are outlined in Appendix 2.
- 3.5 It was noted that Kier Integrated Services Ltd, a subsidiary of Kier Group Plc is the legal entity noted on the novation agreement. The financial checks for Kier Integrated Services

did not pass, however, a Parent Company Guarantee with Kier Group Plc was obtained as part of the novation agreement to provide additional security for WMCA.

- 3.6 In addition to financial checks carried out on Kier Group Plc prior to approving the decision to novate, a value for money exercise to compare options between either continuing to novate or terminating/reprocuring was carried out and was outlined in the WMCA Board report in October 23.
- 3.7 The situation experienced with BGCL going into administration was unfortunate and a result of unforeseen circumstances which were outside of WMCA control. Given the recent market fluctuations due to external global economic and political factors, WMCA will inevitably have on-going exposure risk.
- 3.8 Prior to the BGCL situation WMCA had recently reviewed and refreshed its existing financial due diligence processes to reflect current best practice and ensure that they remain fit for future. These are an integrated part of any procurement process and allow for any identified financial risks to be considered. This may include the use of mitigations strategies such as parent company guarantees or performance bonds.
- 3.9 Once contracted, ongoing supplier due diligence is undertaken on the basis of risk. The vast majority of goods and services are paid in arrears of receipt which limits the financial exposure of WMCA in the event of an administration in terms of recovering monies. Advance payment profiles require sign off by S151 to ensure that risks have been assessed and exposure limited, e.g. paying in advance by 1 month, regular performance monitoring meetings.
- 3.10 There are limited actions that any organisation can take to protect itself against the delivery risks associated with supplier financial failure, which include cost exposure for full projects. However, WMCA's organisational response to the BGCL situation was swift across all areas of the business to ensure that decision making was informed and timely to reach the best possible outcome for the ongoing project.

4. Legal Implications

- 4.1 The construction sector is notorious for the financial volatility of its construction companies as such entities are usually little more than a commercial cash flow hub for the receipt and distribution of income to third parties.
- 4.2 The key to insolvency is a policy that allows action by the Client to take early or timely action to control and mitigate the consequences of insolvency.

Forewarning of insolvency

- 4.3 Although insolvency events occur suddenly, a client should by its project management teams use insolvency indicators in their administration and supervision of a project, the usual indicators of a contractor's financial difficulties are:
- Reduced or absent site activity

- Productivity decline
- Programme delay
- Failure to close out the works
- Failure to pay sub-contractors
- Other clients' experience with the contractor
- Increase in defects picked up on inspections during the carrying out of the works
- Rumours from site, mutterings about not being paid on time or at all
- Contractor requests for changed/improved payment terms, including advanced payments

4.4 Once a picture of potential difficulties builds up, the project administration should put the project on an escalated level of supervision to manage the period before any insolvency formally happens.

Contractual obligations

4.5 It is important that the contract is properly administered in order to use the mechanisms in the contract that will enable the client to limit the impact of any insolvency such as requiring in the building contract:

- full administration of the contract
- requiring the contractor's application for payments to include evidence of payment to date of subcontractors and the right to temporary withholding of further payment to the contractor if such evidence is not forthcoming.
- security from the Contractor such as Parent Company Guarantees and Performance Bonds at contract (and not leaving it post contract)
- inclusion of terms for retention in the contract
- inclusion within the contract of prior written approvals from the Client for all selection of subcontractors and sight of the subcontract terms
- requiring vesting certificates where payment is made for materials in advance of delivery to site
- collateral warranties on appointment of subcontractors to be received at contract and not leaving it post contract
- clear provisions requiring the contractor to provide all documentation for a project on an insolvency event and a requirement to assign the benefit of subcontracts to the client (to include provisions for transfer of data and software if BIM is used)
- asking for annual confirmation of insurances being maintained

4.6 In this case, the contract was correctly drafted by Addleshaw Goddard but it would be worth checking that the project management team does implement the terms.

Appendix 1 – timeline of events leading up to BGCL contract award.

Date	Check / Evaluation	Project	Result
October 2019	Financial PQQ Evaluation	University Station	Pass all tests in all 3 years 2016/2017/2018
September 2020	Credit Safe Report	Rail Package 1	Score = 96 [A] Very Low Risk
September 2020	Financial PQQ Evaluation	Rail Package 1	Pass all tests in all 3 years 2017/2018/2019.
September 2021	Credit Safe Report	Rail Package 2	Score = 96 [A] Very Low Risk
September 2021	Financial PQQ Evaluation	Rail Package 2	Pass all tests in all 3 years 2018/2019/2020.

Appendix 2 – Summary of Kier Group Plc financial due diligence checks

Kier Group Plc (KG Plc): £3.1bn Turnover 2022

- Credit Score: 67 Grade B Low Risk
- 2023 Full Year trading update ahead of publishing Full Year 2023 results on 14/09/2023 – released 20/07/2023.
- Half Year to December 2022 (unaudited) – statement released 09/03/2023 - Pass Flag as Risk
- Full Year to June 2022 (audited) – Pass Flag as Risk.
- Full Year to June 2021 (audited) – Pass Flag as Risk.

Kier Transportation Limited (KT Ltd): 532m Turnover 2022

- Credit Score: 100 Grade A Very Low Risk
- Full Year to June 2022 (audited) – Pass.
- Full Year to June 2021 (audited) – Pass.

Kier Integrated Services Limited (KIS Ltd): £593m Turnover 2022

- Credit Score: 93 Grade A Very Low Risk
- Full Year to June 2022 (audited) – Fail on Liquidity grounds.
- Full Year to June 2021 (audited) – Fail on Liquidity grounds.