

Transport and Environment Committee

10.00am, Thursday, 5 October 2017

Leith Walk Phase 4 – Appointment of Land Engineering

Item number	7.10
Report number	
Executive/routine	
Wards	
Council Commitments	

Executive Summary

At the meeting of Council on 29 June 2017, a motion was approved seeking additional detail of the circumstances surrounding the appointment and subsequent collapse of Land Engineering, the company responsible for undertaking the Phase 4 Leith Walk repairs between Pilrig Street and McDonald Road.

In discharging the motion, this report details the assessment undertaken prior to contract award, the actions taken by the Council immediately following the collapse and proposed improvements to mitigate the risk of similar business failure going forward.

Leith Walk Phase 4 – Appointment of Land Engineering

1. Recommendations

- 1.1 It is recommended that members of the Transport and Environment Committee:
- 1.1.1 note the contents of this report; and
 - 1.1.2 refer this report to the Finance and Resources Committee for consideration of any relevant improvements that may be introduced across the Council's wider procurement and contract management processes.

2. Background

- 2.1 The Leith Programme comprises £9.1 million of major improvement works to the roads, footways and street furniture in Leith Walk and Constitution Street, to be delivered in a number of phases over several years. Phases 1 to 3 of the scheme have previously been completed.
- 2.2 Land Engineering was contracted by the Council to undertake Leith Walk Phase 4, being the section between Pilrig Street and McDonald Road. On 1 June 2017, however, whilst working on the scheme, the Council was formally notified that the appointed contractor had been placed into administration.
- 2.3 While, in accordance with established contingency arrangements, a replacement framework contractor was quickly mobilised, in view of any potential costs arising from the disruption and wider lessons to be learned, a motion was approved by Council on 29 June 2017 requesting details of:
- the work undertaken, if any, to assess the financial viability of Land Engineering in light of the company's large losses in 2015;
 - an explanation of whether and when any subsequent reviews of the company's financial position took place after awarding of the contract;
 - whether any bonds, or other indemnities, were included in the contract; and
 - the financial consequence of the demise of Land Engineering for Council Tax payers.

3. Main report

Due diligence

- 3.1 The due diligence of potential contractors is carried out at the tender stage of procurement projects. This includes carrying out mandatory checks of suitability, including legal and financial standing, experience, adherence to policies and other standards specific to the requirement.
- 3.2 The financial checks currently include a detailed review of the most recent two years' financial accounts, the organisation's turnover relative to the anticipated contract value, the current ratio (current assets / current liabilities), net worth and a third-party credit agency check. The checks are undertaken by the Council's Finance Division and the level of checking is proportionate to the value and complexity of the contract, aligning with other public sector and most commercial organisations.
- 3.3 The specific financial checks performed as part of the procurement process are reviewed on a project-by-project basis. There is, however, an overriding objective of maintaining consistency of approach, balancing the consideration of all normal commercial risks with looking to avoid creating barriers for small and medium enterprises (SMEs).
- 3.4 For limited companies, accounting records are historic, filed up to twelve months after the year-end on a public register. The Council may additionally ask for up-to-date accounts, particularly for high-value, high-risk projects. These statements will, however, be unaudited and may contain commercially-sensitive information which companies may be unwilling to share and the Council cannot oblige them to do so in terms of relevant procurement rules.
- 3.5 If potential or actual risks are identified, the Council can ask for insurance or performance bonds to be put in place to mitigate any risk of financial loss. In some instances, putting in place this safeguard may incur additional costs for the Council. This approach would not, however, address the disruption caused to the Council from an insolvency and is recognised by the Scottish Government to create barriers for SMEs. Public authorities are therefore asked to act proportionately when introducing such measures.
- 3.6 While a potential provider may present apparently-healthy financial figures, the Council cannot predict future events. Examples would include poor decisions, court actions and bad debts that could occur following the contract award and could send the company into administration.
- 3.7 Due diligence prior to contract award is carried out on all contracts procured through Commercial and Procurement Services (CPS). Building on this, CPS's Contract Management team is working with service areas to embed a consistent approach to contract management across the Council.
- 3.8 Post contract award, ongoing, proportionate contract management is a key requirement to manage suppliers, ensuring operational and financial performance is

maximised while commercial risk is minimised and managed. This is further supported through business continuity plans and contractual terms and conditions that assist with the identification and management of unforeseen events.

Land Engineering – pre-contract financial assessment

- 3.9 In accordance with the process above, financial assessments are carried out on bidders using the most recently-available audited accounts, with contracts assessed for risk using a standardised matrix. In the case of Land Engineering, the accounts assessed were prepared as of 31 August 2015, with the accounts for 31 August 2016 not due for submission until 28 May 2017 in line with Companies House's normal requirements.
- 3.10 As part of the evaluation, it was noted that Land Engineering's Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) were £0.808m but, after depreciation, there was an operating loss of £0.146m and a loss for the year after interest and tax of £0.305m, compared to a small profit of £0.067m in 2014. Expressed relative to the organisation's turnover and in comparison with industry norms, however, this level of loss did not cause any specific concerns or in any way form the basis of non-consideration of the organisation's tender submission.
- 3.11 The turnover for the most recent financial year was £39.912m which, against an expected annual contract value of £1.000m, ensured that Land Engineering comfortably passed the financial capacity (turnover) test for the contract.
- 3.12 The financial assessment process also includes consideration of an organisation's ability to meet its short-term and long-term obligations through calculation of its current ratio. In general terms, a higher ratio is considered to indicate greater relative financial stability. For the year ending 31 August 2015, Land Engineering's current ratio was 1.36, similar to the 1.34 for the previous year. These ratios compared favourably to those for the other bidders. Assessments of Land Engineering's net assets were also favourable in both absolute and relative terms.
- 3.13 Land Engineering's credit score was also requested from a third-party credit agency which returned a value of 92, representing a 0.9% likelihood of failure as assessed by the agency. The Council additionally now has access to services from a separate agency and, even for the period immediately preceding Land Engineering's collapse, this continued to note a low risk of failure.

Reviews undertaken post-contract award

- 3.14 After the awarding of the Leith Walk Phase 4 works contract, further reviews were carried out on Land Engineering, albeit in the context of other tender commissions. As the next annual accounts were not due until 28 May 2017, however, these were by necessity undertaken on the same financial statements.

Bonds or other indemnities used

- 3.15 The use of performance bonds for procurement contracts is not generally a practice employed by the Council as they are not considered to represent value for money.

As Land Engineering comfortably passed the overall financial assessment, however, no further indemnities were included in the contract.

Action taken following Land Engineering's entering administration

- 3.16 Land Engineering's employment under the Leith Walk Phase 4 project was terminated on 2 June 2017. Another framework contractor was, however, appointed to complete the works within two working days, with the successful novation of contracts limiting disruption to service users and related projects. The Council is exercising its rights to offset the additional costs to complete the works from any sums due to Land Engineering. The Council is in discussion with the administrator on this issue.

Potential improvements to financial assessment processes

- 3.17 The Council awards, on average, around 450 contracts annually. No process can eliminate delivery risk entirely and, as a result, the Council will continue to consider any opportunities to improve its business continuity arrangements on a regular basis.
- 3.18 Opportunities will, however, be examined to improve the assessment process further by setting up news alerts for all companies working on medium- and high-risk contracts. This will make the Council more aware of events potentially resulting in significant changes to the financial standing of the companies concerned. As with Land Engineering, however, it may be that the company enters administration before this information becomes available; a thorough search for information on the day of its collapse revealed no obvious signs of immediate distress being signalled.
- 3.19 A pilot is also currently being run to improve contract management on all Council contracts. This should encourage the development of mutually-beneficial relationships and, in some cases, provide earlier warning of potential difficulties.

4. Measures of success

- 4.1 Measures of success will include a further reduction in the small percentage of Council suppliers entering administration. Given that this risk can never be entirely eliminated, however, where it materialises, of equal importance is that the Council mitigates any disruption and associated financial impact to the citizens of Edinburgh.

5. Financial impact

- 5.1 There are no direct financial impacts of this report but the Council is seeking independent legal advice regarding its right to offset the amount due for Leith Walk Phase 4 with the administrator of Land Engineering.

6. Risk, policy, compliance and governance impact

- 6.1 There is a risk that relying on historic financial information fails to alert the Council to the likelihood of a supplier's failing. While, as noted above, this risk cannot be eliminated, it should be mitigated by using an up-to-date third party credit score and becoming more pro-active with supplier relationships.

7. Equalities impact

- 7.1 There is no direct relevance of the report's contents to equalities-related issues. However, the Council should ensure value for money for all of Edinburgh's inhabitants.

8. Sustainability impact

- 8.1 There are no impacts on carbon, adaptation to climate change and sustainable development arising directly from this report.

9. Consultation and engagement

- 9.1 Finance and procurement will engage with staff across teams and consult key stakeholders as part of the improvements to the processes.

10. Background reading/external references

- 10.1 [Item 25 – Leith Walk Works – Motion by Councillor Daggart](#)

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11. Appendices

None.