

Norwich City Council

SCRUTINY COMMITTEE

Item 6

REPORT of the Chair of the scrutiny committee for the meeting to be held on 24 February 2011

Letting of Housing & Maintenance, and Environmental Contracts – Due Diligence

Purpose

Examination to assess the council's due diligence process of the letting of contracts and to see if improvements could be made for the future.

1. The Tender Process

- 1.1 There was a thorough and lengthy process leading up to the awarding of the contract to Connaught Partnerships Ltd, by the council. This involved all of the political groups that made up the council at the time in the form of the contracts working party. Because the decision was within the budget and policy framework the final decision was made by the cabinet. The working party was set up as a consultative body to advise the cabinet.
- 1.2 In 2008 the council entered into a standard bidding process in accordance with public contracts regulations. This work was completed in February 2010. There were 171 initial responses to the council's advert for contracts. At the pre-qualification stage bidders had to respond to a detailed questionnaire and also provide supporting materials. This questionnaire was completed by 57 companies. The questionnaire requested detailed information such as financial, contractual, capacity and experience. From this a shortlist of 38 was produced. At this stage the council provided the interested bidders with a detailed specification and requested that tenders be submitted that detailed how the requirements of the council would be met and the price that would be charged.
- 1.3 An evaluation model was then agreed and published with the tender documents, and this was used during the evaluation process. Two teams were set up, one to carry out a price review and the other to review quality. The groups then asked a series of further questions of the companies. The results of this part of the process were then collated and a final point score given to each tender. This equated to 60% of the marks available for the housing contract on quality and 40% on price.

- 1.4 All the evaluations carried out were overseen by an external procurement specialist (Tribal Helm).

2. The collapse of Connaught Partnerships Ltd - understanding what happened

- 2.1 KPMG were called in as administrators to wind up Connaught's social housing unit in early September 2010. There had already been rumours of accounting irregularities, and at the time of the collapse of the company, it had been widely reported that due to the new government's cost-cutting requirements there was a reduction in available funds for housing projects in local government.
- 2.2 It has been reported in the mainstream media and the specialist construction industry press that many felt that a major factor in Connaught Partnerships Ltd fall was a succession of loss – making service contracts that they had entered into with the public housing sector. In the construction and maintenance industry these loss making contracts/bids are known as “suicide bids”. Charlie Parker, the investment editor of Citywire said when interviewed regarding the collapse of the company, on BBC radio's five live - wake up to money programme; “In the construction trade they rather unpleasantly call it suicide bidding, where you bid so low that it actually potentially jeopardises your company”.
- 2.3 The other prime factor alluded to, local government cut backs would have had an impact on Connaught Partnerships Ltd and this was highlighted in views expressed by unions. Dave Prentice, general secretary of the Union of Public Services has said that the collapse of Connaught Partnership's Ltd should be “a huge wake up call to the damage that public spending cuts are having on the private sector”.
- 2.4 Connaught Partnerships Ltd itself warned in the summer that it would suffer from public sector austerity drives and that deferred contracts from local authorities could take £13m off this financial years profits and £16m off next years. This news led to damaged confidence on the FTSE 250 in the company.
- 2.5 Could it be the case that Connaught Partnerships Limited engaged in so-called suicide bidding, which left them more vulnerable than most of their competitors once austerity measures in local government began to take hold?

3. Scrutiny Questions to be considered

- a) A general evaluation of the bidders seems to have taken place but was a detailed due diligence look into Connaught Partnerships Ltd taken? If so, when did evaluation end and due diligence in to Connaught Partnerships Ltd begin?
- b) Who was selected to assess Connaught Partnerships Ltd suitability? How were they selected?
- c) Why did we use who we did for this work?

- d) What was the brief given to the contractors? And in hindsight, was the brief adequate? What regard was given to due diligence principles?
- e) Were the right questions asked of Connaught Partnerships Ltd? If as stated and the Connaught Partnerships Ltd business model was rigorously tested, how does the council account for the extensive administrative problems during the contract's time of operation, an example of which would be repeated reports of missed appointments?

And before recommendations were made to the contracts working party, Tribal Helm carried out mathematical checks and reviews of the scores to check that marks had been awarded correctly. To what extent was this a qualitative review on the bids themselves and was any work done by Tribal Helm at this stage to ensure that quality commitments by bidders were deliverable?

- f) In procuring the contractors to carry out due diligence, was it considered that they would be required to take account of Connaught Partnerships Ltd being a large FTSE registered company that was exposed to the risks incurred on the stock market?
- g) Was a separate look at and report made on the financial viability of Connaught Partnerships Ltd, including their accounting procedures as opposed to just their financial position?
- h) The current economic situation and austerity measures that affect local government had begun to take effect since the change in government last May. When the contract was awarded the national economic position was known as was the likelihood of a change in government. Was the likely impact of this taken into account in the due diligence process?
- i) What efforts were made to speak with local authorities that had previously employed Connaught Partnerships Ltd to undertake work with them? And were any unions involved approached for information and views?
- j) What further checks were made when Connaught Partnerships Ltd tender bid was found to be so much more competitive than the other tenders?

And based on the concerns raised by Morrison and their challenge of the award made to Connaught Partnerships Ltd, what further checks were made?

- k) Who at the council was responsible for overseeing any due diligence process?
- l) Were questions asked about the level of risks being taken by bidders (Suicide bidding)? What answers did Connaught Partnerships Ltd give to this?

- m) Connaught Partnerships Ltd price was substantially lower than many other bids; was there evidence that Connaught Partnerships Ltd had successfully delivered contracts of the same nature in the past? If so, how many and over what period?
- n) Has Tribal Helm done any work on behalf of Connaught in the past?
- o) If we had found problems with Connaught Partnerships Ltd bid and were not happy to enter into/finalise a contract with them, could we have pulled out and re tendered. If not why not? And how would this have affected the council in terms of consequences?

4 Conclusions and Recommendations

- 4.1 What conclusions can the committee draw from the information gathered? Can recommendations be made which would improve Norwich City Council's procurement process and provide more protection for the council in future?
- 4.2 Should further due diligence checks be carried out before a contract is awarded? Are there any particular factors which might ring alarm bells and suggest that further due diligence is required?
- 4.3 As local authorities are more and more finding themselves in positions of awarding contracts and becoming more involved with companies that are exposed to the gains and dangers of the stock markets, do councils need to be much more diligent in their dealings with contractors and strengthen their testing process? Do similar problems exist in the private sector and if so, how are they addressed?
- 4.4 How much could the accounting practices of a successful bidder be explored before a contract is awarded?
- 4.5 Is it possible for councils to delay settling large contracts in the run up to a general election, just as many private companies do, while waiting to see how any change of government might impact on them and the economy?

Contact Details:-

Councillor Claire Stephenson – Chair of scrutiny

Scrutiny Questions to be considered

Background to aid with answers to questions

To aid with the answers to the questions the following paragraphs give some background and context.

Procurement of goods, services and works by Norwich City Council (“the council”) is regulated directly by the Public Contracts Regulations 2006 (“the regulations”). The regulations determine that procurement must be open, fair and transparent and particularly that the council must treat economic operators (such as tenderers, contractors, suppliers, which are terms which are used interchangeably by many to meant eh same thing – the other party to the contract) equally and in a non-discriminatory way. The council must also act in a transparent way.

The regulations lay down prescribed procedures leading to the award of a contract. In the case of the Connaught Partnerships Limited contract the restricted procedure was adopted. This is a two stage procedure where economic operators are initially assessed for their economic and financial standing as well as technical or professional ability. Once suppliers have passed this, or where there are many suppliers the top suppliers, they are invited to tender and provide quality and price information for the goods, services or works requested by the council.

Regulation 23 of the regulations lists criteria for the rejection of economic operators without any further need for assessment. There are some mandatory requirements to reject economic operators who have been convicted of serious offences such as bribery and fraud. Further there are discretionary grounds for rejection such as for committing an act of grave misconduct or being convicted of a criminal offence relating to the conduct of their business. An example may include a conviction for a health and safety offence and the council would then need to decide whether to reject the economic operator or whether they have improved such that it is unlikely that they would still represent a risk.

Regulation 24 determines the factors that can be taken in to consideration to assess an economic operators economic and financial standing. In summary these are

- Appropriate statements from the economic operators bankers or where appropriate evidence of relevant professional risk indemnity insurance
- Statements of accounts where their publication is required by law
- Statements of the last three years turnover in general and in relation to the goods, services or works that are being tendered.
- Other information if the above is not appropriate

Whatever information is required it must be stated in the notice that the council must publish in the Official Journal of the European Union (OJEU) at the beginning of the tender process.

Due to the nature, complexity and risk associated with the re-provisioning of the services the council engaged Tribal consulting to assist with the programme management for these services. The annual spend on the services was around £37 million for 26 service contracts with CityCare covering housing and non housing works and services as well as highways services, waste services, grounds maintenance and street cleansing.

The council used a pre-qualification questionnaire (PQQ) to assess suppliers suitability and in particular to request information about economic and financial standing.

The PQQ used was a template published by the Office for Government Commerce along with a model evaluation. This was reviewed by the Contracts Working Party on 27 March 2009 who resolved to:

- (2) recommend the use of the Office for Government Commerce Pre-Qualification Questionnaire to the Executive subject to clarification by the Head of Procurement and Service Improvement in regards to the discretionary grounds for rejection on page 26 of the document.
- (3) recommend the approval of the weightings described in the report and as detailed in the Office for Government Commerce Pre-Qualification Questionnaire and the Pre Qualification Questionnaire: Evaluation Methodology Version, to the Executive.

The PQQ was then reviewed by Cabinet on 8 April 2009 who resolved to:

- (1) use the Office for Government Commence Pre-Qualification Questionnaire Version 0.1 as at Appendix 1 of the report;
- (2) approve the weightings as described in the report and as detailed in the office for Government Commence Pre-Qualification Questionnaire : Evaluation Methodology Version 0.1 as at Appendix 2 except for voluntary disqualification items discretion is used as detailed in the report (Part G of the evaluation criteria).

The term due diligence appears to have different meanings depending on who is using it. In general terms due diligence appears to be used in the following circumstances

1) Company takeovers/mergers

This is the formal process for checking that the proposed takeover or a merger of companies will meet the business case objectives and that statements made about the company being taken over are true and can be substantiated.

2) Defences for strict liability offences

For offences that do not require the proof of “mens rea” or guilty knowledge, there is often a defence that the accused took reasonable precautions and exercised due diligence. Reasonable precautions means having a prevention

system or procedure in place whilst due diligence means testing the system to make sure it works. An example would be that a fire alarm system is a reasonable precaution whereas checking that it works by testing it regularly would be due diligence.

Whilst neither of these definitions of due diligence would appear to be appropriate to checking potential suppliers or the tenders they submit, due diligence is often the terms used simply to mean that checks are carried out to ensure that what is offered can be delivered and that the supplier offering it is capable of delivery.

In relation to a restricted tender there is due diligence both at the PQQ stage and the tender evaluation stage.

In relation to the PQQ Tribal conducted the review of the financial elements of suppliers and conducted a further check of Connaught plc in November 2009.

In relation to the tender evaluation, officers and tenant representatives evaluated the tenders. Tribal checked to ensure that this had been applied consistently. Then further checks were undertaken by officers once the intention to award had been confirmed by Cabinet in November 2009.

In relation to Tribal for clarity the council originally contracted with Helm Corporation who later became part of Tribal Consulting.

a) A general evaluation of the bidders seems to have taken place but was a detailed due diligence look into Connaught Partnerships Ltd taken? If so, when did evaluation end and due diligence in to Connaught Partnerships Ltd begin?

As described in the introduction there was a two stage process to evaluate the PQQ's and a second process to evaluate tenders.

As described in the introduction Tribal Consulting carried out the evaluation of suppliers against the pre-qualification questionnaire and evaluation methodology in relation to economic and financial standing in conjunction with officers of the council who evaluated other areas such as previous experience and obtained references.

Part of the evaluation process was the review of 3 years audited accounts of Connaught plc the parent company of Connaught Partnerships Limited. In this case the parent company was evaluated as they would provide a parent company guarantee in relation to the company who were bidding for the contract, in this case Connaught Partnerships Limited.

At the time the PQQ's were evaluated in 2009 the latest set of accounts for Connaught plc that were available was 2008. These accounts had already been audited by external auditors and they stated as follows in the report:

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 August 2008 and of its profit and cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the group financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Bristol
28 October 2008

In November 2009 Tribal conducted a further check of Connaught plc to take in to account the 2009 published accounts.

**b) Who was selected to assess Connaught Partnerships Ltd suitability?
How were they selected?**

c) Why did we use who we did for this work?

To answer questions b) and c) together, Connaught Partnerships Limited were assessed by Tribal Consulting and officers of the council. Tribal were selected from the Office for Government Commerce framework agreement for the provision of Financial Management Consultancy, Accountancy Services and Audit and Assurance. This was a framework where suppliers were pre-qualified to carry out consultancy work. The rules for the framework meant that supplier's capability had already been assessed and they had passed. Calling off from the framework was then against the supplier who offered best value and Tribal had the most competitive rates on the framework.

d) What was the brief given to the contractors? And in hindsight, was the brief adequate? What regard was given to due diligence principles?

Tribal worked with council officers to determine the most appropriate evaluation methodology. The pre-qualification questionnaire and scoring methodology was reviewed by the Contracts Working Party and approved by Executive.

The Public Contracts Regulations do not contain the words "due diligence" but instead list the matters for which economic operators can be rejected and also the information that can be requested by the council to assess a supplier's economic and financial standing.

- e) **Were the right questions asked of Connaught Partnerships Ltd? If as stated and the Connaught Partnerships Ltd business model was rigorously tested, how does the council account for the extensive administrative problems during the contract's time of operation, an example of which would be repeated reports of missed appointments?**

And before recommendations were made to the contracts working party, Tribal Helm carried out mathematical checks and reviews of the scores to check that marks had been awarded correctly. To what extent was this a qualitative review on the bids themselves and was any work done by Tribal Helm at this stage to ensure that quality commitments by bidders were deliverable?

There are a number of questions asked here and the background above is relevant to the timeline and order of events. This question appears to relate to the evaluation of the bid and the checks carried out on the bid rather than checks carried out on Connaught Partnerships Limited. In relation to the bid evaluation process, Tribal consultants reviewed the evaluation by officers to ensure that it was fair and consistent.

There is always a variety of factors that will contribute to the administrative problems identified. The commencement of this contract was hampered by the injunction proceedings for housing repairs and maintenance services and the conclusion of a 10 year contract for the delivery of these services. Over 500 staff were transferred from CityCare to Connaught Partnerships Limited and this was a significant undertaking to ensure staff quickly became familiar with new processes and systems.

Unfortunately as Connaught Partnerships Limited were placed in to administration a mere 4 months in to the contract for housing repairs, maintenance and improvements and 5 months in for the other services there was insufficient time for rectification processes to be implemented.

- f) **In procuring the contractors to carry out due diligence, was it considered that they would be required to take account of Connaught Partnerships Ltd being a large FTSE registered company that was exposed to the risks incurred on the stock market?**

No contractors were procured specifically to carry out due diligence. Tribal were procured to work with the council on the programme to provide services for building cleaning, buildings maintenance, multi storey car park cleaning, grounds maintenance, street cleansing, waste and recycling collection, arboriculture, housing repairs, maintenance and improvements, gas and solid fuel servicing and maintenance, asbestos surveying, electrical and mechanical maintenance as well as highways services.

As part of the market research the council and Tribal were aware that contractors likely to bid for the business would range from smaller businesses to FTSE companies.

- g) Was a separate look at and report made on the financial viability of Connaught Partnerships Ltd, including their accounting procedures as opposed to just their financial position?**

No, accounting procedures were not part of the evaluation. However, as detailed above the accounts of Connaught plc were evaluated and their accounts are audited by external auditors.

- h) The current economic situation and austerity measures that affect local government had begun to take effect since the change in government last May. When the contract was awarded the national economic position was known as was the likelihood of a change in government. Was the likely impact of this taken into account in the due diligence process?**

No.

- i) What efforts were made to speak with local authorities that had previously employed Connaught Partnerships Ltd to undertake work with them? And were any unions involved approached for information and views?**

References were obtained as part of the pre-qualification process. Three references were from private sector organisations and three more were from housing associations and local authorities. Unions were consulted during the process but not specifically for evaluation of Connaught Partnerships Limited.

- j) What further checks were made when Connaught Partnerships Ltd tender bid was found to be so much more competitive than the other tenders?**

And based on the concerns raised by Morrison and their challenge of the award made to Connaught Partnerships Ltd, what further checks were made?

Initially during the tender evaluation prices were clarified with Connaught Partnerships Limited to ensure that they had not made a mistake. The overall price was clarified as well as some specific items with their bid.

In the case presented by Morrison the argument was put forward that councils have a general duty to investigate abnormally low tenders. The judge agreed with this argument. However, in a subsequent case *J Varney & Sons Waste Management Ltd v Hertfordshire County Council* the judge disagreed with the interpretation in the Norwich case and said there is no general duty to investigate abnormally low tenders. The duty arises where the council is intending to reject a tender and it must then investigate and allow the tenderer the opportunity to justify its pricing.

Connaught Partnerships Limited met with officers and presented a full breakdown of their bid including any assumptions made. Officers questioned the resource allocation and assumptions made to test the model and were satisfied by the presentation and answers given.

k) Who at the council was responsible for overseeing any due diligence process?

The head of procurement and service improvement was responsible for overseeing the project on a day to day basis. There was a project board and the deputy chief executive was the project sponsor. The Contracts Working Party reviewed recommendations and Executive approved the recommendations.

l) Were questions asked about the level of risks being taken by bidders (Suicide bidding)? What answers did Connaught Partnerships Ltd give to this?

Questions were not asked specifically about “suicide bidding” as this was not a phrase that was used until the summer of 2010. Officers questioned Connaught Partnerships Limited about their bid and the variation between this and the other potential contractors. Connaught Partnerships Limited was clear about their risk strategy and in particular that the contract notice placed in the Official Journal of the European Union that the council had placed. In the OJEU Notice the council estimated the quantity/scope for housing repairs, maintenance and improvements at £25 million. In the tender document that the council published there were estimated volumes for items such as kitchen replacements, window replacements, bathroom replacements, rewiring etc. The £17.4 million bid from Connaught Partnerships Limited was the total value against the volumes that the council had put in its tender. Connaught Partnerships Limited was clear that if the council only chose to spend £17.4 million it would make a loss on the contract. However, as the council had stated its estimated spend at £25 million Connaught Partnerships Limited expected the council to increase the volumes above those in the tender document up to the £25 million spend. At this level of spend the risk of not making a profit was significantly reduced.

m) Connaught Partnerships Ltd price was substantially lower than many other bids; was there evidence that Connaught Partnerships Ltd had successfully delivered contracts of the same nature in the past? If so, how many and over what period?

Yes. As stated above 6 references were obtained with contract values and volumes as follows:

Contract value p.a.	Contract duration
£2.3 million	5 years
£500k	3 years
£230k	4 years
£15 million	10 years
£20 million	5 years
£5 million	6 years

n) Has Tribal Helm done any work on behalf of Connaught in the past?

Any organisation is obliged to declare any conflict of interest and in this case no conflict of interest was declared. Tribal were appointed in 2007 and this was well before the formal tender process commenced in 2009 when 171 expressions of interest were received.

o) If we had found problems with Connaught Partnerships Ltd bid and were not happy to enter into/finalise a contract with them, could we have pulled out and re tendered. If not why not? And how would this have affected the council in terms of consequences?

Tenders can be rejected in accordance with the Public Contracts Regulations 2006. Depending on the circumstances and time elapsed the second place contractor could have been appointed or a fresh tender could take place.

Pulling out of a contract could have opened the council up to challenge from the supplier. Also there would have been considerable disruption as short term contracts would had to have been entered in to.