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AUDIT COMMITTEE
Friday, 6th September, 2019

The use of Welsh by participants is welcomed. If you wish to use Welsh please inform us by noon, two working days before the meeting

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S U P P L E M E N T A R Y P A C K

1.	UPDATE ON JISTCOURT AND DAWNUS

To review any updates.
(Pages 1 - 12)

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Due Diligence – Additional Concerns

John,

Confirming our conversation earlier today I have detailed below the further concerns that have arisen as a result of additional information which has come to light subsequent to the Audit meeting we had on this topic.

As you know, I have placed Companies House trackers on several of the Dawnus companies, Jistcourt South Wales Ltd. and its parent Jiscourt Holdings Ltd. Recent additions are:

- The administrator's report on Dawnus international Ltd. (This company went into administration in June – some three months after the other Dawnus casualties in March). Although this Dawnus Company did not trade with Powys in any way the report does shed some further light on the circumstances faced by the Group as a whole.
- Th administrator's report on Jistcourt South Wales which, as you know, is the trading arm of the Jistcourt Group. Some financial information is given of the accounts for y/e June 2018 which although never made public, were submitted to Powys for evaluation but which were redacted from the information given to our committee.

  The holding company Jistcourt Holdings is still listed at Companies House as active but its accounts for the year ending 29th June 2018 are now well overdue.

I have attached PDFs of the preamble to the financial appraisal for each. Careful reading of these reveals some common factors which, I think, require attention.

The latest financial accounts/information submitted to Powys for appraisal were:

- For Dawnus - the accounts for y/e 31st Dec 2017.

  We already know from various sources that the Dawnus group had significant cash flow problems at that time (this is confirmed in the administrators report for Dawnus International). These problems had previously been put down to overseas operations but this report says 'the cash shortfall was driven principally by difficulties encountered in the delivery of specific UK contracts', i.e. from Dawnus Construction Ltd.

  Specifically, for that company, there were significant write downs due to client solvency issues on completed contracts and as a consequence of that, reduced turnover and provision for 'substantial' legal costs a loss of some £1.2m was reported. In addition, although net current assets were reported at £11.1m, they were the result of netting off some £63.3m of current assets with £52.1m of creditors! These latter figures are very high in relation to the turnover of just £118m. (The Dawnus Group administrators report, a separate document states that the debtors figure, nearly £58m of the 'assets' was overstated and in the event could not be wholly realised). Our understanding from the Audit meeting is that when submitted these figures, quite rightly, caused some concern and after a request for further information the management accounts for the first six months of 2018 suitably adjusted to a full year were added to the appraisal. We have not seen these figures nor the projections made during that appraisal but the administrator's report says that the Group continued to experience cash flow problems in 2018. Further, Companies House records show that between November 2017 and March 2018 there were no less that seven director changes. Also recorded during March 2018 is the issue of £7m of debentures, including a chattels mortgage, on behalf of HSBC and the Welsh Government. We know from the Audit meeting that no reference was made to Companies house information, although there were rumours of problems and that the Welsh Government was supporting the company in some way. This is unfortunate, but even without that input the appraisal system should have thrown up sufficient concerns, at least to halt the process and/or call for more in depth enquiries.

- For Jistcourt South Wales– the accounts for y/e 29 June 2018.

  These accounts have never been published and although submitted to Powys the details were redacted for our meeting. The administrators report, however, sheds some light on the details. The original draft accounts showed a loss for that year of £73k but this was later amended to a loss of £572k for provisions on loss making contracts. This, I estimate, would be on a turnover of only £10m. I have no idea which loss figure was used. Further, management accounts for July – December 2018 showed continued losses of £176k and during early 2019 a 'time to pay' agreement was negotiated with HMRC. Also due to a severe business downturn in the period January to April 2019 the company recorded a loss of £868k for the first ten months of that company year. How much of this was known to Powys we don't presently know but, once again it is difficult to envisage how this data got through our system.

  That the company continued at all would seem to be due to the support of its principle shareholder and a secured loan from DBW. Support that the 2017 accounts for the holding company (as far as I know never looked at by Powys but a matter of public record) show was only guaranteed until March 2019.

  It is worth noting that back in 2016 the principle shareholder tried to take a backseat by arranging a management buy out financed by 'Finance Wales. Five new directors were appointed, who one by one either left the company or returned to their previous roles by July 2018. All of this is recorded at Companies House.

The similarities between the causes of the two failures are:

- Overstated value of assets particularly wip. Both restated accounts after year end for this reason. Both administrators reports also confirm.
- Cash flow problems (partially caused by the above) which were known by both companies before the contracts with Powys were signed.
- Rapid decline in profitability leading to losses in the last full year.
- Secured loans were taken out by both companies recorded at Companies House but records not examined during the appraisal process.
- Group considerations confusing the analysis.
- Large churn of directors again recorded at Companies House.

That Powys were actually oblivious to some of these issues or were aware but the system used failed to flag up major concerns is a matter that must be addressed. I think that is the view of both Cabinet and Executive, the question is how. Jane presented at the last audit meeting a fresh (dated July 2019) paper 'Assessing and Monitoring the Economic and Financial Standing of Suppliers. I have now had the chance to go through this paper in some detail it is truly excellent and if followed diligently would provide a robust framework for the future. In particular, the paper calls for:

- A rigorous pre-contract financial assessment using all available sources that are appropriate to the level of contract. Including analysis through a selection of metrics with methods, definitions and benchmarks indicated.
- An assessment of other non-financial factors which might affect performance.
- Through a 'Model Services Contract' a duty for potential and current contractors to declare 'Financial Distress Events'. This is substantially what I have been calling for, although I would have liked it to include other factors such as director or key personnel changes.

And, perhaps most importantly,

- In section 2.2.6 that the assessment should be conducted by staff with a financial background who may call on other expertise in-house or external as required.

Taken as a whole, this paper would have provided a framework which would have avoided the contractual problems Powys has experienced this year. However, I believe that unless the last point above on the skills required is addressed the Authority *could* be in danger of a repeat occurrence. A system is only as valid as the data inputted into it.

I hope this helps,

John

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4. CIRCUMSTANCES GIVING RISE TO OUR APPOINTMENT

The Company was incorporated in 1980 offering general construction services. It specialised in large volume maintenance and refurbishment works to social housing stock, predominantly for Local Authorities and Registered Social Landlords.

It operated across all of South Wales, establishing its base in recent years at leasehold premises in Baglan. The Company then expanded to a further leasehold facility in Bristol, following a significant contract win with Bristol City Council.

Funding from National Westminster Bank plc ("NatWest") was originally obtained in 1986, with NatWest providing a variety of facilities over time including loans, bonding and overdraft facilities. Robert Norman, who was appointed as a director in 1993, provided personal guarantees NatWest in relation to their lending.

In January 2016, the Company underwent a share restructure as part of a Management Buy Out ("MBO") and refinance package supported by Development Bank of Wales plc ("DBW"), formerly known as Finance Wales plc. The restructure created liabilities due from Jistcourt Construction Holdings Limited ("JCH"), a newly formed holding company, which were cross guaranteed by the Company. Five new directors were appointed to implement the MBO strategy, with Mr Norman taking a part time chairman role. Responsibilities

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were split between the MBO directors who were appointed as: Finance Director; Commercial Director; Contracts Director; HR Director and Technical Director. By August 2016 it was agreed that the HR and Technical directors would step down to their former non-director roles, with the three remaining MBO directors responsible for running the business on a day to day basis.

Turnover reduced by 19% in the year ended June 2017 and whilst the Company's audited accounts indicate it continued to be profitable, funds tied up in work in progress increased. Due to ill health, Mr Norman was unable to return and take a hands-on role until approximately September 2017. A further board restructure then took place, resulting in the Finance Director leaving the Company and the Commercial Director stepping down to his former role before the end of 2017.

Cash flow issues started to be felt at the beginning of 2018, but this was considered quite normal for this period due to seasonality experienced by the business. Client delays on a key contract had hampered billing, but this was also considered to be a timing issue only. An external consultant was brought in during February 2018 to quickly oversee the tasks needed and produce the management information required by the Board. The final MBO director left the Company in July 2018, with the board supplemented by the arrival of a Technical Director in May 2018 and an Operations Director in October 2018 with a view to stabilising the business and returning it to profitability.

The accounting records were brought up to date and initial draft accounts for the year ended 30 June 2018 indicated a pre-tax loss of £73,000, although this was subsequently re-stated as a loss of £573,000 as it became evident that further provisions of £500,000 were required on loss making contracts. Mr Norman introduced loan funding of £315,000 between July 2018 to November 2018 to assist with cash flow, which appeared to be suffering due a build up in working capital (particularly accrued income and work in progress). This was supplemented by a loan of £250,000 from DBW, which was guaranteed by Mr Norman.

Management accounts for the six months ended 31 December 2018 indicated a pre-tax loss of £176,000. The remaining directors prepared several versions of trading and cash forecasts during 2019 in an attempt to raise additional funding. A Time to Pay arrangement was agreed with HMRC to assist cash flow and Mr Norman provided further loans of £260,000 during January and February 2019. £575,018 remains due to Mr Norman at the date of the administrators' appointment.

However, a severe downturn in trading performance from January 2019 to April 2019 resulted in a pre-tax loss of £868,000 for the 10 months ended 30 April 2019, reducing the Company's balance sheet to net liabilities of £135,000. The forecasts indicated that the Company could potentially trade profitably and turn its fortunes around, but it established the business would require approximately £600,000 of additional funding in the short term to assist with working capital. The Company had a £300,000 overdraft facility with NatWest, which following debtor receipts was only partially being used, but the existing funders were not prepared to meet the shortfall. The directors were concerned about the financial position of the Company and decided to seek professional advice.

On 3 June 2019, the directors and their professional advisors met with Huw Powell and Katrina Orum of Begbies Traynor to establish the options available. This identified that the Company would have required customer consent to novation of contracts, with only existing framework suppliers likely to be accepted by customers. In addition, the directors considered the Company had no realistic prospect of obtaining the additional funding required to support its working capital needs. A review of individual contracts was undertaken and loss making contracts were identified, with steps taken to immediately terminate the contracts. Ultimately only four remaining contracts were considered potentially commercial viable following input from independent agents, Craigdam Limited ("Craigdam").

A Board Meeting was held on 14 June 2019 and Notice of Intention to Appoint an Administrator was filed that afternoon. Thereafter, meetings took place with key customers, suppliers and subcontractors to determine whether any contracts could be brought to practical completion following the administrator's appointment. On 19 June 2019, 48 redundancies were made with the remaining staff identified as being necessary for ongoing trade on the remaining four contracts.

Notice of Appointment of Administrators was filed in court on 27 June 2019.

2 Background to the appointment of the Administrators

2.1 The trade of the Companies

DIL and DSLL managed construction and civil engineering projects in Sierra Leone and Liberia. There are no known UK employees as the employees that worked on the projects were employed by an entity within the group of companies, Dawnus Construction Holdings Limited (DCHL) which is also in administration.

2.2 Factors leading to financial distress

The Companies are part of a group of companies (the Group), for which Dawnus Group Limited (DGL) is the sole shareholder of DIL, and DIL is the sole shareholder of DSLL. The majority of the Group were placed into administration on 15 March 2019 and Matthew Richards, Philip Stephenson and I, were appointed Joint Administrators.

Grant Thornton UK LLP (the Firm) was first consulted by the Group in December 2017 to assist with assessing options available for meeting forecast funding requirements. At that point, the Group was facing a cash shortfall driven principally by difficulties encountered in the delivery of specific UK contracts.

Following this, the Firm was engaged to assist with raising additional finance. In March 2018, the Group secured a £7 million funding injection provided jointly by HSBC Bank Plc (HSBC) and the Welsh Government (WG). The proposed repayment of this new funding was underpinned by a strategic plan designed to unwind the build-up of the historical contract work in progress (WIP) and to refinance or sell certain assets.

The Group realised c£7 million by refinancing or selling assets, with the recovery of historical WIP ultimately proving more challenging than expected. The Group repaid c£4 million, split equally between HSBC and WG with both allowing c£3 million to remain invested into the Group to further ease cash flow pressures.

The Group continued to experience a cash shortfall as underlying trading conditions in 2018 were very difficult in the construction sector, credit terms from the Group's supply chain were further tightened and turnover from its international operations was vastly reduced during 2018, which historically had been the most profitable division.

In early December 2018, the Firm was engaged to secure a buyer or investment into the UK based Group entities. Potential indicative offers were received from two parties for various parts of the Group; however, they were both withdrawn. Given the absence of an investor and the position in respect of the Group's financial position, the majority of the UK based Group entities were placed into administration on 15 March 2019. On the same date, all UK employees who were seconded to the DIL and DSLL projects were made redundant.

Following the UK Group administrations, the directors were exploring a management buyout (MBO) of DIL and DSLL as the companies' cash position was worsening. However, the deal to secure an MBO could not be reached.

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In the months leading up to March 2019, the Companies were under pressure from key suppliers in Liberia to settle outstanding payments. A number of payment plans were entered into with suppliers, but the administration of the UK Group entities was causing additional concern amongst suppliers.

HM Revenue and Customs (HMRC) filed winding up petitions against the Companies in respect of group VAT liabilities with a hearing due to take place on 22 May 2019.