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