

# **Finance, Status & Legitimacy**

*Distance Learning Workbook*

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# 1. Introduction and background

During a public sector procurement process, the purchasing organisation will be seeking to determine the financial standing of bidders, and checking whether they comply with their legal obligations.

Thus finance, status and legitimacy is a key selection criteria. In most processes these questions are 'show stoppers'. That is, a bid will be discounted immediately if the bidder is determined to be of such low financial standing that awarding a contract to them would be a risk to the purchasing body.

It is absolutely essential that bidders answer all relevant questions in the tendering process fully, accurately and clearly.

This workbook deals with some key selection criteria. However, all the topics covered by the workbooks are interlinked. For example, sound financial management arrangements can impact on the ability to deliver.

This module has been compiled to help small and medium sized enterprises (SMEs) understand why particular questions are asked of them during procurement processes, and what you are expected to demonstrate.

Throughout the main part of the workbook there are opportunities to reflect on what you have read and what this may mean for your business.

It is important that you complete as many of the activities as you can as they have been designed to help you move towards successfully competing for public sector contracts. They should be thought provoking and challenging. If you have a procurement mentor, they can help you to plan how best to address the issues that the text and activities have identified.

One of the challenges is getting to grips with some of the jargon. A summary is provided at the back of the workbook.

**It is recommended that you spend a minimum of half a day (3.5 hours) working through this module.**

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## 2. Aims and objectives of workbook

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### **Aims:**

- To explain the financial and legal requirements to successfully tender for public sector contracts.
- To help you prepare an action plan and achieve and sustain compliance.

### **Objectives:**

Upon completion of the workbook you will be able to:

- Explain the key components needed to show that your company meets the financial and legal requirements of working with the public sector.
- Prepare an action plan to address any gaps/omissions and to ensure ongoing compliance.

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## 3. Supplier obligations

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Having a sound financial base is important to all businesses regardless of size.

As you will see in the following pages, whilst finance is important there are other factors that are equally influential in deciding whether a company passes this selection criterion in a public sector procurement process.

You will need to be able to answer a set of standard financial questions, as well as demonstrating that your business is adequately insured. This applies across all business sectors.

You will also need to be able to prove that your business is a fully legal "entity". For example, if you claim to be a limited company, you must demonstrate that you are properly registered at Companies House, run by competent directors and not subject to any legal actions. You must also show that you pay all appropriate taxes.

Even if you are not seeking to win public sector contracts, it makes good business sense to ensure that all of these measures are in place. Private sector organisations tend to ask similar questions. Bear in mind also that having inadequate insurance etc. could put your business in jeopardy in the event of an accident or emergency.

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## 4. Public sector obligations

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The public sector and local authorities in particular, have a legal responsibility to deliver certain services to their communities. Prime contractors, sub-contractors and suppliers all contribute to helping local authorities to deliver those services. If any of those companies were to fail in any way, the service could suffer and the local authority could be in breach of its legal obligations and failing its communities.

It is because of this interdependency that public sector bodies have to evaluate potential suppliers as thoroughly as they do. The questions you are asked may seem unnecessarily detailed, but they are there for a reason.

If your business has a robust financial base and is meeting all its legal requirements then you are well placed to successfully complete a Pre-Qualification Questionnaire (PQQ) or Invitation to Tender (ITT).

That said, it is important to explain exactly what is required and to dispel some of the myths that surround, in particular, the financial requirements. Many of the requirements are in fact obligations on you as a business and employer regardless of the sectors in which you do business.

The opening up of the European market place has had a benefit for small businesses. A truly open market placed across member states, can only occur if the same rules equally apply, regardless of the country doing business. Member states have therefore been working hard to standardise requirements and the U.K. has recognised the important role that small businesses play in the economy.

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## 5. The evaluation of financial standing

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In the past, the minimum requirement for public sector tendering has been the submission of three years of audited accounts. This has prevented many new start-ups and smaller businesses from bidding for work despite having the necessary skills, knowledge and experience to meet the specification and offering competitive rates for the work. This situation is now changing.

### 5.1 Government guidance to the public sector

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The Office of Government Commerce (OGC) has published guidance for public sector buyers, which emphasises the need for a more balanced approach:

"Financial standing should only be considered as part of the risk management exercise. It may not, on its own, reflect candidates' ability to deliver..... Care must be taken to ensure that respondents are treated equally. A key Government strategy is to achieve effective competition for Government business by simplifying access to the Government market place for suppliers. In particular, Small and Medium-sized Enterprises (SMEs) can be inadvertently disadvantaged."

*"Supplier Financial Appraisal Guidance", OGC 2004*

The OGC launched guidance called "**Supplier Financial Appraisal Guidance**", and "**Supplier Financial Appraisal Guidance Annexes**" which places greater emphasis on cash flow rather than past performance as an indicator of future stability.

#### Activity

**If you have internet access, download the Supplier Financial Appraisal Guidance booklet from the OGC website .This is a useful reference document.**

[http://www.ogc.gov.uk/documents/commodities\\_database/Financial\\_Appraisal\\_Guidance.pdf.pdf](http://www.ogc.gov.uk/documents/commodities_database/Financial_Appraisal_Guidance.pdf.pdf)

### 5.2 The public sector approach

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So what do the OGC guidelines mean? Essentially that there should be a movement towards an integrated risk management approach rather than simply a financial assessment. Capability, capacity, dependency and finance should be the selection criteria.

Below we look at each of these elements, one by one.

#### a. Capability

In short, does your business possess the necessary skills, knowledge and experience to meet the specification?

## Activity 1

**Consider a recent bid you have made for work in the public or private sector. What part did capability play in either winning the bid or not?**

If you have ever evaluated bids, consider what part capability played.

### b. Capacity

It is important that prior to bidding you assess whether your business can meet the delivery requirements of the contract.

Having a clear business plan should ensure that you seek contracts that fit your plan. It can, nevertheless, be tempting to seek other work which is not such a good fit particularly if business is a bit slow. Whilst there is nothing wrong with that and at the end of the day, income is income, it is important to minimise the risk of not being able to deliver due to other (now) seemingly less important commitments. Once you sign a contract, there is a clear expectation of delivery.

### c. Dependency

Whilst the public sector is keen to do business with a range of suppliers it has an obligation to ensure that any supplier does not become over-dependent on the contract or contracting authority.

As a good rule of thumb, the annual value of a contract should represent no more than 25% of your turnover. If it does you will need to consider how you can show that you will not become dependent on it or the client. A good business plan and track record will be useful.

## Activity 2

**Review your current contracts. How do they compare to the '25% rule'?**

Is your business dependent on supplying or contracting to a small number of clients? Are you reliant on a particular supplier or contractor? Either way, this could present a risk to your business or this risk may be recognised during a public sector procurement process.

### d. Financial

The issue here is whether or not it is felt that you can financially cope with the contract. In other words, if you are providing goods, do you have the money to buy the raw materials and run the contract (e.g. staff wages, etc.)? The 25% formula mentioned above is a good guide.

**Let's look a little more closely at turnover and contract value.**

### e. Turnover and Contract Value

Turnover is a useful indicator of capacity, although the public sector is encouraged not to use it in isolation. A supplier may have recently invested in productive capacity and be

able to show very clearly that it can now manage a much higher value contract as a result than turnover may at first suggest.

Turnover is also historical. Many new businesses experience rapid growth in the first few years and many double their capacity within the first three years and during the life of the contract.

**A word of caution:** too rapid a growth can lead to overstretching and non-delivery so a balanced view is needed.

### **Activity 3**

**Consider your current turnover, and the turnover demonstrated in previous year accounts.**

**Remembering the 25% rule - is your current turnover large enough for the size of contracts that you would like to bid for?**

If on paper, it doesn't appear to be - how would you demonstrate during a tender that you have the capacity and finance to win contracts of that size?

#### **f. Financial Appraisal**

The public sector has a multi-billion pound annual budget. It is essential that reasonable financial checks are carried out to ensure that suppliers can meet their obligations.

Under European Union (EU) rules, proof of a supplier's financial standing may be provided by one or more of the following documents:

- Statements of accounts or extracts from them relating to the business (as required by the law of the relevant EU member state where the supplier is established).
- Statement of overall turnover of the business and the turnover in respect of the services of a similar type to those to be provided.
- In addition other information may be requested to enable an assessment to be carried out:
  - Parent company accounts
  - Banker's or statement and references
  - Accountant's references
  - Management accounts
  - Financial projections, including cash flow forecasts
  - Details of previous contracts, including contract values
  - Capital availability.

Purchasers may ask for some or all of the above documents from you. In particular, newer businesses may benefit from providing references or statements from the accountant or bank. This independent support is often useful.

In analysing your accounts the first figures that the purchasing body will look at are:

- Turnover
- Current assets
- Current liabilities

The purchasing organisation is also likely to run a credit check on your organisation, and look at any information that is held about you in Companies House. More information about this is given in section 6.

Higher value contracts (for example in the construction field) will necessitate a greater examination of the finances of a company. For example you may be asked to provide the following information:

- Net profit margin
- Current asset ratio
- Return on capital employed
- Gearing

Should you be asked for such detailed financial information, your accountant will be able to ensure that the information you submit is adequate for these needs. For many tenders this depth of information will not be necessary.

## Tips

**If the PQQ or ITT asks for a certain number of years accounts, or audited accounts, and you can't provide them (for example, because you have been trading for fewer years, or you are a small company whose accounts do not legally need to be audited):**

- Check with the contract officer to see if there is a particular reason for this being asked, and whether you can submit what accounts you have
- Submit the accounts that you do have, stating clearly why they are for a lesser number of years, not audited etc.

If your explanations are valid, and all your other paperwork is in order, and the contract is relatively low risk, then what you can submit may be accepted.

If you are asked for an accountant's reference ensure that any glitches are explained when you submit it. Even the most successful companies will experience a downturn - don't ignore it: explain why you believe it has happened and how you have addressed it for the future.

Whatever you do, make sure you submit whatever documents are requested, along with explanatory notes where needed. **If you fail to submit a financial document without adequate explanation, you are likely to be excluded from the process.**

## 6. The evaluation of company status and legitimacy

Basic checks on bidding companies will be carried out at Companies House. When submitting a PQQ or ITT, therefore, the following information will be requested:

- Company title
- Registration number
- Date of registration if limited liability
- Details of holding company if appropriate
- Registered office
- Telephone numbers/fax or email address for correspondence
- Directors, Partners or Associates and Company Secretary names and addresses
- Accountant
- Bank
- Company status - public or private limited liability, partnership, sole trader, consortium
- VAT status - whether or not your business is VAT registered
- Copy of certificate of incorporation

This information will be checked as well as establishing whether the company is trading or dormant, is up to date with its financial returns and whether it is owned by another company or supported by a venture capital organisation.

You will also be asked to declare that the directors have not been disqualified or that the company is not insolvent, in receivership, administration or liquidation.

The purchasing organisation may carry out these and other checks through a credit agency or by using an online database. Debt ratings may also be analysed.

### Activity 4

**Of the list above, which documents would you be able to provide? Could you access these documents easily? Can you explain gaps?**

Certificates of incorporation, in particular, can be difficult to find at short notice, as they are referred to so irregularly.

Create a file containing all these documents and check their accuracy before submitting them (for example, telephone numbers might have changed).

## 6.1 Employers' obligations

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It is worth remembering that most of this is in fact a legal requirement for you as an employer/business owner. This workbook provides an ideal opportunity to gather the information needed into one place - a 'bids file'.

The information you may be asked to provide includes:

- Confirmation that your organisation has fulfilled its obligations relating to the payment of social security contributions.
- Confirmation that your organisation has met its obligations in relation to the payment of taxes.
- Evidence to show that your employees have the appropriate working documents (this can range from a work permit to a driving licence).

It is also worth noting that any business that has failed to pay its business rates could be rejected during a tender process or have its contract terminated if already providing goods/services to a public sector organisation.

## 6.2 Insurance

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An important aspect of the assessment process is to ensure that candidates have the necessary certificates of insurance to operate their business. The standard requirements are:

- Employers' Liability: £10 million
- Public Liability: £2 million
- Professional Indemnity (where relevant): up to £1 million

Additional levels of cover may be required for larger or high risk contracts.

Public sector bodies are encouraged by the Office of Government Commerce (OGC) and others to require levels of insurance that are relevant to the level of risk inherent in the contract. This does not currently appear to be happening as often as it might.

Other required industry/service specific insurances will be outlined in the tender paperwork. For example:

- Taxi firms will require certificates of road insurance and Private Hire and Reward Insurance.
- Construction firms require a Tax Exemption Certificate.

**The key message here is to ensure and demonstrate that you have all the necessary insurances in place. This is a requirement not simply for the public sector but for you as a business owner.**

- You will be asked to provide photocopies of the certificates and must have cover in place prior to submitting your PQQ or ITT.

### **Tip**

If you are asked to submit copies of your insurance certificates, ensure that you do so.

Insurance, along with financial stability, is a 'show-stopper' in a procurement process. If you don't prove that you have the insurance when asked for it, you will almost certainly be excluded from the process.

### **Activity 5**

Check through your insurance policies list:

- Insurance type
- Name of insurer
- Policy number
- Extent of cover
- Expiry date

## 7. Warning signs

If the assessment process uncovers any of the following it will initiate further examination of your business:

- Poor cash flow
- Over-reliance on short term debt
- Late filing of accounts
- Qualified accounts
- County Court Judgements
- Frequently changing auditors and bankers
- Inadequate insurance
- Failure to comply with statutory obligations (e.g. payment of taxes)

The bottom line is: ensure that your business accounts are in order and up to date. Explain any glitches and be prepared to provide as much information as possible to enable a positive assessment.

Increasingly public sector buyers are keen to do business with a range of suppliers however, they must ensure that businesses meet their financial obligations (payment of taxes, etc) and are able to deliver the contract.

## 8 Example questions asked during procurement process

### 8.1 In Pre-Qualification Questionnaires

The following is taken from a Haringey Council PQQ

#### PART A - GENERAL INFORMATION

- A. 1 Current legal status of the Potential Provider (e.g. partnership, private limited company, etc.)

	<i>Please (tick one box)</i>	
<b>Sole Trader</b>		
<b>Partnership</b>		
<b>Public Limited Company</b>		
<b>Private Limited Company</b>		
<b>Other (please state)</b>		

- A. 1 Date and place of formation of the Potential Provider, registration under the Companies Act, please provide copies of Certificate of Incorporation and any changes of name, registered office and principal place of business.

<b>Date of formation</b>	
<b>Place of formation</b>	
<b>Date of</b>	

<b>registration</b>	
<b>Registration number</b>	
<b>Certificates enclosed</b>	<b>YES / NO (please delete)</b>
<b>Registered Office</b>	
<b>Brief Description of the Potential Provider's primary business and main products and services.</b>	
<b>Brief history of the Potential Provider's organisation, no more than 400 words, including details of any parent and associated companies and any changes of ownership over the last 5 years including details of significant pending developments, changes in financial structure or ownership, prospective take-over bids, buy-outs and closures etc which are currently in the public domain.</b>	

**PART B - FINANCIAL DETAILS**

- B. 1 Name and address of principal banker. You need to be aware that the maximum value of any contract awarded will not exceed 25% of your annual turnover for the last financial year.

<b>Bank Name</b>	
<b>Address</b>	
<b>Town/City</b>	
<b>Postcode</b>	

**Banker’s Reference will be requested by the Authority. Please inform your banker accordingly.**

- B. 2 Accounts information — please provide a copy of the full report and audited accounts for the last 2 financial years. If the accounts you are submitting are for a year ended more than 10 months ago please also enclose the latest set of management accounts.

	<b>Please tick if enclosed (✓) or state ‘N/A’</b>
<b>Profit and Loss Accounts</b>	
<b>Balance Sheet</b>	
<b>Full accompanying notes</b>	
<b>Director’s/Managing Partner’s Report (if available)</b>	

**If your organisation is a member of a group, please ensure that you enclose the accounts of your organisation only. If group accounts, only, are available, please enclose a separate statement of turnover for the individual company.**

B. 3 Please supply the following information for the last 2 financial years:

	<i>Amount</i> (£K) 2007/2008	<i>Amount</i> (£K) 2008/2009
<b>Overall turnover for last 2 years</b>		
<b>Turnover in relevant services</b>		
<b>Operating Profit</b>		
<b>Profit in relevant services</b>		
<b>Current Assets</b>		
<b>Current Liabilities</b>		
<b>Long Term Liabilities</b>		
<b>Net Assets</b>		
<b>Numbers of Staff working in relevant services</b>		

If the information you are submitting is for a financial year-end more than 10 months ago, please submit the latest available information or a statement signed by the

Finance Director detailing any major changes in the current financial position since the date of the latest information provided.

Potential Providers who do not have 2 years of audited accounts should provide whatever audited accounts they may have. Newly formed Potential Providers should provide a statement of the Potential Provider's turnover, profit & loss account and cash flow for the most recent year of trading and / or a statement of the Potential Provider's cash flow forecast for the current year and a letter from the Potential Provider's bank outlining the current cash and credit position.

- B. 4 Insurances - Please provide evidence of the employers' liability, public liability insurance [and professional liability or indemnity] insurance held by the Potential Provider. The evidence should include the name of the insurers, policy numbers, expiry dates and limits for any one incident and annual aggregate caps and the excesses under the policies.

<b>Employer's Liability</b>	
Name of insurer	
Address	
Type of insurance	
Policy numbers	
Expiry date	
Limits of indemnity (per occurrence and aggregate)	
Excess (if any)	
The Council requires suppliers to hold a policy providing a minimum £10m of cover and is a	

condition of contract award	
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<b>Public Liability (Third Party)</b>	
Name of insurer	
Address	
Type of insurance	
Policy numbers	
Expiry date	
Limits of indemnity (per occurrence and aggregate)	
Excess (if any)	
The Council requires suppliers to hold a policy providing a minimum £2m of cover and is a condition of contract award	

<b>Professional Indemnity</b>	
Name of insurer	
Address	

Type of insurance	
Policy numbers	
Expiry date	
Limits of indemnity (per occurrence and aggregate)	
Excess (if any)	
The Council requires suppliers to hold a policy providing a minimum £1m of cover and is a condition of contract award	

**If successful please indicate if you would take out all levels of the insurances above.**

**Yes..... No.....**

- B. 5 Please provide a statement of any material pending or threatened litigation or other legal proceedings where the claim is of a value in excess of £50,000.

Disclosure of legal proceedings (300 words or fewer)
Either insert required details or state 'None'

## 9. Action Plan

Looking at the list of information, below, how much of it would you be able to provide? If you have identified any gaps, how will you fill them?

If you are likely to become involved in a tender in the near future, begin to collect copies of this material together. Store it all together in one place. You could call this your 'bid file'.

### Tick

Appropriate statement from the company bank

Statements of accounts or extracts from them relating to the business (as required by the law of the relevant EU member state where the supplier is established)

Statement of overall turnover of the business and the turnover in respect of the services of a similar type to those to be provided

Company title

Registration Number

Date of registration if Limited Liability

Details of holding Company if appropriate

Registered Office

Telephone numbers/fax or email address for correspondence

Directors, Partners or Associates and Company Secretary names and addresses

Accountant

Bank

Company status: public or private limited liability, partnership, sole trader, consortium

VAT registration number (if appropriate)

Insurance certificates

Employers' Liability

Public Liability

Professional Indemnity

Industry specific

Social security obligations met

Tax payments (including business rates) made

Remember: if you are unclear about a particular requirement during a procurement process, seek clarification from the contact officer within the purchasing organisation.

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## 10. Conclusion

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The increased emphasis on capability, capacity and dependency will enable newer businesses to compete for contracts. Financial information is still a key consideration however it is one of four.

All businesses should keep good financial records.

With regards to status and legitimacy it is important that businesses are operating with the correct insurances and are legally sound. The public sector contracts on behalf of the local community and beyond and must take reasonable steps to ensure that its suppliers meet its standards as the purchaser in turn is accountable for the expenditure.

A legally binding contract will be signed at the end of the tendering process and it is important that both parties are confident about delivery.

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## **11. Jargon Busters**

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### **PRE-QUALIFICATION QUESTIONNAIRE**

The initial questionnaire seeking information about a company such as financial status, legal compliance, customer base, policies and procedures, etc.

### **INVITATION TO TENDER**

Although they can be merged together, successful completion of a PQQ will lead to an Invitation to Tender. An ITT will contain the contract specification, terms of contract and other related documents to be completed and submitted to a defined timetable.

### **OGC**

Office of Government Commerce. An independent office of HM treasury is a key player in ensuring that the public sector is opened up to more small and medium-sized businesses.

### **SMEs**

Small and medium-sized businesses make up over 99% of employers in the U.K. A small business is defined as one employing less than 50 employees and a medium-sized business employs less than 250. SMEs account for around 50% of U.K business turnover.

### **BMEs**

Black and Minority Ethnic businesses: many of whom are SMEs.