National Audit Office

INSIGHT

Lessons learned: Monitoring and responding to companies in distress

Cross-government

SESSION 2022-23
27 OCTOBER 2023
HC 1866

Introduction

Why have we produced this report and guide?

1 The UK government's position is that, in general, private sector companies should be allowed to fail as part of the efficient working of markets and the economy, and that direct government intervention in the private sector is a last resort. Where there are known risks of market inefficiency or potential harm to consumers, the government will generally seek a regulatory approach to monitor and manage those risks.[1] Insolvency may be the best outcome for a failing company, and does not necessitate the end of the company if a buyer is found. But in some circumstances a company failure could expose the government, taxpayers or service users to disproportionate levels of risk, and the government may decide that intervention is necessary.

2 In our audit work we have examined many examples of government interventions to support companies in distress across various sectors, including the unprecedented interventions in banks during the 2008 financial crisis (Appendix Two). These examples show that government interventions in distressed companies: involve complex decision-making at speed; require access at short notice to specialised skills that are not widely held across government; can be very costly in the short term; and may take a long time to exit.

1 National Audit Office, *Good practice guidance: Principles of effective regulation,* May 2021.

3 In 2018, the Committee of Public Accounts expressed concern that a culture had developed in which a small number of large companies that were strategic suppliers to government believed they were too big to fail.[2] More recently, the Civil Service Board (which is responsible for the strategic leadership of the civil service including managing systemic risk) has identified the risk that market or supplier failure could have an impact on service delivery of public sector contracts or value for money. Several such risks feature in the 2023 National Risk Register.[3]

4 The COVID-19 pandemic saw a dramatically heightened and unusual level and type of state intervention to keep companies functioning. This was quickly followed by the war in Ukraine and energy crisis in which the government had to intervene to keep multiple companies' customers supplied with power. Data published for the first half of 2023 indicate that the UK had the highest quarterly number of company insolvencies since the financial crisis in 2009.[4]

5 When, in 2021, we examined the government's preparedness for COVID-19 we found variation in capacity, capability and maturity of risk management across government departments.[5] Recent events have further underlined the need to strengthen national resilience – for example, we found that Ofgem did not do enough in the years that preceded the increase in wholesale prices in 2021 to ensure the energy supplier sector was resilient to external shocks.[6] In December 2022, the government published the first UK Government Resilience Framework.[7]

2 Committee of Public Accounts, *Strategic Suppliers,* Fifty-Eighth Report of Session 2017–2019, HC 1031, July 2018.
3 Cabinet Office, *National Risk Register 2023,* August 2023 (viewed on 1 September 2023).
4 PwC, *PwC comments on Q2 2023 insolvency data*, July 2023 (viewed on 1 September 2023) ; The Insolvency Service, Commentary - Company Insolvency Statistics April to June 2023, July 2023 (viewed on 1 September 2023). Available at: www.gov.uk/government/statistics/company-insolvency-statistics-april-to-june-2023/commentary-company-insolvency-statistics-april-to-june-2023#:~:text=Between%201%20April%20and%2030,company%20voluntary%20arrangements%20(%20CVAs%20).
5 Comptroller and Auditor General, *The government's preparedness for the COVID-19 pandemic: lessons for government on risk management*, Session 2021-22, HC 735, National Audit Office, November 2021.
6 Comptroller and Auditor General, *The energy supplier market*, Session 2022-23, HC 68, National Audit Office, June 2022.
7 Cabinet Office, *The UK Government Resilience Framework*, December 2022 policy paper (viewed on 1 September 2023). Available at: www.gov.uk/government/publications/the-uk-government-resilience-framework

When and why does government respond to companies in distress?

6 The government does not intend to look for signs of distress in every company, and it views intervention as a last resort. However, there are circumstances where it may decide to intervene: to support a company and prevent it from failing, to rescue it from insolvency, or to manage the situation so that it does not fail in a disorderly way.[8] Among the possible scenarios, it may be that the company:

- provides public services directly to citizens (for example Southern Cross, which failed with 31,000 residents in its care homes);
- provides essential goods or services, the absence of which could cause harm to customers (for example Bulb energy, which was taken into a special administration regime costing the taxpayer an estimated £3.02 billion gross as of 31 January 2023, although the government expects to recover all the taxpayer funding);[9]
- supplies services to the government to enable it to function (for example, UKCloud Ltd which provided secure cloud data services to several government departments and went into liquidation in 2022); or
- is crucial to national security or to the country's self-sufficiency in certain goods (for example, CF Fertilisers, to which the government provided short term funding to avoid a gap in supply of CO_2 to the UK).

What is in our good practice guide and this report?

7 Alongside this report, we have produced a good practice guide which identifies 10 elements we would expect to see in the government's approach to market and company resilience and the risk of distress (summarised in **Figure 1** on pages 8 and 9).[10] We drew on our past work and a programme of wider consultation to identify insights and practical lessons, from which government bodies can learn. Appendix One gives full details on the scope of this work and our methods.

8 We distinguish between financial failure and delivery failure. An organisation fails financially when it ceases to be a going concern. This paper does not specifically address failure to deliver services to minimum standards without failing financially, although the two may of course be closely linked. We also do not cover failure, financial or otherwise, of local authorities, hospital trusts or other local public service providers in the public sector. See also Appendix One.

9 A special administration regime is a modified insolvency regime that provides an administrator with special objectives, such as the continuity of critical services, that take priority over the court objectives in a normal administration.

10 National Audit Office, *Good practice guide: Monitoring and responding to companies in distress*, October 2023.

8 Under each of the 10 elements in our guide we set out: what we would expect to see; questions for officials and others to ask to support good practice; and examples to illustrate the lessons. It is not a how-to guide but is intended to help government with monitoring, preparedness and response to company distress situations and to support value for money. It complements, and provides signposts to, the key government guidance that officials should follow. We have worked closely with the relevant experts in government, including HM Treasury, the Cabinet Office, UK Government Investments, the Department for Business & Trade and the Insolvency Service.

9 This short report is intended to set the guide in the wider government context, including providing factual updates on the government's evolving approach to national resilience and risk management. It is not an evaluative report and does not have audit findings or a value-for-money conclusion. It covers:

- Roles, responsibilities, and principles (Part One).
- Resilience, monitoring, and preparedness (Part Two).
- Handling complex interventions, access to specialist skills, and learning (Part Three).

Who should read this?

10 Officials in government departments and other bodies such as regulators will have interests, responsibilities and accountabilities regarding the resilience of key companies and the risks to taxpayers or citizens. We have designed the guide to help those officials understand the issues, find examples to learn from and ask the right questions. The guide should be useful for both senior and junior officials, as well as members of Audit and Risk Committees. We also aim to help members of Parliament consider what they should expect of government in future situations, and to support them in future scrutiny and accountability. The work will inform any future National Audit Office examinations in this area.

Figure 1

A summary of our 2023 lessons learned report and good practice guide

We identify 10 elements for government to consider when preparing for and responding to companies in distress

A summary of this report's findings

Government departments rely on private companies to support the delivery of public services or other policy objectives (**paragraph 1.1**, **Figure 2**).

The government has set out some broad principles for providing last-resort bespoke support to companies (**paragraph 1.4**, **Figure 4**).

Each department is responsible for monitoring risks and resilience to company distress within its remit, but may need to involve many other bodies when it comes to an intervention (**paragraphs 1.6-1.9, Figure 5**).

Interventions are likely to require a range of specialist skills, including deep knowledge of corporate finance transactions and negotiations, contracting and insolvency law which will often need to be purchased externally (**paragraphs 3.6–3.8**).

The *UK Government Resilience Framework* proposes a shift towards prevention and preparation for risks, and the government is also working to improve its understanding of critical supply chains (**paragraphs 2.2-2.3; 2.16-2.17**)

The 2023 National Risk Register identifies three risks and possible scenarios directly related to company failure (**paragraph 2.4**).

Cabinet Office and Government Commercial Function guidance recommends that departments regularly monitor their suppliers' financial performance, including taking a wider view of their business and financial health and level of risk (**paragraphs 2.7-2.8**).

The Cabinet Office also expects departments to have contingency plans in place, and to require resolution planning information from suppliers for all new or refreshed contracts for critical public services (**paragraph 2.13**).

When a department is appraising options for intervening in a distressed company, it is important to consider the longer-term scenarios and wider implications and risks for the market (**paragraphs 3.1-3.2**).

A government intervention may require significant commitment of resources and external advice and expertise over months or years (**paragraphs 3.6–3.8**).

Like other government spending, interventions in distressed companies are not always formally and transparently evaluated, and government's corporate knowledge in this field is vulnerable to staff turnover (**paragraphs 3.9–3.11**).

A summary of the elements in our good practice guide

Enablers

Understanding objectives

It is important to be clear about government's objectives and duties in the sector, and how companies contribute to achieving them.

Establishing roles, responsibilities and accountabilities

It is important to be clear who in government is responsible for monitoring sector resilience and risks of company failure, and acting if necessary.

Ensuring skills, expertise and capacity

Departments need to ensure they have, or can access, the skills to appropriately monitor and manage the risks to which they are exposed.

Identifying vulnerabilities and building resilience

Identifying risks

Departments need to understand where the systems they oversee could be vulnerable to company failure and how that would affect delivery of their objectives.

Scenario planning

Identifying risks is not enough – departments need to show imagination and attention to detail when working through scenarios.

Monitoring risks and financial performance

Departments will need sources of ongoing data on failure risks they are tracking, whether they have a relationship with companies or not.

Making contingency plans

Scenario-testing and good-quality data will help departments know when to move to detailed contingency planning.

Intervening, evaluating and learning

Appraising options

If intervention is being considered, the government will need to understand the costs and benefits of all its options, and clearly document its decisions.

Managing the intervention

Principles of effective project management will apply, and departments will likely need to be ready to adapt as they go, to ensure taxpayers' money and the interests of vulnerable groups are protected.

Evaluating and embedding learning

Departments are expected to evaluate their interventions for the purposes of accountability, decision-making and learning for future scenarios.

Source: National Audit Office, *Good practice guide: Monitoring and responding to companies in distress*, October 2023