Somerset County Council
Audit Committee
– 29 June 2017

Debtor Management and Pre-Action Protocol

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Cabinet Member: Cllr D Hall, Cabinet Member for Resources
Division and Local Member: All

1. Summary/link to the County Plan

1.1. This report reviews the recovery of outstanding debts (monies owed to SCC) for the 2016/2017 financial year, including the performance and position at year end. The report also shows the latest available position in terms of outstanding debts and their composition as at the end of May 2017.

1.2. The achievement of good performance in this area is linked to the County Plan in relation to “bring in more funding and resources”.

2. Issues for consideration

2.1. Members are asked to comment on the position in relation to outstanding debt performance at the end of the financial year and previous month.

2.2. Members are asked to consider the Pre-Action Protocol and support the proposed action plan from officers to mitigate the impacts on Somerset County Council.

2.3. Members are asked to agree the cessation of the current target of no more than 15% of debt being over 90 days old, until a new target (post Pre-Action Protocol) can be developed.

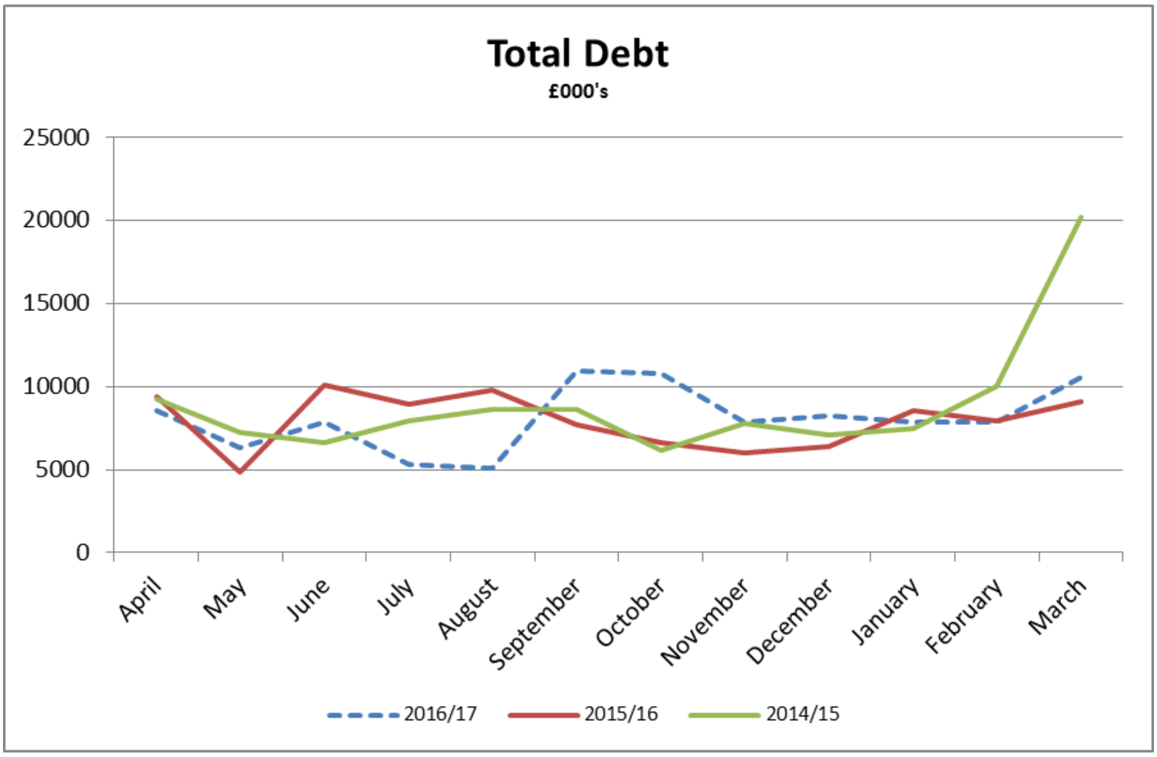
3. Background

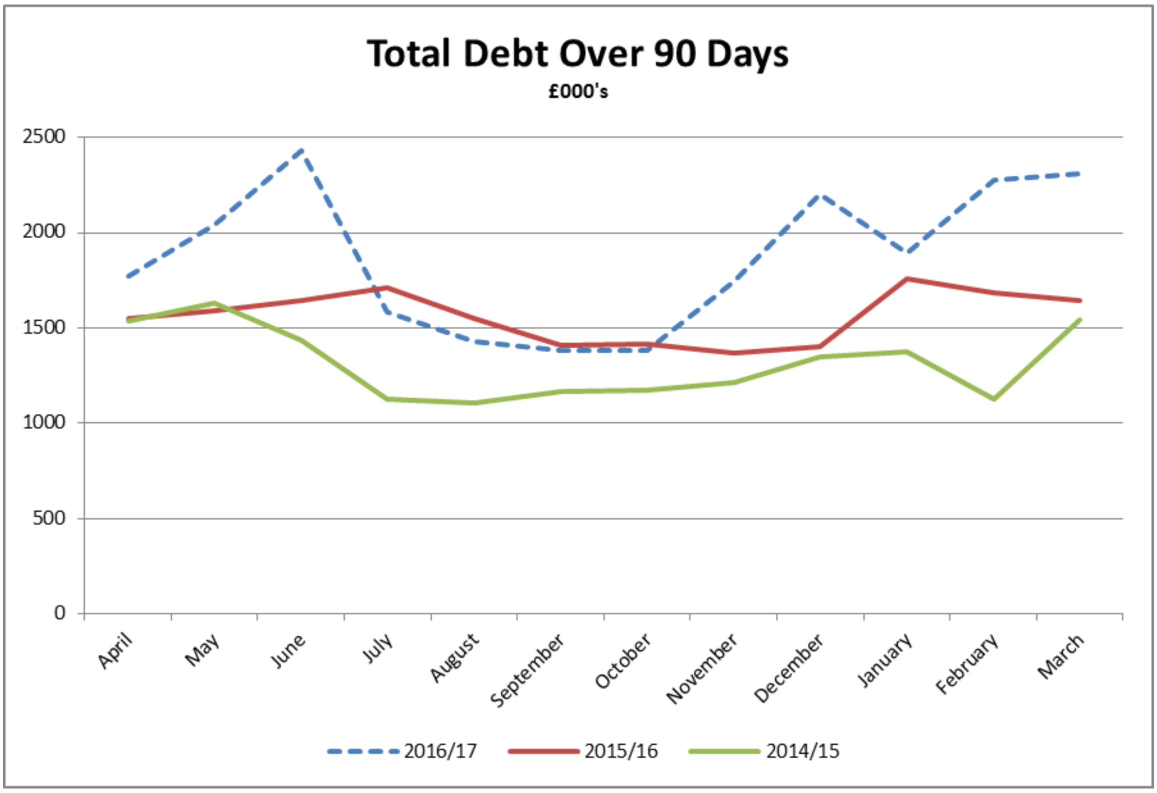
3.1. Headline figures as at 31st March 2017

Services’ total net outstanding debt reported on the Accounts Receivable system stood at **£10.583m** as at 31st March 2017. This compares with a figure of £8.989m as at 31st March 2016.

The percentage of debts over 90 days as at 31st March 2017 was **21.47%,** which compares to 17.9% over 90 days as at 31st March 2016. A breakdown of the larger debts and debtors by category is included below. Our target, which would demonstrate a strong performance, is 15%.

The graphs below show the total debt at the end of the month for the previous 3 years, and the amount of that debt which is over 90 days old. As can be seen, whilst total debt remains relatively consistent, debts over 90 days have been higher than previous years for the last 6 months.



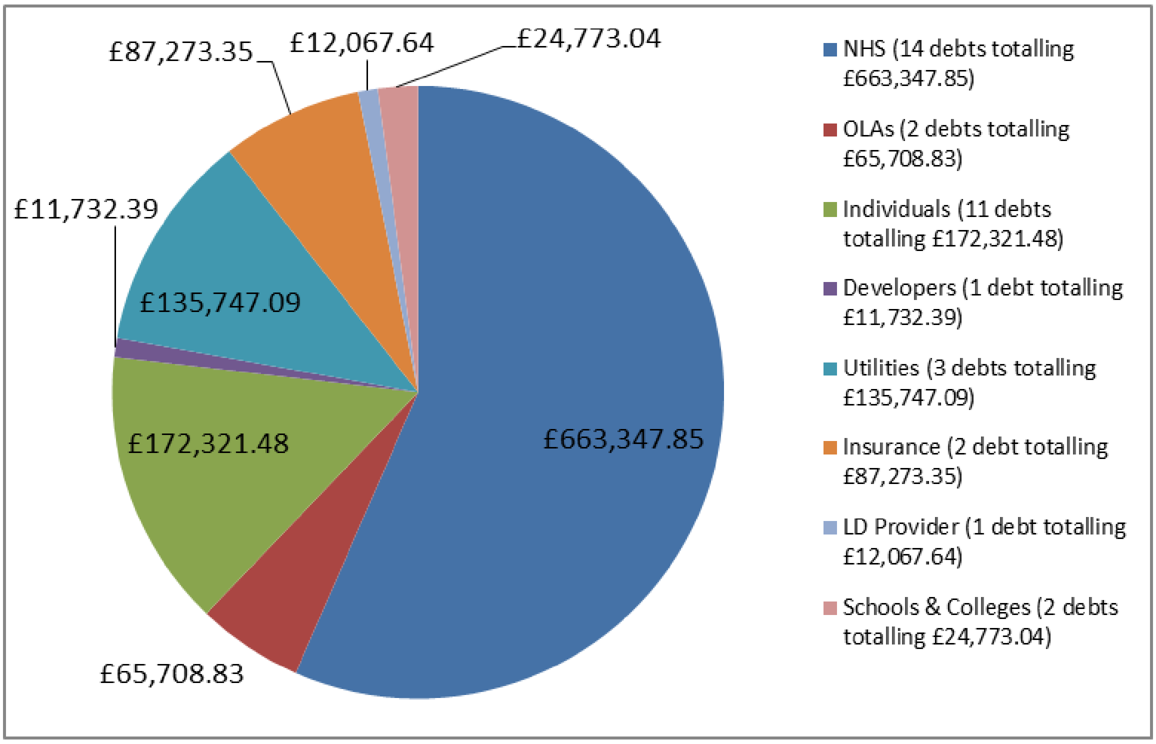


Outstanding debt in itself is not an issue for the County Council, and it would not be a problem if the total amount of fees and charges raised at any one time were to increase as services sought to maximise income. The continued level of underlying debt over 90 days has not improved in the latter half of 2014/2015.

The confidential meeting after the March 2015 meeting explained some of the reasons behind the residual amount of long-term debt (particularly around social care recovery, where processes are often elongated by the legal processes, such as around individuals' estates). However, members' attention is drawn to the additional proposed measures set out below to try and reduce this amount.

3.2. Breaking down the year end debt position

At the year end, the over 90 days debt totalled **£2.307m**. Thirty-six of these debts were over £10,000 in value, and these large debts comprised £1.173m, or 50.8% of the total debt over 90 days. The pie chart below demonstrates the category of debt and value making up these large debts at 31st March 2017.



As at end of May, both local authority debts (OLAs) and the single LD Provider debt have been paid in full. In addition, 4 of the NHS debts have also been cleared. The total reduction of these large debts between 31st March and 31st May was £163,275.52 (13.92% of the total).

3.3. Year End Write-Offs

One of the key measures that we bring to Audit Committee when reporting year end is the amount and reasons for debts being written off. Figures that come from the Accounts Receivable system show a consistent performance in this area when compared to previous years.

We have found a slight improvement in this measure from previous years. Whereas we had always looked at the gross debt raised, it is probably more accurate to take the gross debt less any credits raised against this figure (reissues, errors etc).

Even with this change in calculation, the net debt raised was £88.579m, and the net write-offs were £0.122m, giving a **99.86% collect rate**. This remains very comparable with previous years' performance – 2015/2016 restated would have been 99.82% (previously 99.84%).

3.4. Causes of write-offs

The Legal Debt Recovery Officer has looked at the reasons for debt write-off that have been listed on the write-off authorisation sheets.

It has to be acknowledged that this is not an exact science. Sometimes the reason quoted for write off is not clear, or potentially falls into a number of categories. It is quite possible looking at the analysis and the forms that there is certainly a level of overlap between "Not cost effective to pursue" and "All debt options exhausted" and these might have been interchanged on some write-off forms.

The write-off form has been redesigned for 2017/2018 onwards, and the

The causes are analysed in the table below:-

Reason Quoted	**2015/2016**	**2016/2017**
Not cost effective to pursue	66.4%	13.82%
All debt options exhausted	8.66%	23.91%
Deceased	3.71%	24.35%
Unenforceable	3.09%	11.60%
Insolvent/bankrupt/administration/liquidation	0.61%	6.51%
Other	17.53%	19.80%

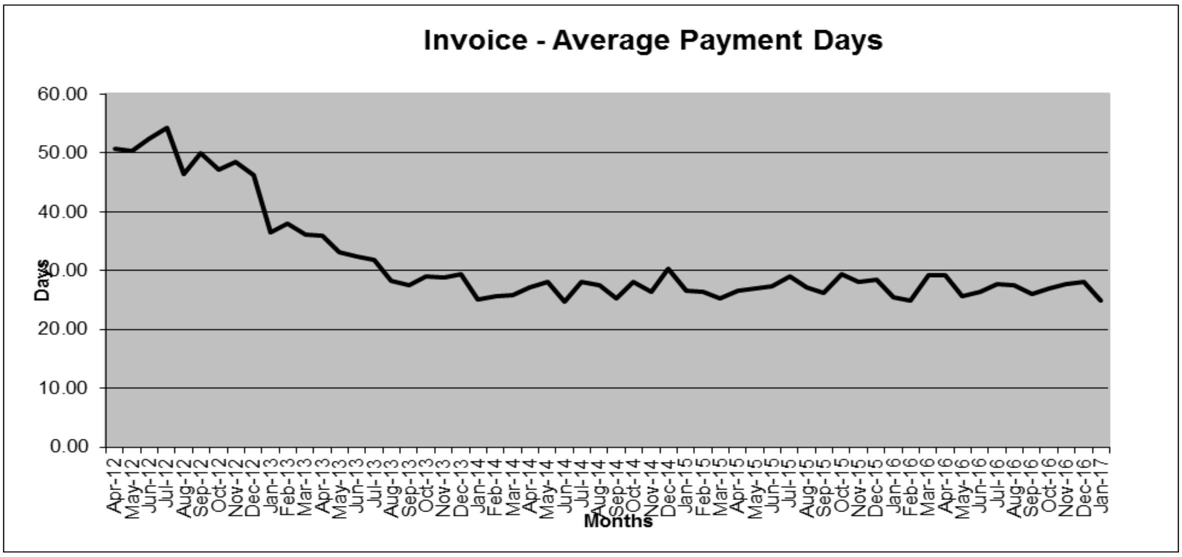
"Other" covers a wide range of reasons, such as when we are unable to trace a debtor, Court Orders, where a settlement is reached, where an error has been made (by us), service decisions not to pursue, exchange rate differences or when the Statute of Limitations has been reached and the debt is no longer enforceable as a result.

The single most common cause for write-offs over the last 2 years remains a simple economic test. At a certain point in the process, depending on the outstanding value, the costs of proceeding with legal debt recovery (i.e. the costs and fees of issuing court proceedings, which may not be recoverable), can outweigh the amounts to be recovered. Typically such smaller debts have been pursued up to the "Letter Before Action stage ", when a decision is made whether they are indeed cost effective to pursue. (This will be particularly of concern when the new Pre-Action Protocol comes into operation – see below).

3.5. Average payment days

The other criterion that officers consider important in debt collection is the calculation of the average number of days for an invoice to be paid. Obviously, this cannot be calculated until a sufficient period of time has elapsed to allow for debts to be paid, so our latest analysis is for January 2017 at 24.84 days.

The average payment days have now been consistently below 30 since December 2014.



If we assume a "cost of carry" as 1% for a whole year, we can make an estimate of the costs of older debt to the County Council. For the £2.307m at year end, £1.805m was between 90 and 365 days old as 31st March, and £0.502m over 365 days old.

For modelling purpose, if we take that the 3-12 months averaged about 6 months at year end, and the debt over a year averaged about 15 months, then the "cost of carry" is only c£17,000 per annum. This is only based on a snapshot in time, and can only be illustrative at best. It also does not take into account money the County Council owes to other parties.

3.6. Latest debt figures and significant debts outstanding

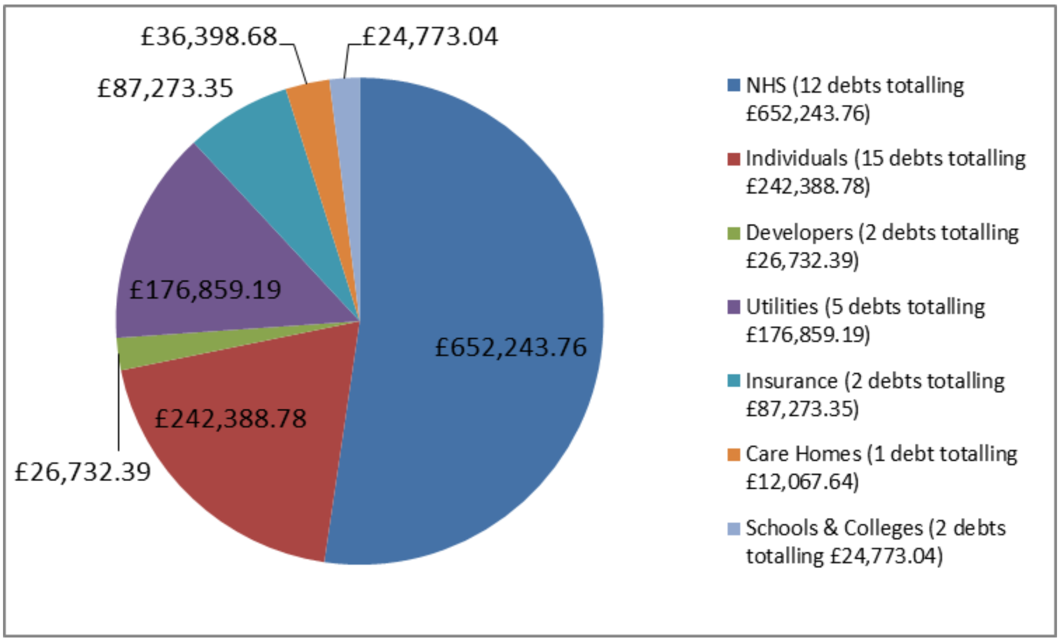
Services' total net outstanding debt reported on the Accounts Receivable system stood at **£13.366m** as at 31st May 2017. This compared with £6.134m as at 31st May 2016.

Debt over 90 days stands at **£2.404m** as at 31st May 2017, which equates to **17.93%** of the total debt. Appendix A shows the current split of debts by services, and the movement between the end of March and the end of May.

3.7. Breakdown of latest debt figures

There are a total of 39 debts over 90 days old and over £10,000 as at the end of May 2017. In total, these larger, older debts total **£1.247m**, or 51.9% of the total debt over 90 days old.

The breakdown of these larger debts is very similar to the end of year figures:-



3.8. New Measures

Previous Audit Committee reports have included a number of new measures that were being implemented to improve our debt recovery performance, including:-

- We have now migrated legal debt recovery to the Norwel system, which is the standard IT system for managing legal cases. (The previous system ARMS was no longer supported. It is also expected that the reports from Norwel will be easier to run and require less manual intervention to reconcile to SAP).
- We commissioned some work from SWAP to look at where there were "bottlenecks" or weaker performance or where controls needed improving. Many of these were around the services, before the debt was passed to the Legal Debt Recovery Officer.

- We have been re-drafting the Income Code of Practice in line with the SWAP recommendations and to speed up the process. This included the idea that services could issue a “Letter Before Action (LBA)”, which is the commencement of any legal recovery processes.
- Debts are a more regular agenda item on the Finance Management Team

This work has, unfortunately, been de-railed by the imminent Pre-Action Protocol, which has caused us to review all of our processes and approach.

3.9 Pre-Action Protocol requirements and analysis

The Pre-Action Protocol comes into force on 1st October 2017. It only applies to debts owed by individuals and by sole traders. It does not apply to business-to-business debts. Two snapshot months of debt information were analysed. Both suggested that (excluding Debts to Accrue) c12% by value and c30% by volume of our debts over 90 days old are with individuals or sole traders. Clearly, this will therefore impact on Somerset County Council’s debt recovery.

Broadly speaking, the Protocol is an attempt to reduce the amount of debt cases coming to the courts, by requiring more stages to be completed and exhausted, (and in more detail), before legal action can be taken. It will also ensure that proceedings that cannot be avoided should go through the courts more efficiently as all information will have already been exchanged. Regrettably, as a result, the requirements of the Protocol are going to **significantly impact** on the time (and even the possibility) of our recovering debts from individuals and sole traders.

The new measures introduced into the Protocol include:-

The **requirement**, when sending a Letter of Claim (effectively a Letter Before Action) to include a substantially increased volume of information about the debt claimed including the actual written or verbal agreement from which the debt arises. (This would be problematic if the agreement is not legally correct and binding, or if it cannot be produced).

The **requirement** to include an Information Sheet about the process, a Reply Form and a Financial Statement for completion in the Letter of Claim.

The **expectation** that both parties will seek to resolve the dispute without starting court proceedings. This could take the form of discussion and negotiation, or could be an Alternative Dispute Resolution (ADR) such as mediation from a third party.

The **warning** that, if a matter proceeds to litigation, the court will expect parties to have complied with this Protocol. The court will take into account non-compliance when giving directions for the management of proceedings.

Effectively, the Letter of Claim starts a 30 day “clock”, and if the debtor has not responded in that period then court proceedings can be commenced. However, there are a number ways that the debtor can stop the clock, or even reset it to 30 days, such as:-

- Requesting further information about the debt that was not included in the Letter of Claim (another 30 days minimum will elapse).
- Returning the Reply Form even if it is not completed correctly (another 30 days to discuss the debt, plus potentially further time if we need to request the Form's completion).
- Returning the Financial Statement, even it is not completed correctly (another 30 days to discuss the debt, plus potentially further time if we need to request the Statement's completion).
- Requesting more time to seek debt advice (another 30 days minimum will elapse).
- All of the above options that are available to the debtor are actually included on the Information Sheet that we are obliged the send to the debtor.

3.10 Pre-Action Protocol action plan

It is essential that the relevant officers respond to mitigate the impact, and a number of actions are already planned:-

All services are being required to review their income budgets to determine the extent to which the Protocol applies to them (i.e. individuals and sole traders) , and for what types of income.

The Legal Debt Recovery Officer and Accounts Receivable Team Leader will meet with each service (or their financial contacts) and review each affected income stream to consider (at least):-

- Whether it is possible to introduce a requirement for payment to be made up front, i.e. before the service is provided to the individual / sole trader.

- Whether or not it would be appropriate to offer incentives for early or immediate payment.

- Whether we are offering enough payment channels for the service to encourage payments.

- Whether or not the contractual documentation around the service provided is suitably robust and whether it needs to be strengthened to be suitable to issue with the Letter of Claim.

- How the service will help the Legal Debt Recovery Officer to complete all the other documentation that is required to send a fully effective Letter of Claim.

The presumption has to be that all such income will be moved to payment in advance or on the point of delivery, unless there is a reason why not. An example might be the payment of County Tickets over the travel period, where we have seen genuine cases of hardship and where a full upfront payment may not be possible in all cases.

4.. Consultations undertaken

4.1 Debt management is considered monthly at the Finance and Performance Management Team meetings. Debt is also regularly reported to Cabinet.

5. Implications

5.1 If debt is not collected promptly it greatly increases the risk that it may need to be written off which has an impact on the revenue budgets of services.

6. Background papers

6.1. Previous reports to Audit Committee.

6.2. Pre-Action Protocol documentation and requirements.

Note For sight of individual background papers please contact the report author