

# **The Current Business Climate - managing financial challenges and evolving fraud risks**

7 March 2024



# A bit about us



**David Baxendale**



**Sarah Richards**



**Fran Marwood**



**Oliver Delve**



# Agenda

- 1 Current business climate and market conditions
- 2 Fraud & “Failure to prevent fraud”

1

*Current business climate  
and market conditions*



**01**

**The current macroeconomic environment**

**02**

**Possible solvent and insolvent options**

**03**

**The insolvency toolkit available**

**04**

**Insolvency trends and statistics**

**05**

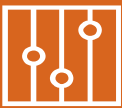
**Restructuring risks - key themes**



**Increased cost inflation / interest rates**



**Supply chain challenges**



**Political volatility / effects of the pandemic**



**Higher debt levels**



**AI and technology - rapid pace of change**



**Cost of living challenges and reduced demand**

**Government support /  
post GFC stimulus**

**Refinancing wall**

**Liquidity vs covenant  
trigger**

**New & different ways of  
working**

**A&E 'runway' to exit**

**Diminishing consumer  
confidence**

**Corporate memory /  
experience**

**Complex structures /  
supply chain / inflation**

**Pension Schemes Act  
2021**

**Suppressed / distressed  
valuations**

Following identification of current / future financial stress there are a wide range of options available to corporates - proactive tool use can preserve the future of companies and deliver value for shareholders.

Time available and funds required	Possible options - solvent	Possible options - insolvent
	M&A - solvent sale of whole or part of the business	Sale of entire business (via insolvency)
	Operational turnaround	Partial sale to 3rd parties (via insolvency)
	Debt / equity raise	Full closure (via Insolvency)
	Liability management	
	Restructure the balance sheet	
	Restructure the corporate group	
	Full closure (solvently)	

Company Voluntary Arrangement  
("CVA")

Restructuring Plan

Scheme of Arrangement

Moratorium

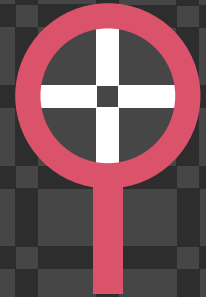
Administration

Creditors' Voluntary Liquidation  
("CVL")

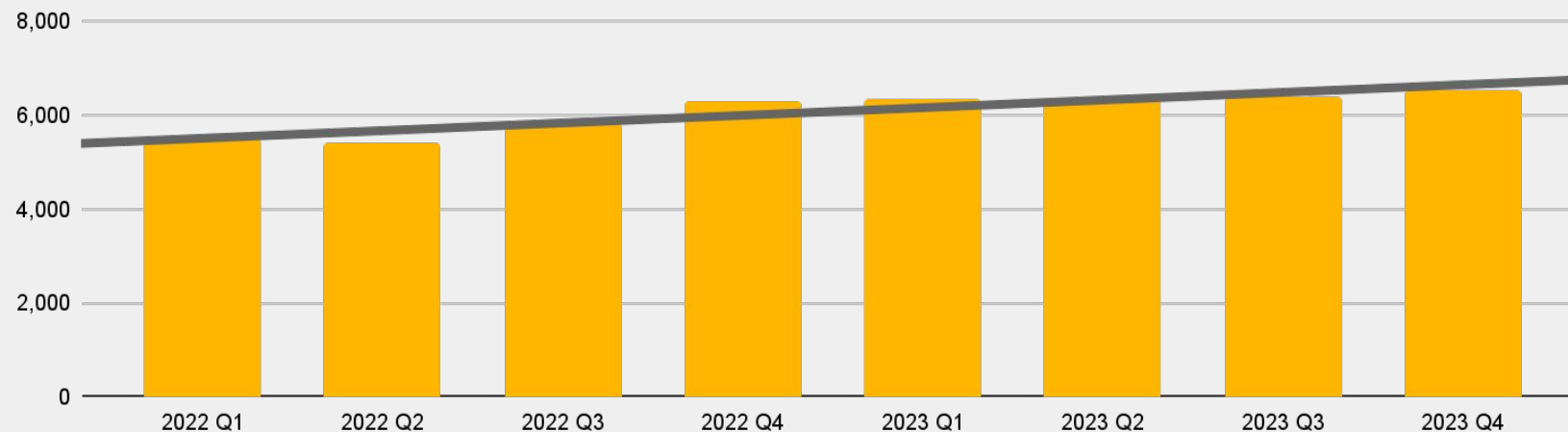
Compulsory Liquidation

Fixed Charge Receivership

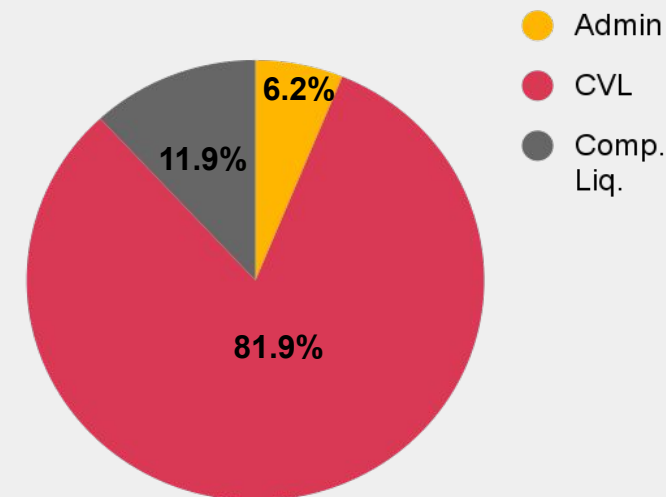
Administrative Receivership



2022 - 2023 Insolvency appointments



2023 Insolvency appointments, by type



11%

Increase in no. of  
insolvencies vs. 2022

24%

Increase in  
administrations vs.  
2022

98%

% of total no. of  
insolvencies with  
revenue of <£1m

30%

Increase in no. of  
insolvencies in  
companies with  
revenue > £1m

45%

Increase in winding  
up petitions vs. 2022

44%

Increase in  
compulsory  
liquidations vs. 2022

## Key themes

## Impact

## Availability of debt financing and lender attitudes

- More difficult to raise new debt or refinance
- Especially in sectors such as retail and if a client is already highly leveraged
- Will be more expensive - e.g. one client replacing SONIA + 4% with WACC of 12%.
- Lenders being far more challenging in face of requests for covenant relief
- Will see more restructurings and insolvencies

## Availability of equity

- Challenging global equity markets especially for clients with low market capitalisation.
- Lack of liquidity : clients will need to demonstrate a strong equity story to raise any additional capital
- Era of “easy” equity for “tech” or fast growth startups has ended - causing liquidity issues

## Reduction in asset valuations esp. commercial real estate

- Currently there is additional risk for those who have debt based on value of real estate esp commercial real estate
- This is especially true regarding commercial property as LTVs will be higher due to valuation drops
- The direct impact is that debt is more expensive and/or can raise less capital

## Pressure on EBITDA and liquidity

- Cost of living and inflation impacting revenue and EBITDA margins - construction and retail heavily impacted
- Credit insurers and payment providers are being more risk averse with impact on liquidity and facility usage
- Credit control teams being more vigorous in collection actions

## Interest and cost of debt

- Higher interest costs - harder to service debt - reduced CFADS
- Interest covenants are now becoming a key covenant that firms are at risk of breaching.

## Recap on the macroeconomic environment



**Increased cost inflation / interest rates**



**Supply chain challenges**



**Political volatility / effects of the pandemic**



**Higher debt levels**



**AI and technology - rapid pace of change**



**Cost of living challenges and reduced demand**



2

## Fraud trends & “failure to prevent offence”



## Fraud & “failure to prevent fraud”

**01**

**Recent fraud trends**

**02**

**Overview of efforts to tackle high levels of fraud in the UK**

**03**

**An overview of the ECCT Act’s ‘Failure to prevent fraud’ legislation**

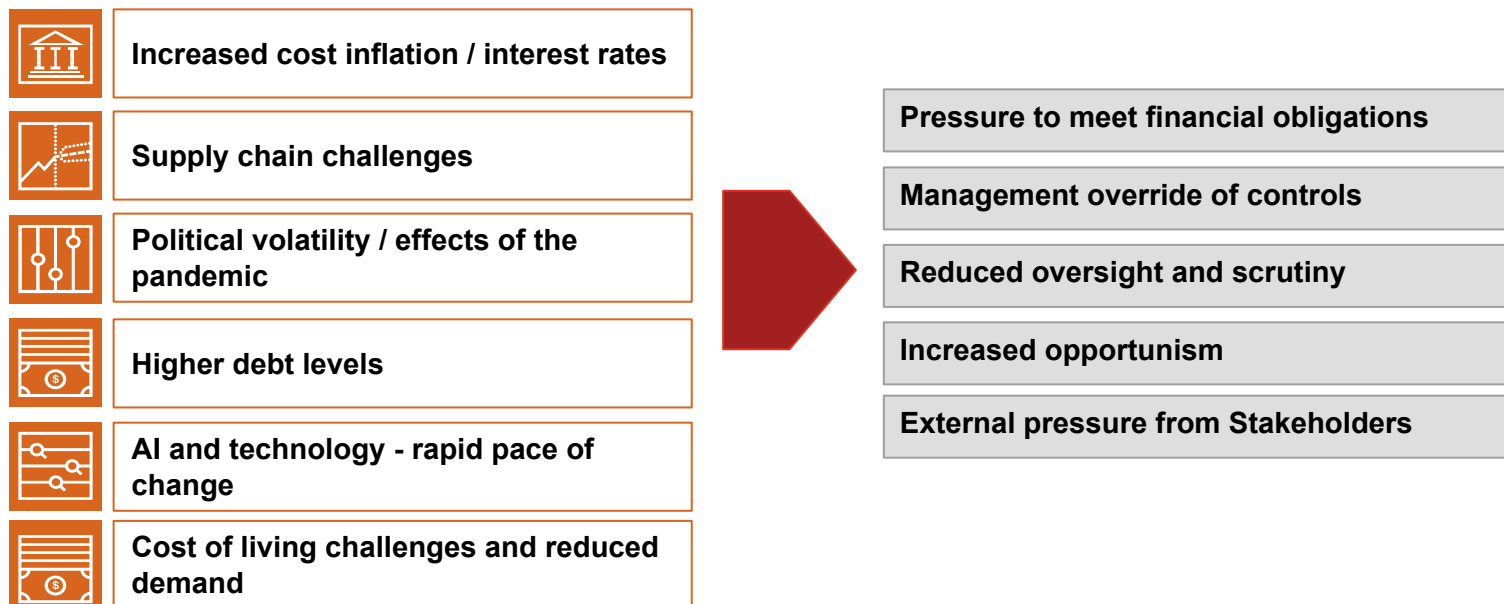
**04**

**What does the ECCT Act mean by Fraud? What is the scope of potential offences which might need to be considered?**

**05**

**The ECCT Act makes reference to ‘reasonable’ procedures defence. What is considered reasonable?**

Due times of financial distress the incentives, opportunities and rationalisation for fraud are heightened



**41%**  
of all crime in  
the UK is fraud

**64%** of  
companies\* in the UK  
have experienced fraud  
in the prior 24 months,  
compared to 46% globally.

#### Top five types of fraud reported by UK respondents

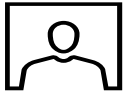
	<b>32%</b> Cybercrime	2020: <b>42%</b>
	<b>29%</b> Customer fraud	2020: <b>33%</b>
	<b>22%</b> Human resources fraud	2020: <b>24%</b>
	<b>19%</b> Supply chain fraud	New since <b>2022</b>
	<b>18%</b> Money laundering and terrorism financing	2020: <b>13%</b>

*Fraud can impact any business and can hit at any time, but there a number of warning signs or indicators to look out for where there could be a heightened risk.*



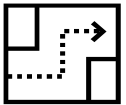
### **Leadership being dominant or inexperienced**

Hitting the results at all costs to maintain reputation / inexperience in a downturn.



### **Poor culture / high turnover of staff**

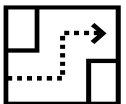
Culture of fear where the pressure to manipulate is higher often accompanies high staff turnover and unusually high (or low) levels of 'speak up' concerns.



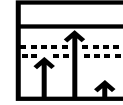
**Weak Finance Functions** - Inability to deliver bad news, under resourced, behind on key reconciliations, evasive to requests for evidence. Incomplete or missing documentation, with poor explanations provided.



**Slow or evasive responses** being provided to what should be simple queries.



**Weak Internal controls** - especially poor segregation of duties.



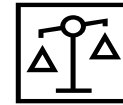
### **Profitability bucking the trend**

despite market conditions.



### **Industries or sectors facing distress or disruption**

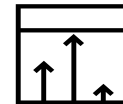
inability to react quickly to changing market conditions can lead to pressures to misstate.



**Local performance incentives focusing heavily on the P&L**, rather than a wider scorecard of measures.



**Operations in high-risk locations**, where other companies have had problems with fraud and misconduct in the past.



### **Complex financial transactions**

Can be exploited to make detection of fraud more challenging.

### UK Governments National Fraud Strategy

Reduce Fraud by 10%, on 2019 levels, by December 2024

Three key elements

1. Government & law enforcement to pursue more fraudsters and bring them to justice

2. Government & industry will work together to stop fraud attempts

3. British people more empowered to recognise, avoid and report fraud.

### Economic Crime & Corporate Transparency Act

Failure to prevent fraud legislation

***“The introduction of a failure to prevent offence and reform of the identification doctrine will better enable prosecutors to hold large companies to account for offences committed under their watch. It should result in greater care to prevent fraud before it happens.”***

**- Crown Prosecution Service**

***“This is the most significant boost to the Serious Fraud Office's ability to investigate and prosecute serious economic crime in over 10 years.”***

**- Serious Fraud Office**

## Who

Incorporated organisation meeting the criteria of a '**large company**' under the CA2006.

## What

## Offence

A person who is **associated with the body** ("the associate") commits a **fraud offence intending to benefit (whether direct or indirectly)**

- (a) the relevant body, or
- (b) any person to whom, or to whose subsidiary undertaking, the associate provides services on behalf of the body"

## Defence

- Had in **place reasonable prevention procedures**; or
- It was not reasonable in all the circumstances to expect any prevention procedures to be in place."

## Penalty

A relevant body guilty of an offence **is liable to a fine** (in Scotland and Wales, not exceeding the statutory maximum)

## When

The legislation is enforceable only once the UK Government has issued its formal guidance. Recent communications indicate the following:

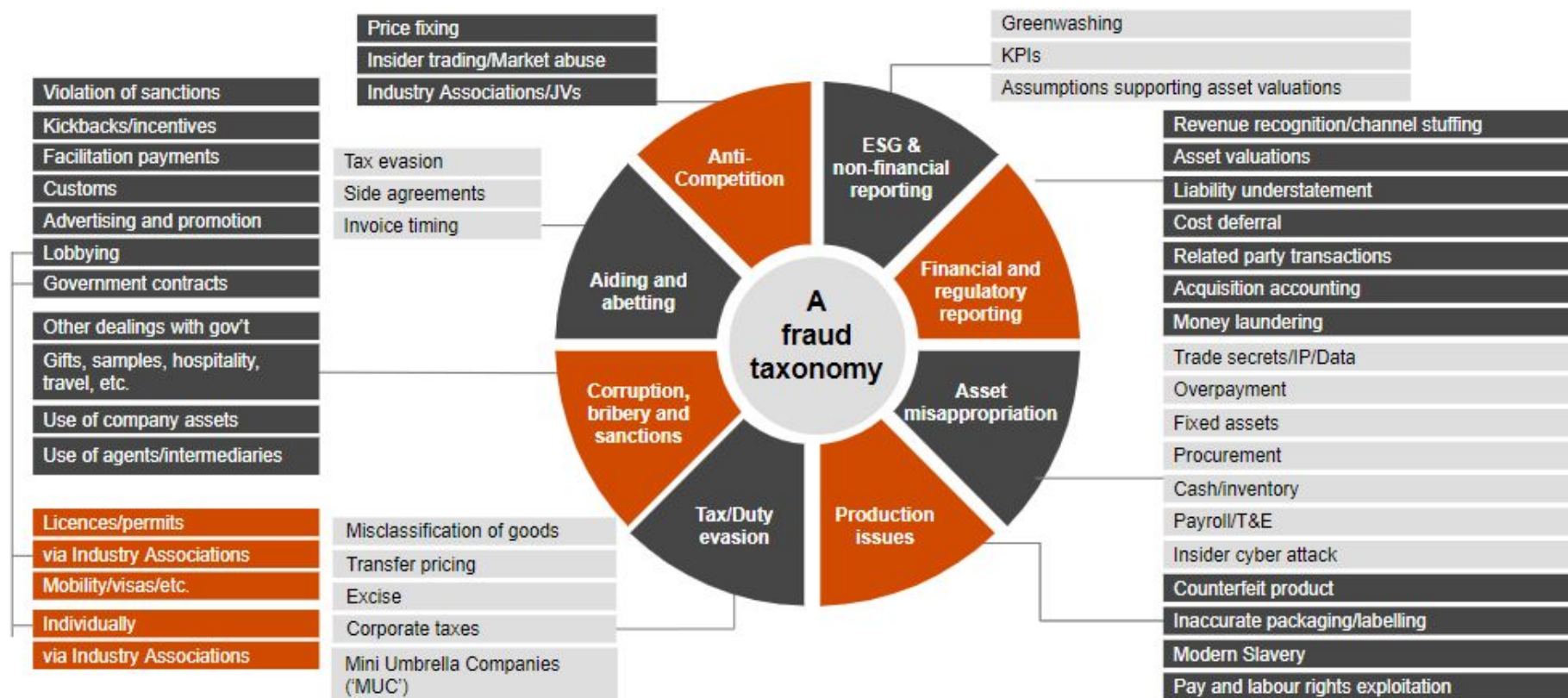
- Final guidance issued: Spring 2024 (i.e. next 2-3 months)
- Deadline for implementation of the requirements : 4-6 months (to be confirmed)

## What offences are in scope?

- **Cheating public revenue**
- **False accounting**
- **False statements by company directors etc**
- **Fraudulent trading**
- **Fraud, Uttering & Embezzlement**

And any offence under the following provisions of the Fraud Act 2006:

- **Fraud (Section 1)**
- **Participating in fraudulent business carried on by sole trader (Section 9)**
- **Obtaining services dishonestly (Section 11)**



## The ECCT Act makes reference to 'reasonable' procedures defence. What is considered reasonable?

The Government has indicated that the guidance on reasonable procedures will be:

- **Principles based;**
- Similar to previous 'Failure to prevent' legislation (i.e. Bribery Act / CCO);
- Consist of the following **six guiding principles**.

Top Level Commitment

Proportionate Procedures

Risk Assessment

Communication & Training

Due Diligence

Monitoring & Review

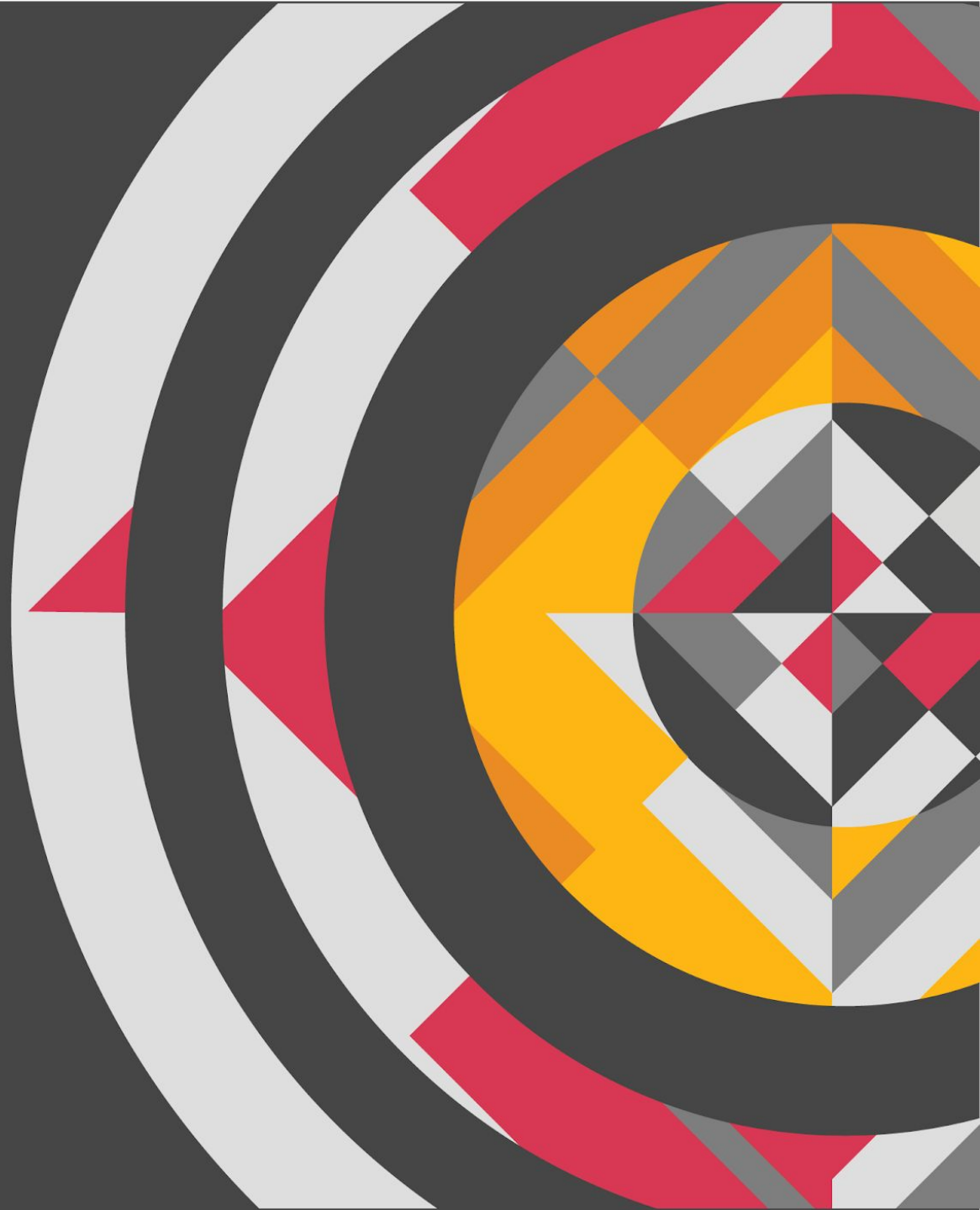
### What 'no regret' actions can you take now?

► **01** Identify relevant stakeholders across the business and assign responsibilities accordingly

► **02** Review and update existing fraud / financial crime policies to reflect new legislation

► **03** Review; update or undertake a fraud risk assessment across the company / group to identify relevant fraud risks and controls

Any questions?



[pwc.com](https://pwc.com)

© 2023 PwC. All rights reserved. Not for further distribution without the permission of PwC. “PwC” refers to the network of member firms of PricewaterhouseCoopers International Limited (PwCIL), or, as the context requires, individual member firms of the PwC network. Each member firm is a separate legal entity and does not act as agent of PwCIL or any other member firm. PwCIL does not provide any services to clients. PwCIL is not responsible or liable for the acts or omissions of any of its member firms nor can it control the exercise of their professional judgment or bind them in any way. No member firm is responsible or liable for the acts or omissions of any other member firm nor can it control the exercise of another member firm’s professional judgment or bind another member firm or PwCIL in any way.

RITM13428034