Public Document Pack

Audit Committee

Thursday 13 November 2014 at 6.00 pm

To be held at the Town Hall, Pinstone Street, Sheffield, S1 2HH

The Press and Public are Welcome to Attend

Membership

Councillors Ray Satur (Chair), Joe Otten (Deputy Chair), John Campbell, Rob Frost, Josie Paszek and Sioned-Mair Richards.

Independent Co-opted Members

Rick Plews and Liz Stanley.

Sheffield City Council

PUBLIC ACCESS TO THE MEETING

The Audit Committee is a key part of the Council's corporate governance arrangements. The Committee has delegated powers to approve the Council's Statement of Accounts in accordance with the Accounts and Audit Regulations 2003 and consider the Annual Letter from the Auditor in accordance with the Accounts and Audit Regulations 2003 and to monitor the Council's response to individual issues of concern identified.

A copy of the agenda and reports is available on the Council's website at www.sheffield.gov.uk. You can also see the reports to be discussed at the meeting if you call at the First Point Reception, Town Hall, Pinstone Street entrance. The Reception is open between 9.00 am and 5.00 pm, Monday to Thursday and between 9.00 am and 4.45 pm. on Friday. You may not be allowed to see some reports because they contain confidential information.

Recording is allowed at Audit Committee meetings under the direction of the Chair of the meeting. Please see the website or contact Democratic Services for details of the Council's protocol on audio/visual recording and photography at council meetings.

If you require any further information please contact Dave Ross in Democratic Services on 0114 273 5033 or email dave.ross@sheffield.gov.uk.

FACILITIES

There are public toilets available, with wheelchair access, on the ground floor of the Town Hall. Induction loop facilities are available in meeting rooms.

Access for people with mobility difficulties can be obtained through the ramp on the side to the main Town Hall entrance.

AUDIT COMMITTEE AGENDA
13 NOVEMBER 2014

Order of Business

1. **Welcome and Housekeeping Arrangements**

2. **Apologies for Absence**

3. **Exclusion of Public and Press**
   To identify items where resolutions may be moved to exclude the press and public.

   (Note: The following reports are not available to the public and press because they contain exempt information described in Paragraphs 2, 3 and 4 of Part 1 of Schedule 12A of the Local Government Act 1972, as amended:

   - Parking Services Audit (Item 8) – Paragraph 2 relating to information which is likely to reveal the identity of an individual and Paragraph 4 relating to information relating to any consultations or negotiations, or contemplated consultations or negotiations, in connection with any labour relations matter arising between the Council or a Minister of the Crown and employees of, or office holders under, the Council.

   - Strategic Risk Management (Item 9) – Paragraph 3 relating to the financial or business affairs of any particular person, including the authority holding that information)

4. **Declarations of Interest** (Pages 1 - 4)
   Members to declare any interests they have in the business to be considered at the meeting.

5. **Minutes of Previous Meeting** (Pages 5 - 10)
   To approve the minutes of the meeting of the Committee held on 25 September 2014.

6. **Independent Review of South Yorkshire Digital Region Project** (Pages 11 - 74)
   Report of the Interim Executive Director, Resources.

7. **Revised Approach for Capital Delivery and Reporting** (Pages 75 - 84)
   Report of the Assistant Director, Capital and Major Projects.

8. Parking Services Audit - Progress Against Outstanding Actions (Pages 85 - 222)

Report of the Executive Director, Place.

(Note: The report is not available to the public and press because it contains exempt information described in Paragraphs 2 and 4 of Part 1 of Schedule 12A of the Local Government Act 1972, as amended)

9. Strategic Risk Management (Pages 223 - 258)

Report of the Interim Executive Director, Resources.

(Note: The report is not available to the public and press because it contains exempt information described in Paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972, as amended)

10. Annual Audit Letter 2013/14 (Pages 259 - 268)

Report of the Director, KPMG.

11. Work Programme (Pages 269 - 274)

Report of the Interim Director of Legal and Governance.

12. Dates of Future Meetings

To note that meetings of the Committee will be held at 6.00 p.m. on:-

- 11 December 2014 (additional meeting if required)
- 8 January 2015
- 12 February 2015 (additional meeting if required)
- 12 March 2015 (additional meeting if required)
- 9 April 2015

ADVICE TO MEMBERS ON DECLARING INTERESTS AT MEETINGS

If you are present at a meeting of the Council, of its executive or any committee of the executive, or of any committee, sub-committee, joint committee, or joint sub-committee of the authority, and you have a **Disclosable Pecuniary Interest** (DPI) relating to any business that will be considered at the meeting, you must not:

- participate in any discussion of the business at the meeting, or if you become aware of your Disclosable Pecuniary Interest during the meeting, participate further in any discussion of the business, or
- participate in any vote or further vote taken on the matter at the meeting.

These prohibitions apply to any form of participation, including speaking as a member of the public.

You **must**:

- leave the room (in accordance with the Members' Code of Conduct)
- make a verbal declaration of the existence and nature of any DPI at any meeting at which you are present at which an item of business which affects or relates to the subject matter of that interest is under consideration, at or before the consideration of the item of business or as soon as the interest becomes apparent.
- declare it to the meeting and notify the Council's Monitoring Officer within 28 days, if the DPI is not already registered.

If you have any of the following pecuniary interests, they are your **disclosable pecuniary interests** under the new national rules. You have a pecuniary interest if you, or your spouse or civil partner, have a pecuniary interest.

- Any employment, office, trade, profession or vocation carried on for profit or gain, which you, or your spouse or civil partner undertakes.

- Any payment or provision of any other financial benefit (other than from your council or authority) made or provided within the relevant period* in respect of any expenses incurred by you in carrying out duties as a member, or towards your election expenses. This includes any payment or financial benefit from a trade union within the meaning of the Trade Union and Labour Relations (Consolidation) Act 1992.

  *The relevant period is the 12 months ending on the day when you tell the Monitoring Officer about your disclosable pecuniary interests.

- Any contract which is made between you, or your spouse or your civil partner (or a body in which you, or your spouse or your civil partner, has a beneficial interest) and your council or authority –

  - under which goods or services are to be provided or works are to be executed; and
  - which has not been fully discharged.

- Any beneficial interest in land which you, or your spouse or your civil partner, have and which is within the area of your council or authority.

- Any licence (alone or jointly with others) which you, or your spouse or your civil partner, holds to occupy land in the area of your council or authority for a month or longer.

- Any tenancy where (to your knowledge) –
  - the landlord is your council or authority; and
  - the tenant is a body in which you, or your spouse or your civil partner, has a beneficial interest.

- Any beneficial interest which you, or your spouse or your civil partner has in securities of a body where -

  (a) that body (to your knowledge) has a place of business or land in the area of your council or authority; and

  (b) either -
  - the total nominal value of the securities exceeds £25,000 or one hundredth of the total issued share capital of that body; or
  - if the share capital of that body is of more than one class, the total nominal value of the shares of any one class in which you, or your spouse or your civil partner, has a beneficial interest exceeds one hundredth of the total issued share capital of that class.

If you attend a meeting at which any item of business is to be considered and you are aware that you have a **personal interest** in the matter which does not amount to a DPI, you must make verbal declaration of the existence and nature of that interest at or before the consideration of the item of business or as soon as the interest becomes apparent. You should leave the room if your continued presence is incompatible with the 7 Principles of Public Life (selflessness; integrity; objectivity; accountability; openness; honesty; and leadership).

You have a personal interest where –

- a decision in relation to that business might reasonably be regarded as affecting the well-being or financial standing (including interests in land and easements over land) of you or a member of your family or a person or an organisation with whom you have a close association to a greater extent than it would affect the majority of the Council Tax payers, ratepayers or inhabitants of the ward or electoral area for which you have been elected or otherwise of the Authority's administrative area, or

- it relates to or is likely to affect any of the interests that are defined as DPIs but are in respect of a member of your family (other than a partner) or a person with whom you have a close association.

Guidance on declarations of interest, incorporating regulations published by the Government in relation to Disclosable Pecuniary Interests, has been circulated to you previously.

You should identify any potential interest you may have relating to business to be considered at the meeting. This will help you and anyone that you ask for advice to fully consider all the circumstances before deciding what action you should take.

In certain circumstances the Council may grant a **dispensation** to permit a Member to take part in the business of the Authority even if the member has a Disclosable Pecuniary Interest relating to that business.

To obtain a dispensation, you must write to the Monitoring Officer at least 48 hours before the meeting in question, explaining why a dispensation is sought and desirable, and specifying the period of time for which it is sought. The Monitoring Officer may consult with the Independent Person or the Council's Standards Committee in relation to a request for dispensation.

Further advice can be obtained from Gillian Duckworth, Interim Director of Legal and Governance on 0114 2734018 or email gillian.duckworth@sheffield.gov.uk.

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SHEFFIELD CITY COUNCIL

Audit Committee

Meeting held 25 September 2014

PRESENT: Councillors Ray Satur (Chair), John Campbell, Rob Frost, Joe Otten (Deputy Chair) and Sioned-Mair Richards.

Co-opted Independent Members
Rick Plews and Liz Stanley.

Officers in attendance
John Mothersole (Chief Executive)
Eugene Walker (Interim Executive Director, Resources)
Andy Eckford (Interim Director of Finance)
Laura Pattman (Assistant Director of Finance, Business Partnering and Internal Audit)
Kayleigh Inman (Senior Finance Manager, Internal Audit)
Clair Sharratt (Finance Manager - Strategic Finance)
Sue Sunderland (Director KPMG)
David Phillips (Senior Manager KPMG)
Gillian Duckworth (Interim Director of Legal and Governance)
Dave Ross (Principal Committee Secretary)

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1. APOLOGIES FOR ABSENCE

1.1 An apology for absence was received from Councillor Helen Mirfin-Boukouris.

2. DECLARATIONS OF INTEREST

2.1 There were no declarations of interest.

3. AUDIT REPORTS WITH A HIGH OPINION

3.1 The Chair of the Committee (Councillor Ray Satur) reported on the previously agreed process for dealing with Audit reports with a High Opinion (an auditable area receiving a High Opinion was considered by Internal Audit to be an area where the risk of the activity not achieving its objectives was high and sufficient controls were not present at the time of the audit review). This involved the final reports being circulated to members of the Committee and members having the opportunity to submit written questions for a response. Following discussions with members of the Committee, it was proposed that the process would be amended by having the reports included on the next available Audit Committee agenda. Members would also have the opportunity to ask for the relevant service officer to attend the meeting if it had not been possible to answer their questions in advance or if there were any particular concerns.

3.2 **Resolved**: That the process for the circulation and consideration of Audit reports with a High Opinion is amended as now reported and discussed.

4. MINUTES OF PREVIOUS MEETING

4.1 The minutes of the meeting of the Committee held on 17 July 2014 were approved as a correct record.

5. 2013/14 STATEMENT OF ACCOUNTS AND EXTERNAL AUDITOR'S REPORT TO THOSE CHARGED WITH GOVERNANCE (ISA 260)

5.1 The Interim Director of Finance introduced a report of the Interim Executive Director of Resources that communicated any relevant matters arising from the external audit of the 2013/14 Statement of Accounts. Appended to the report were the Statement of Accounts and the External Auditor’s Report to Those Charged with Governance (ISA 260).

5.2 The Finance Manager (Strategic Finance) outlined the headlines from the Statement of Accounts, as summarised in the Foreword. In particular, she referred to savings achieved and the £415k overspend on the budget, the introduction of significant changes to local government finance and maintaining the level of reserves.

5.3 The Interim Director referred to the findings from the external audit which had identified an error which had not been amended in the accounts where the revaluation of a property asset had not been properly transacted. This was not considered material to the accounts and would be corrected on the 2014/15 accounts. It was intended that an unqualified audit opinion would be given by the External Auditor on the accounts in relation to internal controls and a qualified conclusion in respect of issues relating to Adult Social Care. Also no material uncertainties had been identified.

5.4 The Director, KPMG introduced the Report to Those Charged with Governance (ISA 260) that summarised the key findings from the audit of the Council’s financial statements for 2013/14 and the work to support KPMG’s conclusion on the Council’s arrangements to secure economy, efficiency and effectiveness in its use of resources (the value for money conclusion). She referred to the summary of the headline messages relating to the control environment, completion of the report and value for money conclusion and risk areas. The controls over the majority of the Council’s key financial systems were sound but there were some weaknesses in respect of individual finance systems relating to pensions data flows and the Credit Clearing Account and a diminution of control following a review by the Council and change in the practice relating to journals. It was anticipated that an unqualified opinion would be issued in relation to the Council’s financial statements by 30 September 2014. The Director also outlined the specific value for money risks in relation to the Adult Social Care overspend and this meant that there would be a qualified opinion on the value for money conclusion.

5.5 In response to a question on the issue of the Council having discontinued its previous practice of requiring all journals to be authorised by an officer separate to the preparer and whether this should be permitted, the Director KPMG commented that other local authorities were making similar changes. One option could be to ask Internal Audit to undertake testing in this area as KPMG's sample testing was small. The Interim Executive Director, Resources stated that it was about moving money between accounts and the level of risk was low. The Assistant Director of Finance added that there was no planned audit for this area of work and it was not considered a high risk.

5.6 Officers responded to further questions from members of the Committee on the External Auditor's report relating to South Yorkshire Trading Standards Unit, the Credit Clearing Account and Adult Social Care.

5.7 In respect of the risk identified relating to savings plans, the Director KPMG indicated that due to the scale of the savings and the decisions that underpin those savings, it was accepted that some savings may not be achieved during the year as planned but that it was about how that would be addressed by management. The Chief Executive stated that the Council continued to deliver a balanced budget at the end of the year and he did not recall having to abandon an in year saving. However, achieving savings was becoming more difficult.

5.8 Officers also responded to questions on the Statement of Accounts relating to Corporate expenditure, how the expenditure spent outside the capital programme was managed and the Sheffield City Trust transactions.

5.9 **Resolved**: That the Committee:-

(a) accepts the Report to Those Charged with Governance (ISA 260) 2013/14;

(b) approves the Statement of Accounts for 2013/14;

(c) requests the Chair of the Audit Committee to sign (i) the Letter of Management Representations in order to conclude the audit and (ii) the Statement of Accounts;

(d) thanks Clair Sharratt and the Finance Team for their work on the Statement of Accounts; and

(e) thanks Sue Sunderland, David Phillips and her Audit Team at KPMG for their work on the ISA 260 report.

6. INTERNAL AUDIT ANNUAL REPORT 2013/14

6.1 The Senior Finance Manager (Internal Audit) submitted a report that highlighted the work that had been undertaken by Internal Audit during the year and which supported the Council's Annual Governance Statement. The report included an executive summary of audit opinion, internal audit resources and the audit reporting process. Overall the response to recommendations made by Internal Audit was positive and the majority were accepted by management.

6.2 Officers responded to questions from members of the Committee relating to Audit Reports with a high opinion and concerns at the reduced budget for Internal Audit and the impact this would have on the audit work. The Assistant Director of Finance commented that she would endeavour to maintain the current level of funding for the service. The Interim Executive Director, Resources indicated that the budget reduction for Internal Audit was lower than for the Finance Team and there were similar pressures across the other parts of his Portfolio. Members were faced with difficult choices and decisions.

6.3 **Resolved**: That the Committee:-

(a) notes the report and the opinion of the Chief Audit Executive (Senior Finance Manager) that she is satisfied that the core systems included control arrangements which were adequate to allow the Council to conduct its business appropriately; and

(b) whilst noting the budget reductions being faced across local government, raised concerns at the level of funding available for Internal Audit and any potential future reductions and the impact of this on delivery of the audit work.

7. EXCLUSION OF PUBLIC AND PRESS

7.1 **Resolved:** That the public and press be excluded from the meeting before discussion takes place on the following item of business to be considered (Financial/Commercial Monitoring of External Relationships) on the grounds that, if the public and press were present during the transaction of such business, there would be a disclosure to them of exempt information as described in paragraph 3 of Schedule 12A to the Local Government Act 1972, as amended (information relating to the financial or business affairs of any particular person including the Authority holding the information).

8. FINANCIAL/COMMERCIAL MONITORING OF EXTERNAL RELATIONSHIPS

8.1 The Interim Director of Finance introduced a report of the Interim Executive Director, Resources that provided a bi-annual update on the risks relating to the financial and commercial monitoring of the Council's main external relationships. This was the first report that was consistent with other corporate performance monitoring and the format had therefore been changed accordingly. This has had an impact upon the previous risk status which was unrelated to any deterioration in actual partnership relations. This has been caused by the revised corporate reporting criteria for assessing risk status which was now objectively based on the relative probability and impact of the issue concerned occurring.

8.2 **Resolved**: That the Committee:-

(a) notes the report now submitted; and

(b) requests that in future it would receive the integrated risk management report that is submitted to the Executive Management Team and this should also include the risk matrix and be in a larger font size.

9. WORK PROGRAMME

9.1 The Interim Director of Legal and Governance submitted a report providing details of the Committee's outline work programme for 2014/15.

9.2 **Resolved**: That the Committee:-

(a) approves the work programme for 2014/15; and

(b) would consider at its next meeting whether the December meeting of the Committee would be held if there was only the one item of business or whether that item would be deferred to the January meeting.

10. DATES OF FUTURE MEETINGS

10.1 It was noted that meetings of the Committee will be held at 6.00 p.m. on:-

- 13 November 2014
- 11 December 2014
- 8 January 2015
- 12 February 2015
- 12 March 2015
- 9 April 2015

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Audit Committee Report

Report of:	Eugene Walker
Date:	13 November 2014
Subject:	Independent Review of South Yorkshire Digital Region Project
Author of Report:	Edward Highfield, Director of Creative Sheffield 0114 223 2349

Summary:

Audit Committee will be familiar with the regrettable demise of the Digital Region South Yorkshire Broadband Project.

At the time that the Shareholders announced the decision to close Digital Region, they committed to an independent review to understand what lessons could be learned for the future.

This report introduces that full report (Appendix 1) and considers the implications and lessons learned.

Recommendations:

Audit Committee is asked to comment on the wider implications and lessons learned.

Background Papers:

Appendix 1 - Independent Review of South Yorkshire Digital Region Project
Appendix 2 – Original SCC Cabinet Report

Category of Report:	OPEN

Statutory and Council Policy Checklist

Financial Implications
NO
Legal Implications
NO
Equality of Opportunity Implications
NO
Tackling Health Inequalities Implications
NO
Human rights Implications
NO:
Environmental and Sustainability implications
NO
Economic impact
NO
Community safety implications
NO
Human resources implications
NO
Property implications
NO
Area(s) affected
All
Relevant Cabinet Portfolio Leader
Cllr Curran
Relevant Scrutiny Committee
Not applicable
Is the item a matter which is reserved for approval by the City Council?
NO
Press release
NO

INDEPENDENT REVIEW OF SOUTH YORKSHIRE DIGITAL REGION PROJECT

1.0 Background

Audit Committee will be familiar with the regrettable demise of the Digital Region South Yorkshire Broadband Project.

At the time that the Shareholders announced the decision to close Digital Region, they committed to an independent review to understand what lessons could be learned for the future.

2.0 Purpose

This report presents the findings from that independent review, conducted by KPMG. Specially, the review examined:

- The original business case
- Governance arrangements
- Information flows and decision making
- Risk management; and
- Procurement arrangements and specialise advice

The full report is included at **Appendix 1.**

3.0 Digital Region Update

Whilst not directly related to the content of this report, Audit Committee will be interested in progress with the close down of Digital Region. To date;

- Customers have been migrated and Network switched off during August
- Asset transfer to Zeo Ltd has been completed and overseen by PWC
- European clawback has been formally agreed and repaid
- Costs to date are lower than the worst case budget provided for and the reduced costs have been released back to help SCC's budget
- The special purpose vehicle, Digital Region Limited, is being prepared for voluntary liquidation.
- Oversight and assurance to Shareholders has been provided by PWC

Whilst not a positive given the overall situation, it should be noted that the close down has been well managed and is on track to complete on time and under budget.

4.0 Why is this Independent Review important?

Clearly given the complexity and scale of the Digital Region project it is essential that lessons are learned and that Sheffield City Council as a major Shareholder fully understands the underlying causes of the project's failure.

To this end, the KPMG report draws some important conclusions:

4.1 Overall

There is evidence that the aims of the project have to some degree been achieved – albeit not necessarily by DRL itself.
KPMG conclude that there is no doubt that since the conception of the DRL project in 2005, and the start of the contract in 2009, the digital communication market in South Yorkshire has changed enormously. The participants that KPMG spoke to were clear in their view that the South Yorkshire digital economy would not have developed at the rate it had done without DRL.
Clearly some of the change in the marketplace is directly attributable to DRL, and the project has delivered the infrastructure and network elements of the business case, but a less 'evidenced' conclusion is that the DRL project has been a catalyst for the large service providers to invest heavily in their digital communication developments in the region.

4.2 Business Case

KPMG highlighted that the external reviews of the business case carried out as part of the original due diligence raised concerns and issues, which would be expected from such reviews. While all four Councils included details of project risks in their reports to decision makers, in KPMG's view these were of variable depth and detail, and did not specifically refer to the outcomes of the due diligence reviews.

SCC officers have reviewed this conclusion against our own decision making process. SCC approval for Digital Region was made in a September 2008 Cabinet Report (see **Appendix 2**). In it, the risks are set out in in some detail and financial sensitivity analysis set out to show the impact for SCC of a slower take up and potential cost of termination. It is reasonable to highlight to Audit Committee that SCC's analysis of risks part of the decision making process are felt to have been more robust that other shareholder authorities, despite the highly regrettable outcome of course being the same.

4.3 Governance arrangements

KPMG conclude that the appointment of officers to the Board by the shareholder Councils should take into account the skills required for the Board. For DRL the Board appointments did not include any IT specialists to provide assurance/challenge on the technological aspects of the project.

They add that where there is potential conflict between the duties to the company and the duties to the Council, there should be clarity as to how that conflict is to be managed and addressed.

4.4 Information flows and decision making

KPMG found that the various Councils' reports to make the decision on the initial investment did not include the information on the sensitivity analysis and the extent to which financial success was dependent on the speed and level of take-up of the service. They conclude that the lack of a robust sales and marketing plan earlier in the process did not help the Councils and DRL to demonstrate the achievability of the business plan.

As above, SCC's approval process did include sensitivity analysis. In retrospect these sensitivities were not as pessimistic as the reality turned out to be but the advice from our technical consultants when challenged at the time was that the income projections were achievable. Clearly this turned out to not be the case.

4.5 Risk management

KPMG find that risks were regularly reported to shareholder Councils through the project.

4.6 Procurement arrangements and availability of specialist advice

Appointment of consultants are highlighted as needing to be managed as part of a formal governance approach that seeks to address knowledge or resource gaps and should not impact demonstrably on the 'ownership' of the project by permanent employees.

5.0 What does it tell us for the future?

The conclusions of the KPMG report pose some important questions to the Council in terms of its risk appetite and capability to deliver major, ambitious projects in the future.

It is true to say that if this project (and many others which Councils consider on a daily basis) were low risk from the outset, then they would likely be delivered by the market without there being a case for public sector intervention. We were trying to make a step change well ahead of a private sector solution and in doing so, knowingly entered into considerable commercial risk.

The report raises important questions about the approval process by which the Council knowingly entered into those risks. The Council does have an appetite for risk and intervening in cases of market failure is part of its role in order to stimulate economic growth. However, that decision making process must at all times be transparent and realistic about those risks in order to allow proper, informed decision making to take place.

Lastly, once having properly accepted those commercial risks, their mitigation and management was ultimately unable to make the project a success. Technological advances, market conditions and delays in getting European approvals all conspired to make the project fail commercially. Something not covered in detail by the report however was the final decision making process to recognise that the project had failed and that it was demonstrably better value to the tax payer to close than to continue. It is regrettable that the strongest governance and project capability came at the end of the project, not the beginning.

KPMG

cutting through complexity

Independent Review of South Yorkshire Digital Region Project

June 2014

Disclaimer

This Report has been prepared on the basis set out in our engagement letter dated 9 January 2014.

This Report is for the benefit of Barnsley Metropolitan Borough Council, Doncaster Metropolitan Borough Council, Rotherham Metropolitan Borough Council, and Sheffield City Council. and this Report is strictly confidential to these four Councils.

Nothing in this Report constitutes a valuation or legal advice. We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the engagement letter.

This Report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtains access to this Report or a copy (under the Freedom of Information Act 2000 or otherwise) and chooses to rely on this Report (or any part of it) does so entirely at their own risk.

There are some important limitations to the work that we have undertaken in respect of this engagement. In particular, we would draw attention to the following:

Our work has been based upon information and data provided by DRL and the Councils. We have not verified the accuracy or sources of this data, nor have we audited this data;

We have worked jointly with DRL and Council officers in obtaining the data. We have therefore placed reliance upon their information, understanding and judgement.

Our work has not considered whether the initial decision to establish DRL was the correct decision, nor has it considered the contract award process to confirm whether Thales was the right contractor for the project.

The project was conceived in 2005 and the contract with Thales was signed in 2009. Through this period there has been a significant turnover of staff, both at Digital Region Limited and at the Local Authority shareholders, and it has not been practicable or possible to interview all involved and relevant parties.

Clearly in light of the decision to close the company the lessons learned from this are articulated in the context of the possible involvement in future projects and schemes that involve complex and technical aspects.

Independent Review of South Yorkshire Digital Region Project

Contents

The contacts at KPMG in connection with this report are:

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Introduction

Background

Following initial considerations in 2005, in 2008 the four South Yorkshire Councils and Yorkshire Forward initiated a project to transform the economy of South Yorkshire through the development, implementation and exploitation of a high speed broadband network.

Digital Region Limited (DRL), a special purpose vehicle (SPV), was created to manage the project, with the four South Yorkshire Councils and Yorkshire Forward (subsequently this became the Secretary of State for Business Innovation and Skills) as shareholders and guarantors. In April 2009 DRL entered into a 10 year contract with Thales to build and operate the network.

In August 2013 the shareholders all determined to proceed with a 'managed closure' of DRL, accepting that the project costs to achieve financial stability, and the barriers to enable the project to proceed in a sustainable manner, were prohibitive. The managed closure will continue until August 2014, when DRL and the project will cease.

Scope of the work

Barnsley Metropolitan Borough Council, on behalf of all four South Yorkshire Council's engaged us to carry out an independent review of the project.

The scope of our work was to carry out a 'phase 1' risk assessment leading to a possible 2nd phase of more detailed focus.

The work has reviewed the whole project cycle, from initial decision to invest to the decision to close the company and included specific reviews of:

- The original business case;
- Governance arrangements;
- Information flows and decision making;
- Risk management; and
- Procurement arrangements and specialist advice available.

Scope of the report

This report is not a lengthy analysis of all decisions and deliberations that have been considered in the past nine years since the project was conceived. Nor is it a consideration of how the problems could have been avoided, and a discussion on the other options that could have been considered.

What this report aims to do is succinctly and clearly set out our observations on the key elements of the project, and identify the successes achieved through the project, and the lessons we consider the participants can learn for the future from this project.

Executive summary – Headlines

Overall conclusion	The aim of phase 1 of our review was to carry out a risk assessment of the stages of the project and consider whether there are any further, more detailed areas of review that we would need to consider. Having carried out our phase 1 work, we conclude that there is no further work that we would consider would provide any further insight to the shareholder Councils.
Positive aspects	The aims and objectives of the project, as set out in the business case were to create a next generation broadband network to: • Stimulate economic growth and inward investment through the availability of high speed communication services to business and residential users; and • Provide a communication network that can be used by the commercial and public sectors to deliver more advanced services to citizens and businesses. The view of all the participants we spoke to was clear, that in regards of both aspects elements of the aims above, there is evidence that the aims of the project have been achieved – albeit not necessarily directly by the DRL project itself. There is no doubt that since the conception of the project in 2005, and the start of the contract in 2009, the digital communication market in South Yorkshire has changed enormously. The participants that we spoke to were clear in their view that the South Yorkshire digital economy would not have developed at the rate it had done without DRL. Clearly some of the change in the marketplace is directly attributable to DRL, and the project has delivered the infrastructure and network elements of the business case, but a less 'evidenced' conclusion is that the DRL project has been a catalyst for the large service providers to invest heavily in their digital communication developments in the region. A related benefit for the local community and for the Councils, is that the public's interactions and transactions with the Council are being transformed, with an increasing number of those interactions and transactions being carried out electronically. All the main parties to the project, DRL officers, the DRL Board and the wider Council officers have invested a huge amount of energy, and maintained the energy and enthusiasm throughout the past five years. This is an achievement that bears stressing, especially given how clearly difficult the project has been to manage and deliver: we have observed that there has been a consistent commitment at DRL and the shareholders to 'make the project work', despite the continued difficulties.

Executive summary – Headlines

Key lessons to learn

Business case

- The due diligence and review of the business case should be clearly and formally articulated.
- The external reviews of the business case carried out as part of the due diligence approach, raised concerns and issues, which would be expected from such reviews. While all four Councils included details of project risks in their reports to decision makers, these were of variable depth and detail, and did not specifically refer to the outcomes of the due diligence reviews.

Governance arrangements

- The appointment of officers to the Board by the shareholder Councils should take into account the skills required for the Board. For DRL the Board appointments did not include any IT specialists to provide assurance/challenge on the technological aspects of the project.
- Where there is potential conflict between the duties to the company and the duties to the Council, there should be clarity as to how that conflict is to be managed and addressed.

Information flows and decision making

- Council's reports to make the decision on the initial investment did not include the information on the sensitivity analysis and the extent to which financial success was dependent on the speed and level of take-up of the service.
- The lack of a robust sales and marketing plan earlier in the process did not help the Councils and DRL to demonstrate the achievability of the business plan.

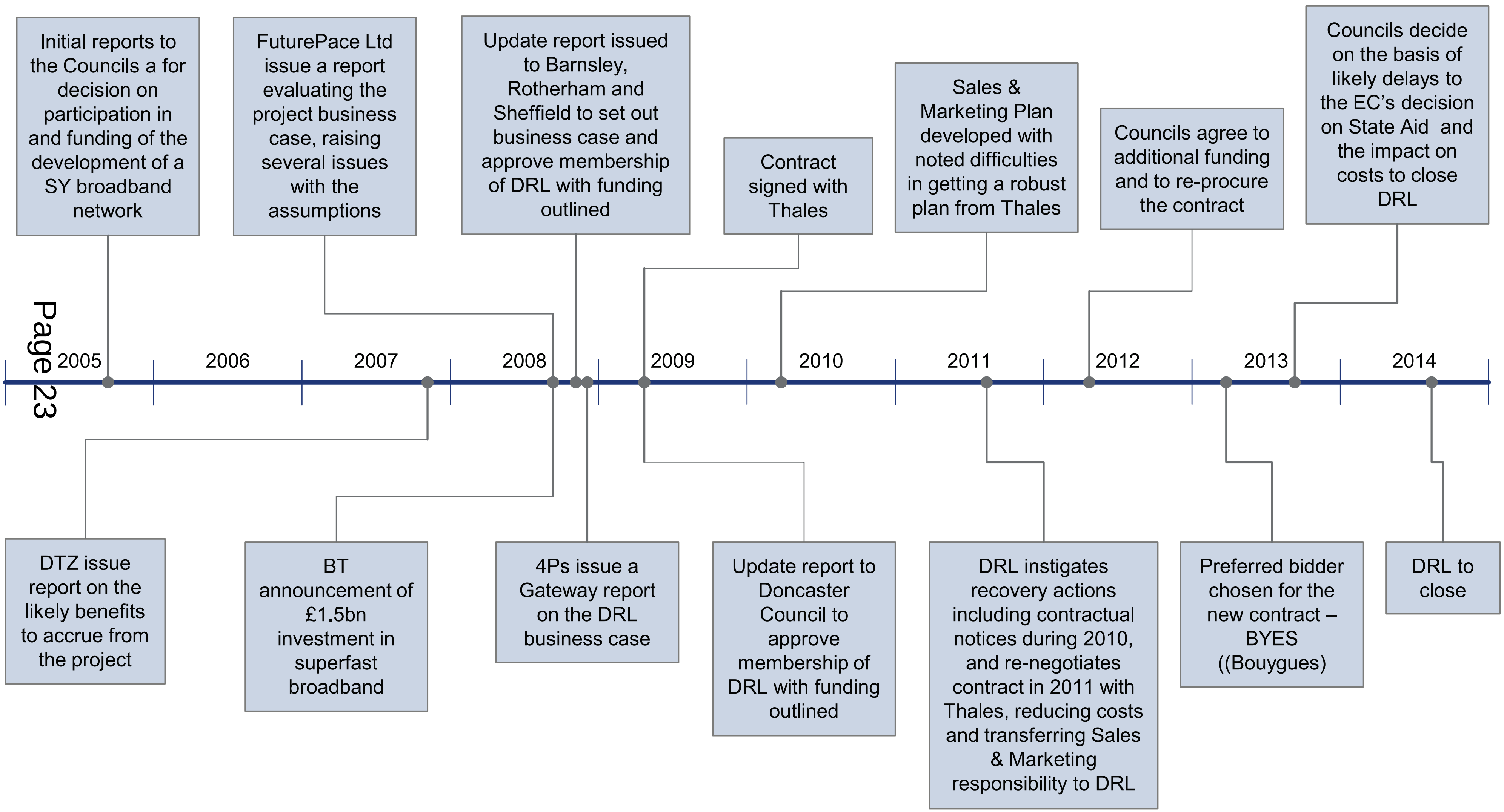
Risk management

- Risks have been regularly reported to shareholder Councils through the project focusing on the financial risks to the Councils.

Procurement arrangements and availability of specialist advice

- Appointment of consultants needs to be managed as part of a formal governance approach that seeks to address knowledge or resource gaps and should not impact demonstrably on the 'ownership' of the project by permanent employees.

Executive summary – Key Decision Chronology



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Executive summary – Business Case assessment

The Five Case Model

The Five Case Model is the approach for developing business cases recommended by HM Treasury, the Welsh Government and the UK Office of Government Commerce. It has been widely used across central government departments and public sector organisations over the last 10 years.

We have considered the extent to which the South Yorkshire DRL business plan met the requirements of the Five Case Model below.

The Case	The question	What the Business Case must demonstrate		
Strategic Case	Is the proposal needed?	will it further the aims and objectives?	is there a clear case for change?	Yes. The business case articulates the reasons needed for the change and how the project would deliver the project aims and objectives.
Economic Case	Is it value for money?	has a range of options been considered?	is it the best balance of cost, benefits and risk?	Partial. The business case does not articulate the 'value for money' of the project but does consider the benefits from the investment. It is not clear what other options have been considered and consequently it is not clear that the project would deliver the best balance of cost, benefits and risk.
Commercial Case	Is it viable?	is there a supplier who can meet our needs?	can we secure a value for money deal?	Partial. The business case includes the risks in the project and a financial sensitivity analysis. This articulates the importance of achieving the sales income targets. The business case has a short section on the procurement process, outlining that Thales are the preferred bidder. It is not clear from the business case that a value for money deal can be secured.
Financial Case	Is it affordable?	are the costs realistic and affordable?	is the required funding available and supported?	Yes. The business case includes a funding section which is based on assumptions. No assessment of 'affordability' is included, but the level and balance of funding between ERDF, RDA and local authority is supported by statements that give assurance that the funding is in place.
Management Case	Is it achievable	are we capable of delivering the project?	do we have robust systems and processes in place?	Partial. The business case makes positive statements on the achievability of the project, but does not consider the extent to which the systems and processes in place, given the complexities in a multi-shareholder arrangement, were robust or would help deliver the project as designed.

Yes. The business case demonstrated that the 'question' and aim was to develop a new generation broadband network in South Yorkshire, in the absence of any input from the other broadband providers. The necessity for this is to stimulate the economic growth in the area.

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Detailed observations

Key findings

We have outlined below the key observations and learning points arising from our review in the five specific areas on page 3.

Review area	Key observations	Lessons to learn
Page 25 **Original business case**	▪ The business case, dated May 2007, is a lengthy and thorough document which was co-ordinated/produced by a 'consultant' employed for that purpose. ▪ The business case assumes that income will start in the second year (£3.5M of which £2M would come from the 'public sector') even though the 'build' of the network wasn't expected to be complete until the third year. The income was assumed to rise very sharply to over £15M for 2009/10. As has been well documented elsewhere, these income streams did not come close to being achieved. ▪ Producing the business plan (as distinct from the business case) was a lengthy and difficult process, but having an accurate and achievable business plan was fundamental to demonstrating the robustness of the project. We've not been able to conclude whether the resources available to produce the business case were sufficient and appropriate, but the final business plan wasn't produced and approved by the DRL Board until March 2009. ▪ There were many assumptions in the business case, for example around the technology developments and the financial projections. With the benefit of hindsight, a significant number of these fundamental assumptions were not realistic and did not come to reality. ▪ The financial projections in the business plan included a wide range of sensitivities in detail with associated explanatory narrative. The dependence of the future financial success of the project on the speed and level of take-up of the service was clear and articulated. ▪ The business case did form the basis of reports to the four Councils requesting approval to participate and contribute resources to the project. The project risks were outlined to the Councils but it is not clear that all the Councils were aware of the extent of the sensitivities in the financial analysis, or the heavy dependence on the level and speed of the take-up. ▪ The business case refers to an exit plan needing to be produced subsequent to the business case being approved. It is not clear whether this was produced, and what its focus was if it was produced, but the clear view of the participants we spoke to was that there did not seem to be a clear exit strategy as the project became more problematic and a positive outcome became more unlikely.	▪ The income projections in the business case were detailed and thorough. At that stage the projections were not on the basis of a robust and coherent sales and marketing plan. ▪ The due diligence and review of the business case should be clearly and formally articulated, and it is not clear that this was the case for this business case. ▪ It is not clear what the formal due diligence process was on the business case. There were reviews of the business case and its assumptions, including a review by DTZ Ltd in October 2007, a review by FuturePace Ltd in July 2008, and a Gateway Review by 4Ps in October 2008. It is not clear who commissioned these reviews and how they were reported. ▪ These reviews raised concerns and issues, which would be expected from such reviews. It is not clear the extent to which these were formally reported to the shareholder Councils to form part of their decision making process.

Detailed observations

Health check area	Key observations	Lessons to learn
Governance arrangements	▪ The governance arrangements were clearly understood by the participants. ▪ Each shareholder appointed a senior officer to the DRL Board. There has been a lack of clarity on how the shareholder Board Directors were expected to manage the potential conflicts of a) their fiduciary duty to DRL Ltd and b) their duties to their employing Council. This uncertainty gets the heart of a wider observation, detailed on page 10 which relates to the extent to which the shareholder Councils as a whole, understood what DRL was and how they could or should, assist with its successful delivery. ▪ As has been reported to us, the discussions between DRL and the ISPs, particularly the large ISPs, were largely handled by the DRL chairperson. Due to the technical telecommunications nature of these discussions the shareholder Board appointees were not involved in these discussions. This is understandable and a pragmatic approach. It is not clear though how the shareholder Directors were able to challenge the discussions and conclusions that were of a highly technical nature, and hence how the were able to be satisfied that the explanations and outcomes were reasonable. ▪ There has been a huge amount of 'non-financial' investment in the project by DRL staff and officers at each of the shareholder Councils. The drive and enthusiasm to make it work has been notable and commendable, and the project hasn't failed to succeed because of a lack of commitment by DRL and the Board.	▪ The appointment of officers to the Board by the shareholder Councils should take into account the skills required for the Board. For DRL the Board appointments did not include any IT specialists to provide assurance/challenge on the technological aspects of the project. ▪ Where there is potential conflict between the duties to the company and the duties to the Council, there should be clarity as to how that conflict is to be managed and addressed. ▪ The Councils should be clear on the reporting and governance arrangements where information is presented to Board meetings, but is relevant and informative to the Council in delivering its duties.

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Key findings

Health check area	Key observations	Lessons to learn
Information flows and decision making	▪ Hindsight has shown the income projections to be clearly optimistic, and there was a sensitivity analysis in the bus case that set out the dependence on the level and speed of the 'sign-up' of customers. ▪ The information available and presented to the Councils to make their decisions on participating in the project appear to include the key project risks, and includes some of the financial projections. It is not clear that the Councils received and were aware of the sensitivity analysis in the business case, and the extent of the dependence on the speed and level of take-up to achieve financial success. ▪ Shareholder Councils have reflected to us a lack of clarity around the extent to which issues raised at the DRL Board meetings were able to be shared with the Councils. To exemplify this, finance and IT colleagues in Councils were not routinely 'in the loop' with the information being sent to the Board and the decisions that the Board made. This did not help to raise the profile and understanding of DRL within the Councils. ▪ It took until late 2009 to have a sales and marketing plan that was robust and accepted by the DRL Board, despite this being routinely raised and discussed at the Board meetings through 2008 and 2009. The sales and marketing plan was clearly so significant to the achievement of the business case, and was revised many times through the drafting process. Ultimately, as judged through the actual delivery, the sales and marketing plan was not realistic and not achievable. ▪ It is evident that DRL, as a project, has not been commonly and consistently understood within the shareholder Councils. This is a consistent view expressed to us through the review. This lack of common understanding has likely been a factor in DRL not persuading all Councils to put all their IT business through the new network. ▪ The communication of information, and for decisions to the shareholder Councils has increased as the DRL project has become more problematic and required more input from Councils. The reporting, particularly to Council members had been quite limited between 2009 and 2011. While there have been no gaps in the decision making process, and no points at which reports must have been taken to Council members, this lack of formal reporting/communication will not have helped raise the profile and understanding of DRL across Council senior officers and members.	▪ Council's reports to make the decision on the initial investment did not include the information on the sensitivity analysis and the extent to which financial success was dependent on the speed and level of take-up of the service. ▪ The lack of a robust sales and marketing plan earlier in the process did not help the Councils and DRL to demonstrate the achievability of the business plan. ▪ The communication plan for strategic delivery projects such as DRL should include clear internal communication to raise the profile of the project and achieve full buy-in.

Key findings

Key findings

Health check area	Key observations	Lessons to learn
Risk management	▪ The project risks were clearly set out in the business case, and these were made clear to the Councils when they approved their participation and investment in the project. What is less clear is the extent to which the sensitivities and the clear dependence on the delivery of the sales targets to the timescales in the business case, was communicated to each Council when they made their decision. ▪ The shareholder Councils have included DRL related risks on their own corporate risk registers through the project. The primary focus on these risks has been on the financial risk to the Council as would be expected, and these risks have been reported through the Council risk management systems.	

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Key findings

Key findings

Health check area	Key observations	Lessons to learn
Procurement arrangements and availability of specialist advice	▪ It is clear that DRL and the shareholders intended that Thales were responsible for producing and delivering the sales and marketing targets, though Thales disputed this. The wording in the contract was not sufficiently tight and robust to enforce, which led to compromise amendments to the contract subsequently. ▪ Not all the Councils have transferred all their IT business onto the DRL network. Although the income stream from the Council's was not expected to be relatively large this would have provided an initial strong statement of support to the project and given the opportunity for a 'snowballing' of business. The business case presumed that the Councils would transfer all of its IT business to DRL quickly, and while that may have over-simplified the processes required to make that happen, it is clear that securing the Councils, and other public sector, business, was important both to the financial viability (with projected income of £4M income from 2010/11 onwards) and to the reputation of DRL. ▪ There were many changes in personnel at Thales, DRL and the shareholders for a variety of reasons, some related and some unrelated to the performance of the project/contract. This turnover has not helped the continuity and delivery of the project, the buy-in at the shareholders, and the ability of shareholders to understand the project and what it was and wasn't. ▪ Throughout the conception and initiation of the project there were a number of consultants involved. This is understandable given the level of specialist skill and knowledge required for a project such as DRL. Given the turnover of permanent staff and the time since appointment of some of these, it is unclear the extent to which the consultants have been appointed through an agreed and consistent governance process.	▪ Appointment of consultants needs to be managed as part of a formal governance approach that seeks to address knowledge or resource gaps and should not impact demonstrably on the 'ownership' of the project by permanent employees.

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REPORT OF THE CHIEF EXECUTIVE

CABINET 24TH SEPTEMBER, 2008

THE DELIVERY OF THE SOUTH YORKSHIRE DIGITAL REGION BROADBAND NETWORK (SYDR)

1. Introduction and Purpose

1.1. In July 2005 Cabinet gave approval for Sheffield City Council to lead in the commencement of a procurement process to develop a Next Generation Broadband Access network across South Yorkshire. The key elements of that approval being;

- The entering into of an Agency Agreement with the other South Yorkshire Councils with SCC acting as agent. Under this agreement Sheffield has managed and resourced the procurement phase of the project on behalf of the 4 Authorities.
- SCC's contribution to the funding of the procurement phase of the project
- Authority to carry out a procurement exercise under the OJEU negotiated procedures and conclude negotiations with the selected preferred bidder.
- Authority to negotiate and enter into appropriate funding agreements.
- Authority to appoint appropriate external consultants.
- Report back to Cabinet at the appropriate stage of the project

1.2. That procurement process whilst extended considerably from the original timeline due to delays in putting together an appropriate funding package and progressing the funding applications, is now nearing completion and the purpose of this report is

1.2.1. **To update Members on the project setting out progress to date and future programme details.**

1.2.2. **To set out the business case and financial arrangements for progress to the implementation phase of the project and seek approval to them.**

1.2.3. **To describe the legal and commercial arrangements as negotiated with the selected preferred bidder Thales Transport and Security Limited ("Thales").**

1.2.4. **To describe the South Yorkshire Digital Region partnership working and governance arrangements including the establishment of a Special Purpose Vehicle ("SPV") to contract for and run the project.**

1.2.5. **To seek Member approval to the Council becoming a shareholder of the SPV , guaranteeing the obligations of the**

SPV in proportion to its shareholding, and to appoint a senior officer to the SPV Board.

1.2.6. **To seek member approval to the Council's share of the required investment funding**

2. Outcome and Sustainability

2.1. The principal objective of the Digital Region project is to enable the transformation of the economic development and social prosperity of the South Yorkshire region through the availability of high speed, next generation broadband services to the public sector, to business and residential sectors.

2.2. It will bring forward investment in the ICT infrastructure in the area by 5 to 7 years giving the region technological and regeneration capabilities to equal the best in the UK.

2.3. The major benefits focus on jobs and additional Gross Value Added (GVA) contributed to the economy. The recent (October 2007) independent economic analysis carried out by DTZ (see Appendix C) states that the Digital Region project will enable the following numbers of jobs in South Yorkshire, particularly in ICT and businesses with greater use of digital technology –

- 2,500 over 3 years
- 3,200 over 5 years
- 4,700 over 10 years
- 7,400 over 15 years

2.4. The analysis also states the Digital Region project will contribute an additional £198m p.a. in GVA, through growth in the ICT and digital sectors, and attracting inward investment to the region.

2.5. <u>It is considered that the project will bring the following benefits:</u>

2.6. <u>For Households</u>

2.6.1. Increasing ease of access – the convergence of computer, TV and phone, reducing costs

2.6.2. Increased access to employment and education from home

2.6.3. Increased access to public sector services from home

2.6.4. Community TV channels

2.7. <u>For Businesses</u>:

2.7.1. Access to a much larger market place through direct communication and interaction without taking any risk or increasing costs.

2.7.2. Will be able to receive an enhanced broadband product at significantly reduced rates against current prices, making implementation and ongoing costs more attractive.

2.7.3. Will have access to advanced applications including enhanced videoconferencing, 3D etc.

2.7.4. Advertising, home/flexible working, business support applications become more cost effective.

2.8. For the public sector

2.8.1. Increased efficiency through a greater ability to support flexible/home working and reduced transaction costs

2.8.2. Increased accessibility to the public through ease of communication, reduced requirement for face to face meetings and the promotion of community based TV channels

2.8.3. Direct cost savings from use of the network

2.9. In creating this network based on a Fibre To The Cabinet (FTTC) deployment, South Yorkshire will be better positioned to develop to the next level of broadband capability through Fibre To The Premise (FTTP) in years ahead.

3. Executive Summary

Why?

3.1. . South Yorkshire is a region that requires social and economic development.

3.2. Such development has been proven to be substantially accelerated in areas across the globe by the investment in ICT infrastructure which will help to stimulate an e-economy.

3.3. Development of an e-economy will transform the region by bringing additional jobs in to the region and increasing GDP by creating an environment that encourages businesses and individuals to step-up to the next generation of electronic services.

3.4. However, as was the case in the initial roll-out of broadband infrastructure in the UK, South Yorkshire is likely to be in the last quarter of the country to benefit from such investment.

3.5. This project therefore seeks to use public funds to intervene in an area where there has been market failure and to buy a Next Generation broadband infrastructure that that will advance the region by 5 to 7 years putting it in the upper quartile for broadband capability and kick-starting it's transformation in terms of economic regeneration and social inclusion.

What?

3.6. .South Yorkshire Digital Region (SYDR) intends to lay fibre optic cable, rather than use the existing copper, from the exchanges to the street cabinet (FTTC) and install VDSL equipment in a second street cabinet alongside BT's. The reliance only on short lengths of copper wire to the premise then means that high bandwidths can be downloaded and uploaded. This technology would allow speeds of 50mbps for all users with a guaranteed quality of service rather than an average speed currently available of around 6Mps.

3.7. The proposed contract with Thales allows for the network to enable up to 97% of the population of South Yorkshire with a current BT connection to be reached.

3.8. As a result South Yorkshire will be the first sub-region in the country to enjoy the benefits of this technological advance.

How?

3.9. A Special Purpose Vehicle (SPV) will be formed, the members of which will be the four South Yorkshire Authorities and Yorkshire Forward. The SPV will enter into a contract with Thales Transport and Security LTD (Thales) who will build and operate the network and will provide Sales and Marketing services.

3.10. Thales will enter into contracts with Service Providers (e.g. Tiscali, Carphone Warehouse, Sky) for wholesale broadband services and they in turn will sell services to households, businesses and public sector bodies.

3.11. To fund the build of the network and the initial operating costs until such time as the SPV is self financing, the project will receive Grant funding from ERDF and YF totalling £44m and loan funding from the Local Authorities and Yorkshire Forward totalling £40m. In addition Thales themselves will provide £10m of loan funding.

3.12. Sheffield City Council's role in this project is;

3.12.1. **As a shareholder in the SPV; it will guarantee the performance of the company and will share in the surplus of the company in proportion to its 17% shareholding.**

3.12.2. **As a provider of loan funding; it will provide £4m of loan funding and will underwrite the repayment of the loan of £0.5m per annum should the SPV not receive sufficient revenue.**

When?

3.13. The start of the operational phase of the project is largely dependant on two work streams being complete; the first being negotiations with Thales and the second being the approval of funding applications from the Grant bodies.

3.14. The negotiations with Thales are expected to be completed by 30th September 2008 to enable a conditional contract to be entered into.

3.15. The funding approvals are expected to be complete by the end of November 2008.

3.16. The contract will become effective immediately after this point and deployment of the network which will be spread evenly across the sub-region will take 3 years.

3.17. The deployment of the network and in particular the extensive civil engineering work across the city will be co-ordinated with other projects such as the Highways PFI project to ensure that there is no unnecessary duplication of streetworks.

3.18. The contract will then operate for 10 years from when the network is fully working with an option to extend by up to 5 years.

4. Background

4.1. South Yorkshire is a region that requires social and economic development.

4.2. Without intervention South Yorkshire is likely to be in the last quarter of the country to benefit from investment in next generation ICT infrastructure as it has to date.

4.3. Development of an e-economy will transform the region by bringing additional jobs in to the region and increasing GDP by creating an environment that encourages businesses and individuals to step-up to the next generation of electronic services. It is an essential component of the twenty-first century economy to match the Council's aspirations.

4.4. Today we operate in a global economy and South Yorkshire must kick start a new industrial position. The industry of the future is digital and this project gives the region an outstanding opportunity to be at the forefront. However it is considered unlikely that this opportunity will present itself through normal market conditions, as there are already significant digital sectors in the UK and beyond and the market will invest in those places first.

4.5. As jobs in traditional industries such as manufacturing continue to be in decline in the region and the country, a step change is required if South Yorkshire's economy is to be transformed.

4.6. Public Sector funding at this point to provide a new broadband infrastructure could advance the region by 5 to 7 years putting it in the upper quartile for broadband capability.

4.7. Officers of the South Yorkshire Authorities have worked with Yorkshire Forward and Objective 1 to explore the market position and technological developments, building a viable case for procuring the physical broadband infrastructure that will lead to transformation of the sub-region.

4.8. This culminated in the production of the South Yorkshire Business Plan considered by Chief Executives and Leaders of the 4 Councils in March 2005.

4.9. In July 2005 Cabinet approved the entering into an Agency Agreement with the other South Yorkshire Authorities for the purpose of managing and resourcing the procurement phase of the project with Sheffield City Council as lead Authority. Yorkshire Forward and Objective 1 have also provided funding for this phase of the project.

4.10. This procurement was completed in January 2007 with the selection of a consortium headed by Thales (with Alcatel and Kingston Communications as sub-contractors) as the preferred bidder.

4.11. Since this time a number of key activities have been progressed including;

- 4.11.1. Detailed contractual negotiations with Thales
- 4.11.2. Creation of a company limited by share (Digital Region Limited) as the SPV through which the project will be delivered.
- 4.11.3. Negotiation and submission of funding bids

4.12. It is the latter of these that has led to considerable delay in moving from the procurement phase of the project to a point when Cabinet can be asked to consider the business plan, benefits and risks of moving to a full implementation of the project and closing a contract with Thales.

5. **Project Description**

5.1. The objective of the project is to create a high speed, next generation broadband access network across South Yorkshire and to market this to Internet, Application and Entertainment Service Providers.

5.2. The proposal from Thales is to create a network based on fibre distribution rather than copper that will reach 97% of the population of the South Yorkshire region who are currently served by a BT connection.

5.3. This network will allow broadband speeds of 50Mbytes per second for all users with a guaranteed bandwidth and quality of service that are not available today.

5.4. To operate the network, Thales will create a Network Operations Centre based at their existing premises in Doncaster.

5.5. The Digital region SPV itself will be based at the Digital Campus in Sheffield.

5.6. It is anticipated that each of the 4 South Yorkshire Councils will migrate their existing services from their current provider on to the Digital Region network thereby providing a secure revenue stream for the SPV but also generating savings for the Councils on their current provision.

6. **South Yorkshire Partnership and the SPV**

6.1. The work of the project, until September 2007, has been overseen by a Project Board representing Barnsley, Doncaster, Rotherham, Sheffield, Yorkshire Forward and Objective 1 supported by the Project Team. The Project Board met regularly to consider progress, project budget, manage project issues and risks, while giving guidance to the project team for the ongoing procurement and contract negotiations. This Project Board has been recently reconvened as a result of an acceptable funding package being developed with Stakeholders.

6.2. The South Yorkshire Chief Executives' Meeting has also been the focal point of decision making, with the focus being on:

- the reduction of risk associated with the project, in particular the Business Plan,
- the mix of funding to enable the capital investment in the project, and
- the setting up of the Special Purpose Vehicle (SPV) to deliver the project and related issues of ownership and risk and reward.

6.3. Throughout the project there has been periodic reporting of progress on the project to the South Yorkshire Leaders' meeting and other appropriate forums.

6.4. In the period between now and the start of the project, consideration is being given as to the required governance arrangements that need to be in place to ensure a smooth transition to the proposed SPV.

6.5. To enable one single organisation to act on behalf of Yorkshire Forward and the 4 Local Authorities, and in order to comply with Local Authority Trading Legislation, an SPV has been formed. The main features of the proposed SPV are:

- The SPV will operate as a commercial business.
- It will contract with Thales through the execution of the Project Agreement and be responsible for monitoring the Project Agreement and the performance of Thales, as well as having sign off of the annual Business Plan, the strategy and any significant changes to the project.
- The SPV will be a company limited by shares and may have an associated charitable entity, which could be used for the distribution of profits.
- The first call on surplus revenues after covering contract and SPV operating costs will be the repayment of any Local Authority investment.
- It will have a board of directors, including an independent chairperson, senior officers from each of the Local Authorities and Yorkshire Forward and non-executive directors from appropriate commercial organisations and partners.
- There will be a Chief Executive and an operational team of approximately 15 people.
- It is proposed that one Local Authority will undertake a monitoring role on behalf of the other Authorities which will report on the performance of the company and audit the company's finances on a regular basis

6.6. Share ownership and voting rights in the SPV will be split as follows;

6.6.1. Yorkshire Forward 50%
6.6.2. Sheffield City Council 20%
6.6.3. Barnsley Metropolitan Borough Council 10%
6.6.4. Doncaster Metropolitan Borough Council 10%
6.6.5. Rotherham Metropolitan Borough Council 10%

6.7. Underwriting of the SPV's obligations and subsequently any sharing of any surplus will be split in the following proportions.

6.7.1. Yorkshire Forward 40/70ths
6.7.2. Sheffield City Council 12/70ths
6.7.3. Barnsley Metropolitan Borough Council 6/70ths
6.7.4. Doncaster Metropolitan Borough Council 6/70ths
6.7.5. Rotherham Metropolitan Borough Council 6/70ths

6.8. Surplus revenues will be available for distribution from the SPV after the payment of –

6.8.1. Contract costs payable to Thales
6.8.2. SPV running costs
6.8.3. Taxation
6.8.4. Loan repayments & interest (including Thales loan)

6.8.5. Thales Revenue Share

6.8.6. Additional network build costs beyond first phase commitment.

6.9. Surplus revenues may be distributed through a charitable trust if the SPV board consider this to be the most efficient mechanism for tax or other purposes.

6.10. As noted above, it is proposed that the Council appoints a Senior Officer to serve as a Director on the SPV Board.

7. Legal and Commercial Proposition

7.1. It is proposed that subject to the satisfactory finalisation of contract negotiations, the SPV will enter into a conditional contract with Thales comprising a Project Agreement and its associated Schedules. These documents are at an advanced stage of completion and a summary of the key aspects of the legal and commercial arrangements contained in these documents is set out in Appendix A to this report . The conditional nature of the contract is principally about the need to secure funding for the project from Yorkshire Forward and ERDF before the contract can become effective. It will also have to take account of any conditions that might be imposed as part of the offer of funding. Such conditions precedent are described in more detail in section 11 to this report.

8. Funding Arrangements

8.1. Basic Project Structure

The project is modelled on a three year build out (access available to approx 97% of the population of South Yorkshire with a BT copper connection) followed by a ten year operational phase.

The model is based on a level of revenue generation commencing in quarter 3 of year 1 and stepping up during the first 5 years reaching a cash positive position in year 4.

In this model, the Service Provider revenue is forecast to grow over the life of the contract to approximately £36m p.a. based on a take up of 21.3% of the total population.

On this basis the gross funding requirement including deployment, operating and SPV costs will be approximately £112m funded by:

Source	Amount	Type of Funding	Drawdown Priority	Repayment Priority
ERDF	£30m	Grant	First	NA
Yorkshire Forward Single	£14	Grant	Second	NA

Pot				
LA Loan Funding SCC £4m BMBC £2m DMBC £2m RMBC £2m	£10m	Unsecured loan	Joint Third	Primary
Yorkshire Forward Loan Funding	£30m	Unsecured loan	Joint Third	Subordinate to LA Loan
Thales	£10m	Unsecured loan	Joint Third	Subordinate to LA & YF Loan
Net Trading Income Received	£18m	Income received from Service providers during deployment period	Assumed to commence in quarter 3 of the contract	NA

N.B. The above table reflects the expected type and priority of repayment as this is still to be finalised with each of the funding bodies.

8.2. Whilst funding applications have been submitted and initial approvals cleared, the exact details of the funding offers from each of the providers has yet to be finalised in terms of the confirmed amounts, timing, draw down eligibility, outputs, claw back etc.

8.3. Only when these issues are satisfactorily resolved and final approvals are received will the contract become effective between the SPV and Thales..

8.4. Further details as to the timing and split of funding are contained in Appendix B.

9. Apportionment of Risk

9.1. Detailed risk registers for the project are contained at **Appendix C,** however the key risks are described below.

9.2. There are a number of risks leading up to the commencement of the contract which could have a significant impact on the viability of the business case and/or the project timetable. The most critical of these risks are;

9.2.1. Project Financing

The model is sensitive to the amount, timing and eligibility of ERDF, YF and Local Authority funds and the terms on which they are made available. If the assumptions cannot be achieved then this could impact on the business case.

9.2.2. **SPV Formation and Operation**

The contract can only be signed when the SPV structure is finalised and appropriate guarantees in place. There are significant obligations on the SPV as soon as the contract commences with regard to control and approvals, and therefore it is particularly critical that a clear, robust and well resourced client structure is put in place with the necessary governance structures back into the Council This will include a specific Local Authority monitoring role that is contained within the Shareholders Agreement. If the necessary resource and expertise is not available then the project and the SPV are at considerable risk.

9.3. The key risks that the SPV will be carrying throughout the operation of the contract are set out below. Any additional costs/funding shortfalls as a result of these risks will have to be covered by the guaranteeing parties to the SPV.

9.3.1. **Increases In Cost Assumptions**

Whilst the majority of deployment and operational costs are fixed, there are possible increases as a result of surveys and inflation which could exceed the business case assumptions.

9.3.2. **Demand**

This is by far the biggest risk that this project carries. The risk that sufficient revenues will not be received from those using the network to fund the initial investment and pay for the ongoing operation of the business over the contract period. This risk will only be mitigated when Service Providers commit to the network through entering into Access Agreements. These agreements are generally 12 month rolling contracts and so the risk remains with the SPV throughout the contract period. Whilst this risk rests predominantly with the SPV, Thales do carry a degree of the risk in that the repayment of their £10m loan will be dependant on the success of the business and further they only recover the costs of the sales and marketing service through the revenue share arrangements if sufficient revenue is generated.

9.3.3. **Funding / Claw Back Risk**

ERDF funding is likely to be subject to specific conditions in terms of the achievement of outputs. Failure to achieve outputs within the required timescales could result in claw back of some or all of the funding.

9.3.4. **Residual Value**
The business case assumes that the value of the network can be used to offset any financial exposure carried by the stakeholders and that the grant providers will have no rights over those assets. The value of the network is based on estimates which it is not possible to validate.

9.4. All other risks in relation to costs overruns, delays and performance of the network rest primarily with Contractor. However these can impact on the reputation of the network and thus impact on demand.

9.5. It should be noted however, that there is also a risk to the region of doing nothing. In the first roll-out of ADSL enabled exchanges by BT several years ago, there were no exchanges in South Yorkshire in the initial phase of the deployment and the sub region as a whole was not covered until some considerable time after the first more commercially attractive areas..

BT's most recent announcement (15^{th} July 2008) to deploy a fibre to the cabinet capability in the UK could leave the region further disadvantaged. The deployment is unlikely to be across the UK as a whole and if the previous pattern is repeated in terms of roll-out, South Yorkshire is unlikely to be a priority area and it so the gap between it and those areas which are covered will widen further.

10. **Programme Plan**

10.1. The key programme milestones achieved to date are set out below:

- Appointment of Project Manager; July 2005
- Appointment of external advisors; July 2005
- Finalisation of Agency Agreement by the 4 South Yorkshire Authorities; August 2006
- Signature of Objective 1 and Yorkshire Forward funding agreements by SCC; July 2005
- Agreement of stakeholder requirements and output specification for the project; August 2005
- Determine appropriate commercial structure for the project post contract award; August 2005
- Detailed Invitation to Negotiate; September 2005
- Published OJEU Notice; September 2005
- 70 bidders short listed to three; November 2005
- State Aid approval; November 2006
- Preferred bidder selected; January 2007
- ERDF Operational Programme launched; January 2008
- ERDF Major Project Submission; 19th June 2008
- ERDF PMC Meeting, 24th June 2008
- Yorkshire Forward Board approval; 25th July 2008

- Rotherham MBC Cabinet Approval ; 30th July 2008
- Informal ERDF submission to European Commission; 1st August 2008
- South Yorkshire Programme Monitoring Board; 7 August 2008
- Barnsley MBC Cabinet approval; 13th August 2008

10.2. The key project milestones through to Contract Award' are as follows:

- Sheffield Cabinet approval 24 September 2008
- Completion of negotiations with selected bidder, Thales Transport and Security Ltd; September 2008
- Commence recruitment for SPV; August 2008
- Local Authority Gateway Review; 12 September 2008
- Yorkshire and Humber Programme Management Committee; 17th September 2008 (to approve ERDF major project application)
- Formal ERDF consideration commences; 18th September 2008
- Inaugural SPV Board Meeting; w/c 22 September 2008
- CPRG & Treasury Approval; September 2008
- Conditional Contract Award; 30th September 2008
- Yorkshire Forward get Secretary of State approval to section 5(2)(c) powers to become member of SPV; November 2008
- EU Major Project Approval; November 2008

11. **Conditions Precedent**

11.1. The contract, which will be conditional, will only be awarded when the following matters have been properly resolved:;

11.1.1. Project Agreement and Schedules Satisfactorily Complete
Whilst the Project Agreement and Schedules are substantially complete, there is further work required to finalise these. Only when these are complete to the satisfaction of the Project Board/SPV in terms of the balance of risk, level of control and deliverability, will the contract be awarded.

11.1.2. SPV Set up satisfactorily complete
Whilst a draft set of documents has been developed which sets out the roles and responsibilities of the members of the SPV, these have yet to be finalised. Only when each of the Authorities and Yorkshire Forward have agreed a final structure and appropriate governance arrangements for the SPV and it is appropriately formed, guaranteed and resourced will the contract be awarded. This includes Yorkshire Forward's ability to participate in the SPV itself following a section 5(2)(c) approval from the Secretary of State.

11.1.3. Loan Agreements complete
Each of the parties will enter into loan agreements with the SPV. Contract Award will be conditional on having all of these agreements in place.

11.1.4. Business Case Assumptions Sufficiently Validated

The Business Case for Digital Region is dependant on the commitment of Service Providers to migrate to the Network at an early stage and to grow the market for next generation broadband services.

Discussion with a range of Service Providers has been ongoing throughout this procurement process and will continue. It was a requirement of the approval given by Cabinet in July 2005 and it remain the case currently, that evidence (preferably letters of intent) should be sought from the market as to the likelihood that the demand assumptions are valid in terms of speed of take up and product mix.

11.2 It is proposed that, as a result of all of the required approvals not being in place at contract close, such approvals and consequent conditions of delivery become ‘conditions precedent’ to the effective operation of the contract, that is the contract will only become effective once such approvals have been received on satisfactory terms. These are identified below:

11.1.5. YF Single Pot Funding Satisfactorily Agreed

Whilst the amount of funding from each of the Authorities allocation of single pot funds has been agreed in principal, further work will be required to clarify the terms of the funds and for the applications to achieve full approval. Only when formal offer letters have been received from the relevant body and the terms of the offers are acceptable will the contract be effective.

11.1.6. ERDF Funding Satisfactorily Agreed

Whilst the amount of funding from the Objective 1 allocation of ERDF funds has been agreed in principal, further work will be required to clarify the terms of the funds and for the applications to achieve full approval. Only when formal offer letters have been received from the relevant body and the terms of the offers are acceptable will the contract be effective.

11.1.7. Positive Outcome from Gateway Review

It is a requirement of the Project Board that a further external Gateway review be carried and that the project receives a positive outcome from that review before the contract becomes effective.

11.2. It is proposed that the preceding two points will form Conditions Precedent within in the Project Agreement with Thales and only when they are satisfied will the Project Agreement become operative.

11.3. It is likely that there will be a time limit within which such conditions have to be met for the terms of the contract to remain valid.

12. **Financial Implications**

12.1. It should be noted that the following financial implications are based on the proviso that:

- All assumptions included within the current business case are achieved with the main assumptions being around demand risk and residual value of the assets;
- The proposed contractual arrangements are completed in accordance with the Council's current understanding;
- Formal approval / confirmation of all funding streams is granted.

12.2. The Council's share of the funding requirement is **£4m**. It is proposed that this will be made available to the SPV as a loan and will be funded through prudential borrowing.

12.3. In the event that the SPV meets the business case assumptions in terms of revenue generation then the drawdown of that funding is as follows;

Year	Investment
2009/10	**£1,652k**
20010/11	**£2,348k**

12.4. If the business case is achieved then repayment of the Council loan will commence in year 4 (2011/12) and could be complete by year 8 (2015/16).

12.5. The worst case in terms of paying back the loan is that insufficient revenue is generated to repay loans in which case the Council will underwrite its own loan repayment. The annual costs to the Council of this underwriting, assuming payment of capital and interest over ten years, will be

Year	Financing Costs
20010/11	**£175k**
20011/12 to 2020/21	**£530k p.a.**

12.6. The interest rate on the loans to the SPV will be fixed at contract award based on the prevailing PWLB rate for a ten year loan. The Council will carry the risk on any movement in those rates between contract award and the point at which it enters into the loan agreement with PWLB (or other source of funding).

12.7. In addition the Council will be required to provide a guarantee to cover the performance of the SPV in proportion to its share of the initial investment. This means that in the event that the SPV does not generate sufficient revenue to cover the contractual payments to Thales and the SPV's own operating costs, the Council will be liable for a proportion (12/70$^{\text{Th}}$'s) of any shortfall.

12.8. It is not possible at this stage to quantify the impact of the underwriting on the Councils revenue account as this will depend on an assessment as to the probability of liabilities arising under the guarantee. The likelihood of the revenue assumptions being achieved will be monitored as we begin to get some meaningful response/commitment from Service Providers and this will continue on an ongoing basis as part of the governance of the project and provisions will be made in the accounts where appropriate.

12.9. The following examples show the effect of a reduction in revenue due to slower penetration of take up of services over the network and the resultant amount of additional funding to be provided by SCC;

12.9.1. Penetration growth at 25% below base case assumption (15% by Year 4)

Year	SCC Additional Funding
2010/11	£102k
2011/12	£693k

12.9.2. Penetration growth at 50% below base case assumption (10% by Year 4)

Year	SCC Additional Funding
2010/11	£600k
2011/12	£1,359k

In each case the additional funding requirement would continue on an annual basis for each year that penetration remained at this reduced level. However if there was no likelihood of take up recovering to modelled levels beyond the initial periods then the SPV would be able to terminate the contract incurring break costs as detailed below.

12.10. In the event that it is not viable for the business to continue, termination of the contract will result in breakage costs being payable to Thales which the Council will also underwrite. The following is an estimate of the Councils share of the likely break costs in each year.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13
	2008/9	9/10	10/11	11/12	12/13	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21
£000													
SHEFFIELD													
Break costs	-857	-1,908	-2,777	-857	-686	-514	-343	-171	-171	-120	-86	-51	-34

12.11. It is assumed that if there is business case failure that there would not be any claw back of ERDF or YF Grant funding and that neither body would have a call over the assets created.

12.12. However, the funding from the Council will contribute to the creation of an asset which the SPV has an option to take ownership of and which it is assumed will have a residual value. It is assumed that the value of the asset will be used to reduce the liability of each of the shareholders. Details of the Residual value assumptions are contained in Appendix E. Based on these assumptions the net exposure to the Council is as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 1
	2008/9	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/2
SHEFFIELD													
Loan Underwriting	0	(1,652)	(4,000)	(3,652)	(3,284)	(2,895)	(2,485)	(2,052)	(1,594)	(1,110)	(599)	(59)	
Revenue Underwriting	(0)	(464)	(1,303)	(1,738)	(572)	(448)	(465)	(491)	(436)	(391)	(347)	(303)	(529
Break Costs	(857)	(1,908)	(2,777)	(857)	(686)	(514)	(343)	(171)	(171)	(120)	(86)	(51)	(34
GROSS EXPOSURE	**(857)**	**(4,024)**	**(8,080)**	**(6,247)**	**(4,542)**	**(3,858)**	**(3,293)**	**(2,714)**	**(2,201)**	**(1,621)**	**(1,031)**	**(413)**	**(563**
Residual value	276	5,200	9,060	10,123	9,671	9,220	8,768	8,317	7,866	7,414	6,963	6,511	6,06
NET RESIDUAL (RISK)/VALUE	**(581)**	**1,176**	**979**	**3,876**	**5,129**	**5,362**	**5,475**	**5,603**	**5,665**	**5,793**	**5,931**	**6,098**	**5,49**

12.13. Based on the above scenarios, if there was business case failure and the contract was terminated at year three and if there was no residual value in the assets, then the Council's total exposure would be £8m. The annual costs to the Council of this underwriting, assuming payment of capital and interest over ten years from 2011/12 would be £1m per annum.

12.14. Based on the modelling assumptions contained in the business case, a summary of which is contained in Appendix E, the SPV will be in a cash positive position by year 4 and will generate surplus revenues by the end of year 13 of £58m. Any such surplus will be shared between the shareholders in proportion to the shareholding in the SPV.

12.15. It is assumed that the South Yorkshire Authorities will begin to migrate their network usage from existing providers onto Digital Region network from quarter 5 of the contract (currently assumed to be Oct

2009). The Council has allowed for this event in its Outstanding Sheffield Programme and talks will be initiated with the OSP shortlisted bidder(s).

12.16. Based on the costs assumed by the OSP bidders for alternative provision, it is envisaged that using Digital Region will result in significant annual savings.

12.17. In addition the Council should also benefit from savings from transferring the schools provision from the current provider.

12.18. The extent and timing of such savings can only be quantified when the detailed requirements of the OSP programme and schools contract are understood.

13. Legal Implications

13.1. Cabinet, in its previous consideration of this project, took the view that the provision of a greatly enhanced Broadband infrastructure within Sheffield and the rest of South Yorkshire would promote the economic and social well-being of Sheffield. Furthermore, this report suggests that the project might also contribute to the environmental well-being of the city by, for example, reducing the number of commuter journeys. If Cabinet holds the view that participation by SCC in the project is likely to achieve the promotion and/or improvement of the economic, social and/or environmental well-being of Sheffield and its residents then this would be permitted by the powers to promote such well-being conferred by Section 2, Local Government Act 2000.

13.2. These well-being powers must be exercised by reference to any guidance issued by the Secretary of State. This has been considered in the preparation of this report and in the development of the project, and there is nothing within these proposals which is at variance with the guidance.

13.3. Additionally, when exercising its well-being powers SCC has to have regard to its sustainable community strategy (‘the Sheffield City Strategy’ prepared pursuant to Section 4 of the 2000 Act). It is believed that the proposed project would help the further achievement of the strategy. One of the “Big Ambitions” in the strategy is “for Sheffield to have an economy that matches the best in Europe”. A priority within the strategy is to “increase connectivity and information and communications technology infrastructure”. The strategy also recognises the importance of climate change issues.

13.4. In order for any public sector support for the project to be lawful, it is essential that European State Aid rules are not breached. Accordingly efforts have been made to structure the project in a manner that has regard to State Aid rules, and following an application for State Aid clearance confirmation has been given by the European Commission that the public sector support for this project, whilst constituting State Aid, is permissible.

13.5. If the project is successful there is the prospect of SCC receiving a significant financial return on its investment. Conversely, SCC will be bearing a share of the financial risk of the project being a commercial failure. Clearly SCC will wish to be in a position to benefit from the profitability of the business that is being created. The Section 2 well-being powers cannot themselves be used to “raise money”. However, the Local Government Act 2003 and the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2004 do authorise a “best value authority” (such as SCC and the other three South Yorkshire Councils) “to do for a commercial purpose anything which it is authorised to do for the purpose of carrying on any of its ordinary functions”. These functions include the promotion of well-being pursuant to Section 2. “Commercial purpose” basically means with a view to profit.

13.6. Before exercising this ‘trading power’ the authority must prepare and approve a “business case” in support of the proposed exercise of the power. This must state:-

13.6.1. the objectives of the business;
13.6.2. the investment and other resources required to achieve those objectives;
13.6.3. any risks the business might face and how significant these risks are; and
13.6.4. the expected financial results of the business, together with any other relevant outcomes that the business is expected to achieve.

13.7. This report, with its appendices, therefore constitutes the business case which Cabinet is being asked to approve.

13.8. The trading power must be exercised through a company within the meaning of Part V of the Local Government and Housing Act 1989. The proposed SPV fulfils this requirement. Any requirements imposed on the SPV by Part V, or the Local Authorities (Companies) Order 1995 made thereunder, will be observed.

13.9. A best value authority has to recover the costs of any accommodation, goods, services, staff etc that it supplies to a company in pursuance of any agreement or arrangement to facilitate the exercise of the trading power conferred by paragraph. This requirement will be built into any arrangements with the SPV.

13.10. There are legal issues in establishing the SPV, but its formation as a body with limited liability is designed to limit the risks, both commercial and operational, to the partners. The other main legal issues in the SPV set up are contractual terms in the project agreement with Thales and exit arrangements at the end of the contract term or at an earlier stage if there is considered to be business case failure. These are described more fully in section 7 of this report and the appendices. The Council will not be a direct signatory of the contract but it will have obligations and liabilities through the arrangements established for the underwriting of the project, through membership of the SPV.

13.11. If a best value authority becomes a ‘zero star’ authority as a result of a CPA assessment basically it loses the trading power referred to above. This has necessitated some complex arrangements to cater for the unlikely eventuality of one or more of the four Councils having to withdraw from the SPV for this reason. These have not yet been finalised but the basic principle is likely to be that in such a situation, the exiting council’s share of any guarantees given, but also of any future profits, would be shared proportionately between the remaining councils.

13.12. Before exercising the trading power regard must be had to any guidance issued by the Secretary of State on the use of the power. This has been considered in the preparation of this report and in the development of the SPV proposals and the wider project.

14. Human Resource Implications

14.1. There are no employee implications arising directly from this report, other than the need for appropriate input of officers into the project on technical, regeneration, procurement, legal, commercial and financial issues.

14.2. Additionally a Senior Officer is required to serve on the SPV Board as the Councils nominated Director and this will require appropriate insurance to cover such liabilities as may arise.

15. Environmental and Sustainability Implications

15.1. As part of this project and in support of the ERDF funding application, Yorkshire Forward commissioned an Analysis of the Environmental Impact of the Digital Region to be carried out. A summary of the key findings of the report is contained at Appendix E. The report also contained a number of recommendations for ongoing actions to ensure environmental best practice and legality.

15.2. Where the recommendations rely on the performance of Thales and its sub-contractors then these will be reflected as appropriate in the obligations under the Project Agreement.

16. Equality of Opportunity Implications

16.1. Consideration has been given to equality of opportunity implications in the project throughout its design.

16.2. This was considered as part of the selection process and forms part of the contractual obligations contained in the arrangement with Thales.

16.3. The SPV will adopt an equal opportunities policy which will be in line with that of SCC.

17. Recommendations

Cabinet is recommended:-

17.1. Having had regard to SCC's sustainable community strategy ('the Sheffield City Strategy') and to the guidance issued by the Secretary of State about use of the powers to promote well-being contained in Section 2, Local Government Act 2000, to confirm its belief that participation by SCC in the South Yorkshire Digital Region project as envisaged in this report is likely to achieve the promotion and improvement of the economic, social and environmental well-being of Sheffield and its residents;

17.2. To note the commercial nature of the project and, having had regard to the guidance issued by the Secretary of State about use of local authority trading powers, to approve SCC's continued participation in the project, including (but without limitation):-

17.2.1. **SCC becoming a shareholder in the SPV that will act as the project delivery vehicle, and subscribing such capital in return for its shares as the Chief Executive shall consider appropriate;**

17.2.2. **SCC acting as a guarantor of the SPV's obligations; and**

17.2.3. **SCC generally entering into such agreements and/or arrangements connected with the project, and on such terms as the Chief Executive, in consultation with the Director of Corporate Resources and the Assistant Chief Executive, Legal and Governance, shall consider appropriate;**

17.3. To support the progression of the project into its implementation phase and approve the commercial and investment

arrangements as outlined in this report (subject to caveats within the report and in particular the Conditions Precedent at section 11);

17.4. To note and approve the business case for the project set out in this report and the financial implications of the project, including prudential borrowing of £4 million to fund SCC's share of the overall investment in the project;

17.5. To authorise the Chief Executive to exercise on behalf of SCC SCC's rights as a shareholder in the SPV including (but without limitation):-

17.5.1. **the giving of any required consents;**

17.5.2. **representing (or appointing a suitable individual to represent) SCC at SPV general meetings; and**

17.5.3. **appointing a suitable senior officer as SCC's nominee on the SPV's board of directors;**

17.6. To authorise the Chief Executive generally to take such further steps to progress the project or to safeguard SCC's interests in relation to it as he shall consider appropriate, including making changes to any of the proposed arrangements described in this report which he may consider to be in the Council's interests or necessary to conclude negotiations with third parties, provided that any such changes shall be made in consultation with the Director of Corporate Resources, the Assistant Chief Executive, Legal and Governance.

17.7. To authorise the Chief Executive generally to take such further steps to ensure the progress of the project is co-ordinated with other projects such as the Highways PFI project to ensure that there is no unnecessary duplication of streetworks.

Appendix A

Summary of Legal and Commercial Proposition.

1.0General

The Project Agreement will be between Thales Transport and Security Limited (the Contractor) and the SPV (the Customer).

Thales will build and operate and manage the network and will carry out sales and marketing activities in order to secure contracts with service providers ("Service Providers") for the use of the network.

The Contractor's primary obligation under the agreement is to build and operate a network with the capability to reach 97% of the population (with a BT copper connection). The Customer may elect at a given decision point to limit the deployment to give a reach to a pre-determined 80% of the "connected" population if it believes it is prudent to do so.

Whilst the network at full capacity can reach 97% of the connected population, the core infrastructure deployment in the first instance will be based on a minimum capacity (i.e. to achieve connectivity to approx. 13.6% of the population). The capacity will be increased incrementally as demand is proven, subject to the approval of the SPV.

Thales will provide £10m of loan funding to the SPV repayment of which will be subordinate to the repayment of the Local Authorities and Yorkshire Forward funding. In addition they will not receive direct payment for the sales and marketing services but will receive a share of revenues only where revenue generated exceeds an agreed threshold.

2.0Network Implementation

The Customer and Contractor will agree an Initial Deployment Plan in advance of Contract Award. This will be developed into a more detailed deployment plan within 4 months of the commencement of the contract.

It is the responsibility of the Contractor to carry out the implementation to the agreed specification in line with all applicable legislation and to obtain any necessary consents.

Payment for the Pre-operational phase of the contract will be subject to completion of agreed milestones which will have to comply with an agreed process of acceptance testing which will be approved/carried out by the Customer.

Any delays to the achievement of milestones, which are the fault of the Contractor, will result in a withholding of payment and in some circumstances to Delay Payments being made to the Customer.

The Contractor will enter into Access Agreements with Service Providers or the Local Authorities to provide access to the network. The form of the Access Agreements and the conditions therein will be agreed with the Customer.

At an agreed decision point, the Customer may suspend or cancel further deployment of the network or terminate the agreement if the Customer reasonably believes that the Network will not provide the benefits envisaged or will not meet the Business Case. The first of these reviews will be 30 months after the commencement of the project and thereafter project progress will be reviewed on an annual basis and following each review, the Customer may terminate the agreement at this point if it reasonably believes that the envisaged benefits are not being delivered or the Business Case is not being met. If the Customer exercises these termination rights it is required to make a compensation payments equivalent to any breakage costs that the Contractor may incur.

3.0Service Supply

The Contractor will carry out the Deployment, Operational and Marketing Services to agreed specifications, plans, service levels, timescales and applicable standards.

There will be two elements of the performance mechanism with which the Contractor will have to comply; the services provided to the Customer under the Project Agreement and the services provided to Service Providers under the Access Agreements.

Failure to meet service levels will result in service credits, which will have a monetary value and be shown as a deduction from the monthly invoice.

Where continued failure leads to aggregated credits above an agreed threshold the Customer has the right to terminate the Project Agreement.

The Contractor will be obliged to monitor technological developments throughout the term of the Project Agreement and identify any resulting potential service improvements.

4.0Access Agreements

The Contractor will be required to enter into Access Agreements with Service Providers and to comply with Open Network Principles.

Thales will collect Revenue from Service Providers under the Access Agreement on behalf of the Customer and will pass such revenue to Customer gross of any deductions Service Providers might make/claim.

A pro forma ‘Access Agreement’ has been agreed with Thales, based on similar agreements currently in the market. This will be used initially but will be reviewed with the Customer once a formal sales and marketing operation commences and the customer base is tested.

Upon termination or expiry of the contract, the Customer may, if it so wishes, elect to have all of the Access Agreements in existence novated to it or a replacement Contractor.

5.0Payments and Value for Money

The Contractor will receive payment on the completion and satisfactory testing of agreed milestones in the deployment stage (the "Pre-Operational Phase") and on the ongoing delivery of services in the Operational Phase. Payment will be by monthly invoice raised by the Contractor.

The amount to be paid in any month will be net of any deductions resulting from service credits awarded in the preceding period.

The majority of pre-operational and operational prices will be fixed in real terms at Contract Award and the risk on any movement in those costs will be carried by the Contractor. Element of costs which are for BT regulated products will not be fixed but will only change as those BT prices increase or decrease.

The Contractor is obliged to comply with Value For Money provisions, which require the Contractor to benchmark their operational services against similar network operators and reduce their charges if they are shown to be above the norm.

6.0Contract Governance

There will be agreed governance procedures, which will ensure the required visibility and control over the performance of the Contractor and its sub-contractors.

In order to oversee the operation of the Project Agreement, a structure consisting of a Management Board and Supervisory Board, on which Thales and the Customer will be equally represented, will be formed. In general the Customer will have a casting vote on each of these forums. There are a number of circumstances for which exceptions to the standard governance arrangements have been agreed.

Any changes to implementation, services, service levels etc. requested by either party after the commencement of the Project Agreement, will be subject to the Change Control procedure.

Any disputes arising during the term of the Project Agreement will be dealt with under the Dispute Resolution Procedure. This involves a process of escalation to the senior management of the Customer and Contractor, Mediation, Expert Determination and finally Arbitration.

7.0Personnel

The Contractor will be obliged to appoint the required level of staff with appropriate experience and expertise and to comply with agreed policies including Health and Safety and Equality & Diversity.

A number of Key Personnel will be appointed by agreement and the Contractor will be obliged to replace such personnel as quickly as possible with suitable replacements.

8.0Contractor and Customer Protections

The Contractor has general obligations to provide the services and to comply with all relevant consents, licences and permissions whether statutory, regulatory or contractual.

In turn The Customer is obliged to provide reasonable assistance to the Contractor and to respond to request for information within agreed timescales.

The Customer is required to use best endeavours to ensure it continues to receive the funding. Any delay or withdrawal of funding will become a Customer Cause (unless it is withdrawn because of a material default of the Contractor) and in the event of termination the Contractor will be compensated accordingly.

The Contractor will supply a Parent Company Guarantee in an agreed form. Thales has proposed that the guaranteeing body is not their ultimate parent, being the UK Holding company rather than the France registered parent. This is subject to negotiation but may be acceptable.

The Contractor and its Guarantor will be regularly monitored to ensure they remain financially robust. This will be done by reference to published credit ratings and financial ratios.

The costs arising from changes in law which are specific to the provision of the Services will be borne by the Customer all other changes in law will be borne by the Contractor. What constitutes a specific change in law is quite narrowly defined to include OFCOM mandated price increases and changes to certain road traffic management, streetworks and health and safety legislation that mandate variances in the standards and working practices which the Contractor is required to follow in the provision of the Services.

9.0Risk Protection

The Contractor will be required to comply with agreed security requirements and method statements and produce and comply with a Business Continuity Plan.

Both parties will be relieved from their obligations in the event of a Force Majeure event.

10.0Indemnities, Liability and Insurance

The Contractor will indemnify the Customer from any liabilities arising out of third party intellectual property rights claims.

Under the terms of the Project Agreement, the Contractor has unlimited liability with respect to costs, claims, losses etc arising in relation to Tax Liability, the Employment (i.e. TUPE) Indemnity, Access Agreements and the IPR indemnity.

Subject to the exceptions outlined below, the amount the Customer can recover from the Contractor in relation to a default with respect to the Pre-operational Phase is capped at £30m. The exceptions being where the network fails to achieve a key milestone by the relevant "longstop date" up to and including the Final Acceptance test, in which case the liability cap increases to the greater of £30m and the payments made or due to the Contractor at the point of default. Therefore, if the network does not achieve final acceptance Thales liability will be capped at approx. £94 million being the payments due or made at the stage. If there is a network failure after the final acceptance then the Contractor's liability cap is calculated on a reducing balance from the full deployment costs down to the £30m by the end of year 10. The Contractor's liability for defaults during the Operational Phase which relate to the operational Services is capped, in each year, at the annual charges paid or payable for the Operational services.

The Contractor is required to take out insurance cover for agreed risks at minimum required levels of cover.

11.0Ownership of the Assets

The Customer will not take ownership of the network assets during the term of the Agreement but instead has an option to elect to take a transfer of the assets upon termination or expiry. The rationale for adopting this approach is two-fold. Firstly, as a network owner and operator Thales will assume all liabilities associated with the management and operation of the network including regulatory responsibility. Secondly, the option to take ownership of the network assets means that the SPV can get the benefits of the capital allowances.

12.0Terms, Termination and Exit Management

The term of the Project Agreement is for an initial period of 10 years from an agreed "go live" date (a point at which the network deployment is materially complete). The Customer has the option to extend the agreement for a period of up to 5 years on the same terms (" Extension Period").

Further network expansion beyond the initial term will be subject to a technology audit being carried out at year 7. If the audit demonstrates that any of the assets will not be economically viable beyond the initial10 year term, then if the Customer elects to extend beyond the initial period it may pay for a technology refresh or if it does not will relieve the Contractor for any service failures if any of the identified equipment subsequently fails. During the Extension Period all other services will be provided at the same levels and at the same price where the Customer has elected to implement all the Contractor's proposals for technology refresh.

The Customer may terminate either all or part of the services early and may be liable to pay compensation to the Contractor in certain circumstances as follows:

12.1Contractor Default (including Business Case Failure due to Thales breach of its marketing obligations) , Change of Control of the Contractor and continuing Force Majeure

If the Customer terminates in these circumstances no compensation payments are payable to the Contractor

12.2Convenience and Customer Default

If the Customer terminates in these circumstances a compensation payment will be payable to the Contractor, which will consist of breakage costs reasonably incurred and up to 12 months loss of profit if sufficient notice is not given.

12.3Withdrawal of Funding and Business Case Failure at Project Review Points

If the Customer terminates in these circumstances a termination payment will be payable to the Contractor, which will consist of breakage costs reasonably incurred

The extent of breakage costs payable is to be finalised but will include in general, the costs of making safe the network (if termination for convenience is made before the build of the network is completed), redundancy costs and the cost of terminating any sub-contracts. Thales will be obliged to mitigate such costs in all circumstances.

The Customer's right to partially terminate the Project Agreement is limited to the sales and marketing and billing and revenue collection functions. These services can be terminated on the grounds specified above so that if these services are persistently failing they can be terminated rather than the whole Project Agreement and the Customer can, if necessary, appoint an alternative provider appointed for those services.

As noted above on termination, either early or at expiry of the term, the Customer has the option to either take over ownership of the assets and operation of the Network or appoint a Replacement Contractor.

If the Customer: (a) terminates the Agreement for convenience or following a project review and (b) it does not elect to take a transfer of the network assets and termination occurs before the end of the agreed build, the Customer will be responsible for decommissioning costs, if termination occurs after the completion of the agreed build the decommissioning costs will be paid by Thales.

If the Customer elects not to take a transfer of the network assets it will not make or receive any residual payment for the value of the network assets unless Thales subsequently sells or otherwise disposes of the network asset for more than £10million, in which case the Customer will get 50% of the value above £10million.

On exit, the parties will comply with the Exit Plan, which will be developed and agreed after Contract Award.

The Customer has the right to step into the shoes of Thales if it is failing or if there is a Force Majeure or similar circumstance, and carry out the services itself. It may do so for a specified period after which it may step out and either allow Thales to resume the services or terminate all or part of the Project Agreement, as appropriate.

13.0Assignment and Novation

The Contractor cannot assign or novate the Project Agreement without the prior written consent of the Customer.

The Customer may assign or novate its interest in the Project Agreement to any of the Authorities and any other third party who will carry out the functions of the Customer.

14.0Sales and Marketing

Thales will be responsible for the marketing of the network to the private sector in accordance with an agreed marketing plan. The SPV will be responsible for promoting the network and its capabilities across the wider Public Sector throughout the sub-region and will act as facilitator between the public Sector bodies, Thales and the Service Providers.

Appendix B

Detailed Overall Funding Spread

£000

	2008/9	2009/10	2010/11	Total
Funds Required				
Deployment Costs	(17,668)	(41,346)	(33,977)	(92,991)
Operational Costs	(1,366)	(6,800)	(10,706)	(18,873)
Total Funds Required	**(19,034)**	**(48,146)**	**(44,683)**	**(111,863)**
Funded By:				
Net Trading Income Received		2,705	15,335	18,040
ERDF	19,034	10,788		29,822
Yorkshire Forward		14,000		14,000
YF Loan		12,392	17,608	30,000
LA Loans		4,130	5,870	10,000
Thales Loan		4,130	5,870	10,000
Total Fund Sources	**19,034**	**48,146**	**44,683**	**111,863**

The above detail is based on a 1st October 2008 commencement date.

Appendix C : Risk Registers

Public Sector Retained Risks - Pre Contract Commencement

Risk Heading	Detail/Rationale	Impact	Probability	Mitigation
Project Financing				
PWLB Interest rate increases prior to contract award	Interest on LA and YF loans will be fixed at contract award but movements up to that point will impact the business case	L	L	The current model is based on a prudent assumption which is above the current PWLB rates.
ERDF Grant not approved /terms not acceptable	The model is sensitive to the amount, timing and eligibility of ERDF funds. If the assumptions cannot be achieved then this could impact on the business case	H	L	The Commission has been closely involved in this project throughout and detailed consultation will continue to ensure the optimum outcome
YF Grant not approved /terms not acceptable	The model is sensitive to the amount, timing and eligibility of YF funds. If the assumptions cannot be achieved then this could impact on the business case	H	L	YF has been closely involved in this project throughout and detailed consultation will continue to ensure the optimum outcome
YF/LA Loan Funding not approved /terms not acceptable	The model is sensitive to the amount, timing and use of Loan funds. If the assumptions cannot be achieved then this could impact on the business case	H	L	LA approval secured from Members. Full engagement of all parties in Due Diligence process
Price Movement				
Delays in contract commencement lead to price uplift	Prices currently fixed until 1st January 2009. Any delay beyond that point is likely to lead to an uplift in contract costs	L	H	Ensure programme is managed as effectively as possible to speed up all necessary processes/approvals.
SPV Creation				
SPV Legal structure cannot be agreed	The contract can only be finally signed when the SPV structure is finalised and appropriate guarantees in place.	H	L	LA approval secured from Members. Full engagement of all parties in Due Diligence process
SPV appointments not completed in time	There are significant obligations of the SPV as soon as the contract commences with regard to control and approvals. If the necessary resource and expertise is not available then the project and the SPV are at risk.	M	M	Early commencement of appointment process at board and operational level.
Taxation				
Assumptions regarding treatment of assets results in higher Corporation Tax	Business case assumes that assets are on the SPV's Balance Sheet and are eligible for tax relief	L	L	Treatment will be agreed with HMRC prior to contract award. If the assumptions are not valid then gift aid to a charitable trust may be used to limit the tax charge.
Assumptions regarding VAT status of SPV results in un-recoverable VAT	Business case assumes that the SPV will have a business supply and can therefore recover input VAT	H	L	Treatment will be agreed with HMRC prior to contract award.

Public Sector Retained Risks - Post Contract Commencement

Risk Heading	Detail/Rationale	Impact	Probability	Mitigation
Design and Construction				
BT Openreach Costs higher than modelled	Assumptions as to number and extent of upgrades required to BT cabinets can only be verified post contract	M	M	Discussions have been ongoing and will continue with BT and OfCom to minimise pricing as much as possible
Indexation on build costs higher than modelled	A proportion of build costs are to be increased annually by the prevailing RPIX.	L	M	The modelled assumption is 3.5% p.a. which is felt to be prudent for the 3 year build period
Price increases on pass through elements higher than modelled	Elements of costs which are for BT regulated products will increase with any increases in those published prices	L	L	The modelled assumption is 3.5% which is felt to be prudent for the 3 year build period
Change in deployment leads to additional costs	The price is based on a set deployment across the sub region. Any changes requested by the SPV may lead to additional costs	L	L	Stakeholder expectations to be managed by Project Board
Commission and Operating				
Indexation on Operating costs higher than modelled	A proportion of operational costs are to be increased annually by the prevailing RPIX.	L	H	The modelled assumption is 2.5% p.a. which is felt to be prudent for the 10 year operational period
Price increases on pass through elements higher than modelled	Elements of costs which are for BT regulated products will increase with any increases in those published prices	L	L	The modelled assumption is 2.5% p.a. which is felt to be prudent for the 10 year operational period
Fibre rates higher than modelled	Assumptions as to the likely Heriditament charge will only be confirmed after the fibre length is confirmed	L	M	Work with Thales and the Valuation office to minimise the charge as much as possible
SPV Operating costs higher than modelled	The business case is based on a staff of around 15 people at an annual costs of £1.7m	L	H	Early and ongoing work to identify and review the resource requirements of the SPV
Demand				
Commercial take up delayed from model assumptions	The Business Case assumes user take up commences in month 9 of the deployment and steps up quite rapidly across the remainder of the build period. The funding of the network build is dependant on revenue generation in those early periods.	M	M	Continued engagement with Service Providers with the aim of obtaining commitment as to likely migration to the Network.
Penetration lower than modelled	The Business Case assumes penetration reaches 21% of the population by year 5 of the contract and remains flat thereafter. The funding of the network operation is dependant on revenue generation in those periods.	H	M	Continued engagement with Service Providers with the aim of obtaining commitment as to the likely user base and forward sales plans.
Wholesale revenue per user lower than modelled	The Business Case assumes users are taking multiple services across the network with an increasing mix of higher value services	H	M	Continued engagement with Service Providers with the aim of driving up use of the network and the delivery of next generation services.
Public sector revenue delayed	The Business Case assumes Public Sector (including L.A.) take up commences in month 15 of the deployment and steps up quite rapidly across the remainder of the build period. The funding of the network build is dependant on revenue generation in those early periods.	L	M	Continued engagement with appropriate LA officers and other Public Sector bodies with the aim of obtaining commitment as to likely migration to the Network.

Public sector revenue lower than modelled	The Business Case assumes Public Sector Revenue reaches £6m p.a. by year 4 of the contract and remains flat thereafter. The funding of the network operation is dependant on revenue generation in those periods.	M	M	Continued engagement with appropriate LA officers and other Public Sector bodies with the aim of driving up the use of the Network.
Funding / Claw Back Risk				
Outputs not achieved	ERDF funding is likely to be subject to the achievement of outputs. Failure to achieve those outputs within the timescales could result in claw back of some or all of the funding	H	L	Continued engagement with the EU to ensure outputs are acceptable and achievable before commitment to contract.
Expenditure ineligible	ERDF funding is likely to be subject to regulations in terms of what it can be used for. Failure to comply with those regulations could result in withholding of funds.	M	L	Continued engagement with the EU to ensure eligibility in line with business case assumptions before commitment to contract.
Drawdown period expired	ERDF funding may be subject to timescales in terms of when it has to be claimed. Failure to comply with those timescales could result in withdrawal of funds.	L	L	Continued engagement with the EU to ensure timescales are understood and are in line with business case assumptions before commitment to contract.
Residual Value				
Realisable value of assets created is less than modelled	The business case assumes that the value of assets created can be used to offset any financial exposure carried by the stakeholders but this is based on estimates which have not been validated.	M	M	Ongoing analysis of assets created and view of likely market interest in those assets.
Assets have a residual cost to de-commission and make good	If the assets are not consider to have a sale value then there could in certain circumstances be a cost to de-commission the network	M	L	Ongoing analysis of assets created and view of likely market interest in those assets. Contractual obligation for Thales to mitigate cost of decommissioning
ERDF or YF Grants secured against the assets	The business case assumes that the assets and any value realised from them will be fully available to the SPV shareholders in any circumstances. Any call on those assets by grant providers will increase the financial exposure of the Shareholders.	H	L	Continued engagement with the EU and YF to ensure the terms of the grants are understood and are in line with business case assumptions before commitment to contract.
Technology/obsolescence				
New technologies emerge making Digital Region less attractive	It is possible that new technologies may emerge (especially mobile and wireless access) over the life of the contract which undermine the demand for the network.	H	L	The network is based on the next generation of fibre based technology and puts the region in a strong position to move to the FTTH which is recognised as the ultimate in fibre based broadband provision. Completely new technologies will take several years to develop as has been the case thus far. Mobile and wireless access is increasing and whilst it may not offer a complete alternative across the sub-region it could provide a degree of competition. The

				SPV will keep abreast of developments and will consider the impact in its forward planning.
Regulation				
Specific Changes In Law result in additional costs	Changes in law as defined by the contract may occur during the term of the contract incurring additional costs	L	M	SPV to keep abreast of OFCom mandated changes and analyse the impact on an ongoing basis. Impact of Traffic Management Act and other legislation affecting street works to be reviewed with LA's.
Legal				
Breach of the terms of the State Aid clearance	The European Commission granted the project state aid clearance based on a detailed submission setting out the objectives and terms of the project.	H	L	The project has and will continue to be reviewed against that submission to ensure that it is still compliant.

Appendix D : DTZ Economic Impact Report

See Separate Document

Appendix E : Environmental Impact Analysis

Yorkshire Forward 7 Digital Region P582100
South Yorkshire Fibre Optic Cable Installation
Digital Region
European Regional Development Fund Annex XXII F

7 RECOMMENDATIONS

This report has been written at the feasibility stages of planning for the Digital Region project. Considering that numerous details have not yet been determined nor conditions applied, Grontmij believe it timely to provide recommendations for ongoing actions for the project to ensure environmental best practice and legality.

Environmental Management Plan

The development of an Environmental Management Plan for Digital Region Project will provide a framework to outline the environmental needs of the project and clients. Such a plan enables the objectives (goals or policies to be achieved) and targets (performance requirements to enable objectives to be met) to be set. Through designating the responsibilities for certain actions to specific key staff in this way and by providing a timeframe by which the action should be competed will allow project progress.

The plan can be used throughout the project as a live working document and should be reviewed periodically to ensure progress against targets is being made. The topics to be included are numerous however some likely inclusions for Digital Region are listed below.

Ecological Surveys

Understanding the site specifics where works will be taking place and relationships with related designated areas (e.g. SAC SPA SSSI) is crucial as through legislation such as the Countryside Rights of Way 2000 Act and Conservation (Natural Habitats &c.) Regulations 1994 have conferred restrictions to certain areas and species thereby requiring additional planning and consultation prior to works. To reflect this it is recommended that site ecological surveys are undertaken, the success of which is highly dependent upon timings and as such surveys often span many months. By undertaking ecological investigation it is possible to avoid disturbance to protected species and habitat and also to prevent delays to the development schedule as it also allows time in order for licences to undertake works in such areas to be applied for and supplied. Protected species are safeguarded against capture, killing, injury or disturbance, with plants protected against collection, uprooting or destruction.

In addition to protected species, the SSSI SAC and SPA outlined earlier within the report other habitat and feature considerations include:

Tree Protection Orders - In addition to individual species there may be interaction with trees with Tree Protection Orders requiring fencing off of areas in line with BS5837:2005 to ensure sufficient protection is conferred to avoid damage to trees or their roots.

Hedgerows - Covered under Hedgerow Regulations 1997 most hedgerows over 20m in length and / or form part of a longer stretch of hedgerows are protected and need a Removal Notice in order to achieve this.

Phase 1 habitat surveys by qualified, licensed and experienced surveyors provide broad analysis of the types of habitat present along with an indication of the associated potential species present. Indications from Phase 1 will prompt a more detailed Phase 2 survey to highlight the presence of specific groups of plants and animals thereby identifying protected species. In the event that protected species are present, such surveys provide developers with scope to ensure species and habitat are not harmed. It is likely that (but not restricted to) the following species may be encountered during the Digital Region works:

Nesting Birds - Wild birds are protected during nesting season potentially impacting installation if nests as are found in the area of works, all activities will have to cease until breeding has ceased with nests to be inspected by a trained ecologist.
Badger Setts - Nearby setts will impact site traffic routes for tracked and light machinery with only hand digging and clearance allowed within 10m. Any sett destruction must be approved and overseen by a licensed professional to close the sett and encourage badgers to relocate to other setts nearby.
Bats - Potential for bat roost in trees near to installation is problematic as even damage to a potential roost without bats present is illegal. Therefore licensed bat workers should be approached to investigate options for the scheme.
Great Crested Newts (GCNs) - Presence of GCN will require exclusion from working areas by newt netting, trapping and translocation to ensure the area is clear for works to continue avoiding detriment to the species. For example the identification of a high density of ponds with interconnected vegetation may hold potential for great crested newts.
Water Voles - Works near canals and other watercourses have potential for interaction with water voles.

Pollution Prevention

Although there are minimal pollution impacts associated with the project it is important to ensure pollution potential is managed appropriately.
Enforcing Authorities - Site visits should be arranged with local Environment Agency and Environmental Health officers prior to starting on site to avoid any serious problems from arising and to obtain best practice guidance for activities within the region.
Watercourse Quality - Proximity of works to watercourses should be mapped to ensure no reduction in water quality through contamination of run off from excavated areas. Works should be conducted in line with Environment Agency Guidance PPG 5 Working In, Near, of Liable to Affect Watercourses. Where necessary water sampling should take place if included in planning conditions or if recommended by the EA.

Ground Investigation Survey

As discussed with preferred contractors, 25 % of materials excavated from new cable runs will be discarded as waste. As at the time of writing a ground investigation survey was not available it must be considered that contaminated land may be present in areas of the installation. It is necessary for such waste to undergo WAC (Waste Acceptance Criteria) testing to determine its classification within the hazardous hierarchy. In the event of the waste being considered Hazardous, registration with the Environment Agency is required to obtain a Hazardous Waste Carriers Certificate.

Site Waste Management Plan

It is the responsibility of the client to produce the initial Site Waste Management Plan prior to any works being undertaken. This enables all members of supply chain, design and operation to contribute towards reduce, re-using and recycling site produced waste.

The plan is to contain:
- The types of waste removed from the site
- The person removing waste from site, their waste carrier registration number, and a description of the waste
- The site the waste was taken to
- An environmental permit or exemption held by the site where the material is taken.

It is then the responsibility of the client to pass on the plan to the principal contractor with review every 3 months if project managing is not sub contracted. At the end of the project, the Site Waste Management Plan should be reviewed against targets and the explanations for disparities between plan and actuality recorded.

Statutory Nuisance

Development projects can be subject to potential dust and noise issues which arise when the source of production is close to a receptor such as local residents. With this in mind cable installation will take place in a manner to avoid dust and noise generation.

Dust will be controlled through a process of dampening down regularly using a fine mist of water and by following available Best Practice guidance such as ‘CIRIA Compliance+ Emissions to Air’.

Complaints and damage as a result of excessive noise can be prevented through using noise controls on machinery where possible, implementing screens if appropriate and ensuring plant is correctly maintained. This will be led and reinforced through use of available Best Practice guidance such as ‘CIRIA Compliance+ Noise’.

Appendix F : Residual value Calculation

RESIDUAL VALUE ESTIMATE (Total value)

	Residual Value Assumptions	
Exchange Equipment	50% of Build costs	Fully depreciated by contract end
Fibre Cable & Cabinets	80% of Build costs	Depreciated over 30 years
Network Operating Centre	30% of Build costs	Fully depreciated by contract end

	Year 1		Year 2				Year 3				Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13
	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 5	Qtr 6	Qtr 7	Qtr 8	Qtr 9	Qtr 10										
Exchange Equipment	0	402	1,360	1,885	2,365	3,427	4,241	4,488	4,959	5,772	6,137	5,455	4,773	4,091	3,409	2,727	2,046	1,364	682	0
Fibre Cable & Cabinets	0	1,206	5,195	13,318	19,953	26,391	33,445	37,303	41,488	45,141	50,498	48,814	47,131	45,448	43,765	42,081	40,398	38,715	37,032	35,348
Network Operating Centre	0	0	512	512	512	512	1,737	1,934	1,934	1,934	2,415	2,147	1,879	1,610	1,342	1,073	805	537	268	0
Cumulative Residual Value	0	1,608	7,067	15,715	22,830	30,331	39,423	43,725	48,381	52,847	59,050	56,416	53,783	51,149	48,516	45,882	43,249	40,615	37,982	35,348

Appendix E : Summary Business Case

CASH FLOW SUMMARY

	Year 1		Year 2				Year 3													
£000's	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 5	Qtr 6	Qtr 7	Qtr 8	Qtr 9	Qtr 10	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13
Period Commencing	01-Oct-08	01-Jan-09	01-Apr-09	01-Jul-09	01-Oct-09	01-Jan-10	01-Apr-10	01-Jul-10	01-Oct-10	01-Jan-11	01-Apr-11	01-Apr-12	01-Apr-13	01-Apr-14	01-Apr-15	01-Apr-16	01-Apr-17	01-Apr-18	01-Apr-19	01-Apr-20
Contract Months	1-3	4-6	7-9	10-12	13-15	16-18	19-21	22-24	25-27	28-30	31-42	43-54	55-66	67-78	79-90	91-102	103-114	115-126	127-138	139-143
Revenue																				
Household and SME Revenue																				
Installation	0	0	277	415	562	702	843	1,124	1,124	423	1,482	772	556	548	540	532	524	516	371	0
rental	0	0	191	637	1,186	1,965	2,917	4,136	5,427	5,248	30,442	32,493	32,642	32,662	33,699	34,574	35,414	36,219	30,835	14,753
Public Sector	0	0	0	0	500	750	800	875	875	875	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	2,000
South Yorkshire LA's	0	0	0	0	250	375	400	450	475	500	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	1,000
	0	0	468	1,052	2,498	3,792	4,960	6,584	7,900	7,047	37,924	39,266	39,198	39,210	40,239	41,106	41,938	42,735	37,206	17,753
Variable Costs	0	0	(700)	(1,072)	(1,455)	(1,879)	(2,295)	(3,079)	(4,827)	(2,191)	(8,117)	(5,057)	(3,986)	(3,934)	(3,881)	(3,828)	(3,776)	(3,723)	(2,279)	(1,072)
NET REVENUE	0	0	(232)	(19)	1,043	1,913	2,665	3,505	3,074	4,856	29,807	34,209	35,212	35,276	36,358	37,278	38,162	39,011	34,926	16,682
Deployment Costs	0	(5,668)	(9,134)	(11,705)	(9,768)	(10,740)	(15,053)	(6,553)	(7,322)	(7,429)	(12,767)	0	0	0	0	0	0	0	0	0
Advance Payment Guarantee	(12,000)	0	0	0	0	0	0	0	0	2,380	9,620	0	0	0	0	0	0	0	0	0
Operational Costs	(224)	(706)	(1,022)	(1,190)	(1,378)	(2,031)	(2,056)	(2,239)	(2,349)	(2,689)	(12,168)	(12,960)	(13,316)	(13,653)	(13,991)	(14,328)	(14,666)	(15,004)	(15,341)	(7,756)
Thales Revenue Share	0	0	0	0	0	0	0	0	0	0	(2,869)	(4,299)	(4,419)	(4,354)	(4,493)	(4,884)	(5,372)	(5,486)	(4,367)	(2,016)
SPV Costs	(218)	(218)	(295)	(295)	(295)	(295)	(343)	(343)	(343)	(343)	(1,876)	(1,923)	(1,971)	(2,021)	(2,071)	(2,123)	(2,176)	(2,231)	(2,286)	(976)
Pre-Finance Pre-Tax Cashflow	**(12,442)**	**(6,592)**	**(10,682)**	**(13,209)**	**(10,398)**	**(11,152)**	**(14,787)**	**(5,630)**	**(6,941)**	**(3,226)**	**9,747**	**15,027**	**15,506**	**15,248**	**15,803**	**15,942**	**15,948**	**16,291**	**12,932**	**5,934**
Tax Paid	0	0	0	0	0	0	0	0	0	0	0	(1,557)	(2,879)	(3,277)	(3,847)	(4,241)	(4,552)	(4,931)	(4,177)	(1,863)
Pre-Finance Post-Tax Cashflow	**(12,442)**	**(6,592)**	**(10,682)**	**(13,209)**	**(10,398)**	**(11,152)**	**(14,787)**	**(5,630)**	**(6,941)**	**(3,226)**	**9,747**	**13,470**	**12,627**	**11,971**	**11,956**	**11,701**	**11,396**	**11,359**	**8,756**	**4,071**
Funding																				
Equity Drawdown	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ERDF	12,441	6,592	10,682	107	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
YF	0	0	0	11,598	2,402	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Thales Investment	0	0	0	301	1,599	2,230	2,957	1,126	1,388	398	0	0	0	0	0	0	0	0	0	0
LA Loan Funding	0	0	0	1,203	6,397	8,922	11,829	4,504	5,553	1,592	0	0	0	0	0	0	0	0	0	0
ERDF Loan	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
LA Loan Funding Capital Repayment	0	0	0	0	0	0	0	0	0	0	(3,482)	(3,678)	(3,885)	(4,104)	(4,335)	(4,579)	(4,837)	(5,109)	(5,397)	(2,352)
LA Loan Funding Interest Payment	0	0	0	0	0	0	0	0	0	0	(2,252)	(2,155)	(1,948)	(1,729)	(1,498)	(1,254)	(996)	(724)	(436)	(132)

ERDF Loan	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Interest / Overdraft on Cash Balances	0	0	(0)	(0)	(0)	0	0	0	0	(0)	(56)	68	261	437	601	770	935	1,098	1,264	1,368
Cash Brought Forward	0	0	(0)	0	0	0	0	0	0	0	(1,236)	2,722	10,427	17,481	24,057	30,781	37,419	43,917	50,541	54,727
Cash Carried Forward	**0**	**(0)**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**(1,236)**	**2,722**	**10,427**	**17,481**	**24,057**	**30,781**	**37,419**	**43,917**	**50,541**	**54,727**	**57,682**

TOTAL UNDERWRITING EXPOSURE FOR ALL STAKEHOLDERS (indiviual LA/YF exposure dependant on extent of loan and Revenue underwriting)

Assumptions

£40m Loan funding underwriting to be split between YF& LA's

Revenue and Break Cost Underwritingto be split between YF and LA's in proportion to SPV Shareholding

YF £30m not guaranteed in any way by LA's

Residual value split between YF and LA's in proportion to SPV Shareholding

No clawback risk on ERDF and YF funds

		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13
Cumulative Loan Underwrting		**0**	**(16,522)**	**(40,000)**	**(36,518)**	**(32,840)**	**(28,954)**	**(24,850)**	**(20,515)**	**(15,936)**	**(11,099)**	**(5,990)**	**(593)**	**0**
Annual Revenue Exposure														
Years Funding Requirement		**(0)**	**(2,705)**	**(15,336)**	**(19,443)**	**(17,038)**	**(17,235)**	**(17,403)**	**(17,560)**	**(17,706)**	**(17,838)**	**(17,958)**	**(18,064)**	**(8,864)**
	Less Previous Years Committed Revenue.	**0**	**0**	**7,733**	**9,306**	**13,699**	**14,622**	**14,689**	**14,698**	**15,165**	**15,558**	**15,936**	**16,299**	**5,782**
Contract Break Costs		**(5,000)**	**(11,130)**	**(16,200)**	**(5,000)**	**(4,000)**	**(3,000)**	**(2,000)**	**(1,000)**	**(1,000)**	**(700)**	**(500)**	**(300)**	**(200)**
NET RISK		**(5,000)**	**(30,358)**	**(63,803)**	**(51,655)**	**(40,179)**	**(34,567)**	**(29,565)**	**(24,378)**	**(19,477)**	**(14,079)**	**(8,512)**	**(2,659)**	**(3,283)**

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Audit Committee Report

Report of:	Simon Green
Date:	13th November 2014
Subject:	Revised Approach for Capital Delivery and Reporting
Author of Report:	Daniel Ladbury, Assistant Director of Capital & Major Projects, 0114 273 5628

Summary: This report provides an overview of the progress that has been achieved to date in improving the delivery and management of the capital programme and summarises the key works that are in development to further improve the delivery of the capital programme.

Recommendations:
That the Audit Committee notes the progress that has been achieved to date in improving the delivery of the capital programme.

That the Audit Committee notes and supports the planned activity for implementing further and continual improvements in the delivery of the capital programme.

Background Papers: N/A

Category of Report: OPEN

Statutory and Council Policy Checklist

Financial Implications
NO Cleared by:
Legal Implications
NO Cleared by:
Equality of Opportunity Implications
NO Cleared by:
Tackling Health Inequalities Implications
NO
Human rights Implications
NO:
Environmental and Sustainability implications
NO
Economic impact
NO
Community safety implications
NO
Human resources implications
NO
Property implications
NO
Area(s) affected
N/A
Relevant Cabinet Portfolio Leader
Cllr Ben Curran
Relevant Scrutiny Committee if decision called in
Not applicable
Is the item a matter which is reserved for approval by the City Council?
YES/NO
Press release
NO

REVISED APPROACH FOR CAPITAL DELIVERY AND REPORTING

1.0 INTRODUCTION

1.1 This report follows on from the audit that was undertaken relating to Risk Management and Reporting on Capital Schemes, the report for which was issued on 23rd December 2013.

1.2 The audit report coincided with the outcome of a review undertaken by the Head of Capital Delivery Service as to how the delivery of the capital programme could be improved, from which fundamental changes to the way in which the capital programme is delivered were proposed. As risk management is a key component of capital project management, the audit recommendations were incorporated into this strategic review of capital delivery and the subsequent improvement plan.

1.3 It was therefore agreed that an overarching report be brought to the Audit Committee to outline the strategic changes that are being implemented for the delivery of Capital Projects. This report covers these changes.

2.0 SUMMARY

2.1 The progress that has been achieved to date to improve capital delivery is summarised as follows:

- Appointment of a Private Sector Capital Delivery Partner;
- Development of Project Prioritisation Matrix;
- Development & implementation of Project Delivery Process;
- Development and implementation of Capital Gateway Approval process;
- Continued audit and challenge of projects in the capital programme;
- CDS Project Manager training;
- Development of a 3 year capital delivery improvement roadmap.

2.2 The further developments that are currently being progressed in order to improve the delivery of the capital programme are as follows:

- Development of a baseline programme to capture all projects;
- Further review of the Capital Gateway Process;
- Development of project reporting and monitoring;
- Development of programme reporting;
- Restructure of the Capital Delivery Service to improve project delivery, project monitoring and develop the Capital Programme Office function;

2.3 A summary highlight report showing the progress to date and future works is included at Appendix A.

3.0 CAPITAL DELIVERY IMPROVEMENT

3.1 Progress Achieved to Date

3.1.1 Capital Delivery Partner

A private sector capital delivery partner has been appointed to support the capital delivery service with the ongoing development and improvement of the delivery of the capital programme and provide additional resource support as part of the "core and flex" operation model. This provides valuable cross-sector expertise to support the ongoing development of the capital programme office and improvement of delivery of the capital programme whilst providing additional valuable expert resource as required.

3.1.2 Project Prioritisation Matrix

A project prioritisation matrix has been developed to help assess the deliverability of projects. This works by assessing the amount of effort that needs to be input into a project (for example resource requirements, risks, delivery costs) against the benefit the project will realise. This tool is currently being used to prioritise bids to the Corporate Resource Pool and it is anticipated that it could be used across the wider capital programme in future as resources become more limited to help ensure that resources are directed where they will have the greatest impact.

A copy of the matrix is included at Appendix B.

3.1.3 Project Delivery Process

An ISO9001 project delivery process has been developed and implemented within the Capital Delivery Service with certification planned for November 2014. All projects delivered by the Capital Delivery Service will be required to follow this process, which will be subject to both internal and external audit. Risk Management is an integral part of this process which will help to ensure that risk is well managed at all stages of project delivery.

3.1.4 Capital Gateway Process

A Capital Gateway Process has been developed which was rolled out across the Capital Programme in February 2014. This pulled together new and existing approvals and clarified the purpose of the reviews undertaken at each stage with the aim of ensuring that project risks are determined and addressed throughout the delivery lifecycle. This process is currently being reviewed again to determine whether there is scope for efficiency to be made and to develop the formal governance documentation around the process.

Once established, the CDS Capital Programme Management Office will be responsible for the management of the Gateway Process and will ensure that project reviews, including assessments of Risk Management, are undertaken at each Gateway prior to approval.

An overview of the Capital Gateway Process is included at Appendix C.

3.1.5 3 year Capital Delivery Improvement Plan

A 3 year continual improvement plan for capital delivery has been developed which provides a framework for the ongoing review and development of the capital programme with the aim of delivering projects faster and cheaper whilst ensuring that the required outcomes and benefits are maximised. This is now integrated into the service plan for the capital delivery service and provides the development plan for the service over the next 3 years.

A copy of the improvement plan summary is included at Appendix D.

3.2 Ongoing and Planned Developments

3.2.1 Capital Programme Office

The Capital Delivery Service is developing a Capital Programme Management Office (PMO) function that will monitor and challenge the progress of all projects and ensure that audits are undertaken at key stages. The PMO will also provide support to Project Managers and develop best practice.

3.2.2 Capital Delivery Service Restructure

The Capital Delivery Service will be restructured by April 2015 in order to align the service to the Capital Programme and improve the capacity of the service to support programme delivery. This restructure will include a strong focus on improved project and programme management and will also formally create the Capital Programme Office function, some of which is already in place through a re-alignment of existing working arrangements.

3.2.3 Capital Project Reporting and Monitoring

Continued development is being made with regards to the monthly reporting on projects and programmes to facilitate project and programme management and monitoring.

Once established the programme office will be responsible for ensuring that all necessary reports are issued and that the content is challenged. This will in turn support the ongoing improvement of delivery by helping to identify common elements for improvement or risks and issues that need to be addressed or escalated.

3.2.4 Consolidation of delivery teams

It has been the recommendation of a number of previous internal and external reviews that capital delivery activity be amalgamated within a single service area to create a single centre of excellence and single area of accountability. To date, this has not yet been realised and the pace of improvement is being slowed by the disparate arrangements currently in place. This continues to be an area of discussion but no firm plans are currently in place for consolidating capital delivery activity.

4.0 RECOMMENDATIONS

4.1 That the Audit Committee notes the progress that has been achieved to date in improving the delivery of the capital programme.

4.2 That the Audit Committee notes and supports the planned activity for implementing further and continual improvements in the delivery of the capital programme.

Appendix A – Summary Capital Delivery Improvement Report

Objectives

To deliver improvements in Capital Delivery and Management to address issues relating to ongoing slippage on projects. The outcomes are as identified in the reports and presentation taken to EMT in Autumn 2013.

Programme - Original Tasks

Note - new tasks and activities are indicated in red text

Task	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15
1. Project Audits																
Desktop review of projects	◆															
Identification of high risk projects	◆				*Ongoing identification*											
Monthly review - high risk projects	★	★	★	★	★	★	★	★	★	★	★	★	★	★	★	
2. Gateway Delivery Process																
New Projects Moratorium	★	★	◆		*Complete*											
Gateway Process Established			◆		*Action complete - see below.*											
Gateway Process Review & Update											◆	Initial review complete. To be finalised by end Nov.				
Capital Programme Management Office																
3. ProjMan Review																
Define Central/ Dispersed arrangements	◆				Addressed for Place portfolio											
Define PM Core skills & competence										*Work ongoing - pick up in CDS restructure*					◆	
PM Skills Audit										*Work ongoing - pick up in CDS restructure*					◆	
Training and Development Programme										*Work ongoing - pick up in CDS restructure*					◆	
CDS Restructure inc Programme Office															◆	
Best Practice Project Delivery Approach									★							
Consolidation of Capital Project Management																◆
4. Project Monitoring and Reporting																
Develop CDS monthly project/ programme reports																
Develop baseline capital programme											◆	Work commenced.				
Develop monthly programme reporting																
Monthly performance monitoring by PMO																

Progress Summary

1. Achieving Change for Sustainable Development Service agreed - to move under CDS from 1st November 14.
2. Review of Gateway Process commenced. Will identify process improvements and develop governance docs. Hard roll out to staff proposed once this has been reviewed.
3. Shadow PMO meetings continue between CDS & Finance to target schemes and identify improvements.
4. Status reports for all CDS schemes and targeted non-CDS schemes being produced. This will now be a monthly activity and will inform programme / EMT / Cabinet reporting.
5. Project Delivery Procedures have been implemented in CDS. External ISO9001 gap audit undertaken and no issues raised. ISO 9001 certification expected Nov14.
6. Capital Delivery Transformation Roadmap has been completed. Forms core part of CDS service plan.
7. CDS restructure is progressing. Achieving Change to be launched in Nov 14 with restructure planned for completion by Apr 15.
8. Ongoing meetings between DL & Angie Cawkwell to align PM procedures/ best practice.

Outputs over next 2 months

1. Complete review of Gateway Process and launch docs / briefings.	DL / Del Pr	30-Nov-14
2. Develop master capital programme.	DL / Del Pr	30-Nov-14
3. Complete scope for Capital Hub and develop formal structure.	DL	30-Nov-14
4. PM skills / training plan included in CDS restructure proposals.	DL	30-Nov-14
5. Identify all PM's across each Portfolio & clarify in QTier - status cleanse.	DL/Del Pr	31-Oct-14
6. Continue chasing PM's for project status updates.	DL / Del Pr	ongoing
7. ISO9001 Certification of Project Delivery Procedures	DL	30-Nov-14
8. Develop and pilot improved way of working with CYPF Portfolio	DL	30-Nov-14

Issues

1. Resourcing improvements continues to present a challenge due to fire fighting and resource constraints.
2. Consolidation of delivery needs to be progressed or benefit of changes/ ongoing improvements will not be realised.
3. Planning and resourcing of works remains an issue across the programme.
4. Endorsement as to future role and purpose of CDS would benefit change realisation.

Appendix B – Project Assessment Matrix

PROJECT NAME **Sample Assessment**

	CRITERIA	WEIGHT	SCORING	PROJECT SCORE	WEIGHTED SCORE	SUPPORTING COMMENTS & EVIDENCE / NOTES
Effort	Delivery Resources	20	0: Heavy resource requirements across multiple service areas, limited skills in house 3: Heavy resource requirements across multiple services, skills in house or can be supplemented 6: Low resource requirements across multilpe areas, capacity to outsource additional support 9: Low resource requirements across few service areas, high availability in-house		0	
	Project Risks including approvals and planning	20	0: Risks not identified or no management plan in place 3: High risk, management plan in place 6: Moderate risk, management plan in place 9: Low risk, robust management plan in place		0	
	Feasibility Funding established	10	0: No funding identified 3: Funds identified, costs > £50k 6: Funds identified, costs £25k - £50k 9: Funds identified, costs < £25k		0	
	Project Funding Availability	20	0: Funding dependant on trading income or cost savings 3: Fully funded through mixture of internal and external funds, including grants 6: Fully funded through single allocated external grant funding eg ERDF, CIL, S106 9: Fully funded through internally allocated budgets, eg HRA, LGF, CRP		0	
	Cost Certainty	15	0: lots of unknown or hidden costs 3: some high level costs are known, 6: many/ detailed costs are known 9: all costs, direct & indirect, are known and tabulated		0	
	Stakeholders	10	0: Multiple Stakeholders, low support for scheme 3: Limited Stakeholders, low/ medium support for scheme 6: Multiple Stakeholders, moderate or high support for scheme 9: Limited stakeholders, high support for scheme		0	
	Complexity	5	0: Highly complex, innovative, unique and new scheme 3: Complex, some similarity to previous schemes 6: Limited complexity, similar to previous schemes 9: Low complexity, Business as Usual, repeat project, tried and tested methods		0	
	Total Effort Score			**0**	**0**	
Benefit	Strategic Outcome Alignment	20	0: No alignment with outcomes 3: Alignment with 1 outcome but is not driven by outcomes 6: Alignement with 1 or more outcome, driven by outcome programme 9: Achieves 2 or more outcome benefits, HRA or ITA funded		**0**	
	Improves Economic Sustainability	10	0: No benefit/ impact 3: Improves sustainability of service / function / neighbourhood within limited area 6: Improves sustainability of service / function / neighbourhood within neighbourhood area 9: Improves sustainability of multiple services across neighbourhood areas with economic and environmental benefits		**0**	
	Reduces Energy Consumption / Carbon Emissions	10	0: No benefit/ impact 3: Reduces energy consumption and/ or carbon emissions by <10% 6: Reduces energy consumption and/ or carbon emissions by 10-25% 9: Reduces energy consumption and/ or carbon emissions by >25%		**0**	
	Addresses existing issues including Asset Management & Maintenance	10	0: Does not address any existing issues / no benefit 3: Addresses single specific identified issue 6: Addresses multiple existing issues 9: Precautionary, planned, remedial or emergency works to address identified asset maintenance issues		**0**	
	Users and Impact	10	0: low impact, low number of users (1 ward or less) 3: low impact, high number of users (more than 1 ward) 6: high impact, low number of users (1 ward or less) 9: high impact, high number of users (more than 1 ward)		**0**	
	Financial Benefit: Investment Payback	20	0: No benefit/ impact 3: payback beyond 5 years 6: payback within 3-5 years 9: payback within <3 years		**0**	
	Financial Benefit: Revenue Benefits	20	0: No benefit/ impact 3: Reduces revenue costs by/ generates income of < £50k p.a. 6: Reduces revenue costs by/ generates income of £50k - £100k p.a. 9: Reduces revenue costs by/ generates income of > £100k p.a.		**0**	
	Total Benefit Score			**0**	**0**	

Total Score	**0**	**0**

Appendix C – Gateway Process Overview

SHEFFIELD CITY COUNCIL CAPITAL PROGRAMME GATEWAY PROCESS

Version 2.0
17th June 2014

Pre Gateway 1

Capital Programme Drivers

- Strategic Outcomes
- HRA Requirements
- ITA Requirements
- Asset Management. Maintenance & Repair
- Property Requirements
- Grants and External Funding Opportunities
- Local and Regional Development

Gateway 1

Mandate / Initial Business Case Review

Outcome Programme/ Commissioning Board*

Submissions
- Mandate or Initial Business Case
- Risk Register

Evaluation Criteria
- Strategic Fit with Outcomes
- Fit with internal and external partners.
- Opportunities and Risks
- Funding & affordability assessment
- Project Assessment Matrix
- Timescales

SCC Capital Project Stage: STARTUP

Outcome: Proceed to Gateway 2 or Reject

Gateway 2

Strategic Fit & Deliverability Review

Strategic Property & Capital Investment Group

Submissions
- Mandate or Initial Business Case
- Resource & Funding Plans

Evaluation Criteria
- Gateway 1 approval
- Cross Portfolio Strategic Fit with other projects and strategies in Asset Strategy
- Fit with Capital Programme
- Impact on Carbon & Energy Reduction
- Financial & human resource requirements
- Deliverability & Risk Assessment
- Corporate Resource Pool
- Cost forecasts & budgets

SCC Capital Project Stage: STARTUP

Outcome: ***Proceed to Gateway 3 & appoint Project Manager or refer back to Gateway 1 & recommend Improvements***

Gateway 3

Final Business Case Review

Outcome Programme/ Commissioning Board*

Submissions
- Outline Business Case
- Options Appraisal & Feasibility Assessment
- Risk Register

Evaluation Criteria
- Check strategic fit
- Benefits check & how they will be measured
- Risk management plans
- Affordability
- Delivery Resource Requirements
- Demonstration that SPCIG recommendations have been addressed.

SCC Capital Project Stage: PLANNING

Outcome: ***Proceed to Gateway 4 or Reject***

Gateway 4

Financial Approval

Capital Programme Group

Submissions
- CAF & Business Case
- Procurement Strategy
- Resource Plan
- Confirmation of budgets and costs

Evaluation Criteria
- Formal financial approval
- Financial performance against budget
- Contract award & impact on approved limits
- Strategic Fit with Capital Programme
- Gateway 2 and 3 approval
- VAT implications
- External Funding Conditions
- CRP Prioritisation

SCC Capital Project Stage: PLANNING

Outcome: ***Proceed to Delivery Preparation or Reject. CPG report issued to EMT/ Cabinet***

Gateway 5

Contract Award

Capital Programme Group

Submissions
- Revised CAF & Final Business Case
- Contract Award
- Confirmation of Budgets and Costs

Evaluation Criteria
- Affordability against budget
- Capital & Revenue implications
- Delivery Resource Requirements

SCC Capital Project Stage: DELIVERY PREPARATION

Outcome: ***Proceed to Delivery or Reject***

Project Delivery

Delivery through SCC Capital Hub (CDS)

Delivery Preparation & Delivery to SCC Capital Project Delivery Process

- Governance and Project Management following SCC Capital PM Method
- Monthly Progress and RAG Reporting
- Monthly Programme Reviews
- Monthly cost forecasting
- Risk Management and issue resolution
- Change Control

SCC Capital Project Stage: DELIVERY

Outcome: ***Project & Benefit Delivery***

Gateway 6

Benefits Review

Outcome Programme/ Commissioning Board*

Submissions
- Lessons Learned Report (to include Capital Hub team)
- Benefits Realisation Report
- Project Close out CAF
- Performance Review

Actions
- Lessons Learned and Benefits Review report shared online annually.
- Annual performance review at Outcome Boards and SPCIG
- Post Occupancy Evaluation Process

SCC Capital Project Stage: CLOSURE

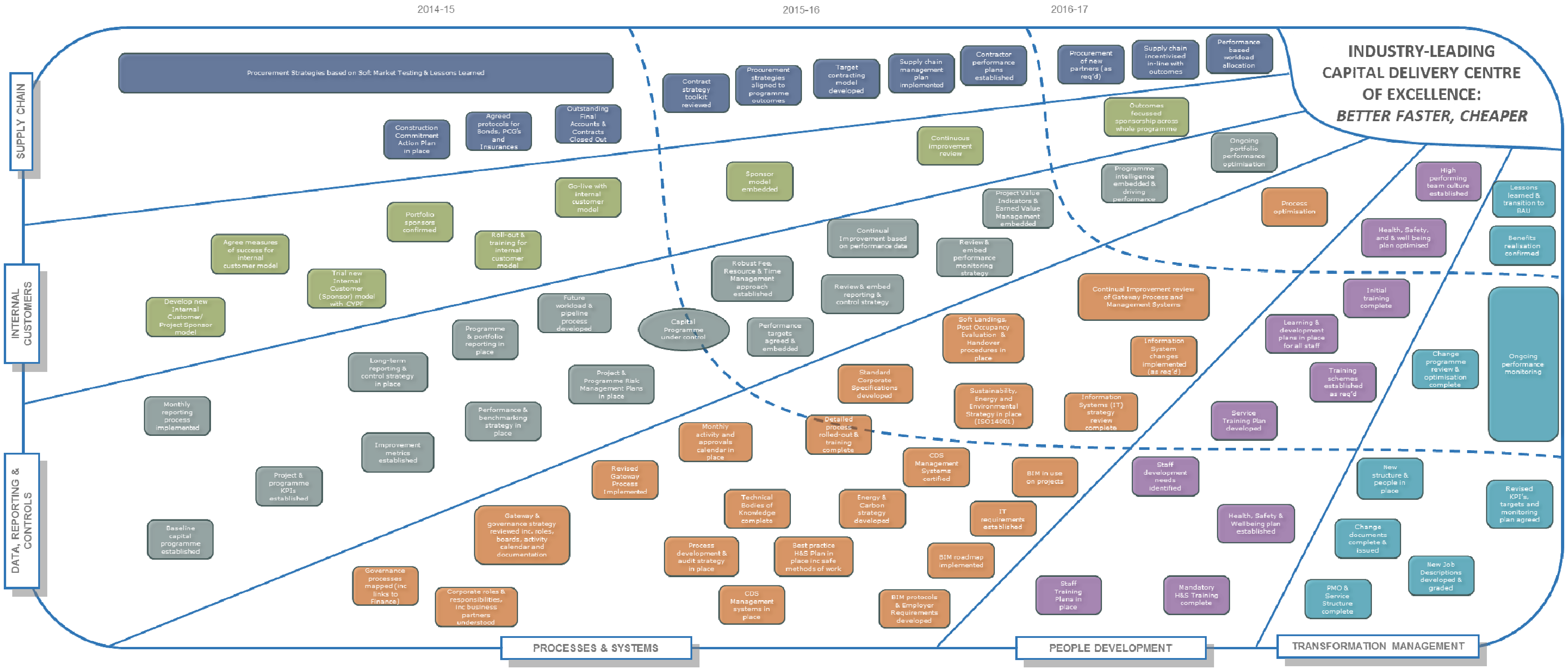
Outcome: ***Project Close & Lessons Learned***

Info issued to Capital Hub

*** Outcome Programme/ Commissioning Boards include: Strategic Outcome Programme Boards, HRA Board, Resources Leadership Team, Combined Authority Transport Committee**

Appendix D – Capital Delivery Improvement Plan Summary

Better, Faster, Cheaper – Capital Delivery Transformation Plan



By virtue of paragraph(s) 2, 4 of Part 1 of Schedule 12A
of the Local Government Act 1972.

Agenda Item 8

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AUDIT COMMITTEE REPORT - 13 NOVEMBER 2014

ANNUAL AUDIT LETTER 2013/14

Report of the Director, KPMG.

Summary

This report summarises the key findings from our 2013/14 audit of Sheffield City Council.

Recommendation

That the Annual Audit Letter 2013/14 is noted.

Category of Report - Open

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cutting through complexity™

Annual Audit Letter 2013/14

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Sheffield City Council

October 2014

Contents

The contacts at KPMG in connection with this report are:

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This report is addressed to the Council and has been prepared for the sole use of the Council. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission's website at www.auditcommission.gov.uk.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Sue Sunderland, the appointed engagement lead to the Council, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 0303 4448 330.

Headlines

This report summarises the key findings from our 2013/14 audit of Sheffield City Council (the Council).

Although this letter is addressed to the Members of the Council, it is also intended to communicate these issues to key external stakeholders, including members of the public.

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Our audit covers the audit of the Council's 2013/14 financial statements and the 2013/14 VFM conclusion.

VFM conclusion	Our VFM conclusion considers how the Council secures financial resilience and challenges how it secures economy, efficiency and effectiveness. We issued an 'except for' qualified conclusion on the Council's arrangements to secure value for money (VFM conclusion) for 2013/14 on 26th September 2014. We considered that weaknesses in the management and leadership of the Adult Social Care Service identified by an internal review, and the service inefficiencies that were uncovered by the review, were significant enough to justify the qualification of our assessment of the Council's arrangements for challenging how it secures economy, efficiency and effectiveness. We recognised that the Council is taking effective action to address the issues identified, and reported on the issues and the progress in resolving them to its July 2014 Audit Committee. We were satisfied that the Council maintained proper arrangements for securing financial resilience.
VFM risk areas	We identified a number of significant risks to our VFM conclusion and considered the arrangements you have put in place to mitigate these. Our work identified the following significant matters: ■ The Council has carried out a detailed and thorough review of the causes of the over-spends within Adult Social Care, and the results were reported to its Audit Committee in July 2014. This review made a significant number of recommendations, which will be monitored by future meetings of the Audit Committee; ■ The Council continues to deliver very significant savings year on year, and overall to deliver its budgeted outcomes, despite the significant overspends within Adult Social Care; ■ To date the costs of winding up Digital Region Ltd (DRL - the company set-up to provide broadband across SY) have been contained within the anticipated provision; and ■ A financial settlement has finally been agreed, and sums received from, the other three SY Metropolitan Authorities in respect of the losses incurred when the SY Trading Standards Unit was wound up.
Audit opinion	We issued an unqualified opinion on your financial statements on 26 September 2014. This means that we believe the financial statements give a true and fair view of the financial position of the Council and of its expenditure and income for the year.
Financial statements audit	The Council has continued to produce good quality accounts, well supported by working papers. Officers dealt efficiently with audit queries and the audit process was completed within the planned timescales. These strong processes meant that only limited amendments were made following our audit.
Annual Governance Statement	We reviewed your *Annual Governance Statement* and concluded that it was consistent with our understanding.

Headlines (continued)

All the issues in this letter have been previously reported. The detailed findings are contained in the reports we have listed in Appendix 1.

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Whole of Government Accounts	We reviewed the consolidation pack which the Council prepared to support the production of Whole of Government Accounts by HM Treasury. We reported that the Council's pack was consistent with the audited financial statements.
High priority recommendations	We raised no high priority recommendations as a result of our 2013/14 audit work. We did raise one medium priority recommendation in relation to the need for further improvements to be made in the timeliness and accuracy of information passed to SY Pensions Authority, and re-iterated one medium priority recommendation from 2013 that the unresolved balance on the Credit Clearing Account should be cleared.
Certificate	We issued our certificate on 26th September 2014. The certificate confirms that we have concluded the audit for 2013/14 in accordance with the requirements of the *Audit Commission Act 1998* and the Audit Commission's *Code of Audit Practice*. During 2014 we were also able to resolve two objections that had been made in respect of the Council's 2011/12 accounts. ■ We did not uphold the objection that the Council had failed to calculate properly in its 2011/12 accounts the sums due to it in respect of SY Trading Standards Unit. ■ We did uphold an objector's view that the Council had failed to maintain proper documentation to demonstrate that it had set taxi licenses with due regard to legislative requirements. However we concluded that we did not need to take any action under our statutory powers, and that taking taxi licensing fees as a whole the fees set were broadly reasonable. We did form the view that there were improvements that can be made to the information presented to the Council's Licensing Committee, and in the underpinning financial information, and we made recommendations accordingly. The Council accepted these recommendations. Following the resolution of these recommendations we were also able to issue our certificates in respect of the 2011/12 and 2012/13 audits on 17th April 2014.
Audit fee	Our fee for 2013/14 was £261,939, excluding VAT. This fee comprises the scale fee for the main audit of £247,860, and additional fees for liaison on the Council's proposed accounting for the financial restructuring of Major Sporting Facilities debt, responding to questions from electors during 2013/14, and a variation to the scale fee to reflect additional procedures required as part of the audit in respect of non domestic rates, following the ending of certification of the non domestic rates return. These additional fees have been agreed by the Council, but in some cases are subject to final determination by the Commission. Further detail is contained in Appendix 2.

Appendix 1: Summary of reports issued

This appendix summarises the reports we issued since our last *Annual Audit Letter*.

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December

2014

January

February

March

April

May

June

July

August

September

October

November

Certification of Grants and Returns (December 2013)

This report on summarised the outcome of our certification work on the Council's 2012/13 grants and returns.

External Audit Plan (February 2014)

The *External Audit Plan* set out our approach to the audit of the Council's financial statements and to work to support the VFM conclusion.

Audit Fee Letter (April 2014)

The *Audit Fee Letter* set out the proposed audit work and draft fee for the 2014/15 financial year.

Pensions payments follow up (June 2014)

The *Pensions Payments Follow Up Report* summarised the results of our follow up review into the above area.

Digital Region Ltd (June 2014)

The *Independent Review of DRL Project Report* summarised the results of our investigation into the project cycle of DRL, setting out our observations on the key elements of the project, its successes and the lessons that can be learned.

Auditor's Report (September 2014)

The *Auditor's Report* included our audit opinion on the financial statements, our VFM conclusion and our certificate.

Report to Those Charged with Governance (September 2014)

The *Report to Those Charged with Governance* summarised the results of our audit work for 2013/14 including key issues and recommendations raised as a result of our observations. We also provided the mandatory declarations required under auditing standards as part of this report.

Annual Audit Letter (October 2014)

This *Annual Audit Letter* provides a summary of the results of our audit for 2013/14.

Appendix 2: Audit fees

This appendix provides information on our final fees for 2013/14.

To ensure openness between KPMG and your Audit Committee about the extent of our fee relationship with you, we have summarised the outturn against the 2013/14 planned audit fee.

External audit

Our final fee for the 2013/14 audit of the Council was £261,939. This compares to a planned fee of £247,860. The reasons for this variance are:

- the Commission has agreed an increase in the scale fee of £1,470 to reflect additional procedures required as part of the audit since we can no longer place reliance on procedures carried out as part of our certification of an NNDR return (this return ceased from 2013/14);
- £8,004 of extra fee was agreed for additional work on liaison with officers on the Council's proposed accounting for financial restructuring of Major Sporting Facilities debt; and
- £4,605 of additional time was spent responding to questions from electors during 2013/14.

All additional fees have been discussed and agreed with the Council. The fee for responding to electors is still subject to final determination by the Audit Commission.

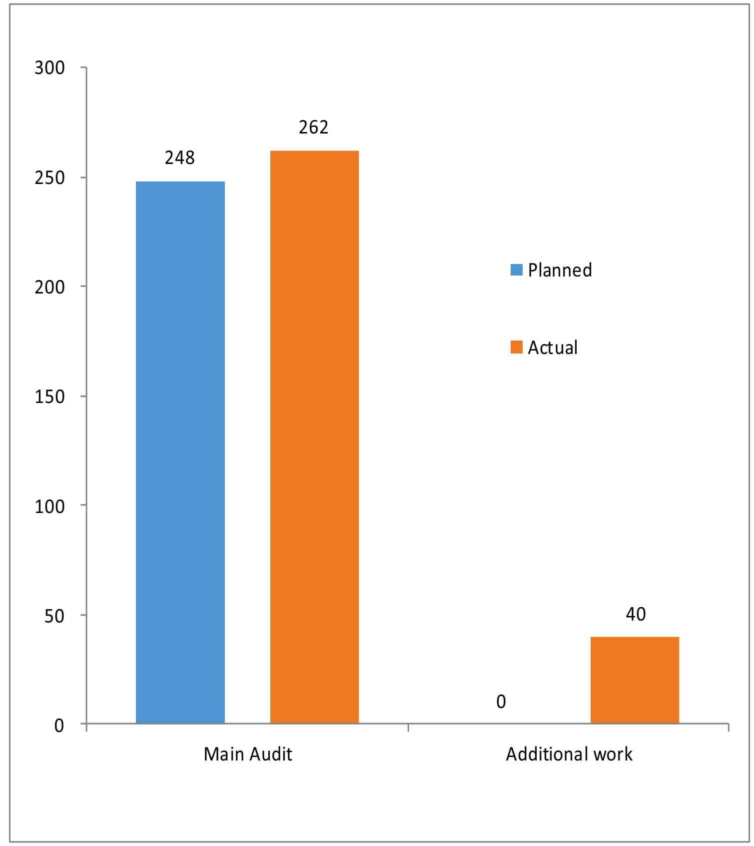
Certification of grants and returns

Our grants work is still ongoing and the fee will be confirmed through our report on the *Certification of Grants and Returns 2013/14* which we are due to issue in January 2015.

Other services

We also charged £7,500 for an independent review of the Digital Region project, £12,800 for advice on various pensions matters, and £19,900 for a review of the financial governance of Sheffield International Venues. These pieces of work were not related to our responsibilities under Audit Commission's *Code of Audit Practice*.

External audit fees 2013/14 (£'000)



cutting through complexity ™

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Sheffield City Council

Audit Committee Report

Report of:	Interim Director of Legal and Governance
Date:	13 November 2014
Subject:	Work Programme 2014/15
Author of Report:	Dave Ross

Summary:

The report provides details of a proposed work programme for the Committee for 2014/15

Recommendations:

That the Committee:-

(a) considers the Work Programme and identifies any further items for inclusion; and

(b) approves the work programme.

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Background Papers:

Category of Report: OPEN

Statutory and Council Policy Checklist

Financial Implications
NO Cleared by:
Legal Implications
NO Cleared by:
Equality of Opportunity Implications
NO Cleared by:
Tackling Health Inequalities Implications
NO
Human rights Implications
NO:
Environmental and Sustainability implications
NO
Economic impact
NO
Community safety implications
NO
Human resources implications
NO
Property implications
NO
Area(s) affected
NONE
Relevant Cabinet Portfolio Leader
NOT APPLICABLE
Relevant Scrutiny Committee if decision called in
NOT APPLICABLE
Is the item a matter which is reserved for approval by the City Council?
NO
Press release
NO

REPORT OF THE INTERIM DIRECTOR OF LEGAL AND GOVERNANCE

AUDIT COMMITTEE
13 NOVEMBER 2014

WORK PROGRAMME

1. Purpose of Report

1.1 To consider an outline work programme for the Committee for 2014/15 and to identify any further items for inclusion.

2. Work Programme

2.1 It is intended that there will be at least five meetings of the Committee during the year with three additional meetings arranged if required. The work programme is based around the attached terms of reference and includes some items which are dealt with at certain times of the year to meet statutory deadlines, such as the Annual Governance Report and Statement of Accounts, and other items requested by the Committee.

2.2 An outline programme for 2014/15 is set out below. Members are asked to identify any further items for inclusion.

Date	Item	Author
11 December 2014	Additional meeting if required	
8 January 2015	Adult Social Care Management Review Progress Report (including systems review)	Laura Pattman (Assistant Director of Finance)/Eugene Walker (Interim Executive Director, Resources)
8 January 2015	Progress report on the recommendations from the External Auditor's ISA 260 Report	Mike Thomas (Acting Assistant Director of Finance)
8 January 2015	Annual Grants Report 2013/14	Sue Sunderland (Director, KPMG)
8 January 2015	Annual Governance Statement Progress Report	Gillian Duckworth (Interim Director of Legal and Governance)
8 January 2015	Progress on Audit Reports with a High Opinion	Laura Pattman (Assistant Director of Finance)
12 February 2015	Additional meeting if required	

12 March 2015	Additional meeting if required	
9 April 2015	External Audit Plan 2014/15	Sue Sunderland (Director, KPMG)
9 April 2015	Annual Audit Fee Letter 2015/16	Sue Sunderland (Director, KPMG)
9 April 2015	Internal Audit Plan 2015/16	Laura Pattman (Assistant Director of Finance)
9 April 2015	Audit Commission Report on Protecting the Protecting the Public Purse/Update on Counter fraud initiatives	Laura Pattman (Assistant Director of Finance)
9 April 2015	International Auditing Standards – Compliance with Internal Control/counter Fraud	Laura Pattman (Assistant Director of Finance)
9 April 2015	Strategic Risk Management/ Corporate Risk Register	Richard Garrad (Corporate Risk Manager)

3. **Recommendation**

3.1 That the Committee:-

(a) considers the outline Work Programme and identifies any further items for inclusion; and

(b) approves the work programme.

Interim Director of Legal and Governance

Audit Committee Terms of Reference (Revised February 2012)

(1) To approve the Council's Statement of Accounts (which includes the Annual Governance Statement) in accordance with the Accounts and Audit Regulations 2003 as amended.

(2) To consider and accept the Annual Letter from the Auditor or the Audit Commission in accordance with the Accounts and Audit Regulations 2003 as amended and to monitor the Council's response to any issues of concern identified.

Audit Activity

(3) To consider the Chief Internal Auditor's annual report and opinion, and a summary of internal audit activity (actual and proposed) and the level of assurance it can give over the Council's corporate governance arrangements.

(4) To consider summaries of specific internal audit reports as requested.

(5) To consider reports dealing with the management and performance of the internal audit service.

(6) To consider any report from internal audit on agreed recommendations not implemented within a reasonable timescale.

(7) To consider specific reports as agreed with the external auditor.

(8) To comment on the scope and depth of external audit work and to ensure it gives value for money.

(9) To liaise with the Audit Commission over the appointment of the Council's external auditor.

Regulatory Framework and Risk Management

(10) To maintain an overview of the Council's Constitution in respect of contract procedure rules, financial regulations and codes of conduct and behaviour (except in relation to those matters which are within the Terms of Reference of the Standards Committee e.g. code of conduct and behaviour of Members).

(11) To monitor the effective development and operation of risk management and corporate governance in the Council.

(12) To monitor Council policies on “Raising Concerns at Work” and the anti-fraud and anti-corruption strategy and the Council’s complaints process.

(13) To oversee the production of the Council’s Annual Governance Statement and monitor progress on any issues.

(14) To consider the Council’s arrangements for corporate governance and any necessary actions to ensure compliance with best practice.

(15) To consider the Council’s compliance with its own and other published standards and controls.

Accounts

(16) To consider whether appropriate accounting policies have been followed and whether there are concerns arising from the financial statements or from the audit that need to be brought to the attention of the Council.