Sheffield City Council

Audit Committee Report

Report of:	Eugene Walker
Date:	13 November 2014
Subject:	Independent Review of South Yorkshire Digital Region Project
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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.