



Audit Committee Report

Report of: Eugene Walker and Edward Highfield

Date: 14 November 2013

Subject: South Yorkshire Digital Region: Progress on management response

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Summary:

This report updates Audit Committee on progress on the management response to the recommendation from the External Auditor's ISA 260 report that "the Council should ensure it has appropriate arrangements to manage the closure of Digital Region Limited to reduce the financial impact on the Council"

Recommendations:

Audit Committee is recommended to note the steps being taken and comment on any further actions considered necessary.

Background Papers: None

Category of Report: OPEN

* Delete as appropriate

Statutory and Council Policy Checklist

Financial Implications
YES Cleared by: E Walker
Legal Implications
NO – not of this specific report
Equality of Opportunity Implications
No
Tackling Health Inequalities Implications
NO
Human rights Implications
NO:
Environmental and Sustainability implications
NO
Economic impact
YES
Community safety implications
NO
Human resources implications
NO
Property implications
NO
Area(s) affected
All
Relevant Cabinet Portfolio Leader
Cabinet Member for Finance
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

Digital Region: Progress on the management response to the recommendation from the External Auditor's ISA 260 report that "the Council should ensure it has appropriate arrangements to manage the closure of Digital Region Limited to reduce the financial impact on the Council"

1. Previous position reported to Audit Committee

1.1 Members of the Audit Committee will be aware that Digital Region Limited (DRL) is a company set up to provide high speed broadband access across South Yorkshire. It was initially jointly owned by the four South Yorkshire local authorities and Yorkshire Forward, but with effect from 30th March 2012 Yorkshire Forward's rights and obligations in relation to DRL have transferred to the Department for Business, Innovation and Skills (BIS).

1.2 Unfortunately history will judge that the original business plan was based on technological and trading assumptions that have been overtaken by events. The Committee have previously therefore been made aware that DRL could no longer continue to trade based upon previous operating models.

1.3 At the time of the last report to Audit Committee, each of the Shareholders had agreed to provide further temporary funding to enable the company to operate in order to allow time for further exploration of the operating model. In reality this meant either;

- Re-procurement of a new commercial partner to take on the risks of running of the network, or
- Closure – should that be the cheaper option

2. Current Position

2.1 The decision has now been taken to close Digital Region Limited. At the heart of this decision was the length of time it was likely to take to get a definitive decision regarding State Aid from the European Commission and the rules around where future operating subsidy could be applied. The consequence was that the risks and costs of closure became demonstrably less than the re-procurement option.

2.2 A number of interlinked work streams are therefore now underway:

2.2.1 For Digital Region Limited:

- Asset realisation: Either the full or partial sale of the network with the objectives of realising best value for the tax payer and maintaining as much of the economic and social value envisaged by the original project as possible.
- Preparing for closure: serving termination notices to existing agreement and planning the orderly migration of customers off the network should the sale option not be viable.
- Seeking to minimise costs e.g. SPV costs, exposure to European funding claw back and driving costs down through commercial negotiation below the closure base case.

2.2.2 For Sheffield City Council:

- Ensuring any sale option represents best value and adequately provides for SCC services currently delivered over the network
- Making alternative arrangements for SCC services currently delivered over the DRL network should the sale option neither be forthcoming nor acceptable.

3. Arrangements to manage the closure of Digital Region Limited to reduce the financial impact on the Council

3.1 Arrangements to manage the closure of Digital Region cover a wide range of aspects across company, shareholder and customer roles.

3.2 SCC continues to have a seat on the DRL Board. The company Director must at all times act in the best interests and its Creditors. The DRL company is reducing in size with key staff retained to manage the closure and wind down period. A full exit plan was presented to the Board on 3rd October covering

- Asset realisation
- Commercial contracts
- Migration
- Operator termination
- Operator decommissioning
- EU Commission
- Finance
- Resources plan

- Communications and information management
 - Corporate contracts
 - Facilities and closure
- 3.3 PricewaterHouse Coopers have been appointed by DRL to oversee the sale process, provide specialist insolvency support to the company executive and provide assurance to the Board around the closure programme.
- 3.4 The Council Chief Executive represents SCC as Shareholder including discharging matters reserved for Shareholder decisions rather than the Board of Directors under delegated authority.
- 3.5 An officer from Commercial Services is overseeing SCC's own customer migration requirements and providing advice to DRL and the other Shareholders on the commercial aspects of the wind down and sale scenarios. SCC is therefore both providing support to assist DRL and scrutiny of DRL activity to ensure all costs are being driven down wherever possible.
- 3.6 Rotherham Council on behalf of the other shareholders is providing Finance support to monitor actual closure costs against the base case, reported to the DRL Board and via local authority Directors of Finance (see Finance section below).
- 3.7 SCC officers have established an internal project board including IT, Legal, Commercial Services and Finance to oversee implementation of SCC's own deliverables.

4. Financial position

- 4.1 At the time of making the decision to close the company and migrate its business (including the Council's) to other networks, the cost to the shareholders was estimated at £83.3m. SCC's share of this is £14.3m. Critically, this was a lower cost than the likely cost of continuing with the procurement and also less risky – because the big problem on re-procurement was the unknown timescales for resolving the EU state aid question. Assuming State aid approval would have taken until March 2014, re-procurement costs would have been over £95m.
- 4.2 The SCC cost of £14.3m is within the amount of money set aside to cover DRL costs in the 2012/13 accounts (£15m was set aside).
- 4.3 All of these figures were based on estimates and some costs cannot be firmed up until existing contracts are terminated and commercial negotiations on termination costs or replacement contracts are concluded. However, since the decision was made to close, progress has been good and costs so far look like they will come in lower than was estimated. The

key issue remaining is the value that may result from a sale of the assets and whether that reintroduces risk.

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