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1. Purpose of this document

The CPA report relating to Liverpool City Council (LCC) published in February 2008 followed by an IDeA peer review of financial management in LCC both indicated potential significant issues that needed to be reviewed in relation to Liverpool Direct Limited (LDL), the LCC joint venture with BT.

At the end of 2008 an LDL Review was established to examine the value for money of the Contract and to produce a strategy for improving the overall relationship. This would be achieved by:

- Examining the transparency around our processes and accountancy approach, including realignment of LDL recharges;
- Taking stock of what we are achieving within the partnership and how this fits with the future direction of the council;
- Ensuring that the joint venture is fit for purpose and that it is delivering value for money.

At the end of 2008 the review was initiated.

This paper reflects (at a high level) the key findings of this review and therefore the key points that require discussion with BT/LDL senior management. Ensuring an effective relationship for the future will require that all of these points are raised, that satisfactory solutions are found and addressed to ensure a platform for a productive and balanced relationship for the future.

The key discussion points and suggested outcomes are as follows:

	Key negotiating points
1	£10 million reduction on the current annual costs excluding indexation/inflation assuming the current charging regime continues
2	Compensation for historical over-charging by LDL which we conservatively estimate as £19m (as at 2009/10)
3	For LDL to agree to the overall investment pot of £59m to 2012 with LCC agreement/sign-off on the specific composition of this based upon supporting evidence (there would be an additional £41m from 2012 to 2017)
4	Full transparency and sign-off on future investment
5	Establishment of an effective LCC/LDL governance structure to provide control and transparency for LCC on all key aspects of the overall relationship
6	Regular joint benchmarking of catalogue pricing in which LDL must clearly justify their prices. Regular production of Continuous Benchmarking reports whose contracts are as specified within the Contract (there should be both an annual report to inform the Annual Review and quarterly reports)
7	Agreement on what is in/out of scope including the delivery of internal and externally sourced training courses and the provision of change capacity
8	Service Improvement Plans/LDL Operational Plans to be produced with LCC input in sync with the corporate planning framework of the Council, reflecting its priorities
9	Enhanced SLA's that are realistic, measurable and reflect LCC priorities
10	Shared LCC/LDL prioritisation over capacity planning, resourcing and continuous improvement. This should be a standard consideration as part of the Annual Review process
11	Application of the Secondment agreement
12	Accurate maintenance of the Asset Register
13	For all operational procedures to be documented and accessible by both LDL and LCC staff

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|----|---|
| 14 | LDL Business Continuity Plans to be produced that document current and future states and mitigate risks accordingly |
| 15 | LDL management support, appetite and action plan to work constructively with LCC to rebuild trust & relationships |

This paper has therefore been produced to highlight the key points of discussion requiring resolution/compromise to ensure a more optimal relationship with BT/LDL in terms of value for money and overall governance.

2. The key discussion points

2.1 Annual cost reduction

Negotiation point	1	Title	Annual cost reduction
Brief description	Based upon the analysis carried out we believe that the cost of LDL's operation of Council Services is too high even allowing for a reasonable profit for BT. In light of the complete lack of certainty/transparency in respect to BT investment and out of scope pricing/charging plus the inability of the Council under the existing arrangement to benefit from the return of efficiency savings, a continuation of existing circumstances will result in a worsening in value for money year-on-year.		
Links to other negotiating points	2. Historical over-charging 3. Investment		
Value for Money Risk indicator (High/Medium/Low)	High		Relationship Risk indicator (High/Medium/Low) High

Key: Value for Money Risk - Indicates the risk of not getting value-for-money (based upon the analysis carried out)
 Relationship Risk - If no compromise is reached with LDL/BT, this indicates the risk to the relationship

The cost of LDL's operation of the Services and associated out of scope charging has been steadily increasing over the years. The reasons for such increase are multifarious including indexation, service take-ons and increasing numbers of changes with ongoing support cost implications. This is coupled with a BT investment arrangement, which BT/LDL claim they have no obligation to make that is in direct contrast to the position of the Council including that of the City Treasurer (the planned investment amount was £100m as per the original Contract (revised in 2003) plus the 2006 Contract extension). Despite known increments in the base Contract cost, a combination of out of scope charges, investment uncertainty, absence of efficiency savings and ongoing support charges raises the issue, quite understandably, of whether value for money is being achieved.

Financial Year:

LDL Contract Financials:

Base contract
 Out of Scope
 Discount
 Net Cost

	2000/1	2001/2	2002/3	2003/4	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Base contract	0.0	15.1	32.5	34.0	36.2	41.4	45.9	55.8	58.0	TBA
Out of Scope	0.0	3.0	7.7	8.7	8.2	14.3	21.6	22.1	13.4	TBA
Discount	0.0	0.0	0.0	0.0	0.0	0.0	3.0	6.0	2.0	TBA
Net Cost	0.0	18.1	40.2	42.7	44.4	55.7	64.5	71.9	69.4	TBA

Source: LCC cost certificate provided by LDL. BT has yet to confirm the absolute composition of the "out of scope" revenue line.

The suggestion that the current level of charging is too high is supported by a Zero Based Budgeting exercise (ZBB) that was performed. Furthermore it is also supported by:

- LDL's inability to provide management accounts information in a form that illustrates their profits from the operation of the Services;
- LDL's lack of transparency as to the profit associated with business outside the SPA in their role as subcontractor to BT or otherwise. This has prevented LCC from accepting a

BT profit sharing proposal to date. The lack of transparency has prevented the Council from making informed decision making;

- LDL not routinely producing Continuous Benchmarking reports (LDL is obliged to produce such documents on both an annual and quarterly basis). This has prevented the performance of the Annual Review as the Contract intends;
- LDL not providing the supporting evidence for BT investment to date despite their assertions that they have such supporting evidence;
- LDL's failure to justify their out of scope pricing despite repeat requests to provide absolute transparency in relation to the prices levied on the somewhat captive customer (the Council);
- LDL's not managing the relationship between the asset register and associated ongoing support costs. This has had a notable impact on the ongoing cost of the Services. It is LDL's obligation under the "ICT Asset Database Hand-over and Acceptance agreement" to maintain the asset register.

As highlighted in the following table, it is conservatively estimated that the current level of overcharging (in terms of in-scope and out of scope charging and LDL's refusal to pay certain invoices) is in the region of £10m per annum. Assuming the current charging regime continues to be applied, the Council should look to achieve a reduction in the base Contract cost of a figure in the region of £10m per annum which is made up from the following component parts:

	2007/08 £'000	Comments
Annual LDL cost	56,668.0	Excludes £3m cash discount as it is neither ongoing and was in return for further service take-ons and an extension of the Contract.
Current ICT staff	(9,880.8)	LCC secondees
Current Revs & Bens staff	(22,631.8)	LCC secondees
Current HR & P Staff	(4,933.3)	LCC secondees
Management (BT secondees)	(1,000.0)	As per LCC Cost Certificate (£3,500k) adjusted to reflect use of existing LCC staff to operate services within existing capacity. £1,000k remains as contingency.
Support charges built into the base Contract cost at the end of 2007/08	(6,316.0)	As per '2008-9 Support' tab
Contingency	(2,000.0)	
Loss of Bulk discount	(960.0)	Broad estimation from ZBB
Supplies & Services	(6,922.0)	As per Contract offsets
Out of scope savings	5,739.1	Based on: <ul style="list-style-type: none"> • 100% of 2006/07 support removed to reflect suspected overcharging in relation to other items in addition to PCs, printers and scanners • Assumed 25% mark up in relation to out of scope purchases removed; (Removal of mark up/staffing cost in relation to Other Projects (in relation to 'Other Projects' assumes 40% relates to hardware/software. Remaining 60% assumed to be for human resources that would be provided within their existing capacity and therefore would not be an additional expense.)
ICT support (printers, scanners and PCs)	1,000	Based on disparity between asset register and the support spreadsheets

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Delivery of L&D training in-scope	1,084	Expectation that £1,084k worth of training should be delivered in-scope as per the Contract.
Saving	9,847.2	

Securing this level of cost reduction should be a critical success factor within overall discussions as well as establishing that minimum investment amounts must be made by BT and the level of investment to date. The external legal advice we have received supports this position on investment.

Furthermore, based upon an analysis that we have completed, we believe that the migration of all LDL services back in-house would yield a significant financial savings opportunity to the Council. In illustration, the projected savings associated with terminating the Contract at 31/03/12 through invocation of the break clause are as follows:

Option A) - In-House Model		£M
Cost to Transition		(2)
Total Savings to 2016/7		86
LDL Termination Costs:		
Enhanced Service Levels		0
Investment shortfall/overspend		0
Cash Discount		(14)
Third-Party Contractual Costs		(1)
Historical over-charging		13
Net savings to 2016/7		82
Annual savings for 2017/8 and beyond		23

Clearly this paper is about resolving the issues with LDL/BT but it provides a reference point for LCC in the discussions to resolve the issues.

2.2 Historical over-charging

Negotiation point	2	Title	Historical over-charging
Brief description	Throughout the analysis we have encountered issues where there has been potential over-charging by LDL. There are two aspects that need to be resolved. The first is to reimburse the Council for incorrect charges levied on it in previous years and the second is a reduction in future charging (this part has been covered in point 1).		
Links to other negotiating points	1. Annual cost reduction		
Value for Money Risk indicator (High/Medium/Low)	High	Relationship Risk indicator (High/Medium/Low)	High

Key: Value for Money Risk - Indicates the risk of not getting value-for-money (based upon the analysis carried out)
 Relationship Risk - If no compromise is reached with LDL/BT, this indicates the risk to the relationship

During the review we noted a number of instances where LCC has been overcharged in light of what the Council should expect under the terms of the Contract. An assessment of the historical overcharging amounts to a figure of approximately £19m as at 31/03/10 based upon an extrapolation back to Contract start.

This includes the following key areas:

- LDL not paying for accommodation costs for the use of LCC premises for the purposes of business outside the SPA;
- Inappropriate charging for the delivery of both corporate & Supported Living training courses as out of scope (both the purchasing of external training courses and delivery of training courses by LDL staff);
- Excessive mark-up of out of scope software, computer equipment, mobile phones, Blackberry, SRAS and other equipment purchases;
- Failure to provide in-scope provision of project/support/change capacity;
- Excessive mark up of software, hardware and other purchases within out of scope projects;
- Overcharging for PC, printer and scanner support based on a series of support charges that are out of sync with the asset register to which they relate.

This list is not exhaustive but it highlights a reasonable starting point for discussions.

Overcharging item (to 31/03/10)	£'000	Confidence	Comments
LDL accommodation costs for use of premises for business outside the SPA	443	80%	Indexation is ignored for the purposes of the 2009/10 element of the one off savings figure. 2007/08 and 2008/09 invoices raised, 2009/10 remains outstanding.
Provision of corporate L&D in-scope	3,252	60%	Based on Supported Living and L&D take-on prices of £450,000 and £634,000 respectively. Assumes that course costs are suitably priced to cover all associated costs leaving LDL with an appropriate profit margin and that the full £1,084,000 will therefore be used to procure training course delivery. Assumes entirety of the £1,084,000 will be saved from out of scope charges currently incurred by the Council. Excludes indexation from cost at ST0.
Excessive software mark-up	866	30%	Based on 2007/08 out of scope purchasing. It assumes an inappropriate mark-up of 25% and an appropriate mark-up of 10%. It therefore returns 15%.
Excessive computer equipment, mobile phones, Blackberry, SRAS and other equipment mark-up	1,773	50%	Average mark-up assumed to be 20%. Acceptable mark-up deemed to be 10%.
Provision of LCC project/support secondees in-scope	4,796	60%	It is understood that there were originally approximately 200 ICT secondees (now 180 ICT secondees - 100 change staff, 80 BAU/support). It is assumed that 50% of these staff are charged as OoS. It is assumed that 50% of this time is inappropriately charged to LCC ((£25,000 * 100) + (£17,500 * 80)) * 50% * 50% annually)
LDL project/support "mark-up" - Software	1,078	30%	Mark-up based on 15% mark-up returned of 2007/08 OoS project cost (£7,306k) - (15% of out of scope project costs assumed to be for software)
LDL project/support "mark-up" - Hardware	1,078	30%	Mark-up based on 15% mark-up returned of 2007/08 OoS project cost (£7,306k) - (15% of out of scope project costs assumed to be for hardware)
LDL project/support "mark-up" - Other	1,078	30%	Mark-up based on 15% mark-up returned of 2007/08 OoS project cost (£7,306k) - (30% of out of scope project costs assumed to be for "other")
PC, printer and scanner support	4,000	70%	Based on Affordability Model and ICT estate at 11/12/09
Total	18,364		

Beyond the agreement of any reimbursement of monies to the Council, there would need to be discussions around how this can effectively be returned to the Council given that this is likely to be a material figure.

2.3 Investment

Negotiation point	3	Title	Investment
Brief description	<p>It is the Council's position (including that of the City Treasurer) that the amounts of investment to be made by BT are the absolute minimum amounts as detailed in both the original Contract and the Contract extension (£56m, subsequently revised to £59m and £41m respectively). A minimum amount of investment supports the fixed price nature of the Contract. This however, is in contrast to the position taken by BT who has stated that they have no obligation to invest. This disparity obviously has a significant financial implication for the Council. Furthermore, LDL have failed to provide the supporting evidence for the investment they claim to have made despite repeat requests preventing the Council from establishing BT investment to date and determining the shortfall in BT's investment obligation.</p>		
Links to other negotiating points	Links to 4. Transparency on future investment.		
Value for Money Risk indicator (High/Medium/Low)	High	Relationship Risk indicator (High/Medium/Low)	High

Key: Value for Money Risk - Indicates the risk of not getting value-for-money (based upon the analysis carried out)
 Relationship Risk - If no compromise is reached with LDL/BT, this indicates the risk to the relationship

The review team has concluded that BT's investment commitment under the original Contract was a minimum of £59m and the amount of additional investment under the Contract extension was £41m. These are absolute minimum amounts that are not subject to any variation except where BT feel it is necessary to invest further to ensure the contractual service levels are met. This is supported by external legal advice. The Council should insist that BT/LDL provides the best supporting evidence for investment it claims to have made to date (including the Council's agreement for such investment to be made) to establish an agreed investment to date figure, thereby identifying the current shortfall/surplus of investment against the planned investment profile.

It is difficult to estimate the specific amount of investment made by BT to date beyond the balance reflected in the latest drawdown statement plus further known investments (Members' ICT refresh and E10k server replacement). In totality, these amount to £27.206m. In contrast the Chief Operating Officer of LDL has stated that BT has invested £51.921m. This includes £1.5m attributable to Capital of Culture and ACCL funding and excludes two rounds of £5m attributable to enhanced service levels as these would only be considered in a termination payment calculation. This is a difference of £24.715m.

Much of the long list provided by LDL is unsubstantiated/conflicts with the view of the City Treasurer and the drawdown statements and furthermore documentary evidence of Council agreement to various investments is lacking.

2.4 Transparency on future investment

Negotiation point	4	Title	Transparency on future investment
Brief description	BT/LDL have clearly failed to engage the Council fully in their investment making decisions by virtue of the evident lack of Council input in to the Service Improvement Planning process, Operational Plan development and the absence of potential BT investment as a consideration as part of the annual corporate planning process.		
Links to other negotiating points	3: Investment		
Value for Money Risk indicator (High/Medium/Low)	High	Relationship Risk indicator (High/Medium/Low)	High

Key: Value for Money Risk - Indicates the risk of not getting value-for-money (based upon the analysis carried out)
 Relationship Risk - If no compromise is reached with LDL/BT, this indicates the risk to the relationship

Fundamentally the corporate planning framework establishes the priorities of the Council including investment priorities. Such priorities are the responsibility of BT/LDL senior management whilst they will have due consideration for necessary investment to ensure satisfaction of the contractual service levels. LDL senior management are not responsible for determining investment priorities due to their allegiance to the majority joint venture shareholder (BT) whose primary motive to increase shareholder wealth and their lack of detailed understanding of LCC priorities. Any proposed investment must be agreed with the Council and monitored to ensure BT's investment obligations are duly discharged.

The success of this item is largely contingent on the success of '3 Investment'. A clear audit trail to monitor the drawdown of investment must be maintained.

2.5 Effective relationship governance

Negotiation point	5	Title	Effective relationship governance
Brief description	Without an appropriate supplier management framework the Council will be unable to align LDL activity and priorities against LCC business strategy and requirements, it will also remain impossible to properly control costs.		
Links to other negotiating points	None		
Value for Money Risk indicator (High/Medium/Low)	High	Relationship Risk indicator (High/Medium/Low)	High

Key: Value for Money Risk - Indicates the risk of not getting value-for-money (based upon the analysis carried out)
 Relationship Risk - If no compromise is reached with LDL/BT, this indicates the risk to the relationship

All LDL activity should be driven by Council strategy and business requirements. A layered governance model is needed that controls costs, oversees LDL activity, agrees priorities, holds LDL accountable to delivery, and provides required transparency. The governance model needs to consist of appropriate group meetings and associated reporting. The Project Director and senior Council management should control the high level activity and funding, with individual Client officers managing the detail and supplying the strategy in relations to their respective service lines, all driven by the Corporate Planning Framework.

This will require LDL and the council to work more closely and a high priority objective should be to closely align LDL activity against council strategy and related business unit plans.

