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# Liverpool Direct Limited

Issues update document

08 October 2014

DRAFT FOR DISCUSSION PURPOSES



## Headlines Context of our involvement

**DRAFT FOR DISCUSSION PURPOSES ONLY**

**This is a revised issues update further to previous draft of 27 August 2014 and original draft red flag report dated 2 July 2014.**

**This document should be read in conjunction with these reports. Furthermore we draw your attention to the draft transmittal letter and important notice within the report dated 2 July 2014.**

We have been engaged by Liverpool City Council to assist in understanding the financial position of Liverpool Direct limited, as part of the proposed acquisition.

Our work has focussed on the balance sheet as at 31 March 2014. As you are aware, this has identified a lack of consistent accounting and record keeping. Furthermore, there are a range of queries from our work, your own queries and the Chief Executive of LDL which remains unresolved.

Despite being provided with a restated balance sheet as at 31 March 2014, there remains uncertainty around whether the net asset position is accurate. This is supported by further information we have received on the 30 June 2014 position, which highlighted balances that should have been accounted for as at 31 March 2014. We note, that detailed work has not been carried out on the 30 June or 31 July 2014 balance sheets.

We would strongly recommend that a complete set of accounts are prepared, with supporting evidence and reconciliations, for both LCC and BT to review and consider. We would further recommend that PwC sign off is sought on the accounts and that tax advice is also taken.

As a revision to our draft report dated 27 August 2014, we have now also included a summary of all of the issues that have been brought to our attention during the course of the work that may affect the 31 March 2014 balance sheet position. We have also included a summary of all post March 2014 transactions that we have been made aware of. We recommend that these items should form the basis of negotiation between LCC and BT in attempting to reach a commercial agreement over the transfer of ownership of LDL.



## Headlines

### Balance sheet reconciliation

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The March 2014 balance sheet has been restated with a net impact of a reduction in the BT Ignite Solutions creditor of £0.4 million.

Balance sheet - 31 March 2014

£'000		Mar-14 Reported	Accrue for LCC offset rec invoice	Remove pre- existing LDL offset year end accrual	Sales credit - JE impact for 2012/13 and 13/14 change control	Vodafone rebate (other receivable)	Revenue share calcs rebased from 1.9% service to 1.25% cash	P&L adjust ment	Total adjust ments	Mar-14 Restated
<b>Working capital</b>										
	1	9,365	-	-	(310)	-	-	-	(310)	9,055
Trade debtors - gross										
Prepayments/accrued income		2,400	-	-	-	-	-	-	-	2,400
Prepaid expenses	2	-	-	-	-	887	-	-	887	887
Trade creditors		(61)	-	-	-	-	-	-	-	(61)
Accrued expenses	3	(3,241)	(1,904)	199	-	-	385	-	(1,321)	(4,563)
Deferred income		(6,147)	-	-	-	-	-	-	-	(6,147)
External VAT creditor		(2,079)	317	-	52	-	-	-	369	(1,710)
<b>Net debt</b>										
Cash at bank		4,366	-	-	-	-	-	-	-	4,366
Intragroup creditor (BT treasury)		-	-	-	-	-	-	-	-	-
Intragroup creditor (Ignite)	4	(4,591)	-	-	-	-	-	375	375	(4,216)
<b>Net assets</b>		<b>10</b>	<b>(1,587)</b>	<b>199</b>	<b>(258)</b>	<b>887</b>	<b>385</b>	<b>375</b>	<b>-</b>	<b>10</b>

The following adjustments have been made to the 31 March balance sheet:

1. An amount of £0.3 million (gross of £0.1 million VAT) decrease in trade debtors to reflect the previously disputed job evaluation invoice (see Appendix 1). **We are unaware as to whether this adjustment now removes the dispute in full.**
2. An additional £0.9 million prepayment to reflect an expected Vodafone rebate as referenced in LDL's notes (see Appendix 2). This effectively reduces the impact of disputed items on the Ignite creditor. As you have already noted, the rationale for why this rebate benefits BT only, is unclear. Furthermore, there is no support for the actual value of this rebate. **We suggest LCC includes this in their disputed items.**
- 3a. The accounts previously showed an accrual of £0.2 million in relation to the LCC offset reconciliation which was disputed. The accounts now show an amount of £1.9 million relating to the LCC offset reconciliation invoice (gross of £0.3 million VAT) and the reversal of the existing LCC offset accrual of £0.2 million. **This amount is no longer disputed and should be included in net debt.**
- 3b. The restated balance sheet now shows a further £0.4 million reduction to accrued expenses, which relates to the Mayor's Fund and revenue share accruals. There is no support for the rebasing of this calculation. **As this reduces net debt, we recommend that you query this adjustment (and note you have already sent some queries to BT).**
4. A £0.4 million reduction in the Ignite intragroup creditor, to reflect the net impact of the above items.

The restated net debt position now reflects the adjusted 31 March 2014 balance sheet together with our previous findings on the 30 June 2014 accounts that have been communicated to you via email.

We have not undertaken work on the 31 July 2014 accounts and our work on the 30 June 2014 balance sheet is not exhaustive.

Net debt update	
£'000	
<b>Net debt at March 2014</b>	
Cash	4,366
Debt	
Mayor's Fund	(2,381)
LCC profit share	(229)
FY14 LCC offset reconciling item	(1,904)
Deferred income of LDL relating to commitments of LDL to LCC	(800)
Historical provision for apprenticeship scheme	(800)
Intercompany creditor	(4,216)
<b>Net debt at March 2014</b>	<b>(5,964)</b>
<b>June update</b>	
BT drawings	(11,950)
Less:	
Repayment of intercompany creditor	4,216
Q1 management charge	2,500
Q1 costs	3,315
<b>Net BT drawings</b>	<b>(1,919)</b>
BT charges paid twice (June 2014)	(200)
Historical amounts owed by LCC to LDL (eg JE as agreed)	400
<b>Adjusted net debt</b>	<b>(7,684)</b>

The following definition of net debt includes items that we have come across in the course of our analysis and should be used as a guide for negotiations with BT. There may be other issues (including those that were identified by the Chief Exec of LDL) that you may wish to discuss.

1) A £2.4 million provision held on account for LCC as a 'Mayors Fund', relating to historical billing surpluses which are yet to be offset against LCC costs;

2) A £0.2 million accrual relating to 'revenue share' held on account for LCC;

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3) A £1.9 million accrual for offset invoices.

4) Deferred income of £0.8 million relating to commitments made by LDL to LCC.

5) A £0.8 million provision for historical obligations to LCC for the apprenticeship scheme, adult services training and children's services training.

6) Amounts owed to BT Ignite Solutions at March 2014. Net debt includes £4.2 million of intragroup creditors owed to BT and Ignite Solutions. An element of this balance may be working capital in nature relating to ongoing services provided by BT. Based on FY14 Titan costs excluding margin and overhead (£14.6 million) on 30 day credit terms the working capital element could be £1.5 million each month including VAT. LDL should consider the proposed credit terms with BT in assessing the level of working capital included in this balance.

7) Drawings in the period to 30 June included a cash sum of £12.0 million extracted by BT to cover the following items:

- BTGS management charge of £2.5 million;
- Other Titan 'third party pass through costs' of £2.8 million (leaving an outstanding balance of £0.5 million at this date);
- Charges under the TCA of £4.6 million (to reflect the original creditor balance at 31 March 2014, before adjustments); and,
- A BT treasury VAT settlement of £2.1 million.

8) A £0.2 million provision in relation to BT charges in June 2014 that are repeat charges of costs paid by LDL in 2013/14.

9) A £0.4 million debtor in relation to amounts owed by LCC to LDL.

Initial findings		
Headline	Issue	Status
<p><b>Outstanding issues</b></p> <p>A £0.8 million provision in relation to a historical obligation of LDL is yet to be reflected in the accounts at 31 March 2014.</p>	<p>Per email, the following items still remained unresolved as of 14 August 2014:</p> <ol style="list-style-type: none"> <li>1) BT ignite solutions creditor of £4.6 million is overstated by [£ ] million due to accounting errors (understated accrual to LCC for the year end offset reconciliation, understated provisions overstated invoicing to LCC)</li> <li>2) The accrual for amounts owed to LCC of £0.2m for the year offset reconciliation is understated by £1.4 million.</li> <li>3) Provisions for historical obligations to LCC for the apprenticeship scheme, adult services training and children's services training (currently nil) are understated by £0.8 million.</li> <li>4) Amounts invoiced to LCC at 31 March 2014 in respect of historical items (e.g. job evaluation) of £1.5 million are disputed and the debtor is overstated by £[ ] million.</li> </ol>	<ul style="list-style-type: none"> <li>■ Partially resolved</li> <li>■ Resolved</li> <li>■ Unresolved</li> <li>■ Partially resolved</li> </ul>
<p>Various further outstanding items raised by LDL's chief executive are also yet to be reflected in the accounts.</p>	<p>Additional issues were raised by the LDL chief executive per your email of 20 August 2014 . These items are addressed below:</p> <ol style="list-style-type: none"> <li>1) No SIA, LMH, L&amp;Q or Knowsley MBC provisions (total value £0.03 million)</li> <li>2) Vodafone - £0.5 million cash bonus (subsidy payment due) plus unconfirmed value for the revenue rebate have not been provided to LDL. – [figure of £0.9 million has now been added to prepaid expenses] <b>A figure of £0.9 million has now been added to prepaid expenses, however we have not had confirmation that this outstanding balance is now fully accounted for.</b></li> <li>3) Cisco overcharging – Overcharge of £0.2m to be returned plus support cost overcharge of [£0.04 million].</li> <li>4) David McElhinney salary – BT have not paid £0.1 million salary (April-August 14).</li> <li>5) LCC believe that an intercompany recharge will be raised for (4) LDL Directors paid in OCL March 2012 which should be against LDL. Estimated at £0.05 Million.</li> </ol>	<ul style="list-style-type: none"> <li>■ Unresolved</li> <li>■ Partially resolved</li> <li>■ Unresolved</li> <li>■ Unresolved</li> <li>■ Unresolved</li> </ul>

Initial findings		
Headline	Issue	Status
<b>Outstanding issues</b>  Various further outstanding items raised by LDL's chief executive are also yet to be reflected in the accounts.	<b>6) 2013/2014 provisions</b> <ul style="list-style-type: none"> <li>£2.6 million Mayoral Fund provision as at 31.03.14. <b>This figure has been adjusted down to £2.4 million.</b></li> <li>£0.4million Profit share provision as at 31.03.14. <b>This figure has been adjusted down to £0.2 million.</b></li> <li>£0.2million Offset reconciliation provision as at 31.03.14 understated by £1.4million - relates to non-payment of invoice LCC X1901296490 £1.6million (£1.9million gross). <b>This figure has now been adjusted to £1.9 million.</b></li> <li>£0.04million third party accrual- BSF Computacenter as at 31.03.14 – This has since been paid in June 14.</li> <li>£9k third party accrual – PwC invoice – note in accounts- "Hscavelli e-mail19/2/14 at 14.15"</li> <li>£1.3million 2013/14 ICT Investments with no provision. <b>This potentially looks to be an "off-balance sheet" item and could impact upon net debt.</b></li> <li>£0.64 million Apprenticeship under spend with no provision</li> <li>£0.19million Adult Services training under spend with no provision</li> <li>£0.03million Children's services training under spend with no provision</li> </ul>	<ul style="list-style-type: none"> <li>Partially resolved</li> <li>Partially resolved</li> <li>Resolved</li> <li>Immaterial?</li> <li>Immaterial?</li> <li>Unresolved</li> <li>Unresolved</li> <li>Unresolved</li> <li>Unresolved</li> </ul>
	<b>7) 2013/14 LCC debtors</b> <ul style="list-style-type: none"> <li>£15k Parking Services discount               <ul style="list-style-type: none"> <li>2013/14 Invoice 352732 included the disputed £0.24m against BRC24128. There was an agreement for a £15k discount to settle the issue. The £15k has not been set aside within provisions.</li> </ul> </li> <li>£0.35million overstated Job Evaluation impact – (now adjusted for)               <ul style="list-style-type: none"> <li>Invoice 352732 included a £0.77m charge for the impact of the Job Evaluation (JE) between Oct 12-Mar 14. This has been disputed as LCC believe it has been overstated by approximately £0.35million. No JE adjustment should be paid as LDL made a 25% GM in 2013/2014 also the staffing affordability budget is well under spent. <b>We are unaware as to whether this adjustment now removes the dispute in full.</b></li> </ul> </li> <li>£0.19million Director's Buyout               <ul style="list-style-type: none"> <li>Invoice 352753 was disputed on the grounds that it had to go via the offsets and that £0.19m was based on 6 directors when it should have only been 5. A request has been made to BT to issue via the offsets (for 2013/2014) and withdraw the invoice. No response to date.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Unresolved</li> <li>Partially resolved</li> <li>Unresolved</li> </ul>

Initial findings		
Headline	Issue	Status
<b>Outstanding issues</b>  Various further outstanding items raised by LDL's chief executive are also yet to be reflected in the accounts.	8) TITAN Intercompany recharges 2013/14	
	<ul style="list-style-type: none"> <li>£2.74m Closing third Party Accrual - Require detail of what 3rd party invoices are covered by this £2.74m accrual.</li> </ul>	<ul style="list-style-type: none"> <li>Unresolved</li> </ul>
	<ul style="list-style-type: none"> <li>£0.06m Closing iBuy Feed Accrual- This accrual is system generated and is due to the over receipting of purchase orders in iBuy. The accrual is invalid as it simply required the closing of the relating purchase orders in the system.</li> </ul>	<ul style="list-style-type: none"> <li>Unresolved</li> </ul>
	<ul style="list-style-type: none"> <li>Confirmation is required that 2013/14 SIA winning business charges are correct - In Nov13 and Mar14 in particular revenue stream appears unusually low (£39k and £1k respectively).</li> </ul>	<ul style="list-style-type: none"> <li>Unresolved</li> </ul>
	<ul style="list-style-type: none"> <li>Confirmation is required that 2012/13, 2013/14 and 2014/15 OCL charges are correct. It appears no print or postage has been charged.</li> </ul>	<ul style="list-style-type: none"> <li>Unresolved</li> </ul>
	9) TITAN Intercompany recharges 2014/15	
	<ul style="list-style-type: none"> <li>£2.5m Management Fee               <ul style="list-style-type: none"> <li>LCC agreed fee for Q1 2014/15 but LCC has no evidence of BT being engaged with LDL for this period. No contact by BT with any member of LDL BT accountants moved off site and provided no service or support.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Unresolved</li> </ul>
	<ul style="list-style-type: none"> <li>£0.57m prepayments reclaimed in April'14               <ul style="list-style-type: none"> <li>Evidence that the relating invoices were previously paid in full 2013/14 via TITAN, however no evidence that they were then credited back and treated as a prepayment on the balance sheet. Without supporting evidence it would appear the invoices in question have been paid twice.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Unresolved</li> </ul>
	<ul style="list-style-type: none"> <li>£0.08m charged in P2 but no supporting data provided               <ul style="list-style-type: none"> <li>Related to May TITAN charges, Gavin Hooker advised supporting data would follow but not received.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Unresolved</li> </ul>
	<ul style="list-style-type: none"> <li>£1.53m Unidentified pass through third party costs in P3. No data provided by BT</li> </ul>	<ul style="list-style-type: none"> <li>Unresolved</li> </ul>
	<ul style="list-style-type: none"> <li>£0.08m External Billing for Q1 with no evidence (Knowsley MBC/LIVIH/L&amp;Q)</li> </ul>	<ul style="list-style-type: none"> <li>Unresolved</li> </ul>
	<ul style="list-style-type: none"> <li>Q1 OCL revenue recharge               <ul style="list-style-type: none"> <li>£30k was credited back for April &amp; May, no evidence of June recharge (£30k outstanding) or print/postage.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Unresolved</li> </ul>
	<ul style="list-style-type: none"> <li>Q1 SIA revenue recharge               <ul style="list-style-type: none"> <li>Only £26k recharged back to LDL for April 14. There is no validation of these costs.- No evidence of SIA recharge for May/June/ July.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Unresolved</li> </ul>



## Headlines Outstanding issues

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We have provided a summary of all potential issues that we have been made aware of by you during the course of our work, that may affect the 31 March 2104 balance sheet position.

Net debt update at 31 March 2014 - per info rec'd at 24.9.14	
£'000	
<b>Agreed items</b>	
Cash	4,366
Debt	
Mayor's Fund	TBC
LCC profit share	TBC
FY14 LCC offset reconciling item	(1,904)
Deferred income of LDL relating to commitments of LDL to LCC	(815)
Historical provision for apprenticeship scheme	(49)
Intercompany creditor	TBC
<b>Total agreed net debt items at March 2014</b>	<b>TBC</b>
<b>Disputed or yet to be agreed items</b>	
Mayor's Fund	(2,600)
LCC profit share	(350)
ICT investments	(1,156)
SIA accommodation charge	(796)
Parking services discount	(15)
Intercompany recharges	TBC
Vodafone revenue share	(574)
Cisco charges	(220)
CAF One Bill overcharging	(191)
Backlog disposals and cessations	TBC
Refresh investment	8,750
Overstated Job evaluation impact	(350)
Directors pay protection	(48)
Refurb costs	875
Early retirement	685
Protected pay	169
Mayors fund costs (actual)	328
Credit on 4 year accommodation cost prepay	262
<b>Revised net debt</b>	<b>TBC</b>

Source: Correspondence with LCC





## Headlines

### Outstanding issues

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We have also provided a summary of all post March 2014 transactions in LDL that we have been made are of by you, which may further form the basis of negotiation between LCC and BT.

Post 31 March 2014 transactions - per info rec'd at 24.9.14	
£'000	
<b>Agreed items</b>	
Cash drawings by BT	11,950
BTGS pass through third party costs	3,310
Post 30 June BTGS transfer	3,180
Q1 recharges due	700
Revenue in respect of Q1 billing	80
LDL CEO salary not funded April - Sept 14	175
BT's use of LCC's Northgate system	125
Rec of monthly billing/offsets	TBC
<b>Total agreed items</b>	<b>TBC</b>
<b>Disputed transactions</b>	
Q1 management fee	2,500
Prepays reclaimed in April 2014 - paid twice?	570
<b>Total disputed transactions</b>	<b>TBC</b>
<b>13/14 transactions that may affect 14/15 position</b>	
Vodafone cash bonus and rev rebate	TBC
SIA accommodation charges	TBC
CAF requests One Bill overcharging	TBC
Backlog disposals and cessations	TBC
<b>Total post March 31 2014 transactions</b>	<b>TBC</b>

Source: Correspondence with LCC



## Supporting analysis Restated balance sheet

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Balance sheet				
£'000	Mar-14 Restated	Previously reported movements	Adjusted movements	Jun-14 Restated
<b>Working capital</b>				
Trade debtors - gross	9,054.5	(1,453.7)	-	7,600.8
Prepayments/accrued income	2,400.0	50.0	-	2,450.0
Prepaid expenses	886.8	1,851.5	(296.1)	2,442.2
Trade creditors	(61.5)	(1,948.3)	-	(2,009.8)
Accrued expenses	(4,562.7)	215.4	613.5	(3,733.8)
Deferred income	(6,147.4)	221.4	-	(5,926.0)
External VAT creditor	(1,709.7)	1,376.7	(317.4)	(650.4)
<b>Net debt</b>				
Cash at bank	4,365.7	(4,365.7)	-	0.0
Intragroup creditors - BT treasury	-	2,645.9	-	2,645.9
Intragroup creditors - Ignite Solutions (BT)	(4,215.9)	1,406.9	-	(2,808.9)
<b>Net assets</b>	<b>10.0</b>	<b>(0.0)</b>	<b>0.0</b>	<b>10.0</b>



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