



*cutting through complexity*

# Liverpool Direct Limited

Final report

13 October 2014



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*For the attention of Becky Hellard, Peter Casterton and Paul Jones*

13 October 2014

Dear Sirs

**Project Router**

In accordance with our Framework Agreement dated 2 July 2014 ('our Engagement Letter'), we enclose our report on the proposed acquisition of Liverpool Direct Limited dated 10 October 2014. As stated in our Engagement Letter, you have agreed that this final written report supersedes all previous oral, draft or interim advice, reports and presentations, and that no reliance will be placed by you on any such oral, draft or interim advice, reports or presentations other than at your own risk. The scope of work set out in our Engagement Letter is attached as Appendix 1 to the report. This details the agreed scope of our enquiries, directed at those issues which you determined to be critical to your investment. You should note that our findings do not constitute recommendations to you as to whether or not you should proceed with the proposed transaction. The Important notice on page 3 should be read in conjunction with this letter.

Our report is for the benefit and information of the addressees only and should not be copied, referred to or disclosed, in whole or in part, without our prior written consent, except as specifically permitted in our Engagement Letter. The scope of work for this report included as Appendix 1 has been agreed by the addressees and to the fullest extent permitted by law we will not accept responsibility or liability to any other party (including the addressees' legal and other professional advisers) in respect of our work or the report.

Yours faithfully

**KPMG LLP**

Our work commenced on 11 June 2014 and our fieldwork was completed on 10 October 2014. We have not undertaken to update our report for events or circumstances arising after that date. Our original work was commissioned to assess the balance sheet as at 31 March 2014. Due to the circumstances set out below, we raised a number of issues which needed to be resolved and we assisted with the resolution of these matters to support LCC in their negotiation with BT.

In preparing our report, our primary source has been Liverpool Direct Limited and BT plc internal management information and representations made to us by management of Liverpool Direct Limited and BT plc. We do not accept responsibility for such information which remains the responsibility of management. Details of our principal information sources are set out in our detailed report and we have satisfied ourselves, so far as possible, that the information presented in our report is consistent with other information which was made available to us in the course of our work in accordance with the terms of our Engagement Letter. We have not, however, sought to establish the reliability of the sources by reference to other evidence.

This engagement is not an assurance engagement conducted in accordance with any generally accepted assurance standards and consequently no assurance opinion is expressed. LDL have provided us a copy of PwC draft audited accounts for the year ended 31 March 2014.

We draw your attention to the significant limitations in the information available to us. Furthermore, the nature of our engagement changed as a result of the significant limitations. As set out in the main body of this report due to difficulties with accounting data in LDL, we assisted LCC in their commercial negotiations. BT and LCC have had to agree the respective transactions to form the accounts for the year ended 31 March 2014. We have not verified this balance sheet. We tracked the adjustments to the agreed draft balance sheet audited by PwC. We have not been able to complete our original terms of engagement as set out in this report due to the accounting issues mentioned above. As a result of the changes in nature of this assignment and as a result of the issues with information, our role on this engagement has been amended in assisting LCC in agreeing the balance sheet as at 31 March 2014.

Our report makes reference to 'KPMG Analysis'; this indicates only that we have (where specified) undertaken certain analytical activities on the underlying data to arrive at the information presented; we do not accept responsibility for the underlying data.

The analysis of 'underlying' earnings and working capital is for indicative purposes only. We have sought to illustrate the effect on EBITDA (earning before interest, tax, depreciation and amortisation) and working capital of adjusting for those items identified in the course of our work that may be considered to be 'non-recurring' or 'exceptional' or otherwise unrepresentative of the trend in EBITDA and working capital using criteria established by the management of Liverpool City Council. However the selection and quantification of such adjustments is necessarily judgmental. Because there is no authoritative literature or common standard with respect to the calculation of 'underlying' earnings and working capital, there is no basis to state whether all appropriate and comparable adjustments have been made. In addition, while the adjustments may indeed relate to items which are 'non-recurring' or 'exceptional' or otherwise unrepresentative of the trend, it is possible that earnings and working capital for future periods may be affected by such items, which may be different from the historical items.

The prospective financial information set out within our report has been prepared by BT plc (Q1 FY15) and Liverpool Direct Limited (FY15 budget); we do not accept responsibility for such information. We must emphasise that the realisation of the prospective financial information is dependent on the continuing validity of the assumptions on which it is based. The assumptions will need to be reviewed and revised to reflect any such changes in trading patterns, cost structures or the direction of the business as they emerge. We accept no responsibility for the realisation of the prospective financial information. Actual results are likely to be different from those shown in the prospective financial information because events and circumstances frequently do not occur as expected, and the differences may be material.

LCC commissioned our engagement. The directors of BT plc or Liverpool Direct Limited have not read our report and have not confirmed the factual accuracy of this report, as they have not yet been requested to do so.

We accept no responsibility or liability for the findings or reports of legal and other professional advisers even though we have referred to their findings and/or reports in our report.



## Notice: About this Report

This extract forms part of a fuller Report which has been prepared on the basis set out in commercially sensitive and confidential engagement terms agreed by KPMG LLP ("KPMG") with Liverpool City Council.

Nothing in this extract or the 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 agreed with Liverpool City Council.

This extract is illustrative and not designed for use or reliance other than at own risk by anyone. The Report is for the benefit of Liverpool City Council only

This extract has not been designed to be of benefit to anyone. In preparing the Report we have not taken into account the interests, needs or circumstances of anyone apart from Liverpool City Council, even though we may have been aware that others might read this extract from the Report or the Report itself. We have prepared the Report for the benefit of Liverpool City Council alone.

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In particular, and without limiting the general statement above, since we have prepared the Report for the benefit of Liverpool City Council alone, this extract and the Report have not been prepared for the benefit of any other local authority or council, nor for any other person or organisation who might have an interest in the matters discussed in this extract or the Report, including for example those who work in any relevant sector or those who provide goods or services to those who operate in any relevant sector.

## Glossary of terms

<b>ACCL</b>	Arena and Convention Centre Liverpool
<b>FYXX</b>	Financial year ended 31 March 20XX
<b>HMRC</b>	Her Majesty's Revenue and Customs
<b>HR</b>	Human resources
<b>IT</b>	Information technology
<b>LCC</b>	Liverpool City Council
<b>LDL</b>	Liverpool Direct Limited
<b>LGS</b>	Local Government Scheme
<b>Outturn</b>	Two months actual and one month forecast trading ending 30 June 2014
<b>PAYE</b>	Pay as you earn
<b>Q1XX</b>	The three months ending 30 June 20XX
<b>SIA</b>	Security Industry Association
<b>SPA</b>	Sale and purchase agreement
<b>TSA</b>	Transitional services agreement
<b>VAT</b>	Value added tax

### 1 Context and background

Liverpool City Council (LCC) have a 17 year contract for the provision of services via a Joint Venture (JV) with BT, under the title of Liverpool Direct Limited (LDL). Recently, an agreement was reached between BT and LCC to terminate the contract. As part of the reason for this piece of work was because both parties wanted to change the ownership of the organisation (LDL) – the contract between LCC and LDL continues.

Our work has focussed on the balance sheet as at 31 March 2014. This has identified a lack of consistent accounting and record keeping. We carried out an assessment and found various anomalies and discrepancies in the information presented. Furthermore, there are a range of queries from our work, queries raised by LCC and the Chief Executive of LDL which has resulted in LCC and BT resolving these issues through commercial negotiation. We subsequently advised LCC in their negotiations with BT which involved the assessment of the Balance Sheet supplied by BT. We advised LCC on their negotiations regarding the Sale and Purchase of LDL.

### 2 Our conclusion

We have checked through the LCC accounts tracker to confirm that all agreed adjustments between the two parties have been made in the final 31 March 2014 balance sheet. We have not had access to the books and records of LDL to confirm that these items have been reflected properly in the underlying company records. Furthermore, we have not received confirmation from BT that this final position has been formally agreed.

The majority of transactions arising in the books and records of LDL are generated by transactions with BT and LCC. Therefore BT and LCC have been able to agree between them the transactions in the year ended 31 March 2014 and agreed between them the final balance sheet at that date, based on commercial negotiations. We have agreed the balance sheet which has been submitted by BT to PwC as auditors of LDL. We recommend the following next steps:

- 1 Obtain from PwC the audit and sign off for the year ended 31 March 2014.
- 2 The tax considerations of the commercial negotiations are fully considered by yourselves.
- 3 The commercial negotiations are properly documented and legal advice obtained.

The final agreed 31 March 2014 balance sheet between LCC and BT has been restated with a net impact of a reduction in the BT Ignite Solutions creditor of £0.1 million.

The key sources of information is set out in Liverpool City Council tracker document and their supporting analysis.

Balance sheet - 31 March 2014											
		Mar-14 Previous position	Small trade debtor movements (-<£50k)	Sales credit directors pay protection	Accrued income - mayors fund	Mayor's Fund adjusted to 1.9% service	LCC profit share adjusted to 1.9% service	Historical provision for apprentice-ship scheme	P&L adjust ment	Total adjust ments	Mar-14 Finalised
£'000											
Working capital											
Trade debtors - gross	1	9,055	26	(238)	-	-	-	-	-	(213)	8,842
Prepayments/accrued income	2	2,400	-	-	324	-	-	-	-	324	2,724
Prepaid expenses		887	-	-	-	-	-	-	-	-	887
Trade creditors		(61)	-	-	-	-	-	-	-	-	(61)
Accrued expenses	3	(4,563)	-	202	-	(265)	(119)	(49)	-	(232)	(4,794)
Deferred income		(6,147)	-	-	-	-	-	-	-	-	(6,147)
External VAT creditor		(1,710)	(4)	6	-	-	-	-	-	2	(1,708)
Net debt											
Cash at bank		4,366	-	-	-	-	-	-	-	-	4,366
Intragroup creditor (BT treasury)		-	-	-	-	-	-	-	-	-	-
Intragroup creditor (Ignite)	4	(4,216)	-	-	-	-	-	-	119	119	(4,097)
Net assets		10	21	(30)	324	(265)	(119)	(49)	119	0	10

Source: Correspondence with LCC

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

- 1a. A net £0.03 million increase in trade debtors, reflecting an increased JE debtor of £44,000 and a trade debtor credit in relation to a parking services discount (£18,000).
- 1b. A £0.2 million sales credit in relation to directors pay protection, with a corresponding £0.2 million reduction in accrued expenses.
2. A £0.3 million increase in accrued income relating to the Mayor's Fund.
- 3a. There has been a reversal of a previous adjustment to reflect the fact that the Mayor's Fund and LCC profit share accrued expenses will be taken as services rather than cash.
- 3b. A £0.05 million reduction to correct a historical provision for the apprenticeship scheme.
4. A £0.1 million reduction in the Ignite intragroup creditor, to reflect the net impact of the above items.

# Headlines

## Balance sheet reconciliation

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>										
Trade debtors - gross	1	9,365	-	-	(310)	-	-	-	(310)	9,055
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>

Source: Correspondence with LCC

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).
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. **Through negotiations, LCC will receive approximately £0.9 million post 31 March 2014.**
- 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.
- 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.
4. A £0.4 million reduction in the Ignite intragroup creditor, to reflect the net impact of the above items.



*Note: This schedule has not been updated to reflect the final agreed position, but represents the trail that has been used as part of the commercial negotiations between LCC and BT.*

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
Net BT drawings	(1,919)
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;

- 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.



## Headlines Updated findings (1)

Initial findings		
Headline	Issue	Status
<b>Outstanding issues</b> 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.		<div>Resolved</div> <div>Resolved</div> <div>Resolved</div> <div>Resolved</div>
Various further outstanding items raised by LDL's chief executive are also yet to be reflected in the accounts. 1, Third party income provisions  2, Vodafone rebates  3, Cisco charging  4. LDL CEO salary  5. Intercompany recharge for 4)		<div>Resolved</div> <div>Resolved</div> <div>Resolved</div> <div>Resolved</div> <div>Resolved</div>

Initial findings		
Headline	Issue	Status
<b>Outstanding issues (continued)</b> Various further outstanding items raised by LDL's chief executive are also yet to be reflected in the accounts. 6. 2013/14 provisions		Resolved Resolved Resolved Immaterial Immaterial Resolved Resolved Resolved Resolved
7. 2013/14 LCC debtors		Resolved Resolved Resolved
8. TITAN intercompany recharges 2013/14		Resolved Resolved Resolved



## Headlines Updated findings (3)

Initial findings		
Headline	Issue	Status
<b>Outstanding issues (continued)</b> Various further outstanding items raised by LDL's chief executive are also yet to be reflected in the accounts. 9. TITAN intercompany recharges 2014/15		<ul style="list-style-type: none"><li>Resolved</li><li>Resolved</li><li>Resolved</li><li>Resolved</li><li>Resolved</li><li>Resolved</li><li>Resolved</li></ul>

# Supporting analysis Restated balance sheet

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>

# Appendix 1

Engagement letter and scope of work



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