Transport for the North Board – Item 7, Appendix 1

Subject: Appendix 1: Budget Revision 3 Analysis

Author: Gareth Sutton, Financial Controller

Sponsor: Iain Craven, Finance Director

Meeting Date: Thursday 7 February 2019

1. Executive Summary:

1.1 This document is Appendix 1 to the 'Budget Revision 3 and Year-to-Date Financial Monitoring' report in the main pack.

2. Recommendation:

2.1 Note the analysis in this report.

3. Programme Activity

Integrated & Smart Ticketing

Background

3.1 Financial reporting throughout the year has highlighted underspends within the Integrated and Smart Ticketing (IST) programme.

3.2 These underspends have arisen for two principal reasons:

a) Programme slippage; and,
b) The management of contingency.

The first issue reflects adjustments to programme delivery timelines. Delays to the passage of the Phase 3 Accounts Based Back Office project through the government's gateway review process has impacted upon the project's timetable with an associated impact on expenditure profiles.

3.3 This is a particular issue for financial monitoring and reporting as significant amounts of capital expenditure were forecast for this project in quarters 2 and 3 of the financial year. The activity associated with this expenditure is now forecast to fall into financial year 2019/20.

3.4 Reporting has also highlighted ongoing underspends within the Phase 1 ITSO on Rail project. Delays to the conclusion of contracting with train operating companies (TOCs) in the prior financial year impacted upon the planned level of activity and expenditure in the current financial year. This has led to delays in the purchase of capital equipment notably, around platform validator machines which will now largely fall into financial year 2019/20.

3.5 These delays did not impact upon the 'go-live' date for the ITSO on Rail project before Christmas, as the delayed activity is largely around enabling the physical infrastructure required for later phases of the IST programme.

3.6 These issues have been exacerbated by the treatment of programme contingency within the budget. Contingency is simply grant resource that is held within the budget to mitigate risk around unforeseen costs, or costs on planned activity that is higher than forecast.

3.7 Contingency is held in line with government guidelines, and within the IST programme is held at particularly high levels due to the innovative nature of the programme and its reliance on the implementation of new technology.

3.8 Over the first three quarters, this contingency has not been required at the levels budgeted. This reflects three principal issues:

a) That activity that contingency was held for has slipped (as in the Phase 3 capital expenditure);
b) That activity that has been undertaken has not required draws on contingency (as in Phase 2); and
c) That requirements for contingency aren't always clear at the start of the programmes and aren't necessarily linear to activity undertaken.

3.9 Not using contingency held within the budget creates underspends. However, point 2 highlights that not using contingency should not necessarily be seen as a negative issue. It is TfN's aspiration to deliver its programmes in the most cost-effective manner and TfN manages its projects to mitigate the risk that contingency serves to underwrite. Accordingly, if risks are mitigated TfN may not need to draw on budgeted contingency.

3.10 As identified in the Revision 2 paper at the last Board, in the forthcoming year, TfN proposes to isolate contingency resource from its budgets to ensure that the use of those values is transparent, and to avoid the distorting effect that occurs in financial reporting when contingency is not drawn upon.

3.11 Significant revisions were made to the IST programme budget at both Revision 1 and Revision 2. These revisions reduced programme expenditure forecasts materially to realign to the latest delivery timelines, particularly around Phase 3. Adjustments were also made to reflect better cost information around VAT charges on capital grants, and the need for contingency across Phase 1 and Phase 2.

3.12 **Period 1 – 9 Financial Position**

Over the first three quarters of the financial year the IST programme has spent £7.75m against a budget for the period of £21.78m.

3.13 Of the three phases of activity, the majority of costs have been in relation to the Phase 1 ITSO on Rail and the Phase 3 Accounts Based Back Office projects. Phase 1 is in its delivery phase, whilst the Phase 3 project is progressing towards full business case submission.

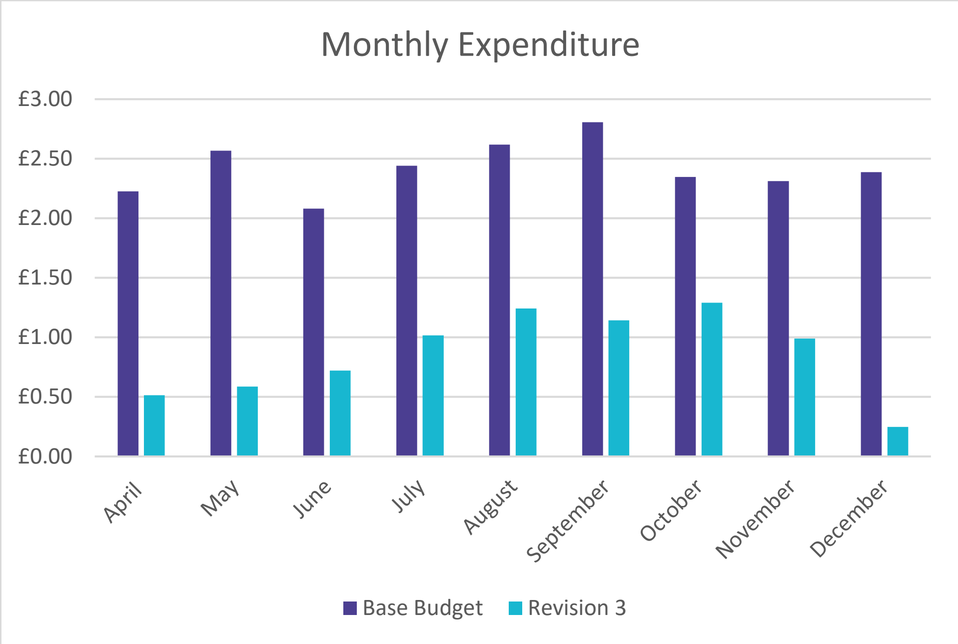
3.14 All phases of activity show material underspend against the base budget:

Area	Actual £m	Budget £m	Variance £m	Variance %
Phase 1	£3.18	£9.93	£6.75	68%
Phase 2	£0.70	£3.24	£2.54	79%
Phase 3	£3.54	£7.69	£4.15	54%
Programme Support	£0.34	£0.93	£0.59	64%
	£7.75	**£21.79**	**£14.04**	

3.15 This variance is principally around the capital programme elements of the activity where underspend was £13.81m for the three quarters compared to £0.22m for the revenue programme elements:

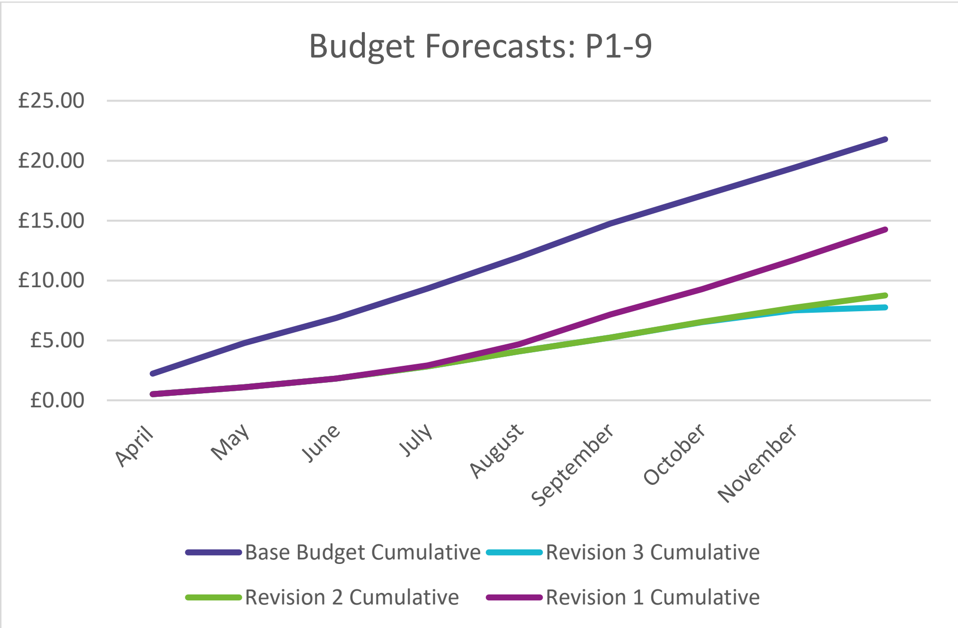
Area	Actual £m	Budget £m	Variance £m	Variance %
Revenue Programme	£0.71	£0.93	£0.22	£0.24
Capital Programme	£7.05	£20.86	£13.81	£0.66
	£7.75	**£21.79**	**£14.03**	**£0.90**

3.16 This material variance has been consistent throughout, with the monthly base budget forecast not being met on any occasion:



3.17 As the year has progressed, revisions have been made to the IST budget to reflect the changes to the delivery time line and reflect better information around assumptions made on the level of contingency required and the likely cost of activity.

3.18 Although variances persist, these revisions have largely arrested the material variances giving TfN a better basis on which to undertake its financial planning:



3.19 The impact of underspends on contingency within these figures is material. Over the first three quarters of the year, contingency totalling £7.27m was budgeted but not called upon. Stripping this budgeted value out of the base budget has a significant impact on the view of the phases’ variances.

3.20 In particular, removing contingency from the Phase 3 budget shows that the project is much less underspent against its net forecast than it would otherwise appear:

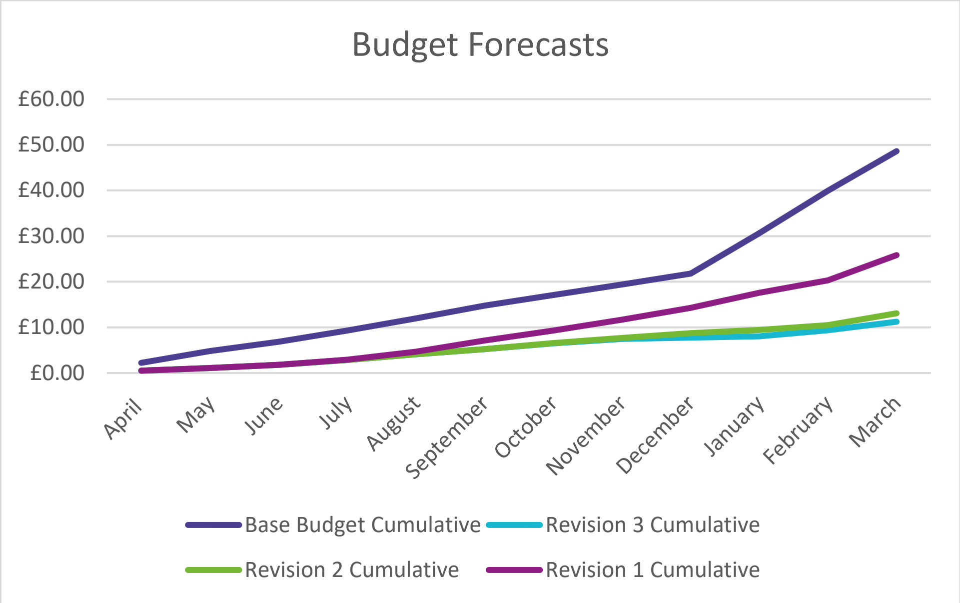
Area	Actual £m	Budget £m	Conting. £m	Net Budget	Variance £m	Variance %
Phase 1	£3.18	£9.93	£2.99	£6.94	£3.77	54%
Phase 2	£0.70	£3.24	£1.77	£1.47	£0.77	53%
Phase 3	£3.54	£7.69	£2.52	£5.17	£1.63	31%
Programme Support	£0.34	£0.93	£0.00	£0.93	£0.59	64%
	£7.75	**£21.79**	**£7.27**	**£14.52**	**£6.76**	

Forecast to Outturn

3.21 Full year expenditure to outturn forecasts show the IST programme spending £11.24m against an initial opening budget of £48.61m (inclusive of contingency):

Revision 3 Full Year Forecast	Forecast £m	Budget £m	Variance £m	Variance %
Phase 1	£4.72	£13.21	£8.49	64%
Phase 2	£0.94	£4.04	£3.10	77%
Phase 3	£5.08	£30.11	£25.02	83%
Programme Support	£0.49	£1.25	£0.75	60%
	£11.24	**£48.61**	**£37.37**	

3.22 Variances to base budget escalate as the capital expenditure for Phase 3 - originally planned for quarters 3 and 4 - will no longer fall in financial year 2018/19. This is particularly notable in the chart below where the base budget forecast significant expenditure acceleration in the final quarter of the year:



3.23 The chart above also usefully highlights that TfN believes that its outturn position will now be broadly aligned to the Revision 2 position it adopted at the mid-year mark. At that point material revisions were made to reflect known adjustments to the Phase 3 delivery profile, and the need for contingency throughout the programme. Adjustments were also made for assumptions around VAT charges on capital grants made to train operating companies within the Phase 1 ITSO on Rail project.

3.24 The forecast to outturn variance to the opening base budget can be amended to take account of undrawn contingency provisions which were budgeted for on a full year basis at £20.67m:

Revision 3 Full Year Forecast	Forecast £m	Budget £m	Conting. £m	Net Budget	Variance £m	Variance %
Phase 1	£4.72	£13.21	£4.78	£8.44	£3.71	44%
Phase 2	£0.94	£4.04	£2.40	£1.64	£0.70	43%
Phase 3	£5.08	£30.11	£13.49	£16.61	£11.53	69%
Programme Support	£0.49	£1.25	£0.00	£1.25	£0.75	60%
	£11.24	£48.61	£20.67	£27.94	£16.70	

3.25 This again highlights the sensitivity within the programme to the contingency values. With these values stripped out of the comparators, it is clearer to see where delivery delays are driving underspends.

3.26 The following graphic highlights that there is still an increase in expenditure forecast towards the end of the financial year as capital expenditure is forecast to peak in Phase 1 and Phase 3:

3.27 Unused IST grant allocations will be rolled forward into future financial years, to be draw upon as required.

Northern Powerhouse Rail

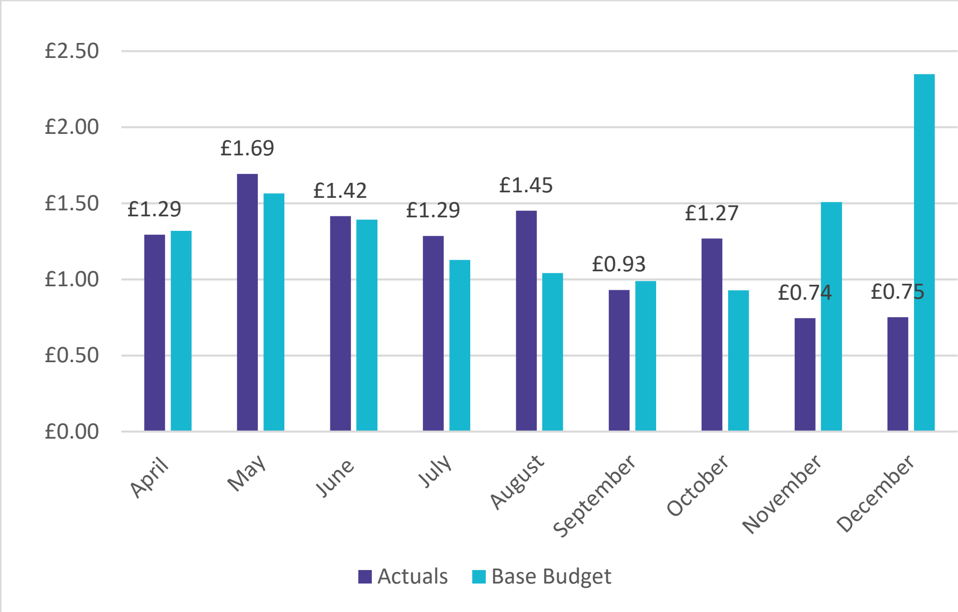
Background

3.28 The Northern Powerhouse Rail programme is centred on a major professional services contract with Network Rail. That contract will deliver studies that will go forward to support the NPR SOBC submission, and a future full business case submission. This activity is complemented by the work of TfN's internal Transport Analysis, Modelling, and Economics team who develop the evidence base on which those business cases rely. Costs are also incurred on the NPR Programme Team who manage the contracts and drive the business case

Periods 1 – 9

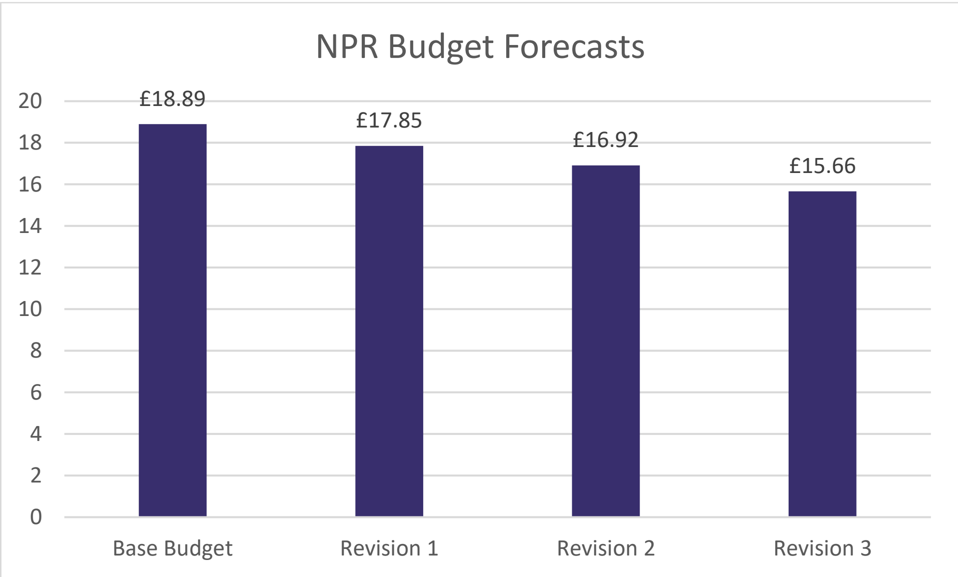
3.29 The NPR budget ran ahead of forecast for the first two quarters of the year before falling behind in Quarter 3. This in part recognises that expenditure initially planned for this financial year was accelerated into the prior year to support the timely delivery of the NPR SOBC, whilst savings have also latterly accrued as the pre-Sequence 4 sift activity was completed below budget.

3.30 Over the first three quarters of the year expenditure of £10.83m was incurred against a base budget forecast of £12.22m:

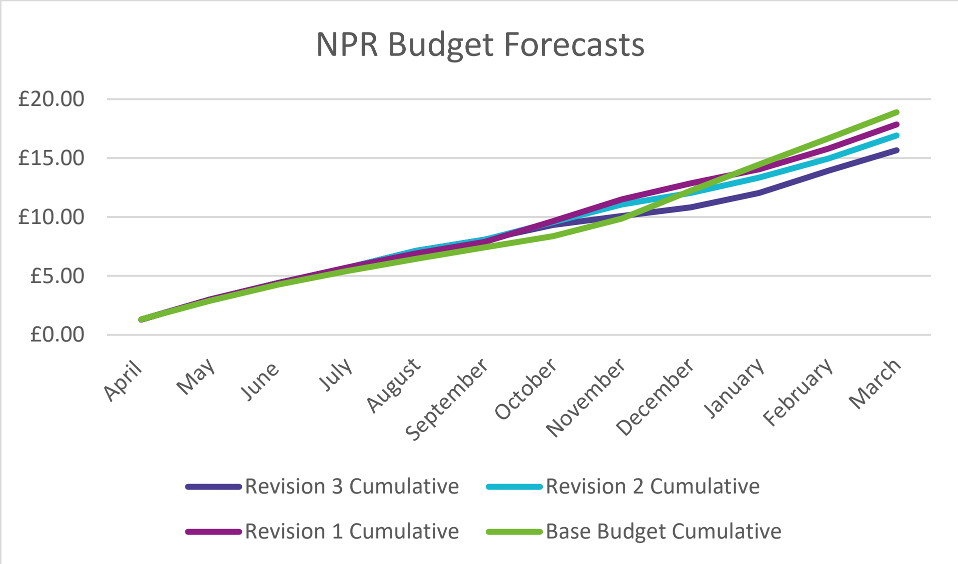


Forecast to Outturn

3.31 The NPR budgets have been revised down throughout the year as savings have been generated and resource reallocated to HS2:



3.32 The Revision 3 budget forecasts that the NPR programme will incur expenditure of £15.66mm against the base budget full year estimate of £18.89m, generating an underspend variance of £3.22m.



3.33 The Revision 3 forecasts recognise savings in the delivery of the Pre-Sequence 4 Sift studies delivered by Network Rail and also the deferment of £0.25m expenditure around HS2 consultation activity. Work is underway to remit additional activity, though delays to that process may generate some slippage into the forthcoming financial year.

3.34 The underspends generated within the NPR programme have allowed for the reallocation of Transport Development Fund (TDF) resource to HS2. This reallocation will allow for the delivery of activity by HS2 on NPR priorities, reflecting the close collaboration between the two programmes.

Major Roads (Strategic Development Corridors) Programme

Background

3.35 The Major Roads programme principally consists of the seven Strategic Road Corridor studies. External consultants are engaged to deliver the individual studies, with TfN's TAME function then analysing the outcomes to support evidence-based submissions to the DfT. This work is led by the Major Roads team.

3.36 Over the course of the financial year a number of claims from external consultants commissioned to deliver SDC studies has been made against TfN. These claims arise from cost overruns incurred by the contractors in delivering the activity.

3.37 Costs have overrun against the contracted values in part because of the addition of scope to existing work packages as the studies generated additional unforeseen complexity, but also in part because of delays in delivering TfN's analytical framework. Following negotiation with the individual contractors, including the de-scoping of nonessential activity, TfN has been able to agree costs for which it is liable:

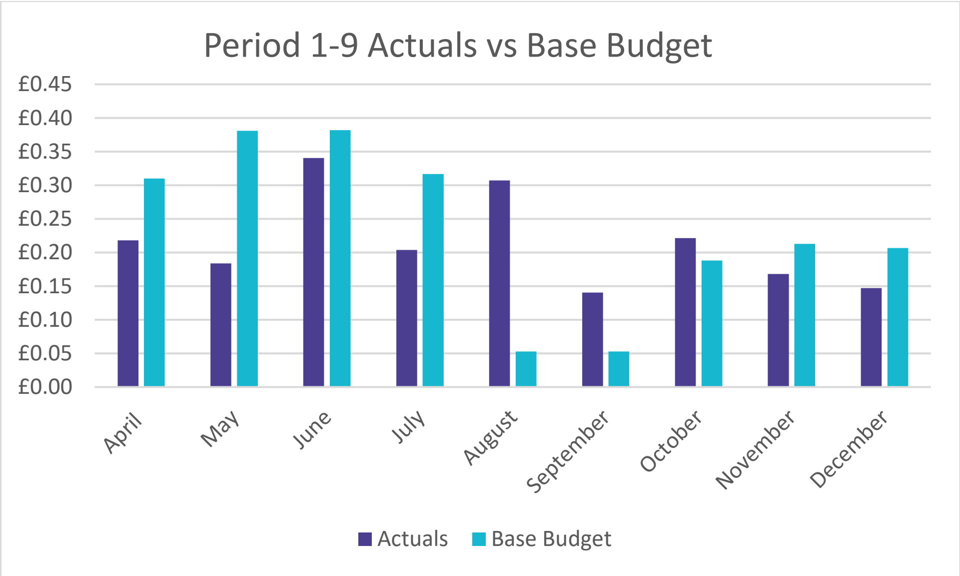
SDC Study	Cost Overrun £'m
Connecting Energy Coasts	£0.05
Central Pennines	£0.07
West & Wales	£0.09

3.38 Contingency originally built into the Major Roads budget has allowed for these costs to be absorbed without displacing other activity and without compromising on the quality of the individual studies. The seven studies will be completed by the end of the financial year and budget has been made available in 2019/20 to allow the TAME function to further refine the activity ahead of business case submission.

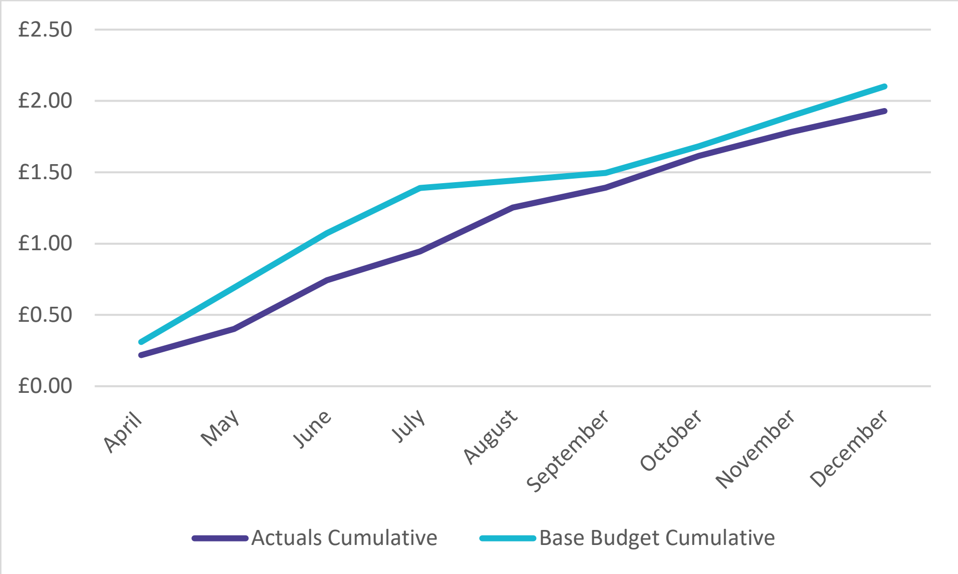
Periods 1 - 9

3.39 Major Roads programme expenditure has been irregular throughout the year. This in part recognises the uncertainty around several of the studies following the claims made against TfN.

3.40 The following graphic shows that expenditure fell behind budget over the first four months of the year before catching up in late summer and early autumn.



3.41 By the end of Period 9 and despite the fluctuations, actual cumulative expenditure was broadly aligned to the base budget:

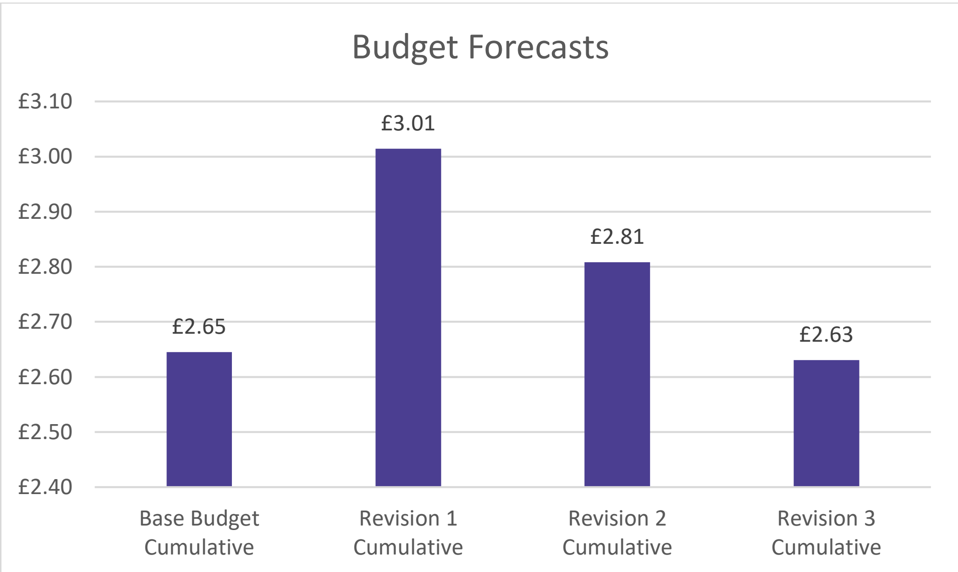


Forecast to Outturn

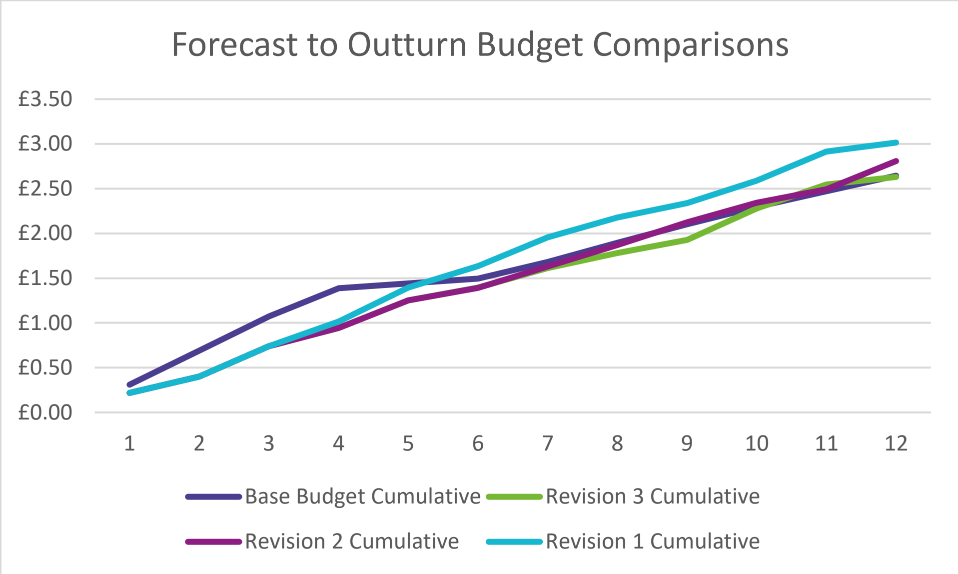
3.42 The Major Roads budget has been amended at each Revision point to reflect the latest delivery profiles, and in particular to reflect the potential for additional costs arising from claims on the SDC studies.

3.43 At Revision 1 the budget was increased to take account of activity that slipped out of financial year 2017/18 in Quarter 4 and also £0.19m of contingency to take account of an initial additional cost claims around three of the SDC studies.

3.44 At Revisions 2 and 3, this increase has been tapered down as negotiation allowed for de-scoping of elements of the SDC studies and other activity was completed at lower than forecast cost. With year-end slippage now expected at c. £0.06m, the Revision 3 budget closely aligned to the opening base position:



3.45 The following chart highlights those movements throughout the year:



Operational Areas

Background

3.46 The operational areas cover the back, middle, and front office teams that provide the necessary organisational infrastructure for TfN's programme teams; deliver necessary control and alignment with statute and regulation; and also deliver on TfN aspirations such as its commitment to evidenced based decision making and allowing the North to speak with one voice.

Periods 1 – 9

3.47 Over the first nine months of the year the operational areas incurred expenditure of £5.74m against a budget of £7.60m, generating an underspend of £1.86m.

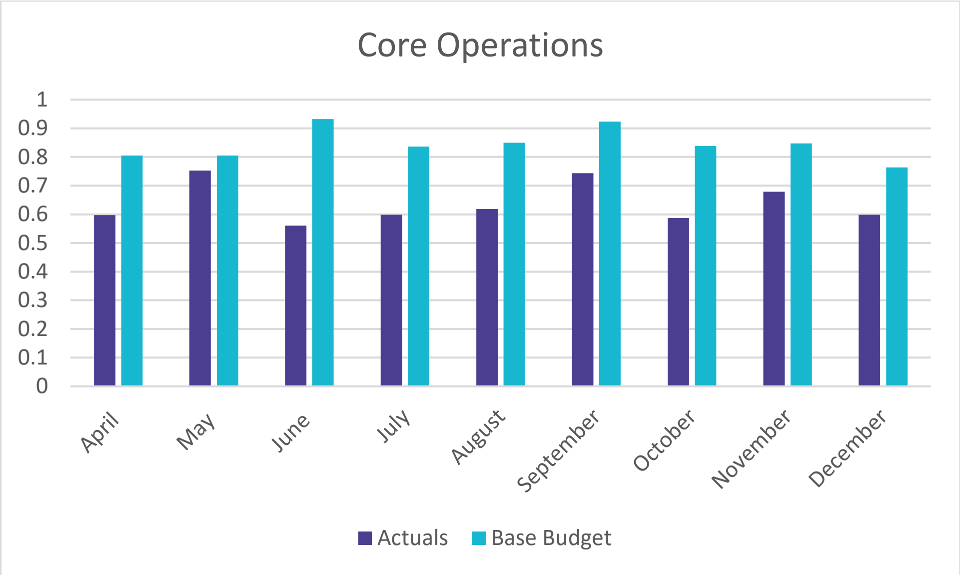
3.48 This underspend is principally generated in the Strategy & Policy directorate, and in particular with the Transport Analysis, Modelling, and Economic (TAME) function where several planned commissions slipped. Material year-to-date underspends were also incurred in the ICT function (£0.27m) and the Corporate Communications and Stakeholder Engagement Team (£0.21m).

3.49 Expenditure ahead of the base budget was incurred in the Rail Operations teams where additional capacity and resource was brought in to support TfN's response to the summer rail timetabling issues.

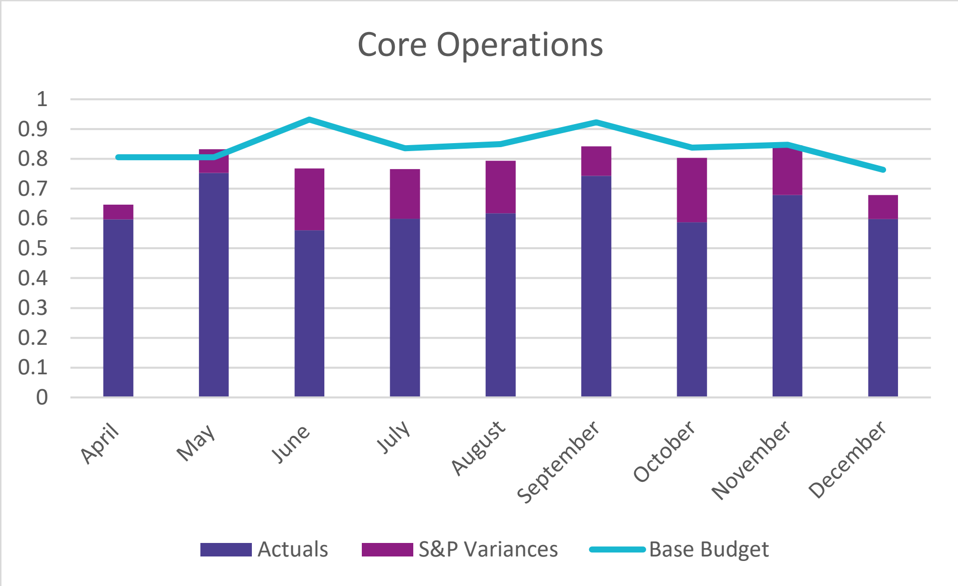
Periods 1 – 9 Directorates	Actuals £m	Budget £m	Variance £m	Variance %

Strategy & Policy	£1.05	£2.29	£1.24	54%
Business Capabilities	£2.37	£2.86	£0.49	17%
Finance	£0.60	£0.62	£0.02	3%
Leadership	£0.22	£0.22	-£0.01	-3%
Programme Management Office	£0.20	£0.39	£0.19	49%
Rail Operations	£1.29	£1.22	-£0.07	-6%
	£5.74	**£7.60**	**£1.86**	

3.50 As a whole, TfN's operational areas have been consistently under the base budget forecast, with total monthly expenditure averaging £0.64m:

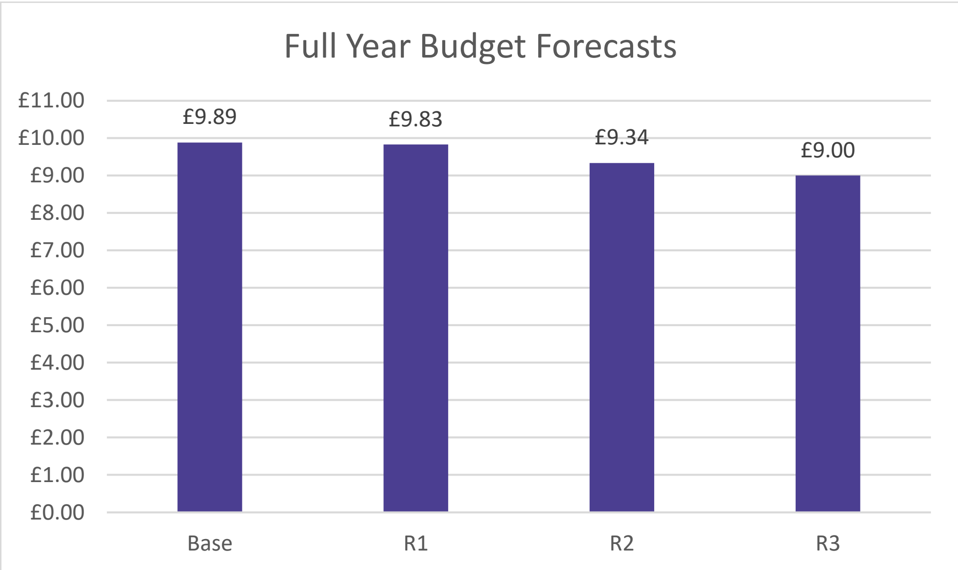


3.51 As the following chart highlights, in most months variance to base budget has principally been driven by underspend in the Strategy & Policy area:



Forecast to Outturn

3.52 The operational area budget has been reduced throughout the year as activity slipped, and savings were made on staffing costs and professional services:



3.53 These reductions offset the increase in costs seen in the Rail Operations area as the teams continue to deliver TfN's response the rail timetabling issues. As set out in Revision 2, mid-year, the Finance Director approved the virement of c. £0.32m of identified TfN Core grant underspend to support that activity whilst £0.12m of additional DfT grant was awarded. At Revision 3, it is not anticipated that the full value of the Core grant virement will be required.

3.54 The Revision 3 budget forecasts expenditure to outturn of £9.00m, leading to an underspend of £0.89m:

	Actuals £m	Budget £m	Variance £m	Variance %
Strategy & Policy	£1.89	£2.81	£0.92	33%
Business Capabilities	£3.59	£3.82	£0.23	6%
Finance	£0.90	£0.87	-£0.02	-3%
Leadership	£0.32	£0.29	-£0.03	-11%
Programme Management Office	£0.34	£0.51	£0.16	32%
Rail Operations	£1.96	£1.58	-£0.37	-23%
	£9.00	**£9.89**	**£0.89**	

3.55 Of this net variance, c. £0.35m relates to slipped activity, the grant for which will need to be carried forward into financial year 2019/20 to match to expenditure. Savings of £0.30m over and above those reported in previous periods have now been identified. This resource will now flow through to the future financial year supporting the resourcing of the 2019/20 business plan.

3.56 The following chart shows the expenditure to outturn at each budget setting stage. The chart highlights that operational expenditure is broadly linear, reflecting the more predictable expenditure flows around staffing and contracts for services. The chart also suggests an acceleration of costs towards the year-end as STP launch costs and modelling commissions come on line: