Transport for the North Scrutiny Committee – Item Item 6

Subject:	TfN Budget Revision 2 and Year-to-Date Monitoring
Author:	Gareth Sutton, Financial Controller
Sponsor:	Iain Craven, Finance Director
Meeting Date:	Thursday, 22 November 2018

1. Executive Summary:

1.1 This report provides an update on Transport for the North's financial position after the first six months of financial year 2018/19.

1.2 Taking account of that position, and updated forecasts for the remaining 6 months of the financial year, the report also presents a revised budget for consideration.

1.3 This revised budget is known as 'Revision 2' and provides the third iteration of the budget for the year following the adoption of the opening 'base' budget in April, and the 'Revision 1' budget in August. This will be presented to TfN Board on 6th December for approval

1.3 At Revision 1, a significant adjustment was made to the budget to reflect the revised timetable for delivery of activity related to Phase 3 (Accounts Based Back Office) of the Integrated and Smart Ticketing (IST) Programme. An adjustment was required to reflect the delays to the passage of that phase of the programme through its government approval gateway. The adjustment had the effect of moving £20.99m of Phase 3 activity and associated expenditure into the following financial year.

1.4 That movement reflected the challenging nature of the programme, and the high degree of sensitivity to external factors outside the direct control of the programme team.

1.5 At Revision 2, it is proposed to further reduce the budget for the year. The proposed changes reflect reduced activity and expenditure within the programme areas, principally within the IST programme area as external factors again impact upon expenditure profiles.

1.6 Over quarter 2, it has become apparent that the processes undertaken within train operating companies to enable the procurement of hardware in support of the IST Phase 1 ITSO on Rail programme would slip, pushing forecast quarter 4 expenditure into the forthcoming financial year.

1.7 Whilst that slipped activity will not impact upon the aspiration for the ITSO on Rail project to 'go-live' in December 2018, it does contribute a further £7.90m of underspend for the year, adding to a cumulative £35.53m full-year forecast underspend across the IST programme.

1.8 Underspend does not always indicate a problem. Within the IST programme underspend, c. £2m relates to savings derived from the contracting mechanism adopted in Phase 1, whilst over £5.7m of contingency has been deferred. Contingency has not been required in year as procurement activity has given confidence that contracting can be managed at forecast rates without requiring additional funding. That contingency resource is now available to support other priorities / activity within the programme.

1.9 Adopting a new budget at this stage affords TfN the opportunity to work to a financial budget better aligned to the latest delivery timetables.

1.10 The proposed Revision 2 budget presented in this report stands at £42.15m: £14.37m below the Revision 1 budget and £37.88m below the opening base budget. Of this variance £35.53m (94%) relates to adjustments made to the IST programme's expenditure profile, with costs principally slipping out of financial year 2018/19 into the following period.

1.11 It should be noted that TfN's grant resource is largely restricted to specified activity and is not generally available for redeployment to other priorities when slippage or savings occur.

1.12 As part of this budgetary exercise genuine savings of c. £0.2m were identified from within the core grant funded operational areas. As part of the budget Revision 2 proposals, these savings are redeployed in their entirety to support an extension to Transport for the North's response to the summer rail timetabling issues through a budget uplift to the Rail North teams. This uplift will support the Rail North teams in building upon the skills and capacity that were brought in to manage the initial recovery plan activity.

1.13 Slipped activity will now be incorporated into the 2019/20 business-planning process as an opening budget estimate. Grant resource received in this financial year associated with slipped activity will be carried forward to support the activity in the forthcoming financial year.

2. Recommendation:

2.1 Note the year-to-date underspend of £2.56m against the Revision 1 budget, and £10.27m against the opening budget.

2.2 Note the proposed full-year Revision 2 budget of £42.15m.

2.3 Note the requirement to carry-forward grant to support slipped activity in the new financial year.

3. Issues:

Base Budget Refresh

3.1 TfN's opening 'base' budget was developed as part of the annual business planning exercise that concluded in February 2018.

3.2 That business planning exercise identified the programmes of activity that TfN would undertake, and the costs of delivering them. The exercise also identified the costs associated with developing and maintaining the organisational infrastructure expected of TfN as a public body.

3.3 The business planning exercise led to the adoption of a budget standing at £80.03m for financial year 2018/19.

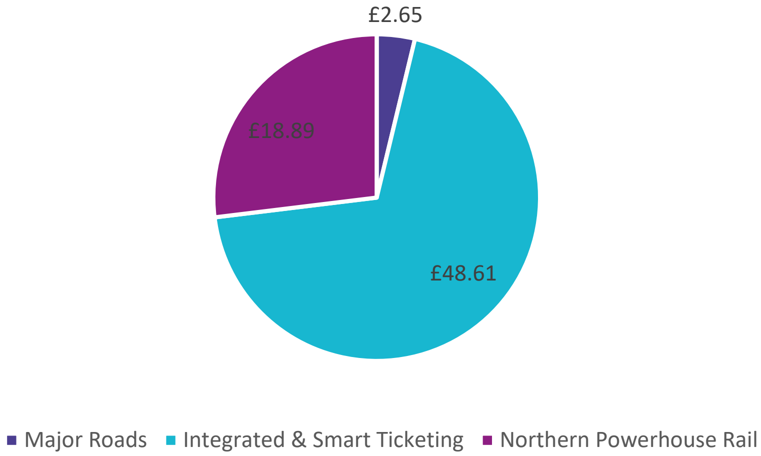
3.4 Recognising the differentiation between delivering discrete programmes and maintaining ongoing activity and basic organisational infrastructure, that budget was further split into two composite portfolios:

Portfolio	Base £m	%
Programmes	£70.15	88%
Operations	£9.89	12%
	£80.04	

3.5 Splitting the budget in this manner encourages cost transparency and oversight by grouping the larger scale and more sensitive programme activity apart from the smaller and more stable patterns of expenditure in the operations areas.

3.6 In this context, it was notable that the majority of TfN's opening budget was centred on its programmes of activity. These programmes are:

a) The Integrated & Smart Ticketing programme (IST);
b) The Northern Powerhouse Rail programme (NPR); and,
c) The Major Roads Network (MRN) programme.

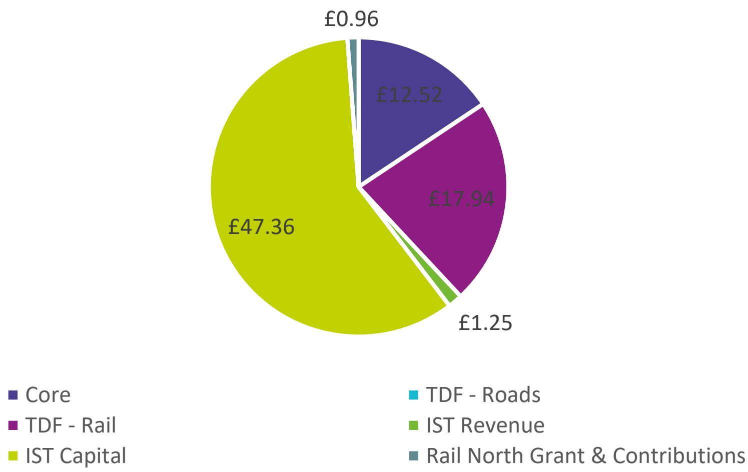


3.7 Together, the programme areas accounted for 88% of the adopted base budget, but also most of the risk.

3.8 Expenditure profiles for the activity were based on assumptions often influenced by external factors, such as the performance of delivery partners and the pace of progress through funding approval gateways. In the case of the IST programme, profiles also included amounts set-aside as contingency reflecting the innovative nature of the activity in line with the requirements of Treasury Guidance on capital programmes.

3.9 The opening base budget was funded from a variety of forecast in-year grant to be received from the Department for Transport, and the use of core-grant reserves accrued from prior-year underspend. The use of reserves in this manner forms part of TfN's prudent reserve strategy that was adopted alongside the budget.

3.10 The following chart shows the sources of funding for the base budget:



3.11 **Year-to-date Budget Adjustments**

Since the adoption of the base budget at the inaugural TfN meeting on 5th April, a number of adjustments have been made to reflect new operating realities. These adjustments ensure that the budget continues to be aligned to delivery profiles, and were agreed as part of the Revision 1 exercise:

a) Budget virements (net-nil movements) were processed over quarter 1 to reflect changes to responsibilities for certain activity;
b) Budget variations (changes to the budget envelope) were considered at quarter 1 to reflect the final outturn position of financial year 2017/18, primarily through the adoption into the budget of slipped prior-year activity;
c) A number of new grants were awarded to TfN over the first two quarters; and,
d) A major budget adjustment exercise was undertaken at the end of quarter 1 (Revision 1) to realign the budget to the latest delivery profiles.

Revision 1 Budget Adjustments

3.12 After the first three months of the year, Transport for the North conducted its first iterative budget adjustment exercise.

3.13 This exercise was designed to realign the budget to the most recent delivery profiles and take account of budget performance over that first quarter. Adjustments were also made for new grants adopted, and internal virements that did not change the organisation's budgetary envelope.

3.14 Such exercises are common to most organisations and reflect both the need for the budget to reflect the organisation's activity and the reality that plans do change as activity progresses.

3.15 The Revision 1 exercise was notable for a major adjustment to the forecast level of expenditure for the year.

3.16 The revised budget removed £23.51m of expenditure, principally from within the programme areas, reducing the organisation's expenditure by 29%:

Portfolio	Revised Base Budget* £m	Revision 1 £m	Variance £m	Variance %
Programmes	£70.17	£46.70	£23.47	33%
Operations	£9.86	£9.83	£0.03	0%
	£80.03	**£56.53**	**£23.51**	**29%**

after virements

3.17 Of this £23.51m reduction, £22.78m or 97% of the variance related to the IST programme, exacerbated by £1.06m of planned underspend within the NPR programme:

Programmes	Revised Base Budget £m	Revision 1 £m	Variance £m	Variance %
Northern Powerhouse Rail	£18.92	£17.85	£1.06	6%
Integrated & Smart Ticketing	£48.61	£25.83	£22.78	47%
Major Roads	£2.65	£3.01	-£0.37	-14%
	£70.17	**£46.70**	**£23.47**	**33%**

3.18 Variations on the NPR programme largely reflected the decision to accelerate activity planned for quarter 1 of financial year 2018/19 into quarter 4 of financial year 2017/18 to support the timely delivery of the NPR SOBC. This decision meant that more expenditure was incurred in the prior financial year than initially planned. Overall, this has been offset by the resulting underspend that occurred in quarter 1 when that work was originally planned to be undertaken.

3.19 Variations on the IST programme represented three principal changes:

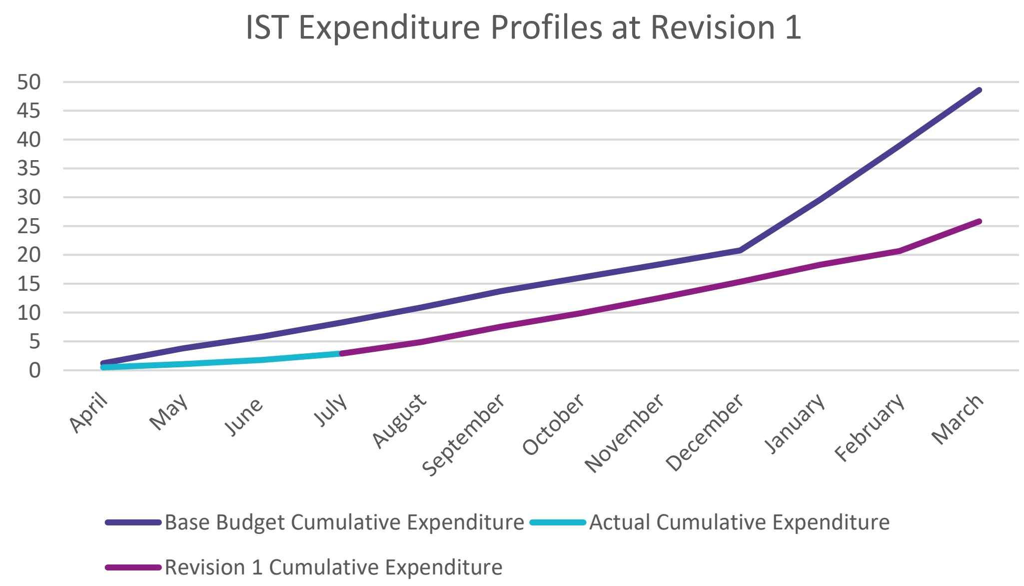
1. The addition of slipped activity from the prior financial year into the Phase 1 ITSO on Rail budget (£1.72m);
2. The removal of contingency and optimism bias in the Phase 2 budget reflecting the successful progression of that project; and,
3. The delays to the passage of the Phase 3 ABBOT project through government's OBC gateway approval process, which affected development profiles and pushed £20.99m of capital development costs into the following financial year.

	Base £m	Revision 1 £m	Variance £m	Variance %
Phase 1	£13.21	£14.10	-£0.89	-7%
Phase 2	£4.04	£1.73	£2.31	57%
Phase 3	£30.11	£9.12	£20.99	70%
Programme Costs	£1.25	£0.88	£0.37	30%
	£48.61	**£25.83**	**£22.78**	**47%**

3.20 Cumulatively, these movements represented a 47% variance to the opening IST budget. This was a material variation to both the IST programme budget, and the Transport for the North budget as a whole.

3.21 Such movements reflect how sensitive the IST programme is to specific events – such as the passage through gateways – and the reliance on external partners for contracting and procurement. These factors make programme management challenging, with associated impacts on budgeting.

3.22 At Revision 1 it was felt that the new expenditure profiles for the IST programme were achievable if the delivery plan ran to course, with most of the more challenging expenditure targets around quarter 4 removed from the budget:



3.23 However, the Revision 1 budget report did highlight the ongoing risk around forecast capital expenditure of platform validators, and budgeted contingency earmarked for that activity. The report noted that there was limited flexibility to absorb slippage on this element of the project without costs slipping entirely out of the financial-year.

3.24 The movements also reflect how sensitive Transport for the North's overall budget position is to the performance of individual programme areas.

3.25 Conversely, at Revision 1, the operational areas that comprise the back, middle, and front office support teams of the organisation were largely forecasting to end the year on-budget:

Operational Areas	Revised Base Budget £m	Revision 1 £m	Variance £m	Variance %
Leadership	£0.34	£0.34	£0.00	0%
Finance	£0.87	£0.88	£0.00	-1%
Business Capabilities	£3.85	£3.66	£0.19	5%
Programme Management Office	£0.51	£0.49	£0.01	3%
Strategy & Policy	£2.71	£2.65	£0.06	2%

Rail North	£1.58	£1.80	-£0.22	-14%
	£9.86	**£9.83**	**£0.03**	**0%**

3.26 This position reflects the more stable and predictable expenditure profiles within the support teams, and the ability to flex budgets to react to issues.

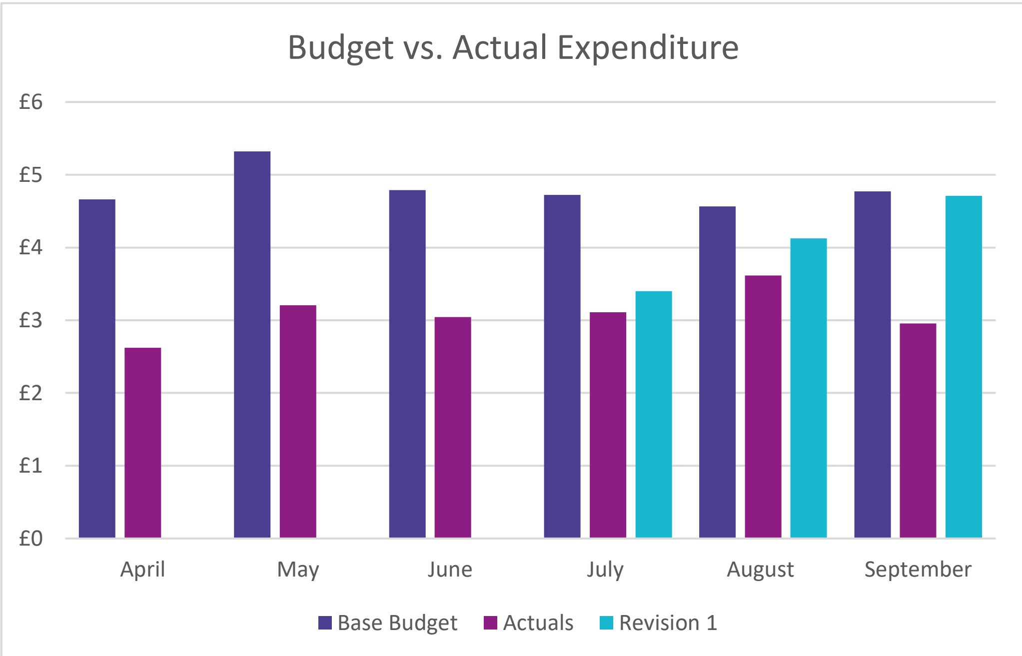
3.27 The latter point is reflected through the decision to reallocate resource from other areas to support Transport for the North's response to the rail timetabling issues that arose during the early summer.

3.28 To enable this response, Transport for the North redeployed core grant resource to match a discrete grant of £0.12m received from the Department. This resource allowed the Rail North team to secure additional skills and capacity.

Financial Performance in Periods 1-6

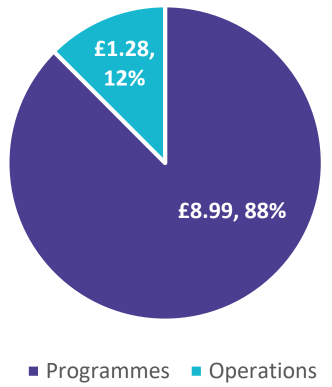
3.29 Over the first six months of the new financial year Transport for the North underspent against the Revision 1 budget forecasts by £2.56m (12%), and the original budget by £10.27m (36%).

3.30 The following graphic highlights that over the course of the year, expenditure has fallen short of the opening and revised budget in every month:

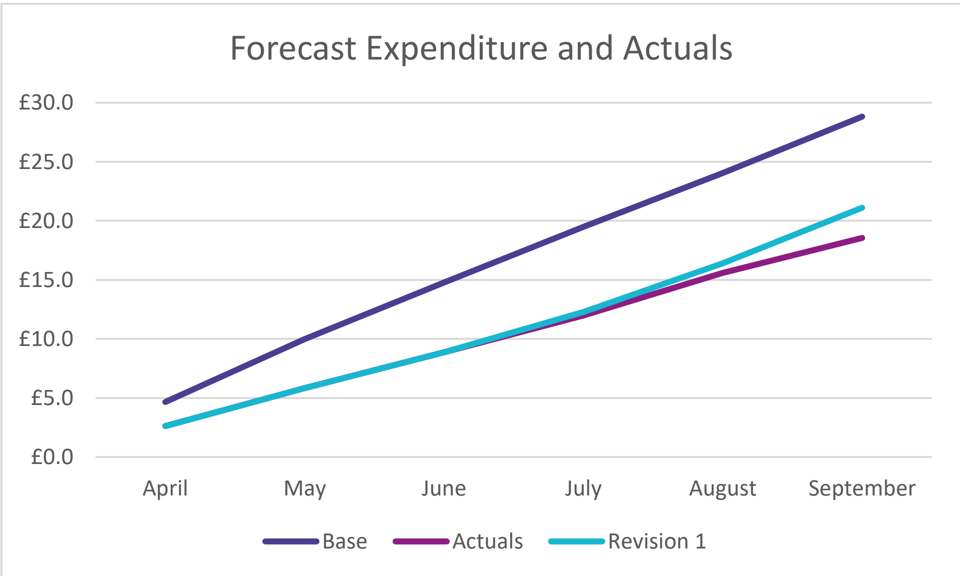


3.31 This underspend principally arose in the programme areas (88%), but was exacerbated by underspend in the operational areas (12%) where planned professional services commissions slipped:

	Base Budget £m	Actuals £m	Variance £m	Variance %
Programmes	£23.67	£14.69	£8.99	38%
Operations	£5.15	£3.87	£1.28	25%
	£28.82	**£18.56**	**£10.27**	**36%**

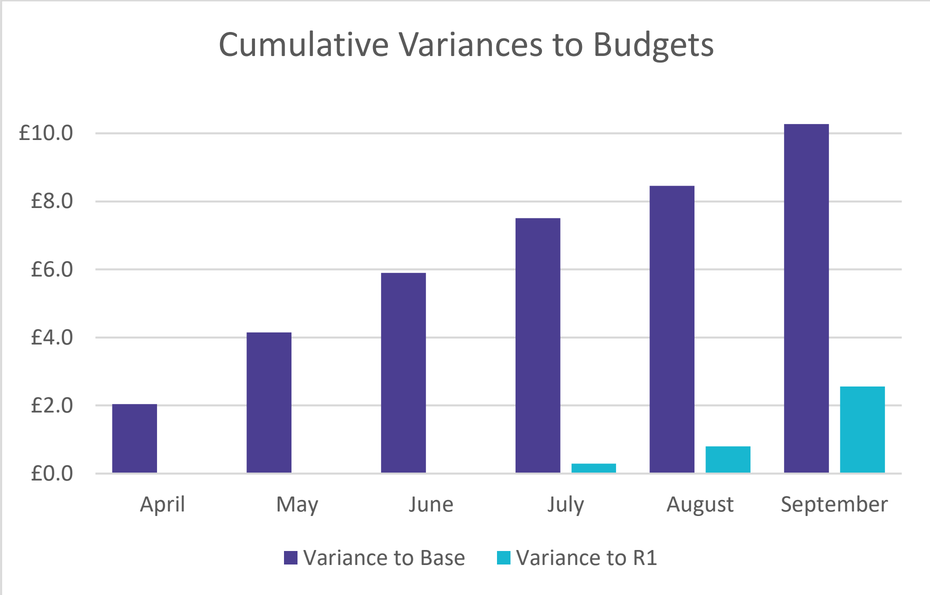


3.32 The following graph highlights that the opening budget quickly diverged from actual expenditure as the reality of the Phase 3 delivery profiles became apparent. Recognising this, officers took the first available opportunity at Revision 1 to adjust the budget to the lower levels of expenditure now expected. Adopting this revised budget has reduced, but not eliminated underspends:



3.33 This picture reflects the assumption that Phase 3 of the IST programme would be in its development stage by quarter 1, having passed its gateway in quarter 4 2017/18, and Phase 1 of the programme would be further into its delivery phase.

3.34 The impact of these two issues on initial forecasts contributed to a c. £2m per month underspend over quarter 1. The Revision 1 budget was adjusted to reflect this:



3.35 Expenditure in the year-to-date highlights that TfN is principally a commissioning body, with the majority of expenditure grouped around the provision of expert third-party professional services for studies and policy support (£9.62m) and the necessary people costs required to deliver the programmes and maintain organisational infrastructure (£4.02m).

3.36 As Transport for the North cannot recover the VAT charged on goods and services, irrecoverable VAT costs also make up a significant amount of the organisation's expenditure (13%). Those VAT costs are variable to other items of expenditure, such that when taxable items of expenditure underspend the associated VAT costs are also not incurred.

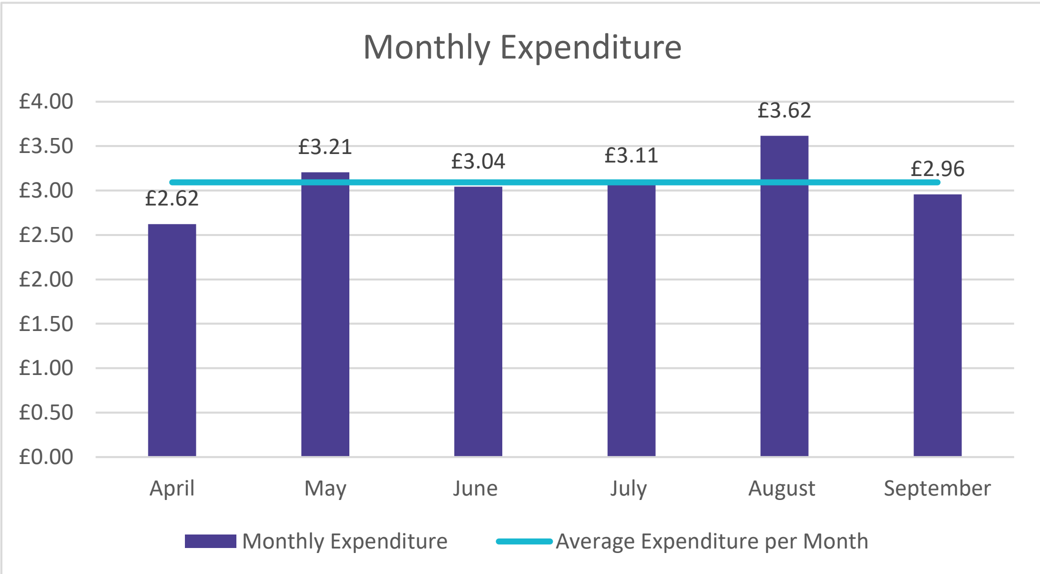
3.37 As noted above, variance analysis by cost-type highlights that the major movements have been within the programme areas, and in particular around forecast capital expenditure in support of the IST programme where expenditure is £7.81m or 81% behind the base budget.

3.38 Capital expenditure underspend precipitates a further £1.56m of VAT underspend. This is further exacerbated by material underspends on professional services.

3.39 Professional services underspends do, in part, correlate to an increase in people costs. Against the base budget, actual expenditure of people costs is running ahead by £0.39m. This principally reflects a change to the IST delivery model, and in particular the planned decision to move away from large, expensive consultancy contracts to more bespoke and often more cost-efficient agency and contractor arrangements. The Professional Service line in the table below includes the Network Rail contract for the delivery of development services for the NPR programme.

Expenditure Type	Base Budget £m	Actuals £m	Variance £m	Variance %
Professional Services	£10.16	£9.62	£0.53	5%
Capital	£9.60	£1.79	£7.81	81%
Irrecoverable VAT	£4.53	£2.47	£2.06	45%
People	£3.63	£4.02	-£0.39	-11%
Stakeholder Engagement	£0.28	£0.12	£0.16	58%
ICT	£0.27	£0.15	£0.12	44%
Premises	£0.18	£0.17	£0.01	7%
Travel	£0.10	£0.10	£0.01	6%
Consumables	£0.06	£0.11	-£0.05	-88%
Insurance	£0.02	£0.01	£0.01	39%
Communications	£0.01	£0.01	£0.00	-5%
Banking Costs	£0.01	£0.00	£0.01	90%
	£28.82	**£18.56**	**£10.27**	**36%**

3.40 Over the first six months TfN's average monthly expenditure has averaged c. £3m:



3.41 This value is around £1.8m short of the monthly run-rate required to meet the base budget forecasts.

Programme Areas Performance in Periods 1-6

3.42 Programme area underspend of £8.99m represents a net figure with underspend in the IST and Major Roads areas offsetting an acceleration of costs and activity ahead of budget in the NPR programme:

Programmes	Base £m	Actuals £m	Variance £m	Variance %
Northern Powerhouse Rail	£7.44	£8.07	-£0.63	-8%
Integrated & Smart Ticketing	£14.74	£5.22	£9.52	65%
Major Roads	£1.49	£1.39	£0.10	7%
	£23.67	**£14.69**	**£8.99**	**38%**

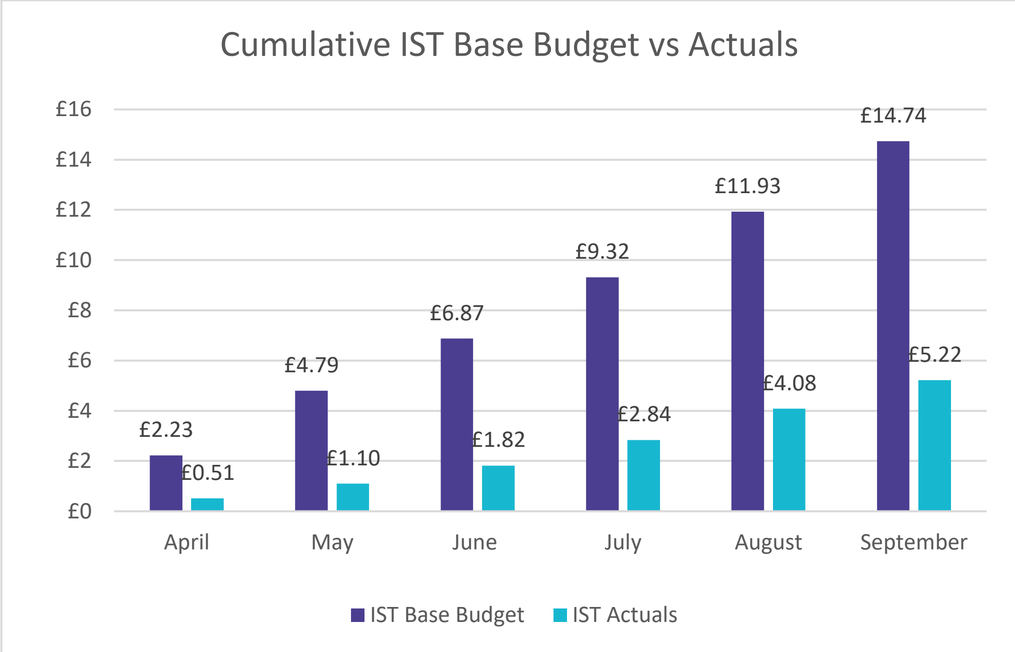
Integrated and Smart Ticketing

3.43 Underspend in the IST programme principally relates to the Phase 1 ITSO on Rail project and continues a trend seen in the previous year, as delays to the conclusion of contracting arrangements with train operating companies (TOCs) impacted on delivery timescales.

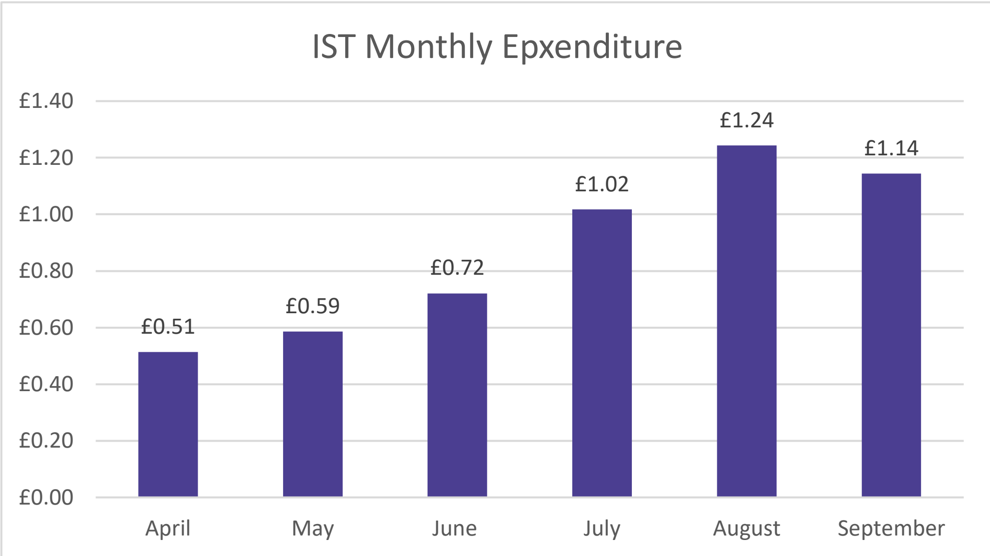
3.44 At Revision 1 it was assumed that with those issues now resolved, costs would accelerate as the TOCs concluded their procurement activity. However, technical issues and delayed TOC procurement have impacted on expenditure on the purchase of platform validators and ticket vending machines, placing Phase 1 further behind budget.

3.45 Phase 1 underspends have been exacerbated by underspends across the entire IST programme, with slippage on Phase 2 and Phase 3 as both phases continue their progress through government's gateway approval processes before entering into the delivery phase:

	Budget £m	Actual £m	Variance £m
Phase 1	£6.70	£2.04	£4.67
Phase 2	£2.39	£0.47	£1.92
Phase 3	£4.98	£2.47	£2.51
Programme Costs	£0.67	£0.25	£0.42
	£14.74	**£5.22**	**£9.52**



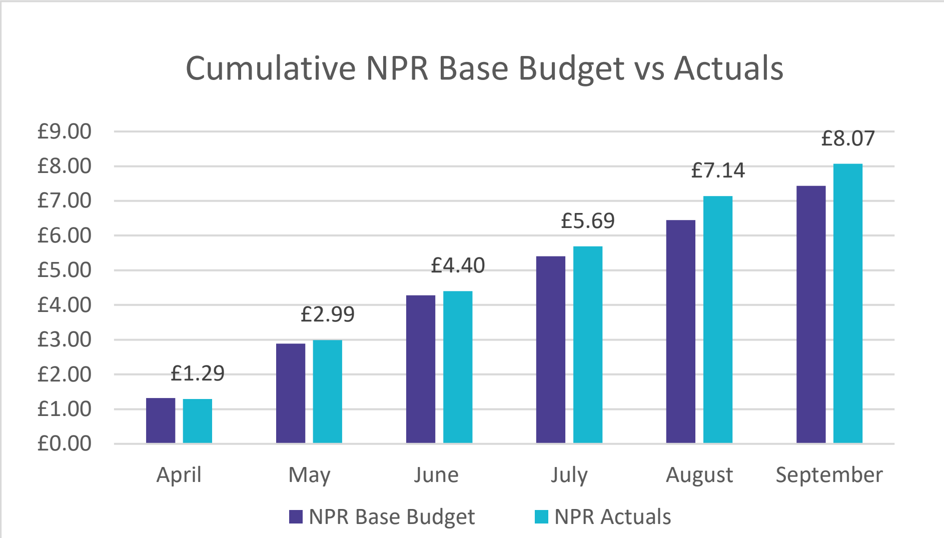
3.46 Despite the prevailing narrative of underspends, IST programme expenditure has increased on a month-by-month basis, only falling short in September when a material capital grant to a TOC did not proceed in the planned timeframe.



<u>Northern Powerhouse Rail (NPR)</u>

3.47 The Northern Powerhouse Rail programme continues to proceed towards the submission of the SOBC document to the Department for Transport at the end of 2018. The programme has spent ahead of budget over the first six months of the year (£0.63m).

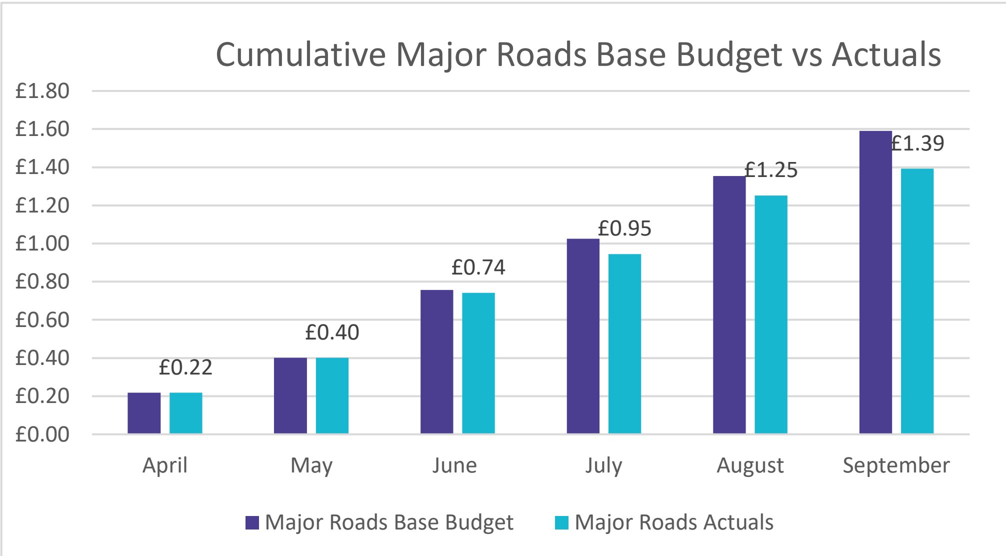
3.48 This acceleration of costs on the Network Rail contract has been tolerated in support of the SOBC delivery. The arrangements for the drawdown of Transport Development Fund grant to resource this activity, as agreed previously with the Department, are sufficiently flexible to support this approach.



<u>Major Roads</u>

3.49 The Major Roads area saw a £0.10m underspend for the first six months of the year representing a marginal movement of c. 7% of its budgeted expenditure. This underspend was principally due to slippage in professional service costs incurred in support of the Strategic Development Corridor (SDC) studies.

3.50 Major Roads slippage is itself largely due to the delays in the release of the required modelling / data analytics. The risks to the delivery timetable, and contractual issues are dealt with as part of the proposed budget Revision 2.



Periods 1-6 Operations Area Performance

3.51 The base budget for the operational areas was set at £5.15m for the first six months of the year. At Revision 1, a material amendment was made to this forecast expenditure profile, with £0.85m of expenditure being moved out into future periods. This was marginally offset by the addition of £0.14m net new Rail North expenditure, representing TfN's response to the Arriva Rail North recovery plan following the summer timetabling issues.

3.52 This decision to slip activity out of the first six months of the year was principally made to reflect a more realistic timeline for the procurement of new basic organisational contracts (ICT, legal, HR), and the need to commission a raft of new professional service engagements within the Strategy and Policy area.

3.53 At Revision 2 the operational areas have fallen behind the base budget by £1.28m and fell behind the Revision 1 budget by £0.57m.

3.54 Against both the opening budget and the Revision 1 budget, underspend was largely concentrated in the Strategy & Policy area (£0.78m/£0.27m) and the Business Capabilities area (£0.34m/£0.14m):

Operations	Base £m	Revision 1 £m	Actuals £m	Variance to Base £m	Variance to R1 £m
Leadership	£0.15	£0.15	£0.15	£0.00	£0.00
Finance	£0.44	£0.42	£0.39	£0.05	£0.03
Business Capabilities	£1.93	£1.73	£1.59	£0.34	£0.14
Programme Management Office	£0.32	£0.19	£0.15	£0.17	£0.04
Strategy & Policy	£1.50	£1.00	£0.73	£0.78	£0.27
Rail North	£0.82	£0.96	£0.87	-£0.05	£0.09
	£5.15	**£4.44**	**£3.87**	**£1.28**	**£0.57**

3.55 A number of year-to-date savings have arisen in the Strategy & Policy area around modelling and economic appraisal professional services support, where contracts have been awarded for less than the budget estimate. In addition to these savings, expenditure has been reduced as a result of staffing savings due to recruitment delays, and slippage in a number of other modelling studies that have not run to the forecast pace.

3.56 Underspend in the Business Capabilities directorate represents underspends across a number of different activity heads. Principally, expenditure in the ICT business area was below budget due to lower than expected costs associated with the implementation of the new back-office systems, and delays to the conclusion of an outsourced ICT systems support contract.

3.57 This was exacerbated by lower than forecast expenditure in the Corporate Communications and Stakeholder Engagement team area (£0.09m), and lower than forecast expenditure in the Programme Management Office as the implementation of a PPMS system was deferred.

3.58 Underspend of £0.09m was also incurred in the Rail North teams. This issue is largely driven by the teams' reaction to the summer timetabling issues, as focus was firmly on the recovery plan.

3.59 Variances in the operational areas are not unexpected at this stage of TfN's organisational life. As systems and processes are embedded, and contracts for services adopted, it is expected that cost profiles will settle down into more predictable expenditure patterns.

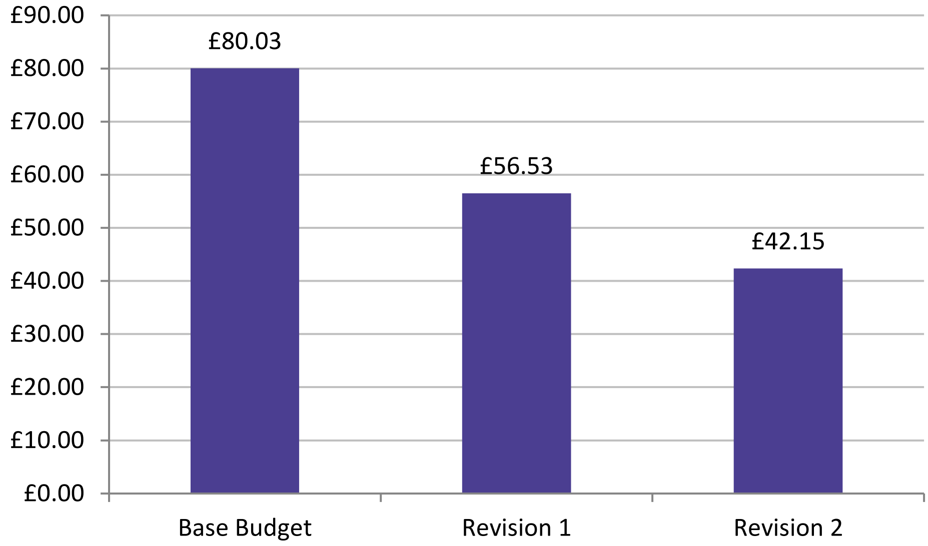
4.0 Proposed Budget to be Adopted as Revision 2

Summary Proposals

4.1 Taking account of the changes to the base budget assumptions discussed; performance over the first half of the year; and the latest delivery plans from the programme teams; it is proposed that a new budget be adopted for the residual 6 months of the financial year. This would be named the 'Revision 2' budget.

4.2 This budget will be better aligned to the latest cost profiling and delivery timetables available to the organisation and will, therefore, afford better transparency over financial activity.

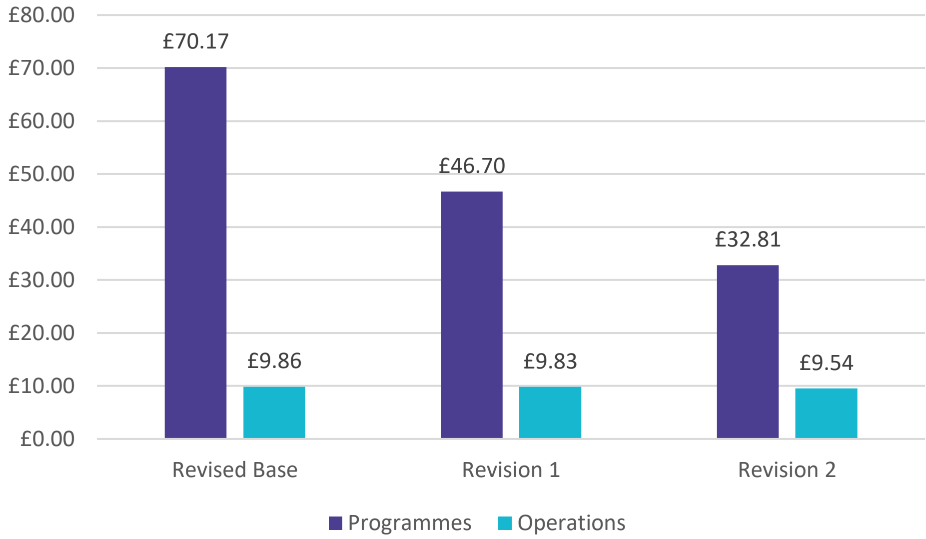
4.3 It is proposed that a revised budget to the value of £42.15m be adopted. This represents a £37.88m, or 47%, reduction on the opening base budget, and a £14.38m (25%) variance on the Revision 1 budget:



4.4 Reflecting the known scale and sensitivity of the programme areas, the Revision 2 budget reduces programme expenditure by a net £37.36m to £32.81m for the year. The Revision 2 budget assumes that expenditure within the operational areas will now underspend by c. £0.53m as planned professional services commissions begin to slip out of the financial year:

Portfolio	Base £m	Rev. 1 £m	Rev. 2 £m	Var. Base-R2 £m	Var Base-R2 %	Var. R1-R2 £m	Var R1-R2 %
Programmes	£70.17	£46.70	£32.81	£37.36	53%	£13.89	30%
Operations	£9.86	£9.83	£9.34	£0.53	5%	£0.49	5%
	£80.03	**£56.53**	**£42.15**	**£37.88**	**47%**	**£14.38**	**34%**

4.5 The following table highlights the movements on the portfolios between the base budget and the Revision 2 proposals, and in particular the major variations on forecast programme area expenditure:



4.6 Programme expenditure variances principally centre on the IST programme, principally reductions in the forecast Phase 3 Accounts Based Back-Office expenditure when considering against the base budget, and Phase 1 when considering variances to the Revision 1 budget.

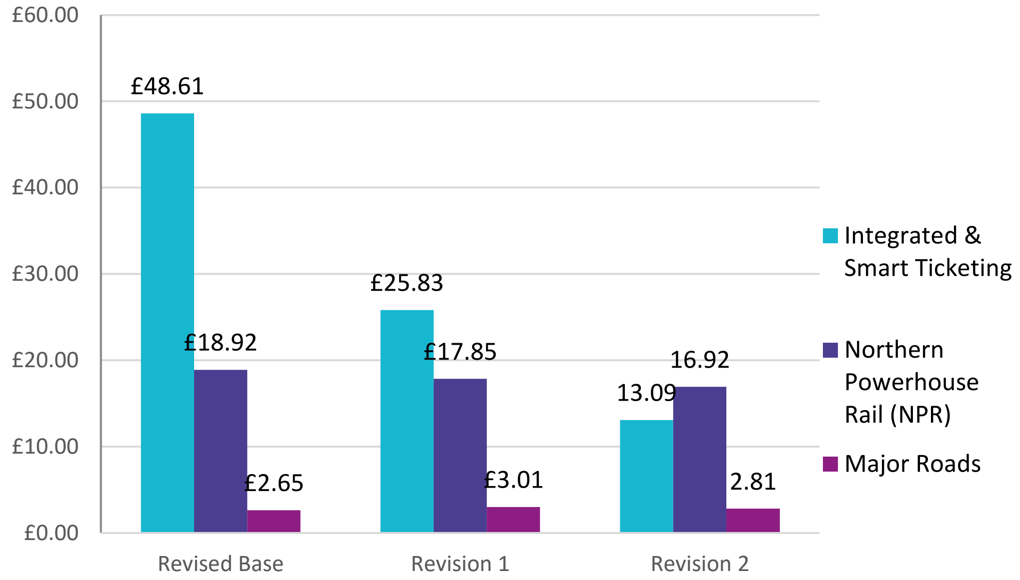
4.7 These issues are compounded by reductions in the in-year NPR programme due to accelerated activity in the prior-year, and savings with regard to the cost of required work in the rest of this financial year.

4.8 Activity in the Major Roads area is forecast to exceed the opening budget but be below the Revision 1 budget. This reflects the absorption of slippage from the prior year that was added at Revision 1, but now the forecast slippage of a number of studies into 2019/20.

4.9 Programme area expenditure is now forecast as follows:

Programmes	Base £m	Rev. 1 £m	Rev. 2 £m	Var. B-R2 £m	Var. B-R2 %	Var. R1-R2 £m	Var. R1-R2 %
Northern Powerhouse Rail (NPR)	£18.92	£17.85	16.92	£2.00	11%	£0.94	5%
Integrated & Smart Ticketing	£48.61	£25.83	13.09	£35.52	73%	£12.74	49%
Major Roads	£2.65	£3.01	2.81	-£0.16	-6%	£0.21	7%
	£70.17	**£46.70**	**£15.90**	**£54.27**	**77%**	**£13.88**	**30%**

4.10 The following table highlights the material movements on the individual programme areas - notably the IST programme - between base budget and the current Revision 2 proposals:



4.11 Operational activity is now expected to underspend against both the opening budget and the Revision 1 budget.

4.12 Operational area expenditure is now forecast as follows:

Operations	Base £m	Rev. 1 £m	Rev. 2 £m	Var. B-R2 £m	Var R1-R2 £m	Var R1-R2 %
Leadership	£0.34	£0.34	£0.28	£0.06	£0.06	18%
Finance	£0.87	£0.88	£0.97	-£0.10	-£0.09	-10%
Business Capabilities	£3.85	£3.66	£3.73	£0.12	-£0.07	-2%
Programme Management Office	£0.51	£0.49	£0.36	£0.15	£0.14	28%
Strategy & Policy	£2.71	£2.65	£1.96	£0.75	£0.69	26%
Rail North	£1.58	£1.80	£2.04	-£0.46	-£0.24	-13%
	£9.86	**£9.83**	**£9.34**	**£0.53**	**£0.49**	

4.13 The prominent changes on Revision 1 principally relate to:

- The forecast slippage of a material number of planned studies to be undertaken by the Transport Analytics Modelling and Economics (TAME) function, along with savings and other deferments within the Strategy and Policy directorate (£0.75m); and,
- The forecast requirement to supplement the existing Rail North response to the Arriva Rail North recovery plan over and above the resource allocated at Revision 1 (£0.24m).

4.14 It is important to note that within these underspends there are two principal drivers:

- Slippage of activity; and,
- Savings.

4.15 Savings are generated from either completing activity in a more cost-efficient manner than initially forecast or by removing the need for a budgeted expenditure item in part or in its entirety.

4.16 Savings generated in this manner are available for redeployment, but such redeployment is often contingent on the grant conditions and restrictions made upon its award.

4.17 Slippage simply reflects timing differences around the completion of activity. When activity is either delayed, deferred, or re-profiled, expenditure profiles must be realigned with it.

4.18 Whilst slippage does create in-period underspends, the resource is still ultimately required and cannot be redeployed to other activity.

The following table highlights that the significant majority of underspend identified at Revision 2 is classified as slippage and is therefore a timing issue. The table further highlights that savings that have been generated within the operational areas have been redeployed in their entirety to support the Rail North resource requirements:

		Base £m	Rev. 1 £m	Rev. 2 £m	Var. £m	Net Save. £m	Slipp. £m
Programmes	IST	£48.61	£25.83	£13.09	£12.74	£2.35	£10.39
	NPR	£18.92	£17.85	£16.92	£0.94	£0.94	£0.00
	Major Roads	£2.65	£3.01	£2.81	£0.21	£0.01	£0.20
Operations	Operations	£9.86	£9.83	£9.34	£0.49	-£0.03	£0.52
		£80.04	**£56.53**	**£42.15**	**£14.37**	**£3.26**	**£11.12**

4.19 It is proposed that the Revision 2 activity be funded in line with the original base budget, through a mixture of in-year grant and brought-forward core grant reserve:

	£m	£m
Total Expenditure		**£42.15**
Resourced from:		
In-Year Grants		
Core Revenue Grant	£10.00	
Transport Development Fund - Roads	£0.12	

Transport Development Fund - Rail	£16.12	
Integrated & Smart Ticketing - Capital	£8.98	
Integrated & Smart Ticketing - Revenue	£0.80	
Rail North Grant & Contributions	£1.07	
		£37.09
Deficit to be Resourced from Reserves		**£5.06**
Reserves		
Draw on Core Revenue Grant Reserve		£1.75
Draw on IST Capital Grant Unapplied		£3.31
		£5.06

4.20 Of note is the lower than forecast requirement to draw upon core grant reserve. This draw was forecast in the base budget to be £2.52m for the year, but as activity slips out of this financial year to the next that requirement recedes. Grant will be held in reserve to resource the slipped activity as it is required.

4.21 The proposed funding drawdown has changed against the base budget to reflect the reduced need for in-year grant; the new grant made available for discrete activity; and the lower need for additional core grant reserve drawdown:

Fund		**Base £m**	**Rev. 2 £m**	**Variance £m**	**Variance %**
Core Revenue Grant	Unrestricted	£12.52	£11.75	£0.77	6%
Transport Development Fund - Roads	Restricted	£0.00	£0.12	-£0.12	-
Transport Development Fund - Rail	Restricted	£17.94	£16.12	£1.82	10%
Integrated & Smart Ticketing - Capital	Restricted	£47.36	£12.29	£35.07	74%
Integrated & Smart Ticketing - Revenue	Restricted	£1.25	£0.80	£0.45	36%
Rail North Grant & Contributions	Restricted	£0.96	£1.07	-£0.11	-11%
		£80.03	**£42.15**	**£37.88**	**47%**

4.22 The Department for Transport is the principal funder of Transport for the North's activity. We therefore meet quarterly with the Department's Sponsorship team and the finance teams responsible for the grants to ensure clear visibility of expenditure and funding requirements between the department and Transport for the North.

Revision 2 – Programme Area Activity

Integrated & Smart Ticketing

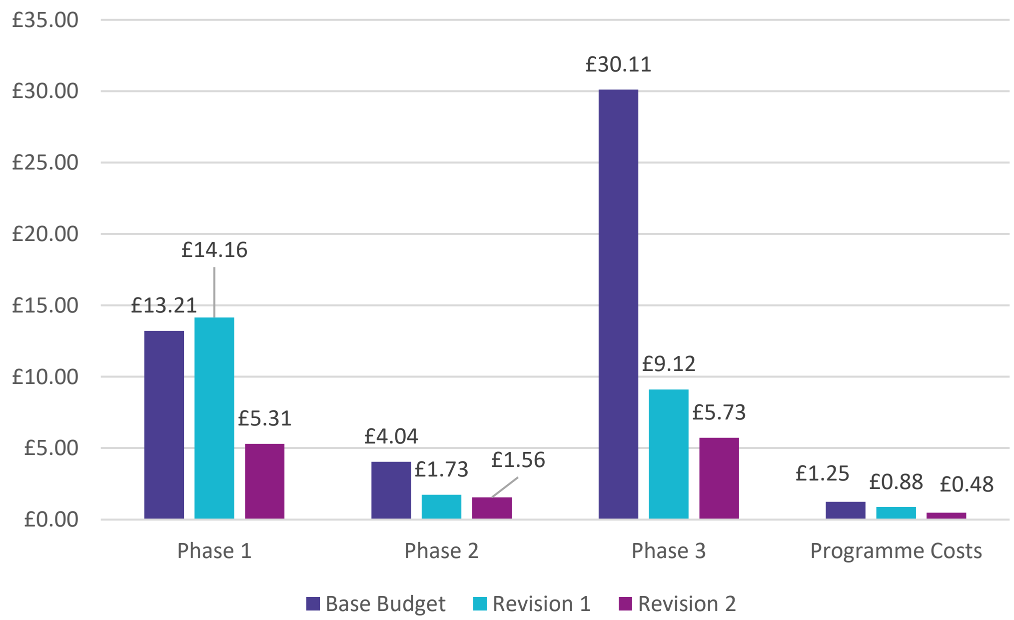
4.23 The principal change at Revision 2 relates to the further material reductions in forecast IST programme expenditure.

4.24 At Revision 1 the IST programme budget was reduced by £22.72m. This mainly related to the removal of contingency and optimism bias on Phase 2, and the significant re-profiling exercise undertaken on Phase 3.

4.25 The Revision 2 proposals reduce the IST programme budget by a further £12.81m to leave the programme with forecast full year expenditure of £13.08m. The significant variations at Revision 2 reflect a major adjustment to the Phase 1 profiles, and a further adjustment to Phase 3 profiles:

Variance to Base	Base £m	Rev. 1 £m	Rev. 2 £m	Var. B-R2 £m	Var. R1-R2 £m
Phase 1	£13.21	£14.16	£5.31	£7.90	£8.85
Phase 2	£4.04	£1.73	£1.56	£2.48	£0.17
Phase 3	£30.11	£9.12	£5.73	£24.38	£3.39
Programme Costs	£1.25	£0.88	£0.48	£0.77	£0.40
	£48.61	**£25.89**	**£13.08**	**£35.53**	**£12.81**

4.26 The following graphic highlights the material movements across all three of the IST Phases between the base budget and the proposals at Revision 2:



4.27 The following table identifies the delta between the opening budgets and the proposals at Revision 2:

	P1 £m	P2 £m	P3 £m	Programme £m
Base Budget	£13.21	£4.04	£30.11	£1.25
+ Virements	£0.00	£0.00	£0.00	£0.00
+ Prior Year Slippage	£1.72	£0.00	£0.00	£0.00
- In-year Slippage and Savings	£9.62	£2.48	£24.38	£0.77
= Revision 1 Budget	**£5.31**	**£1.56**	**£5.73**	**£0.48**

4.28 The material slippage on Phase 3 reflects the known and previously reported delays to the project securing passage through the Department for Transport's OBC gateway, and knock-on delays to procurement of Phase 3 and the submission of a full business case.

4.29 These delays rendered the base budget expenditure profiles out-of-date, with significant amounts of expenditure previously planned for quarter 4 financial year 2018/19 being pushed into financial year 2019/20. At Revision 2, a further adjustment has been made to that adopted at Revision 1 which effectively moves the bulk of all ABBOT capital development costs out of financial year 2018/19.

4.30 Phase 1 forecast expenditure has been significantly reduced at Revision 2 having been increased at Revision 1. The Revision 1 increase reflected the need to absorb brought forward slipped activity from 2017/18, but since that point it has become apparent that TOC procurement processes will afford only limited time to accommodate expenditure on platform validator machines in quarter 4 and will not provide clarity at this stage on the need for contingency associated with those purchases.

4.31 The Revision 1 budget flagged this issue, and the requirement for the contingency attached to this procurement exercise, as a material risk:

'It should be noted, however, that these expenditure profiles retain contingency to the value of £3.72m relating to Phase 1 procurement. The requirement for this resource to be deployed will become clearer as the year progresses. Should the contingency not be required this will be of benefit to the project and the public purse, however it will result in increased underspend against the budget.

4.32 Based upon the latest profiles provided by the programme teams, only one TOC will be in receipt of grant for platform validator purchases in this financial year and only at 20% of the full cost of procurement and implementation. It is now expected that the residual costs will fall into financial year 2019/20.

4.33 As at the time of writing the procurement processes for these purchases were still underway, and therefore a clearer view on the requirement for contingency was not available. This issue will be picked up in the business planning process for financial year 2019/20.

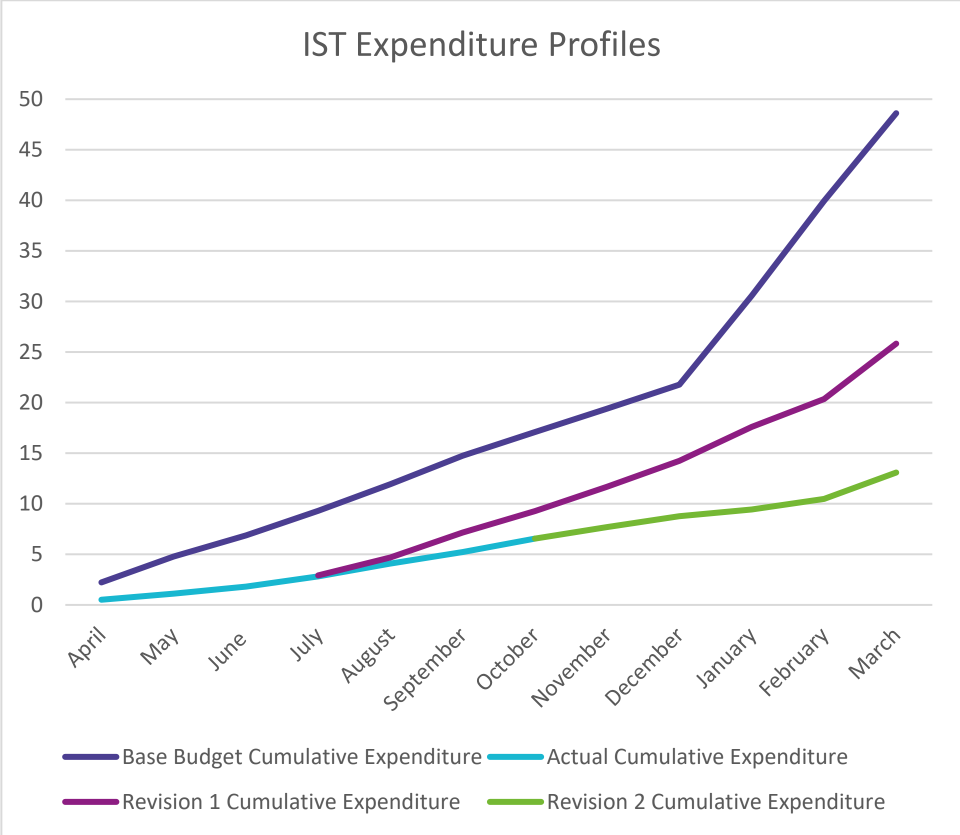
4.34 Timing issues around the implementation of platform validators do not impact on the intention to 'go-live' on ITSO on Rail by December 2018. It is still expected that the programme will achieve this milestone.

4.35 An element of Phase 1 underspend has also accrued due to the treatment of VAT costs on the award of grants to the TOCs. VAT has been budgeted on all IST activity (barring staffing costs) to reflect Transport for the North's inability to recover VAT costs.

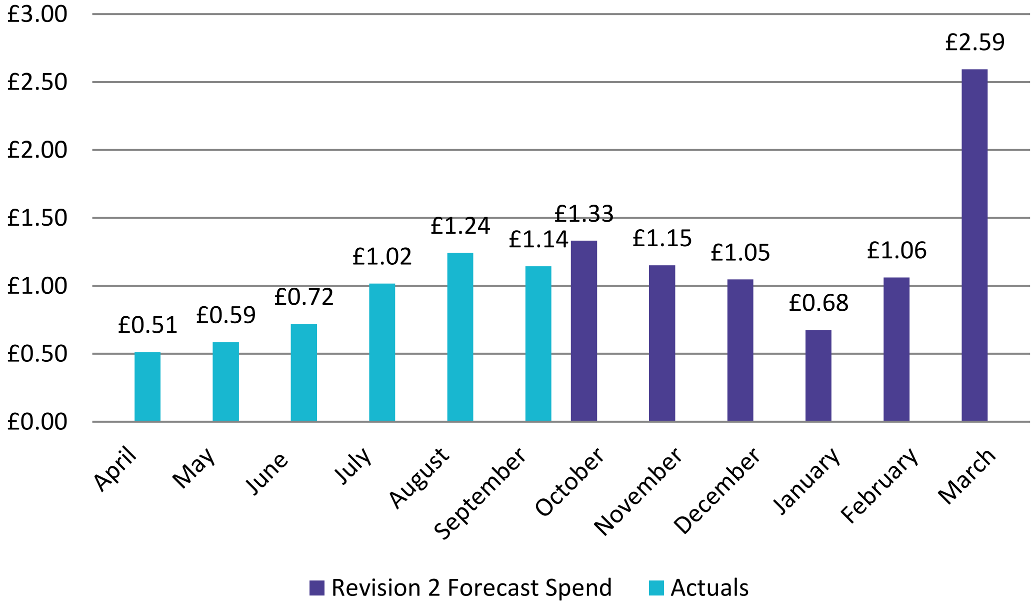
4.36 However, due to the nature of the Phase 1 contracting with TOCs via franchise side-agreements, Transport for the North is transacting with each TOC via grant awards. Grant awards fall outside-the-scope of VAT, and so do not attract irrecoverable VAT costs.

4.37 This factor returns a 'saving' to the IST programme, with resource earmarked for VAT available for redeployment. Government and the public-purse are not disadvantaged as there is no net impact of this approach to HMRC.

4.38 The following graphic highlights that the significant increase in the pace of expenditure forecast for Quarter 4 in the opening base budget has now been reduced, whilst the less pronounced up-tick in quarter 4 costs seen in the Revision 1 budget has also been largely smoothed as further adjustments to Phase 3 activity were made:



4.39 The proposed expenditure profiles as at Revision 2 assume a per-month average expenditure rate of £1.31m. The following profile highlights that in most months expenditure will be at or less than the monthly average in the year-to-date, followed by one larger month in March:



4.40 Expenditure in the final month of the year relates to a number of forecast grant awards to TOCs in Phase 1, and commissions currently under tender in Phase 2.

4.41 Risk remains that small variations could move these costs out of March and into the new financial year. This issue will be monitored and reported on at Revision 3 in the new calendar year.

4.42 TfN has ensured the Department for Transport remain informed of the sensitivity around this programme, including the impact on likely funding requirements in future years, supporting the Department in its cash and budget management.

Northern Powerhouse Rail (NPR)

4.43 The Revision 2 budget reduces forecast NPR expenditure by £2.00m against the base budget and £0.94m against the Revision 1 budget.

Programme	Revised Base £m	Rev.1 £m	Rev.2 £m	Var. B-R2 £m	Var. R1-R2 %
NPR	£18.92	£17.85	£16.92	£2.00	£0.94

Variances reflect a number of issues, notably:

a) The removal of £0.25m of forecast expenditure associated with HS2 consultation activity (£0.30m after VAT);
b) The removal of £0.63m (£0.76m after VAT) of Network Rail contract costs from this financial year; and,
c) Lower than forecast costs for the completion of Pre-Sequence 4 sift activity.

4.44 The second issue reflects that the activity associated with this cost was accelerated into Quarter 4 of the prior year in support of the timely delivery of the NPR strategic outline business case.

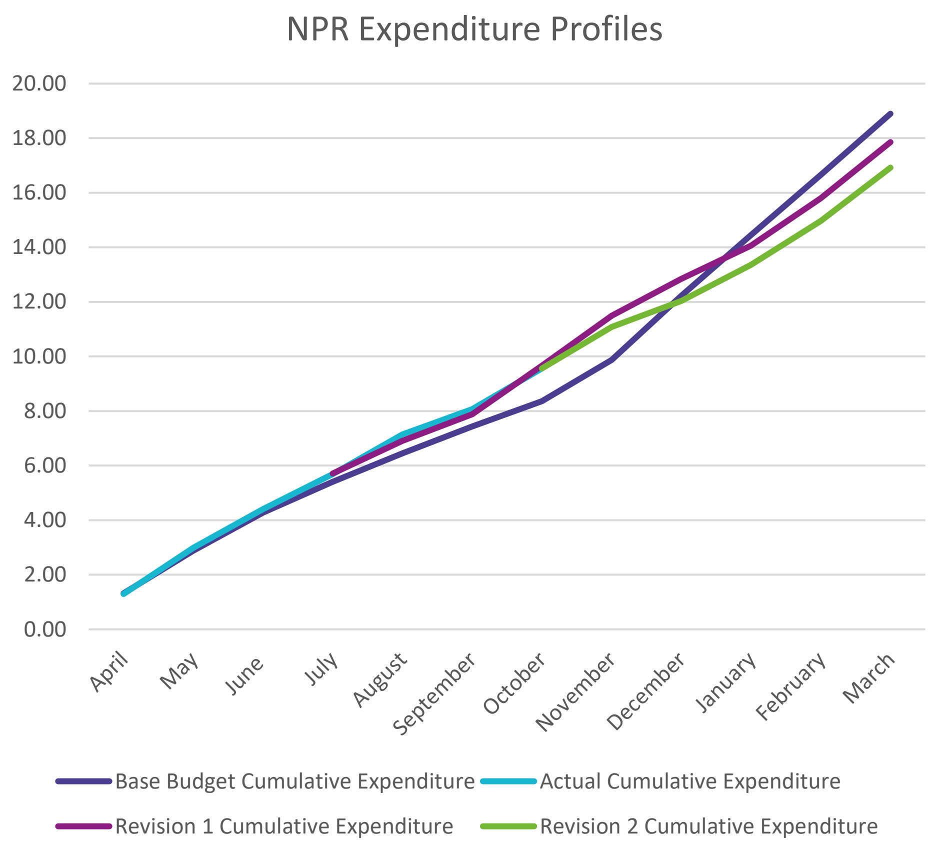
4.45 Of this forecast NPR expenditure, Transport for the North contributes a core grant allocation of £0.8m with the balance (£16.12m) coming from Transport Development Fund (TDF) grant.

4.46 This financial year, the Department has made £20m of TDF available to NPR in cash terms. As the NPR programme only has an in-year requirement of £16.12m, and a need to back-fund prior-year accelerated activity of £0.36m, a balance of £3.5m remains on the TDF allocation.

4.47 In collaboration with the Department and partners through the NPR Programme Board, a decision has been taken to by DfT and TfN to release the headroom to allow HS2 to conduct HS2/NPR touch-point studies.

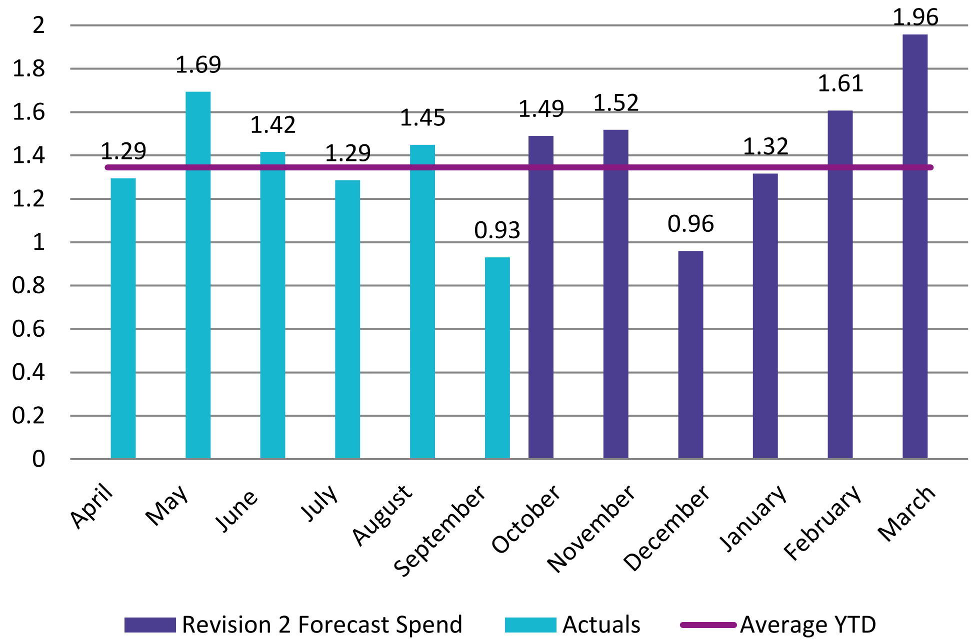
4.48 These studies will complement NPR development and represent a sound use of resources that would otherwise be lost to the North.

4.49 Revised expenditure profiles for the programme highlights that though expenditure has run ahead of the base budget and marginally ahead of the Revision 1 budget over the last quarter, it will begin to fall behind over the final two quarters of the year:



4.50 This position reflects both the acceleration of activity into earlier parts of the year in support of the timely delivery of the NPR SOBC and the lower than forecast costs of the Pre-Sequence 4 sift activity.

4.51 The following table shows the monthly expenditure profiles overlayed onto the average year-to-date monthly expenditure:



4.52 The expenditure profiles reflect the rise and fall of the major Network Rail contracts, with the ramp up to the end of the year reflecting the post SOBC submission acceleration towards Sequence 4 works.

4.53 Performance over the year-to-date and in the prior financial year gives Transport for the North confidence that these expenditure profiles are achievable. It is noteworthy, however, than £0.3m of contingency remains in March's expenditure profile. This element is retained to give the programme team flexibility to react to opportunities or risks that may arise.

Major Roads Programme

4.54 The Major Roads programme's cost-base is centred around the delivery of the Strategic Development Corridor studies. The budget adjusted for Revision 1 shows an increase in expenditure of £0.16m over the base budget, but a reduction on the Revision budget of £0.21m.

Programmes	Base £m	Rev.1 £m	Rev.2 £m	Var. B-R2 £m	Var. R1-R2 %
Major Roads	£2.65	£3.01	£2.81	-£0.16	£0.21

4.54 This position reflects a number of movements, including the addition of new grant and the accommodation of prior-year slippage:

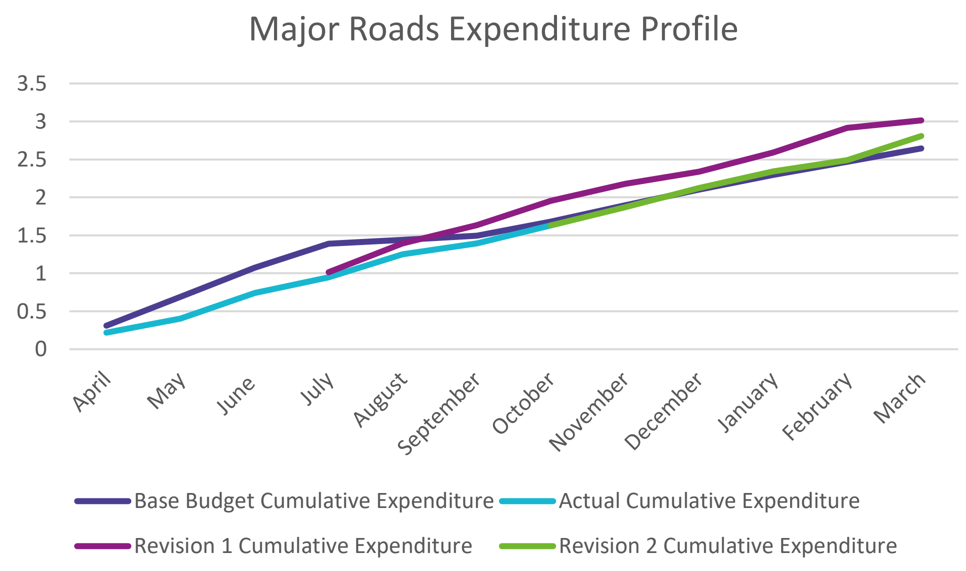
	Major Roads £m
Base Budget	£2.65
+ Virements	£0.00
+ Prior Year Slippage	£0.23
+ New Grant Award	£0.12
- Slippage	£0.19
= Revision 1 Budget	**£2.81**

4.55 New grant was awarded from the Highways Agency for a Trans-Pennine Tunnel modelling related study in year, but this is offset by forecast slippage.

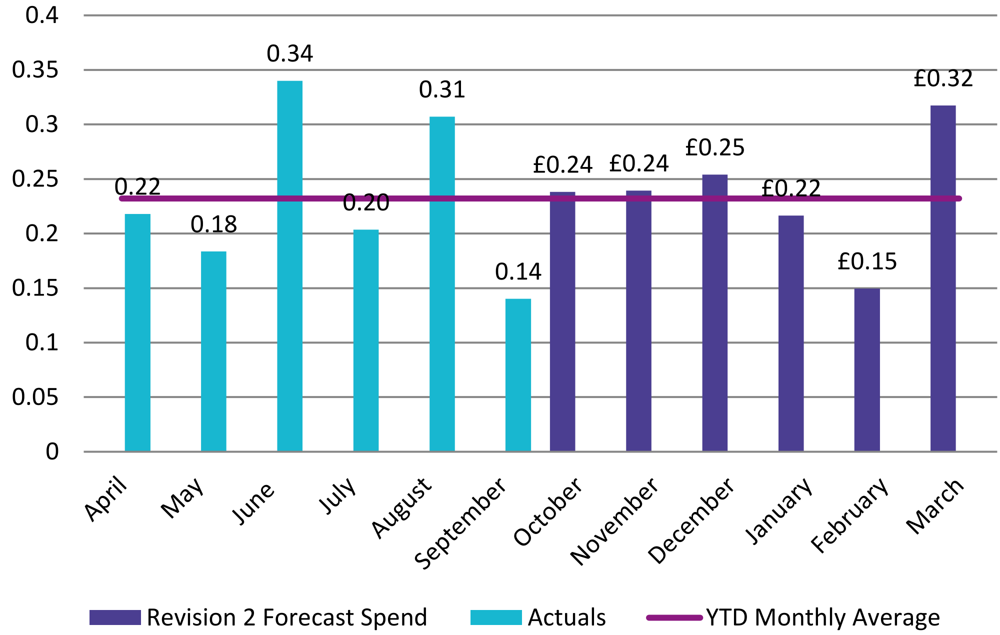
4.56 Slippage has largely arisen due to delays in the provision of data analytics required to support the Strategic Development Corridor studies. Without key data-sets, these studies cannot progress, which has led to the loss of time and the risk that suppliers are unable to deliver within agreed budgets.

4.57 This situation is being actively managed by officers, and budgetary provision has been taken with the Major Roads budget area to support any claim that is made against the organisation.

4.58 The following graphic highlights that although expenditure has fallen behind budget over the year-to-date, it is now expected to climb ahead of the base budget over Quarter 2 as costs catch up to profile and then accelerate beyond:



4.59 The following table shows that a forecast monthly run-rate to the end of the financial year of £0.24m is achievable in the context of the year-to-date monthly expenditure of £0.23m:



Core Operations

4.60 The core operations area is forecast to underspend against the base budget by £0.55m, and against the Revision 1 budget by £0.49m:

Operations	Base £m	Rev. 1 £m	Rev. 2 £m	Var. B-R2 £m	Var R1-R2 £m	Var R1-R2 %
Leadership	£0.29	£0.34	£0.28	£0.00	£0.06	18%
Finance	£0.87	£0.88	£0.97	-£0.10	-£0.09	-10%
Business Capabilities	£3.82	£3.66	£3.73	£0.09	-£0.07	-2%
Programme Management Office	£0.51	£0.49	£0.36	£0.15	£0.14	28%
Strategy & Policy	£2.81	£2.65	£1.96	£0.86	£0.69	26%
Rail North	£1.58	£1.80	£2.04	-£0.46	-£0.24	-24%
	£9.89	**£9.83**	**£9.34**	**£0.55**	**£0.49**	

4.61 This variance does, however, mask a number of in-year movements including: virements; the accommodation of brought forward slippage; the adoption of new grants; and, in-year underspends and cost pressures:

Operations	Base £m	Virement £m	Slippage £m	Addition. Grant £m	Net In-Year Movement £m	Revision 2 £m
Leadership	£0.29	£0.06	£0.00	£0.00	-£0.06	£0.28
Finance	£0.87	£0.00	£0.00	£0.00	£0.10	£0.97
Business Capabilities	£3.82	£0.03	£0.00	£0.00	-£0.12	£3.73
Programme Management Office	£0.51	£0.00	£0.00	£0.00	-£0.15	£0.36
Strategy & Policy	£2.81	-£0.11	£0.04	£0.00	-£0.79	£1.96
Rail North	£1.58	£0.00	£0.16	£0.11	£0.19	£2.04
	£9.89	**-£0.02**	**£0.20**	**£0.11**	**-£0.64**	**£9.34**

4.62 The principal source of movement in-year has been around the Rail North area, where the reaction to the rail time-tabling issues were felt most keenly.

4.63 Rail North started the year with a cost pressure of around £0.16m on slippage brought forward from the prior year relating to professional service activity.

4.64 This was then exacerbated by the need to resource TfN's response to the Arriva Rail North recovery plan through the acquisition of additional capacity for the team. The Department for Transport have indicated that they will release £0.11m of new grant to support this activity, with TfN meeting the balance from its core grant resource and in-year savings.

4.65 As part of the Revision 2 and business planning process, the Rail North team identified an ongoing need for the capacity and skills that were brought into the organisation to support the initial Transport for the North response.

4.66 Whilst the specific on-going requirements are being developed, a budget provision has been taken (£0.24m) through the use of underspends and deferment of other activity, noting the imperative to support this key Northern priority.

4.67 Since Revision 1 it has become apparent that a number of studies within the Strategy and Policy directorate will now likely slip into the new financial year. In particular, a number of proposed projects have now been cancelled with the TAME team reflecting their prioritisation of work on the delivery of the NPR SOBC and the Strategic Development Corridor studies.

4.68 In addition, within the Policy team savings were made on the STP consultation and in relation to further work on the Transport for the North funding framework which has been deferred awaiting the development of the Strategic Transport Plan key messages, and the development of a Transport for the North Corporate Strategic Plan.

4.69 Transport for the North's operational areas are predominantly funded from core grant. That core grant consists of in-year allocations and brought forward reserves. Slippage reduces the need for use of reserves in-year, though that reserve will be needed in future periods when activity does progress.

Cash Position

4.70 As at the end of Period 6, Transport for the North's cash position remained robust. Balances were principally held by TfN in its own right, though cash was also retained by Greater Manchester Combined Authority to allow it to discharge the obligations it entered into as TfN's financial accountable body during its pre-statutory body phase.

4.71 Transport for the North started the financial year with £15.39m of cash at bank. Since that point, the Department for Transport has advanced funds in relation to activity for the new financial year (£13.12m), whilst cash payments of £16.42m have been made.

4.72 At the close of Period 6, Transport for the North retained £12.09m cash in liquid deposit accounts, which after cash is set aside for existing obligations leaves £5.41m of uncommitted resource:

	TfN £m	GMCA £m	Total £m
Opening Cash Position	**£0**	**15.39**	**15.39**
Transfers	£9.45	-£9.45	£0.00
Grants Received	£13.12	£0.00	£13.12
Payments Made	-£10.66	-£5.76	-£16.42
= Closing Cash Position	**£11.91**	**£0.18**	**£12.09**
- Accrued Expenditure	-£6.65	-£0.03	-£6.68
= Net Available Cash	**£5.26**	**£0.15***	**£5.41**

**to be returned to TfN following the final settlement by GMCA of outstanding amounts incurred on behalf of TfN through its role as TfN's accountable body*

4.73 This cash is earmarked to resource part of this financial year's budget and Transport for the North's target year-end cash reserve balance of no less than £3m of core grant reserve.

Grant Unapplied and Reserves

4.74 TfN holds unapplied grants and reserves on its balance sheet awaiting deployment.

4.75 These balances are held as part of TfN's adopted reserve strategy which aims to retain a core grant cash buffer against financial shock and enable the organisation to react to opportunities that may arise. As part of this strategy TfN aims to hold no less than £3m in core-grant reserve at the end of financial year 2018/19, with that value reducing down to £2m by the end of financial year 2019/20.

4.76 At this stage TfN is forecast to hold in excess of its target year-end core grant reserve. This is principally due to the accommodation of brought-forward slippage within the Revision 2 budget, which has reduced the need to carry-forward 2017/18 slipped grant resource, and the addition of in-year slippage. It is anticipated that this resource will now largely be required to fund current year slippage that will fall into the next financial-year:

Grant & Reserves	Bal b/f £m	Expend. £m	Received £m	Required £m	Bal c/d £m
Core Revenue Grant	£6.16	-£11.75	£5.00	£5.00	£4.41
Transport Development Fund - Roads	£0.00	-£0.12	£0.00	£0.12	£0.00
Transport Development Fund - Rail	-£0.37	-£16.12	£7.89	£8.60	£0.00
Integrated & Smart Ticketing - Capital	£3.32	-£12.29	£5.00	£3.97	£0.00
Integrated & Smart Ticketing - Revenue	£0.00	-£0.80	£3.00	£0.00	£2.20
Rail North Grant & Contributions	£0.00	-£1.07	£0.12	£0.95	£0.00
	£9.11	**-£42.15**	**£21.01**	**£18.64**	**£6.61**

5. Options Considered:

5.1 The Revision 2 budget proposed in this paper has been developed with budget holders across the organisation.

5.2 An opportunity to amend this proposed budget will be available at the end of Quarter 3 before the close of the financial year.

6. Considerations:

6.1 TfN must operate to a budget throughout the financial year. It is proposed that a new 'Revision 2' budget be adopted at this stage to align to the latest programme delivery timetables.

7. Preferred Option:

7.1 This report recommends that the Revision 2 budget proposal be adopted by TfN Board in December 2018.

7.2 Continuing to work to the Revision 1 budget would reduce the value of financial monitoring and reporting, as the financial planning would be misaligned to delivery activity.

List of Background Documents

Required Considerations

Please confirm using the yes/no options whether or not the following considerations are of relevance to this report.

Equalities:

Age	~~Yes~~	No
Disability	~~Yes~~	No
Gender Reassignment	~~Yes~~	No
Pregnancy and Maternity	~~Yes~~	No
Race	~~Yes~~	No
Religion or Belief	~~Yes~~	No
Sex	~~Yes~~	No
Sexual Orientation	~~Yes~~	No

Consideration	Comment	Responsible Officer	Director
Equalities	A full impact assessment has not been carried out because it is not required for this report.	Gareth Sutton	Iain Craven

Environment and Sustainability

~~Yes~~	No

Consideration	Comment	Responsible Officer	Director
Sustainability / Environment	A full impact assessment has not been carried out because it is not required for this report.	Gareth Sutton	Iain Craven

Legal

~~Yes~~	No

Consideration	Comment	Responsible Officer	Director
Legal	The legal implications have been considered	Gareth Sutton	Iain Craven

	and are included in the report.		

Finance

Yes	~~No~~

Consideration	Comment	Responsible Officer	Director
Finance	The financial implications have been considered and are included in the report.	Gareth Sutton	Iain Craven

Resource

Yes	No

Consideration	Comment	Responsible Officer	Director
Resource	The resource implications have been considered and are included in the report.	Gareth Sutton	Iain Craven

Risk

Yes	~~No~~

Consideration	Comment	Responsible Officer	Director
Risk	A risk assessment has been carried out and the key risks are included in the report.	Gareth Sutton	Iain Craven

Consultation

~~Yes~~	No

Consideration	Comment	Responsible Officer	Director

Consultation	A consultation has not been carried out because it is not required for this report.	Gareth Sutton	Iain Craven