

Transport for the North Audit and Governance Committee – Item 7a

Subject: Integrated Smart Travel – Phase 1 Asset Monitoring

Author: Pippa Ambrose

Sponsor: Iain Craven

Meeting Date: 10 July 2019

It is anticipated that the public will be excluded from the meeting during consideration of this item because it is likely that there will be disclosure of confidential information as defined in s100A(2) of the Local Government Act 1972 (as amended) and / or of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972 (as amended).

1. Purpose of the Report:

- 1.1 At the Audit and Governance Committee meeting on 13 June, members requested further information regarding how the IST Phase 1 expenditure is managed, and the process for the ongoing monitoring of the assets created through the programme.
- 1.2 The Committee is asked to note the contents of this report.

2. Executive Summary:

- 2.1 The vision of the Integrated Smart Ticketing programme is to focus on encouraging more customers to travel by public transport throughout the region in support of economic growth. This vision can be achieved through enabling greater accessibility to public transport by making it easier for customers to work out the best options available, by making the pricing simple to understand and by making it easier to pay. The programme is split into three phases, phase 1 focuses on the introduction of Smartcards, phase 2 on improving bus disruption information to customers and innovation, phase 3 focuses on introducing a contactless payment method.
- 2.2 Following receipt of Ministerial approval in October 2017, the Integrated Smart Ticketing (IST) Phase 1 project (the northern element of the national smart ticketing on rail programme) received funding, as outlined in the Full Business Case, from HM Treasury.
- 2.3 CAPEX and OPEX funding is capped and clearly identified within the various funding agreements entered into by Transport for the North

with Northern, TransPennine Express and Merseytravel. Other franchises that operate in the North, but where the North is not the focus of their operations, are being managed by the Department for Transport (DfT) through the national programme.

- 2.4 For Northern and TPE, both hardware and software upgrades will be categorised as a Primary Franchise Asset and the contracts put in place to undertake the work will be deemed a 'Key Contract'. This affects how they are treated once they have been installed and commenced in operation. For Merseytravel the CAPEX items will be categorised as a Primary Asset for the purposes of the Concession Agreement
- 2.5 The agreements include a mechanism for overpayment.
- 2.6 As per the agreements Northern, TPE and Merseytravel submitted an implementation plan to monitor progress of delivery and are required to submit a report summarising the use and take up of tickets on smart media. These reports are used by the IST Phase 1 team to monitor their performance.

3. Phase 1 Financial Management – Governance process

- 3.1 Phase 1 will fund a variety of software upgrades to enable Northern and TPE Websites, Ticket Offices, On-Train and self-service ticket machines to retail any Season ticket to a Smartcard. Customers will also be able to purchase a Season ticket from the website and load their Season ticket onto a Smartcard via a Gateline, android phone and self-service ticket machines. In terms of hardware funding, Northern, MerseyRail and TPE will procure and install a number of Platform Validators, this equipment will support both the introduction of a flexible season ticket on Northern and delivery of phase 3 of the programme.
- 3.2 Transport for the North developed the Phase 1 ITSO on Rail Business Case during 2016/17. Prior to the document being formally submitted to the DfT, it was required to pass the Transport for the North assurance process by passing the final stage gate, stage 'Gate D'. This gate aligns with DfT 'OGC Gateway Review 3', and as such the review was based on the relevant OGC requirements for this stage, which had a particular focus on costs and commercial arrangements. In May 2017, the Transport for the North Gateway Review panel scored the Phase 1 FBC as "Green – Requirements fully met' and consequently the document was formally submitted to the DfT.
- 3.3 In June 2017 the DfT Rail Investment Board (RIB) approved the Phase 1 FBC and in October 2017 Transport for the North received formal approval from the Minister to proceed with the delivery of the Phase 1 FBC.

- 3.4 Following receipt of the formal approval from the Minister, Transport for the North entered into contractual agreements with Northern and TransPennine Express (TPE) (via a Franchise Side Agreement) and Merseytravel (via a Memorandum of Understanding). These agreements were all executed in March 2018.

3.5 ***Phase 1 Contractual Agreements – CAPEX***

Each agreement states the maximum CAPEX funding allowed on each of the specific investments required to deliver the Phase 1 FBC. Where savings are made on these specific investments, TOCs have the capability, with the consent of Transport for the North, to utilise these savings and increase the level of expenditure on other CAPEX investments stated within the agreements.

To request consent from Transport for the North, Northern, TPE or Merseytravel must submit an application to re-invest the savings. For requests under £20,000, the Phase 1 Senior Project Manager, Transport for the North's Financial Controller and IST Business Design Lead must all approve the application. Where the re-investment is above £20,000, approval must also be sought from the IST Programme Director.

In addition to the re-investment of savings, the contractual agreements also provide TPE, Northern and Merseytravel with a contingency fund. This is available to cover any additional costs beyond those stated in the agreement and, as with a re-investment of savings, a formal application needs to be submitted requiring the same approvals as a re-investment of savings.

3.6 ***Phase 1 Contractual Agreements – OPEX***

Each agreement caps the annual OPEX cost and at the same time defines what OPEX costs will be covered.

Transport for the North shall pay OPEX costs either for two years from the date in which Smartcards are launched for widespread use or 31st March 2021, whichever is the earliest. After this time, DfT shall pay the OPEX for Northern and TPE until the expiry or early termination of their Franchise Agreement. Following the period of TfN OPEX funding, MerseyRail shall be responsible for the OPEX costs for the remaining life of the CAPEX items or remaining term of Concession Agreement.

In order to demonstrate their OPEX costs, Northern, TPE and Merseytravel are required to monitor the costs and provide Transport for the North with period/monthly reports and copies of disaggregated invoices to determine the actual OPEX to be reimbursed. Where OPEX items have not been defined but are found to be required to deliver the agreed scope of the Project, Transport for the North will with review and seek appropriate internal approvals in line with the CAPEX approvals, before agreeing to any changes.

The agreement also notes OPEX is limited to those items of expenditure which the train operators are not currently liable for under other franchise/concession obligations.

3.7 **CAPEX and OPEX – Supporting Information/Overpayment**

Transport for the North is also entitled to request any reasonable information in respect of either capital or operational costs incurred including:

- i. the right to audit any financial reports of the Franchisee and members of its Group and any invoices associated with the delivery of the relevant Milestones (including invoices from suppliers to the Franchisee);
- ii. the right to open book information in respect of the costs incurred by the Franchisee itself and any members of its Group.

If such information reveals an over payment, Transport for the North has the mechanism in place via the agreements to ensure such overpayment is repaid promptly.

3.8 **Primary Franchise Assets (Northern and TPE)**

The following test is an extract from the contracts.

"The agreement for Northern and TPE states for those CAPEX items which become Franchise Assets, they shall request the Secretary of State designates those Franchise Assets as Primary Franchise Assets (as defined in and for the purposes of the Franchise Agreement). Management of these Primary Asset will be in line with the terms of their Franchise Agreement.

Further, the Franchisee shall request the Secretary of State designates as Primary Franchise Assets existing (not new) equipment which are Franchise Assets and are upgraded or modified by the Franchisee in conjunction with funding from this project, subject to the additional provisions provided below. The Franchisee shall also request that the Secretary of State designate as Key Contracts any contracts entered into by the Franchisee for the lease or maintenance of any items used in order to implement this project.

such designations shall be on the basis that:

- a. *in relation to any contract, lease, licence or other equivalent arrangement so designated and transferred to a Successor Operator under any Transfer Scheme, as per the Franchise Agreement;*
- b. *new hardware transfers to a Successor Operator at nil value;*

- c. in relation to existing equipment which is upgraded or modified in conjunction with and funded by this project, any transfer of such equipment to a Successor Operator under a Transfer Scheme shall be at the written down book value of such equipment in the accounts of the Franchisee as at the date of transfer, disregarding for the purposes of this calculation any value attributed to upgrades funded pursuant to this agreement.*

It is further agreed in relation to existing equipment which is designated a Primary Franchise Asset under this paragraph, the Franchisee shall be permitted to undertake sale and leaseback arrangements in relation to such equipment as upgraded or modified with the consent of the Secretary of State”.

- 3.9 In practical terms, this means that the assets that Transport for the North has created become a part of the ongoing franchise. The DfT, which has fully funded the Transport for the North programme through grant allocations, has an existing process for the management of Franchise Assets. This process ensures that such assets are registered and managed so that they can be passed on to any incoming franchisee as part of the franchise hand over process. The designation of the assets that have been created by Phase 1 as Franchise Assets allows them to be managed through mainstream DfT processes, meaning that Transport for the North (which is not funded in the longer term to carry out this activity) does not need to deploy resources to this end.
- 3.10 Rail North Partnership has the mechanisms in place through the Franchise Agreement to manage the Franchise Assets.

4. Utilisation of Assets

- 4.1 To satisfy Transport for the North that funding has been appropriately spent Northern, TPE and Merseytravel are each required to submit a monthly report summarising the use and take up of tickets on smart media.
- 4.2 Four/Five Phase 1 Quality Assurance stage gates have been developed, as a means of evidencing Transport for the North funding is delivering the desired outcomes of the FBC. Stage gate 1 of the Quality Assurance process focused on the activities delivered by the Pilot. This first stage gate was approved by the Phase 1 Project Board in May 2019. Stage gate 2 builds on stage gate 1 and looks at the geographical area of Northern, TransPennine Express and Merseytravel.
- 4.3 Various pieces of Customer Insight work have been completed, including a baseline survey for Phase 1 only, a baseline survey for the IST Programme, a Phase 1 'panel' survey (provides further insight into

customers opinions of Smart ticketing) and a 'timings' report. These activities will determine the projects benefit realisation and how they compare to the benefits stated in the FBC.

List of Background Documents:

All background documents are commercially confidential.

Required Considerations

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 this is a report that provides a technical description of processes.	Pippa Ambrose	Iain Craven

Environment and Sustainability

Yes	No
-----	----

Consideration	Comment	Responsible Officer	Director
Sustainability / Environment – including considerations regarding Active Travel and Wellbeing	A full Impact assessment has not been carried out because this is a report that provides a technical description of processes.	Pippa Ambrose	Iain Craven

Legal

Yes	No
-----	----

Consideration	Comment	Responsible Officer	Director
Legal	Transport for the North's legal team has confirmed there are no legal implications.	Debbie Dimmock	Dawn Madin

Finance

Yes	No
-----	----

Consideration	Comment	Responsible Officer	Director
Finance	Transport for the North's Finance Team has confirmed that the financial implications have been included in this report.	Gareth Sutton	Iain Craven

Resource

Yes	No
-----	----

Consideration	Comment	Responsible Officer	Director
Resource	The Transport for the North HR Team has confirmed there are no resource implications.	Stephen Hipwell	Dawn Madin

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.	Haddy Njie	Iain Craven

Consultation

Yes	No
-----	----

Consideration	Comment	Responsible Officer	Director
Consultation	A consultation has not been carried out because it was not required in relation to this report.		