TRANSPORT FOR THE NORTH

Transport for the North Board

Subject: Appendix 5.1: TfN Budget and Reserve Strategy 2021/22

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1. Purpose of the Report:

1.1 This appendix provides a more detailed analysis of the proposed draft 2021/22 budget.

2. Operating Environment

2.1 TfN's financial affairs are shaped by its operating environment. Parameters are set by the way in which the organisation is funded, and the practical consequences of certain limitations that are not common to local and combined authorities.

2.2 These limitations affect the organisation's approach and ability to access funds to manage risk. Unlike most partner authorities, TfN cannot access credit in the form of loans for capital investment and overdrafts to manage short-term cash flow fluctuations. In addition, it cannot levy or precept upon local tax bases to manage longer-term requirements as a council or local transport authority would.

2.3 These limitations mean that careful management is required in order to avoid insolvency risk: that is, ensuring TfN maintains sufficient cash and the resource to meet liabilities. The need for careful management is increased by TfN's inability to recover VAT, which means that it is exposed to higher costs without an associated increase in its resources.

2.4 These issues emphasise the importance of risk management when developing budgets, particularly the need for focused cost transparency, and alignment of costs to funding streams. In particular, it underscores the importance of managing resource to ensure TfN protects funding streams which afford TfN flexibility.

2.5 Due to the conditions placed upon the discrete grants which fund programme activity, discretionary resource is limited to TfN's annual Core grant (reduced to £6m in 2021/22), reallocation of attributable costs to programmes and the deployment of the reserve created from underspends against this grant in prior years. This grant, and the reserves that flow from it, must also be used to mitigate the insolvency risk to which TfN could otherwise be exposed.

2.6 This approach is complemented by the manner in which TfN manages its discrete grant streams. 'Discrete' grant streams refer to funding which is restricted to certain activity. For high value and sensitive programmes, TfN allocates part of its grant envelopes as 'contingency'. Contingency is budgeted for separately, but not monitored against in the programme budgets. As calls are made by the programmes on contingency, resource is drawn down through budget variations and then reported and monitored against. This allows TfN to manage risk in its programmes through in-year grant, ensuring that resource is not overcommitted.

Budget Structure

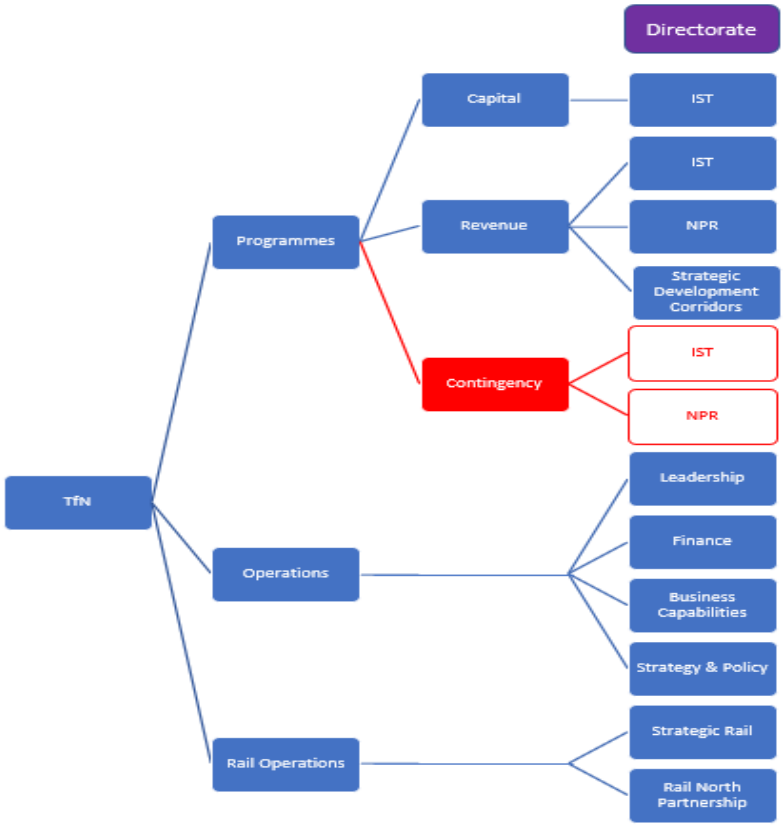
2.7 TfN's budgets consist of its body of capital and revenue delivery programmes and its core operations. For budgetary purposes, a differentiation is drawn between operational and programme costs, based upon the scale of the activity and its funding source. Rail Operations activity is also separately identified to reflect the different governance and funding arrangements for that area, and its high profile.

2.8 Programme expenditure is in support of discrete areas of capital and revenue activity that often attract ring-fenced funding. The programmes are generally materially larger than the underlying cost base of the wider organisation which supports them. Contingency held to manage programme activity risk and support emerging priorities is held discretely, to avoid distorting budget forecasts.

2.9 Organisational operational expenditure consists of those costs incurred in the delivery of the ongoing business of TfN, the infrastructure required of any public body, and the supporting functions that enable TfN to deliver upon its programmes of activity and broader aspirations.

2.10 'Rail Operations' activity reflects the work of the Rail North Partnership team who manage the northern rail franchises on behalf of the Secretary of State and who are hosted by TfN, and TfN's Strategic Rail team which advises the Rail North Committee on franchise matters.

2.11 Broadly, the budgetary structure of the organisation can be presented as follows:



2.12 Drawing a differentiation between operations and programmes in this manner assists TfN in the management of its financial affairs for three principal reasons.

2.13 Primarily, the distinction allows for better cost transparency. It is important for the organisation to see the true costs of running programmes of activity to allow it to both understand and manage those costs.

2.14 In addition, the scale of the NPR programme is sufficiently large that if reported without distinction to the operational costs it could affect the visibility of important issues within the operations element of the budget. That is, a relatively immaterial variance of 1% in the programme area would be equivalent to a material variance of c.10% in the operational area.

2.15 Finally, the budget structure reflects how the areas of activity are funded. Programmes of activity are principally funded by discrete grant awarded by DfT. That grant is awarded for pre-approved activity and is drawn down on a need basis. Conversely, the varied business functions of TfN within the operations element of the budget structure must be funded from the finite £6m Core grant, over which TfN has discretion on its application, its historic reserves, and the ability to assign attributable costs to programmes.

2.16 There is a fundamental assumption that the current business infrastructure of TfN has been established to deliver both operational and programme activity. Any material reduction to the scope of work within this assumption could require significant changes to the business infrastructure.

2.17 TfN has also opted to separately identify the Rail Operations budgets from other activity to recognise the discrete governance and funding arrangements around that activity.

3. Budget 2021/22 Development

3.1 The 2021/22 draft budget is driven by the Business Plan.

3.2 As set out in the Business Plan Report to this meeting, the proposed activity reflects a number of changes arising from the 2021/22 funding allocation. Whilst it is broadly consistent in its objectives and key themes with prior years' activity it has been shaped by the cessation of IST funding and the impact of Core funding cuts.

3.3 The 2021/22 draft budget was derived following a number of year-on-year issues that aggregate to a wider sustainability challenge, notably:

a) Core funding allocation for 2020/21 was reduced in January from £10m to £7m, and the 2021/22 allocation reduced to £6m;
b) How to deploy "single use" carried forward reserves to give the most beneficial impact on TfN's objectives, whilst managing the underlying cost base in the context of the reduced Core funding allocation;
c) How to fund programme development, principally IPBA, costs not resourced from discrete funding; and,
d) How to balance basic organisational requirements with the need to target resource at emerging key development objectives such as sustainable development, carbon reduction, and the climate crisis.

3.4 These issues contribute to cost pressures across the organisation that are not met by the movement in the Core grant allocation for 2021/22.

3.5 To mitigate this issue TfN has adopted processes for identifying where new costs are incremental to the growth of programme activity, enabling those costs to be recharged into discrete grant streams (where grant conditions allow). Recharging costs in this manner is consistent with existing accounting policies and allows TfN to properly resource programme activity and also see the true cost of delivery. This process has now been extended to cover the NPR Programme, including both direct and overhead costs that can be attributed to it.

3.6 As part of the annual budget exercise, TfN also isolates 'one-off' non-repeating costs and activity that will fall out of the budget once

completed. This allows TfN to better see its underlying structural cost-base, allowing for clearer medium-term planning.

3.7 Recharges of costs into discrete grants and the isolation of non-repeating expenditure allows TfN to propose a balanced 2021/22 budget.

3.8 This report proposes that the budget is resourced through a mixture of in-year grant, local contributions, contracted income, and brought forward reserves.

3.9 In-year grant reflects existing commitments made by the Department for Transport, commitments that we forecast may be made, and grant that will be made available to TfN contingent on meeting funding criteria. Where contingent grant is not made available, or assumed grant is not forthcoming, activity will not ordinarily be undertaken with costs being deferred or removed.

3.10 Use of brought forward reserves recognises that TfN's cost-base retains a number of one-off or time limited costs that will not repeat into the future. In addition, TfN intends to use an element of its brought forward reserves to fund ongoing activity in the short- to medium-term as set out in Section 4 of the main report. Using reserves is sustainable in the short-term and allows the organisation to protect key elements of TfN's approach to quality evidenced-based decision-making and resource the delivery of organisational objectives.

4. Programme Budgets

4.1 The programme budgets include the discrete areas of activity where projects are reaching their conclusion (in the case of IST) or working towards business case submission and/or approval.

4.2 The 2021/22 budget includes three thematic elements of the programme budget:

a) Completion and wind down costs of Integrated & Smart Ticketing (IST);
b) Northern Powerhouse Rail (NPR); and
c) Investment Programme Benefits Analysis.

4.3 Activity can be further broken into revenue and capital programmes. It is TfN's policy to capitalise expenditure on programmes that are past outline business case and for which there is a reasonable assumption that the programme of activity will go on to deliver assets (either intangible or tangible) which will provide economic benefit over a period greater than one year.

4.4 IST intangible assets are expected to be transferred out of TfN's accounts to their eventual end user in 2021/22. This will be addressed within the 2021/22 Statutory Accounts.

4.5 Programme costs are presented at the committed level, and then the committed plus contingency level. The committed level reflects the current view on the level of effort and associated cost required to deliver the activity. The contingency reflects the adjustments that are made in line with governmental guidelines on managing risk in innovative projects, or programme funding set aside to address emerging priorities. The differentiation between the two is drawn simply because adding contingency into general budgets when there are no current plans to draw upon it risks distorting financial reporting, leading to a misalignment between financial planning and business planning.

4.6 Committed gross programme expenditure for 2021/22 totals £69.42m, which equates to 88% of TfN's overall draft proposed budget:

2021/22	Expenditure Type	Committed £m	Cont'y £m	Total Budget £m
IST	Revenue	1.22	0.00	1.22
	Capital	0.30	0.00	0.30
		1.52	**0.00**	**1.52**
NPR	Revenue	48.48	18.52	67.00
IPBA	Revenue	0.89	0.00	0.89
		50.90	**18.52**	**69.42**

4.7 The NPR programme includes a contingency of £18.52m. Contingency is required to mitigate against the risk of activity costing more than forecast and to allow the programmes to react to opportunities that arise. This is particularly pertinent for expansive projects such as NPR where there are likely to be both requirements to flex development work to react to events and opportunities and for resource to manage contractual risk.

4.8 The level of NPR contingency held is developed and agreed in collaboration with DfT through the co-client budget arrangements. Within the NPR budget, a material amount of available in-year grant is held uncommitted to reflect that the opportunity may arise to accelerate certain priority workstreams. Uncommitted resource is earmarked to this activity to ensure that should approvals for the activity be forthcoming, the resource is available to deploy without displacing in-train activity.

4.9 Year-on-year the programme areas have seen significant internal changes, but at an aggregated level the total level of net expenditure (exclusive of contingency envelopes) decreased by 7% as reductions in

IST and Investment Programme Benefits Analysis expenditure offset the increase in NPR activity:

TfN Programmes	2021/22 £m	2020/21 £m	Var £m	Var %
IST	1.52	9.69	(8.17)	(84%)
NPR	48.48	43.78	4.70	11%
IPBA	0.89	1.88	(0.99)	(52%)
Net Expenditure	**50.90**	**55.35**	**(4.45)**	**(8%)**

4.10 IST and NPR programmes will be funded from discrete grants, whilst the IPBA will be funded from brought forward reserves that have arisen from prior year underspends on Core grant funded activity.

4.11 The proposed use of reserves reflects an opportunity to match this one-off source of revenue against one-off costs, notably the development work in relation to the Investment Programme Benefits Analysis work, as well as the decision in the short- to medium-term to use TfN's accumulated reserves to support ongoing activity.

4.12 The table usefully highlights that the programme areas are almost entirely funded from discrete grant. This reflects that TfN has relatively little flexible resource, relying upon earmarked resource to fund major programmes of activity.

5. Integrated & Smart Travel (IST)

5.1 In the 4 January 2021 funding allocation, TfN was not awarded any allocation for IST programmes for 2021/22 and future years. DfT has acknowledged that current programmes would need to be wound down in a structured and controlled manner and agreed to fund these costs. The budget of £1.52m represents the estimated costs to conclude the individual phases of the IST programme and includes an estimate for closure costs. Funding will only be requested for actual costs incurred.

5.2 The IST budget comprises both revenue and capital activity. Revenue activity consists of activity that cannot be capitalised, such as marketing, non-apportionable staffing costs, and revenue grants that are provided to third parties to support their operations. Capital activity consists of grant awards to third parties for their asset purchases and development, and asset purchases and development where TfN will retain control (at least in the short term) of those underlying assets. IST assets are expected to be under the control of TfN at 31 March 2021, but to be transferred to future owners during the course of 2021/22.

5.3 All these costs are charged into discrete IST grant awarded by DfT. This grant comprises revenue and capital allocations reflecting the different types of expenditure.

5.4 The IST programme's cost can be shown by the individual phases of activity. The table below shows the forecast cost of activity per phase:

IST Programme	2021/22 £m	%
Phase 1	0.48	32%
Phase 2	0.20	13%
IST Programme Support	0.84	55%
	1.52	

5.5 These costs can then be split between revenue and capital expenditure designations:

IST Programme (No Contingency)	Revenue	Capital	Total
Phase 1	0.19	0.29	0.48
Phase 2	0.20	0.01	0.20
IST Programme Support	0.84	0.00	0.84
	1.22	**0.30**	**1.52**

5.6 Phase 1 – The project is largely delivered, but there are some residual items that will be delivered in 2021/22. These include:

- Agreed software updates for ticket gates and a mobile solution whilst this is being implemented;
- Final payments for PVals and the associated civils work; and
- Contracted operational payments.

5.7 Phase 2 – The budget includes licences and support costs until TfN has transferred the assets to their ultimate owner.

5.8 Programme support costs include the following items:

- Part of the Leeds office lease until 30 September 2021
- Staff costs to deliver the programme activities and an estimate of the costs of closing the programme.

6. Northern Powerhouse Rail (NPR)

6.1 The resource made available to NPR from the DfT reflects a significant increase from earlier years: rising from £59m in 2020/21 to £67m in 2021/22, although the actual amount drawn down in 2020/21 is likely to be c.£42m.

6.2 TfN receives this resource as Transport Development Fund (TDF) grant, with the use of the resource being managed through a co-client mechanism. Under this mechanism there is a budget holder function performed by the Department, with line item level expenditure being approved via funding letters. TfN cannot access TDF grant without

prior approval of all expenditure requests from the Departmental budget holder.

6.3 For budgeting purposes, it has been assumed that £67m will be made available to TfN. TfN's NPR aspirations are further supported by TDF resource of £8m that the department will directly disburse to HS2 in 2021/22 for related activity. TfN does not control or receive that resource, so it is not included in this budget.

6.4 A significant change in the 2021/22 budget, with the agreement of the department, has allowed TfN to allocate to the NPR Programme costs that were previously resourced from Core funding. These include the £0.95m core grant contribution made in 2020/21 towards the NPR management team and an attributable share of central overhead costs of £1.54m.

6.5 For budget planning purposes, the NPR budget is split between items that will be committed to the budget (subject to 6.7) and a sum of resource that will be held in contingency as an effective uncommitted reserve. Within that reserve, resource will, in some cases, be earmarked to known issues and aspirations. This arrangement reflects the nature of the co-clienting arrangement in relation to the NPR programme, and the need to agree and fund activity as the year progresses.

6.6 Retaining a significant amount of resource as uncommitted reserve at this stage is both prudent (noting the inherent risk in some of the major contracting and the opportunities that may emerge for acceleration of activity) but also reflects the reality of decision making in the co-client arrangement.

6.7 In particular, it is considered prudent to hold resources in reserve whilst the co-clients consider the wider programme once the outcome of the IRP is fully understood. As previously noted, significant uncertainty exists in relation to the NPR programme as a result of the delayed Integrated Rail Plan announcement that is expected within the next three months. This may have a significant impact on the work that needs to be undertaken. Whilst the co-clients have adopted an approach to planning that has tried to identify work that will be consistently required across a range of IRP outcomes, there may be a requirement for a rework of both the programme business plan and budget once the IRP has been released and its implications understood.

6.8 Earmarking contingency to expected issues in this manner set out below helps to ensure that the co-clients do not overcommit resource at the expense of emerging issues that are deemed likely to arise, but around which there is insufficient certainty at this stage to include in the committed budget.

6.9 The NPR budget is accordingly presented in terms of committed budget around thematic workstreams and the uncommitted contingency that is held to opportunity and manage risk:

NPR	2021/22 £m
Committed Budget:	
Programme Development	£13.61
Network Rail Studies	£28.80
Programme Support	£4.69
Core Team	£1.38
	£48.48
Uncommitted Contingency:	
Earmarked Resource	
Network Rail	£6.84
Infrastructure Development Partner	£0.48
	£7.32
Unearmarked Resource	**£11.20**
	£67.00

6.10 Should requirements for the deployment of contingency emerge, the budget will be flexed at the normal re-forecast Revision points. However, should the co-clients be able to deliver the Business Plan outputs within the assumed £67m TDF envelope, resource will be redeployed at the Department's discretion. This reflects both TfN's commitment to delivering on its aspirations in the most cost-effective manner and the budget control the department holds over the application of the resource.

6.11 Unlike previous years, the TDF programme is not supplemented with Core grant resource of £0.95m. In 2021/22 this cost has been directly budgeted within the TDF funded programme, freeing up this resource to support other activity.

6.12 The pace at which the co-clients can determine the work-packages for the coming year will determine how quickly activity can be delivered.

7. Investment Programme Benefits Analysis (IPBA)

7.1 The IPBA work will provide a quantified understanding of the Investment Programme's social, environmental and economic benefits and support TfN Board in recommending policy and investment priorities, as statutory advice to the Secretary of State for Transport.

7.2 This activity was originally intended to be delivered within the 2020/21 business plan. However, during the year a decision was taken to defer this activity into 2021/22.

7.3 The IPBA work does not attract discrete development funding at this time, and so serves as a good example of TfN's need to maintain the ability to draw upon its Core grant funding to resource material development costs.

7.4 For 2021/22, it is proposed that the activity is resourced from brought forward reserves that have arisen from prior year underspends on Core grant funded activity.

8. Rail Operations:

8.1 Rail Operations activity consists of the work undertaken by the Strategic Rail team and the Rail North Partnership team in collaboration with DfT. The Strategic Rail Team has included provision for a senior role, supported by a consultancy budget, to support Smart Travel and Fares Strategy. This will allow TfN to retain an element of both capability and capacity in relation to Integrated and SMART Travel after the closure of the IST programme.

8.2 This work is centred on discharging TfN's statutory obligations towards the oversight and advice provided to the Secretary of State for Transport on the northern rail franchises (currently managed via OLR / ERMAs).

8.3 The Rail Operations budget has seen year-on-year increases as additional resource has been recruited to support these functions. Discussions are ongoing with DfT to materially increase the RNP team which, if agreed, would be funded from an incremental grant. As this had not been formally agreed at the time of writing, the budget has been prepared on the basis of the funded position. Any required changes will be addressed as budget revisions during the year.

8.4 Expenditure has been budgeted at £3.16m, representing an increase of £0.18m, or 6% on the prior year:

Rail Operations	2021/22 £m	2020/21 £m	Var £m	Var %
Strategic Rail Team	1.80	1.39	0.41	30%
Rail North Partnership Team	1.36	1.59	(0.23)	(14%)
	3.16	**2.98**	**0.18**	**6%**

8.5 Rail Operations activity is funded from a combination of DfT grant award, local contributions from TfN partners, contracted income, and TfN Core Grant contributions.

Rail Operations	2021/22 £m	2020/21 £m	Var £m	Var %
DfT Grant	0.69	0.98	(0.29)	(30%)
Local Contributions	0.63	0.64	(0.01)	(2%)
Core Grant	1.51	1.00	0.51	52%
Contracted Income	0.33	0.36	(0.03)	(9%)
	3.16	**2.98**	**0.18**	**6%**

8.6 The variance in the DfT Grant line above reflects the Blake Jones posts that were included in the budget but not funded by the department and therefore not subsequently recruited. The increase in TfN Core grant support reflects the additional resources required in year to deliver business plan aspirations, including scheme development and the response to the Williams Review.

8.7 Contracted income relates to the billable time of TfN officers recruited to deliver work on behalf of North Yorkshire County Council for the Esk Valley line reopening, and those officers who will be funded via a contract-for-services with Network Rail for TRU activity.

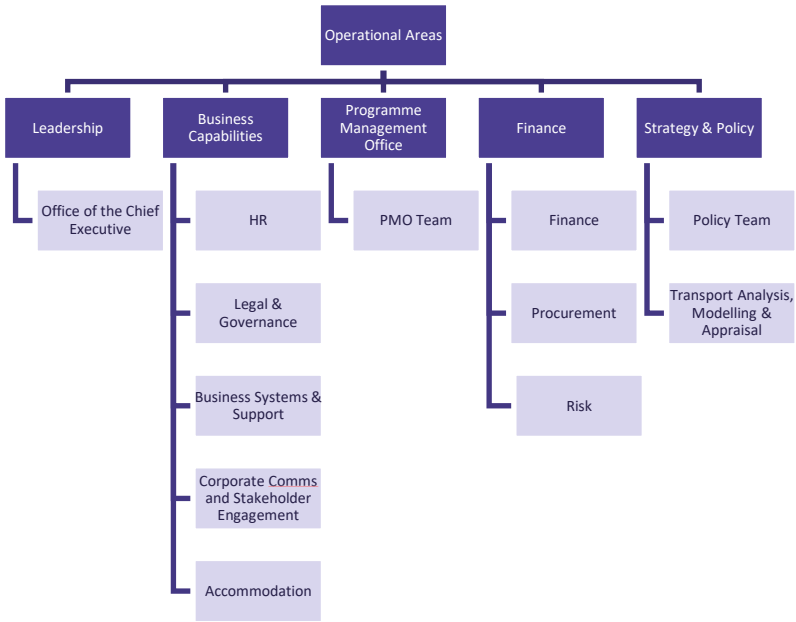
9. Operational Areas

9.1 The operational budget covers the functions of the back, middle, and front office of the organisation along with the business infrastructure.

9.2 TfN is subject to the same regulatory environment as local and combined authorities and must discharge its responsibilities as an autonomous body. It must also act in accordance with the TfN/DfT Memorandum of Understanding and its Grant Funding Agreements.

9.3 Accordingly, the activity carried out within these areas represents the required enabling-functions familiar to all public-sector organisations, but also the teams that develop and deliver upon many of TfN's aspirations. This includes the Policy team that defines TfN's strategic vision; the Corporate Communications and Stakeholder Engagement team that supports the North's ability to speak with one voice; and the Transport Analysis, Modelling and Economics (TAME) team that underpins TfN's commitment to evidenced-based decision-making.

9.4 The operational area budget structure can be shown as follows:



9.5 In response to the reduction in core grant funding, all budget holders were asked to critically review their business plans and associated cost base. The outcome of this process has resulted in gross expenditure proposed for the operational areas of £7.67m, of which £1.54m will be recharged into the NPR programme. This represents a reduction in gross expenditure of £1.52m (16%) and a reduction in net expenditure after programme recharges of £2.06m.

9.6 A budget provision of £0.14m has been incorporated within the Finance directorate to provide for risks that may emerge during the year. As the likelihood and probability of risks diminish with time the provision will be considered to fund emerging opportunities.

Operational Areas	2021/22 £m	2020/21 £m	Var £m	Var %
Leadership	0.31	0.32	(0.01)	(2%)
Finance	1.01	1.35	(0.34)	(25%)
Business Capabilities	3.09	3.78	(0.69)	(18%)
Strategy & Policy	2.51	3.02	(0.52)	(17%)
Major Roads	0.75	0.73	0.03	3%
Total Expenditure	**7.67**	**9.19**	**(1.52)**	**(17%)**
Recharges to Programmes	(1.54)	(1.00)	(0.54)	54%
Net Expenditure	**6.13**	**8.19**	**(2.06)**	**(25%)**

9.7 The Finance Directorate budget has been reduced by £0.34m, reflecting the removal of a provision for development activity associated with the ERP system (£0.26m) and a reduced requirement for external professional services.

9.8 The Business Capabilities budget has fallen by £0.69m. This is mainly due to reductions within Stakeholder Engagement and Human Resources (£0.33m and £0.23m respectively), partly reflecting new ways of working. In addition, expected external events expenditure within Stakeholder Engagement has reduced by £0.1m and the requirement for external communications and design has similarly reduced by £0.1m as a result of work being brought inhouse. Staff and staff related expenditure is reduced by £0.15m within Human Resources, mainly reflecting lower recruitment fees.

9.9 Within the Strategy and Programmes Directorate there has been a £0.52m reduction in budgeted gross expenditure, the majority of which is within the modelling team. This in part reflects the focus on NPR and the IPBA, and that the resource and costs associated with supporting NPR are directly assigned to the programme.

9.10 The lower expenditure requirement within Programme Management Office (£0.18m reduction) predominantly reflects the removal of two posts.

Strategy and Policy Directorate	2021/22 £m	2020/21 £m	Var £m	Var %
Policy Team	0.89	0.92	(0.03)	(3%)
Modelling Team	0.74	1.04	(0.30)	(29%)
Economic Appraisal Team	0.74	0.75	(0.01)	(1%)
Programme Management Office	0.14	0.32	(0.18)	(55%)
	2.51	**3.02**	**(0.52)**	**(17%)**

9.11 As the NPR Programme continues to develop and grow in both complexity and basic metrics such as headcount and funding, the operational areas will need to adjust their levels of service to ensure they can continue to offer the required level of support

9.12 The increase in recharges in 2021/22 over the prior year reflects the net position arising from the wind down of the IST programme, to which £1m of recharges were allocated in 2020/21, and the recharge of attributable costs to the NPR programme.