AGENDA ITEM 8

TRANSPORT FOR LONDON

AUDIT COMMITTEE

SUBJECT: BUDGETARY CONTROL

DATE: 3 MARCH 2009

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1 BACKGROUND

1.1 As part of its on going work to review the effectiveness of internal control throughout TfL, the Audit Committee has asked for a paper on the budgetary control arrangements within the organisation to be presented annually as a standing item. This paper is updated where appropriate from that presented to the Committee last year.

1.2 Since the last report, the TfL group has expanded to include the undertakings of the former Metronet companies, Crossrail Limited and Tramtrack Croydon Limited and its subsidiaries. LT Museum has been set up as a separate company with charitable status, together with a separate subsidiary for its trading activities.

2 CONTROL OF EXPENDITURE

2.1 Planned and actual expenditure is controlled via a number of processes to ensure that TfL is able to carry out its statutory functions in the most economic, efficient and effective manner. They are designed so as to provide a balance between effective control and necessary flexibility to ensure managers can effectively deliver the functions for which they are accountable.

2.2 These processes can most easily be described in the following 3 headings:

- Business Planning and Budgeting.
- In-year Financial control.
- Procurement Authority.

These control processes and the supporting system of monitoring and reporting are described in the remainder of this paper.

3 BUSINESS PLANNING AND BUDGETING

3.1 The business planning and budgeting process is the mechanism whereby resources are allocated to priorities on a short to medium term basis. Last year’s business plan focused over the length of the settlement received from Government as part of the Spending Review 2007 (SR07), so it covers the period to 2017/18.

3.2 The process commences in the Spring when key planning assumptions are distributed across the group, along with indicative financial targets, to allow modes and directorates to commence their bottom-up planning. During the process there are a number of workshops with finance and planning staff across the organisation, MDs, the Board and key stakeholders to ensure the plan reflects agreed priorities, but also that recurring income exceeds recurring costs and that the plan is robust and deliverable, able to withstand scrutiny particularly by the rating agencies.

3.3 The resulting Business Plan, which seeks Board approval each October, outlines the direction and scope of the organisation's activities along with the related outputs and outcomes that are achievable within the resources available. Importantly, it will ensure there is financial balance over the settlement period. A version of the first three years of the Plan is submitted to the GLA to be consolidated as part of the Mayor's budget and presented to the London Assembly in January and February.

3.4 The Business Plan itself is made up of an operating plan and an Investment Programme, a distinction that is important in that they are controlled differently. The first year of the Business Plan forms the basis of an operating and capital budget which is approved by the Board in the March preceding the financial year to which it relates. This Budget is likely to differ from that set out in the first year of the Plan owing to the impacts of:

- The changes in the forecasts during the second half of the preceding year as the Plan is usually based on the second quarter forecast (at period 6 in mid September), and much can change between then and the following March when the budget is approved.
- The effects of any changes agreed with the Mayor following the final agreement of his overall Budget by the London Assembly in mid February.
- Any errors or omissions that may have been discovered subsequent to October that particularly affect the budget year.
- Any new issues that may have emerged in the second half of the year that would impact the budget year. This is especially important this year given the rapid decline in the economy.

3.5 The Budget consists of a set of financially-balanced statements which are supported by schedules of headcount in terms of Full Time Equivalents (FTEs) as well as milestones and Key Performance Indicators (KPIs) to enable proper monitoring of the resultant outputs and outcomes. Once agreed by the Board, the Budget is distributed to each business within the SAP financial system. Each of the Managing Directors is thereby given their financial authority and people resources within which to manage their business for the coming year.

3.6 A subset of KPIs and milestones is selected for each business unit to form the senior management scorecard. Performance against this scorecard forms one part of the senior management bonus award (in conjunction with personal performance, and values and behaviours), paid annually to all managers in pay bands 4 and above.

4 IN-YEAR FINANCIAL CONTROL

4.1 Following approval of the Budget and associated deliverables, responsibility for delivery is held by each Managing Director. They, in turn, delegate through Directors to cost centre and project managers within their business units to manage the agreed and approved budgets, and initiate and approve individual purchase requisitions and payments as is appropriate.

4.2 In respect of both the operating and capital budgets, all business units are required to re-forecast every quarter (i.e. at periods 3, 6 and 9). As a result, this latest understanding of the likely outturn for the year can properly reflect the activities that each area believes are necessary to meet their proposed outputs and outcomes. It also meets any new circumstances that have arisen or will arise. Each period, the business units are also required to amend forecasts for any significant events.

4.3 These forecasts are then reviewed by the modal Finance Director or equivalent with their executive committees, both to approve the financial impacts and ensure they can be funded, and to ensure there is an understanding of what their business to date has or has not achieved compared with their operational targets.

4.4 All these forecasts are input into the SAP financial system, KPIs into the Executive Reporting system and milestones into a programme monitoring system. This enables a Group position to be prepared and reported upon, and in addition allows business units to look at what each other is doing.

4.5 The forecast is across the whole lifecycle for projects and at least for 2 financial years (i.e. the current year and the one after) for recurring income and expenditure, with the focus being on the current financial year. This is to ensure that whilst attention is paid to the immediate financial and delivery performance of the organisation, the impact of that performance on the future year is also identified. This then forms a natural lead into the annual business planning process.

4.6 In respect of the capital budget (and discrete projects / programmes in the operating budget), there is also a requirement for projects to be reviewed, particularly in regard to the business case and affordability, by the appropriate body at appropriate stages in the project lifecycle before expenditure is authorised and can be incurred. For projects with expected final cost of up to £5m budgeted, or £2m if unbudgeted, each business unit has its own approval body.

4.7 In addition to Modal processes, projects with a total value greater than £2m (unbudgeted) or £5m (budgeted) require authorisation at a corporate level. Prior to these projects being submitted to the Project Review Group (PRG) for consideration and approval by the Managing Director, Finance, each of these projects is reviewed through the Corporate Gate Approval Process, which provides assurances that a project or programme is :

- Deliverable – it is likely to deliver the expected benefits within the declared cost/time/performance envelope;
- Affordable – the level of expenditure and financial risk involved is acceptable in light of TfL's overall financial position when set against other priorities; and
- Value for money – it provides the optimum combination of whole-life cost and quality (or fitness for purpose) to meet users' requirements.

4.8 Corporate Gates normally apply to a project at the following stages of their project lifecycles:

- Gate A – Project commencement (compulsory gate);
- Gate B – Single option selection;
- Gate C – Pre-tender;
- Gate D – Contract award;
- Gate E – Project close (compulsory gate); and
- Gate P – Programme review for annualised programmes of minor schemes.

4.9 Each period, a review is performed of the extent to which projects are still within their approved funding authority. If there is a likelihood of exceeding that authority, a supplementary or next stage authority paper including a business case, is submitted to the relevant review body to ensure expenditure and commitments do not exceed the authorised amount.

4.10 Budgeted projects between £25m and £50m, or unbudgeted projects between £10m and £50m, are authorised by the Commissioner following review by the PRG. Those between £50m and £100m (budgeted and unbudgeted) are approved by the Finance Committee, while those over £100m (budgeted and unbudgeted) by the Board, except for emergencies when the Commissioner can authorise but then report to the Board. This is in accordance with Standing Orders.

5 PROCUREMENT AUTHORITY

5.1 Once financial authority (and funding authority in respect of projects) has been granted, the budget holder may sanction expenditure as described above in paragraph 4.1. This does not automatically confer on the budget holder procurement authority, which is required to be able commit to contracts etc., unless such authority was specifically part of the earlier request.

5.2 Procurement authority is an additional control designed to enable contracts and other commercial agreements to be scrutinised by those with the necessary experience or professional expertise to assess the contractual implications for TfL. For straightforward low-value purchases, procurement authority is delegated widely; correspondingly, procurement authority for complex and/ or high value transactions is vested in very few individuals.

5.3 Procurement authority may only be exercised by those individuals who have been delegated such authority within each business unit, and may only be applied up to the limit set for their given role. The procurement element of the SAP system provides the mechanism for regulating the application of procurement authority.

5.4 Each Chief Officer has procurement authority up to £25m. Subject to the written consent, a Chief Officer can delegate up to £5m to Directors, while officers below the level of Director may be delegated authorities below £2m (depending on grade).

5.5 Transactions above £25m up to £100m are approved by the Commissioner or in his/her absence the Managing Director of Finance. Where the Commissioner judges that the transaction is exceptional in nature he/ she may choose to refer it to the Finance Committee and then the Board for approval. All transactions exceeding £100m require Board approval.

6 MONITORING AND REPORTING

Each Period

6.1 Control of expenditure is ultimately managed at by cost centre managers for recurring activities, and by project managers for non-recurring pieces of work within the scope of their delegated budgets or authorities. Cost centre managers have available to them a suite of automatic reports, generated once a period (every 4 weeks), available on-line direct from the SAP system to inform them of the financial and staffing performance for their cost centre. Project managers review the performance of their project periodically through a variety of project management systems, and are scrutinised through Programme Management Offices (PMOs) within each mode.

6.2 This performance is then aggregated, such that each period the Managing Director of each business unit produces a report setting out both the financial and operational performance within the period compared to budget, and associated risks and issues. In order to review this report, the Commissioner holds eleven times a year a Business Management Review (BMR) of each business unit and an Investment Management Review (IMR) with each of business units with large Investment Programmes (LUL, Surface, and London Rail). Each BMR/IMR involves a two stage process:

- Group Business Planning and Performance (GBP&P - for the overall business performance and financial situation) and the Investment Programme Management Office (IPMO - for projects and programmes) carry out detailed analysis and discussions with each mode and directorate of their BMR/IMR reports to understand fully progress during the period and year-to-date along with the impacts on the business for the year as a whole. This culminates with a briefing to the Commissioner by the Chief Finance Officer and the IPMO Director on issues arising from the reports, and any items for inclusion within the agenda for the meeting. The BMR reports are made available to senior managers to ensure maximum visibility activities across TfL and to facilitate joined-up working.

- Any major issues that are likely to be high profile in the public domain or impact the business strategically will be raised at the BMR/IMR itself so that full discussion can be had between the relevant MD (with their senior management team) and the Commissioner. Otherwise the BMR/IMR allows the Commissioner to be involved in decision-making on strategic issues.

6.3 In addition, each period GBP&P produces a period flash financial report and 'Barometer' for the Commissioner (copies of which are also sent to the Chief Officers). These are reports outlining the trends on the key operational key performance indicators and the overall financial position against budget. GBP&P and IPMO issue modal BMR and IMR briefing notes to the Commissioner, copied to the modal Chief Officers highlighting any issues arising with the delivery of key projects.

Quarterly

6.4 Based on the BMR/IMR reports, the Chief Finance Officer submits an Operational and Financial report and an Investment Programme report to the Finance Committee for review before it is then submitted to the TfL Board.

6.5 The latest modal BMR reports forms the basis of the Managing Directors' performance report to the quarterly Advisory Panels relating to each of the 3 modes : Rail, Underground and Surface.

6.6 Externally, following review by the Board, a synopsis of the Board report is submitted to the GLA for inclusion in the Functional Bodies' Quarterly Budget & Performance Monitoring Report to the London Assembly. This often forms the basis of questions from the Assembly Budget Committee, and wider questions put to the Mayor as part of his regular question process. In addition, the LUL and London Rail BMR reports are submitted to DfT officials who review the key movements/issues with representatives from the respective modes and TfL group.

6.7 A summary of key monitoring and reporting arrangements is attached as Appendix 1.

7 CONCLUSION AND NEXT STEPS

7.1 For the first time this year, Crossrail and Metronet were included within the overall TfL business plan. They will also be included and separately identified in the emerging TfL budget. Crossrail performance will be reviewed through the sponsor arrangements and its own BMR which will focus on coordination issues, whilst Metronet performance will continue to be reviewed as part of the LUL's BMR.

7.2 This paper outlines an exhaustive process of control and review of TfL's activity as the year progresses so as, where possible, to avoid any surprises and ensure mitigating actions are put in place, if necessary, to correct adverse trends and to ensure financial discipline remains sound. This whole process is further entrenched with TfL's requirement to ensure that the Rating Agencies continue to uphold TfL's AA rating status. Timely delivery and financial rectitude are key to maintaining this status.

8 RECOMMENDATION

8.1 The Committee is asked to NOTE TfL's detailed budgetary control and review processes.

9 CONTACT

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TfL's performance reporting framework