Office of Rail and Road and
Network Rail

Independent Reporter Lot 4

L4AR002: Review of CP5 Regulatory Financial Statements 2015/16

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1 Executive Summary

1.1 Introduction

This report presents the findings of Arup's review of selected parts of Network Rail's 2015/16 regulatory financial statements. This work is being delivered under the ORR Independent Reporter mandate L4AR002.

The objective of the review is to determine the reliability and accuracy of the information presented in certain sections of Network Rail's regulatory financial statements. To achieve this, we have completed a detailed review of the figures and supporting commentary presented in the respective statements, and carried out selective analysis of underlying evidence.

1.2 Our Approach

Our approach to this review has involved a combination of numerical checks and controls on calculations, review of systems and processes around formulation of the numbers, and qualitative appraisal of the evidence base and rationale for the accompanying management narrative.

Our methodology has been guided by a risk-based approach, involving the targeted review of calculations and supporting evidence underpinning the results presented. Areas of focus and scrutiny applied have been informed by our assessment of where the material issues and potential risks are, with greater emphasis on areas judged to be materially important or higher risk.

The principal source of guidance for this review has been the ORR's Regulatory Accounting Guidelines (RAGs), which specify the manner in which figures are to be presented within the respective statements, and explain the key principles and policies for financial performance reporting. Our assessment has been conducted using the latest RAGs that were revised in May 2016. The most significant change from previous versions being that enhancements are now assessed against new cost estimates set by the Hendy Review as a baseline. The Hendy Review has deferred significant volumes of enhancement project volumes from Control Period 5 to Control Period 6 or later. For the enhancement projects included in Hendy's review that remain scheduled for delivery in Control Period 5, the cost estimates have been revised to the current Network Rail Anticipated Financial Cost levels. The implication on our work as the auditor of the regulatory accounts is that these projects have no impact on the Financial Performance Measure of Network Rail.

1.3 Statement 5: Total Financial Performance

The key measure of Network Rail's financial performance is its Financial Performance Measure (FPM), which it presents in Statement 5 of the regulatory accounts. Network Rail uses the FPM reporting mechanism to compare its actual performance for the given year to the PR13 determination.

Our review has found Network Rail's reporting of financial performance in Statement 5 to be reasonable, reliable and accurate.

The principles and mechanics of the financial performance measure are clearly explained within Network Rail's handbooks, which now incorporate the recommendations from last year's review. Discussion at route meetings suggests that the FPM is well understood and routinely used for financial reporting by route-based teams.

Management commentaries and the narratives accompanying the regulatory accounts were found to be consistent with evidence and the supporting calculations. While there may be scope for providing greater detail, the current descriptions do not misrepresent the financial performance or position of the routes.

While there is no indication of material mis-statement, the quantitative supporting evidence is lacking in detail regarding cost and scope variation. Most Routes provided high-level descriptions rather than detailed project-level breakdowns of the renewals figures. The FPM-neutral deferral of renewal activity in particular is not underpinned by robust, evidenced analysis. Outturn project costs have substantially exceeded planned costs while deferred volumes are declared at the earlier estimated levels of cost. The consequence therefore is that there is uncertainty about whether Network Rail can deliver increased volumes later in the control period, and that the observed cost increases have not been accounted for.

1.4 Statement 14: Renewals Volumes, Unit Costs and Expenditure

Statement 14 presents renewals unit costs (RUCs) covering most areas of renewals expenditure. For each asset category, it presents the activity volume, unit cost and total cost for 2015/16, and compares this to projections of volume and cost from in Network Rail's 2015 Delivery Plan.

Our review of Statement 14 has found that renewals unit costs have been correctly calculated and presented on a basis consistent with the RAGs and Network Rail's Cost & Volume Handbook. 2015/16 outturn volume and cost data have been correctly extracted from source data systems.

The calculation process has been found to be clearly and logically laid out within the Statement 14 tables. The figures have been found to be correctly calculated with only minor discrepancies which relate to the manual adjustments made to volumes and costs to ensure that the totals at Great Britain and England & Wales levels reconcile with the sums of the Routes figures.

As noted last year, the management commentary accompanying the Statement 14 figures provides only a partial narrative, commenting on variations in volumes of work delivered but with no commentary on unit costs. Network Rail argues that it considers renewals unit cost measures to be of limited use given the differences between asset renewals projects, and the method of its calculation of unit cost measures. We consider that it would be useful for Network Rail to provide explanations of the variation in its unit cost figures by asset and by route. It is our opinion that unit cost measures are likely to yield meaningful insights for some renewals activities. The meaningfulness of the unit costs measures can be improved by Network Rail implementing our recommendation regarding the method of its calculation.

The confidence grade of A2 reflects the strength of the processes and procedures in place to ensure robust and reliable figures, but recognises that there are some minor discrepancies resulting from manual rounding adjustments. In our recommendations we have highlighted the opportunity for potential improvement.

1.5 Spend to Save

Spend to Save schemes are projects promoted by Network Rail that are considered self-financing, i.e. capable of providing sufficient returns on investment through cost savings or revenues to cover their costs. The ORR allows Network Rail to identify and pursue opportunities to reduce its costs or increase its revenue.

Additional investment in self-funding schemes beyond the regulatory allowance are RAB funded within the Spend to Save framework.

Due to cash-flow constraints Network Rail has decided to reduce investment in revenue generating property schemes. Four projects were classified as Spend to Save schemes in 2015/16 with total investment below £5 million in 2015/16. The largest of these schemes, Mountfield, is classified as a Spend to Save scheme but the RAB additions have been logged up within the original PR13 arrangement. Earlier RAB additions were reversed in 2015/16. The other three Spend to Save schemes relate to the Rail Innovation Development Centre at Melton Mowbray in which Network Rail has invested under £1 million via Spend to Save in 2015/16.

Our review considers the four schemes suitable for inclusion in the Spend to Save framework, that is, these schemes meet the criteria set out in the RAGs. However, changes to the funding route for these schemes compared to Network Rail's assumed funding route results in no RAB addition in 2015/16 under Spend to Save.

1.6 Recommendations

Our review has not found any material misstatements or any major concerns that justify qualifications to the audit letter. However, we have identified five recommendations for areas in which there is room for improvement.

	Area	Issue	Recommendation
1	Unit Costs	Comparability of Unit Cost Measures	We recommend that this guidance is reviewed so that costs and volumes are reported on a comparable basis that produces a meaningful unit cost
2	Quality of Supporting Calculations	Lack of transparency, detail, and clear documentation	We recommend adopting a “Spreadsheet Modelling Best Practice” approach to ensure the robustness of calculations and demonstrate more effectively that the calculations are in line with the evidence.
3	Quality of Financial Performance & Sustainability Reports	Lack of transparency, detail and clear documentation	We recommend that some changes are made to the level of detail and layout of the reports, in particular ensuring that all routes provide project-level breakdowns (following the good practices of the Routes that provided greater clarity in their management commentaries).
4	Rounding	Broken audit trail	We recommend that Network Rail and ORR agree an approach to rounding that is more transparent and requires fewer manual adjustments.
5	Audit Timescales	Untimely provision of data	We recommend that Network Rail review the phasing of their reporting and internal reviews to improve the flow of the process to produce and review the Statements.

These recommendations are discussed in more detail in Chapter 6.

2 Introduction

2.1 Background and Objectives

This report presents the findings of Arup's review of selected parts of Network Rail's 2015/16 regulatory financial statements (referred to hereafter as the "regulatory accounts"). This work is being delivered under the ORR Independent Reporter mandate L4AR002 (attached as Appendix A to this document).

The objective of the review, as stated in the mandate, is to determine the reliability and accuracy of the information presented in certain sections of Network Rail's regulatory financial statements.

To achieve this, Arup has completed a detailed review of the figures and supporting commentary presented in the respective statements, and carried out selective analysis of underlying evidence.

Our main findings for the statements reviewed are summarised in the chapters that follow.

2.2 Approach and Key Principles

Our approach to this review has involved a combination of numerical checks and tests of calculations, review of systems and processes around formulation of the numbers, and qualitative appraisal of the evidence base and rationale for the accompanying management narrative.

Our methodology has been guided by a risk-based approach, involving the targeted review of calculations and supporting evidence underpinning the results presented. Areas of focus and scrutiny applied have been informed by our assessment of where the material issues and potential risks are. Those aspects and areas that we judge to be materially important and potentially higher risk have been subject to a higher level of scrutiny. This is reflected and explained in the commentary accompanying our findings.

2.3 Guidance and Documentation

The principal source of guidance for this review has been the ORR's Regulatory Accounting Guidelines (RAGs). A key stated objective of the RAGs is "to establish the basis of preparation and disclosure requirements of the regulatory financial statements that are consistent with the regulatory framework established by our 2013 periodic review ('PR13') determination"[1]. The RAGs specify the manner in which figures are to be presented within the respective statements, and explain the key principles and policies for financial performance reporting.

The ORR has recently updated the RAGs. The revised version was published partway through this review, although draft versions were made available to us

[1] CP5 Regulatory Accounting Guidelines May 2016 p5

prior to publication. The key change is that enhancements are now assessed using the Hendy Review as a baseline; our assessment has been conducted on this basis.

Where relevant, we have evaluated the consistency of Network Rail's reporting with the guidance and principles of the RAGs. Examples include requirements for demonstrating robustness of volumes from an asset management perspective, processes for reporting of variances in volumes of work, and details around inclusions / exclusions and adjustments applied to different statements.

Other important documents that have informed this review include:

- ORR's final determination of CP5 income and expenditure set out in its 2013 Periodic Review (PR13);
- Route Financial Performance & Sustainability Reports for all the routes;
- Cost / financial reporting handbooks (FPM handbook, Cost & Volume handbook for renewals); and
- Investment Panel documentation.

We have kept thorough records and documentation in support of the findings presented in this report, in order to provide a full audit trail. These include:

- Minutes of review meetings held with each of the routes and the central finance team;
- Records of all incoming documentation (included as Appendix B);
- Spreadsheets in which the analytical procedures were carried out;
- Emails containing explanations provided by Network Rail; and
- Descriptions of analytical procedures undertaken and results obtained.

2.4 Report Structure

The remainder of this report is structured as follows:

- Chapter 3 presents the findings of our review of Statement 5, discussing each audit procedure in turn.
- Chapter 4 assesses Statement 14, describing the results of each audit procedure in turn.
- Chapter 5 summarises our review of the Spend to Save schemes in the year.
- Chapter 6 makes recommendations based on the issues that have emerged from our review.

The original Mandate from ORR and a list of documents received as part of our review are included for reference in the appendices to this report.

3 Statement 5: Total Financial Performance

3.1 Overview

The key measure of Network Rail's financial performance is its Financial Performance Measure (FPM), which it presents in Statement 5 of the regulatory accounts.[2] FPM links directly to the levels of financial performance and delivery of outputs specified in the ORR's PR13 determination. Through the FPM reporting mechanism Network Rail compares its actual performance for the given year to the PR13 determination.

As well as comparing different categories of income and expenditure, FPM also incorporates adjustments to reflect Network Rail's delivery of outputs. In-year performance ahead of PR13 targets (i.e. cost savings ahead of PR13 efficiency assumptions, or outputs being delivered ahead of target) is reported through FPM as outperformance, whilst shortfalls are reported as underperformance.

3.2 Methodology

Our methodology in completing this part of the review has been based around the specific review procedures set out in the project mandate (see Appendix A). This has entailed a combination of the following:

- Review of controls: evidence of controls in place (processes, systems, validation) that support information presented.
- Numerical testing: checking and analysis of calculations, supporting formulae and processes and consistency of supporting data that underpin the material presented. This combines computational and error checks for the figures presented in the statements, and a sample checks of supporting system data / spreadsheets and original source documents.
- Qualitative assessment: review of logic, rationale and consistency of management narrative and qualitative evidence presented in support of reported figures.

Our review procedures have been fully documented, with a description of the procedure and its purpose, and a summary of the results obtained.

In order to gain detailed, qualitative insights into the formulation and control processes underpinning the FPM figures from a sample of routes, Arup undertook face-to-face review meetings with the following four routes:

- Scotland (16th May 2016)
- Wessex (17th May 2016)

[2] Although Statement 5 is titled "Total Financial Performance", Network Rail uses the term Financial Performance Measure, or FPM. In this report we use the term FPM to refer to this measure.

- Anglia (23rd May 2016)[3]
- Wales (26th May 2016)

Arup discussed in detail the relevant FPM results with each route. This included:

- Overview of data systems and information sources used.
- Key calculations undertaken.
- Logic, rationale and key assumptions applied.
- Accompanying narrative, understanding the story behind the numbers, with specific examples and details discussed.

Key documentation for this section of the review has included:

- ORR Periodic Review 2013.
- Network Rail Delivery Plan (presented through various supporting source files and spreadsheets).
- Statements 5a, 5b and 5c of the Regulatory Financial Statements setting out the results of the FPM measure including a breakdown by operating route, and the supporting calculation spreadsheets.
- ORR CP5 Regulatory Accounting Guidelines (May 2016).
- Financial Performance Measure Handbook by Network Rail (January 2016).
- Route Financial Performance and Sustainability Reports, providing route-level FPM results and management narrative.
- Management narratives accompanying the regulatory accounts.
- Investment Panel packs.

A full list of documents is provided in Appendix B.

3.3 Results

The results of our testing are presented below discussing in turn each of the audit procedures set out in the mandate.

In line with the 2014/15 review, the following grading system is used to summarise the result of each procedure:

❶	Evidence largely complete / consistent explanations with sound rationale
②	Evidence reasonable but with some gaps / inconsistencies in a few areas
❸	Partial evidence with some significant gaps / inconsistencies identified
❹	Evidence contradictory or completely lacking / risk of material misstatement

[3] The proposal included LNW as a sample route. Following discussions with Network Rail and the ORR on 5th May 2016, LNW was replaced by Anglia.

3.3.1 Procedure 1

Definition	Network Rail has clearly documented policies for the recognition of financial performance that are consistent with the ORR's regulatory accounting guidelines.
Results	Network Rail has produced a set of Financial Performance Measure (FPM) handbooks (January 2016) which describe the FPM calculation processes for inclusion in Network Rail's annual Regulatory Financial Statements. The 'Process' handbook explains clearly the overall purpose and scope of FPM and sets out the context for the FPM and a summary methodology for the assessment of the following categories: Support, Network Operations, Maintenance, Turnover, Rates & Industry, Schedule 8, Renewals, Enhancements, Schedule 4, and Other. This handbook does not include a section setting out the overall policy context for the process. The handbooks for the above categories reference sections of ORR CP5 for consideration in calculating and adjusting FPM. Asset management sustainability is defined in the 'Renewals' and 'Maintenance' handbooks and aligns with ORR guidelines. The concept of robustness is identified within the 'maintenance' handbook as a consideration for identifying the network's condition and performance. The FPM handbooks align with the CP5 Regulatory Accounting Guidelines (April 2014); however the May 2016 update adopts new baseline costs for enhancement projects based on 'the Hendy report' (November 2015). The guidance directing how Network Rail's financial performance should be reported is retained in the ORR update and the process for calculating financial performance does not change. The January 2016 update of the FPM handbooks addresses the recommendations made during last year's review, for example by including discussion of sustainability.
Conclusion	❶ Evidence largely complete / consistent explanations with sound rationale.

3.3.2 Procedure 2

Definition	Network Rail has clearly documented processes for calculating financial performance within which assumptions are clearly laid out and which demonstrate consistency with documented policies; these processes should exist both at the route and national level.
Results	The processes for calculating financial performance are described in detail in the following FPM handbooks: Support, Network Operations, Maintenance, Turnover, Rates & Industry, Schedule 8, Renewals, Enhancements, Schedule 4, and Other. The handbooks describe how financial data is extracted from relevant source data systems, the department responsible for undertaking the task and how information is compared with the PR13 baselines. This includes descriptions of adjustments that are applied in order to ensure meaningful comparisons. Principles set out in the handbooks demonstrate consistency with ORR policies in various areas including: • The requirement for FPM reporting to be disaggregated to route level, with input and sign-off required from route asset management teams.

	• The requirement for asset management sustainability and regulated output delivery to be considered as an inherent part of overall financial performance (alongside direct comparative aspects). • The need to differentiate between variations in renewals and maintenance expenditure due to re-profiling of activity between years, as opposed to variations contributing to FPM out-/underperformance. • The requirement to demonstrate that any deferral / slippage of maintenance or renewal activity does not have any adverse impact on asset condition or output delivery, in order for such deferral / slippage to be considered "neutral" in FPM terms (as opposed to inefficient). • Ensuring that the causes of any underspend / overspend are identified and explained.
Conclusion	❶ Evidence largely complete / consistent explanations with sound rationale.

3.3.3 Procedure 3

Definition	The calculation is performed across the necessary stages for each route for example: a) a comparison of PR13 to BP14 and from BP14 to the latest Business Plan; and b) a comparison of these to actual / forecast. The aim being to clearly show the progression from the determination to the latest plan but not prescribing the way this is achieved.
Results	The Financial Performance and Sustainability Reports demonstrate that the calculation for renewals is performed in two stages. The first stage involves comparing expenditure in the 2015 Delivery Plan (DP15) with the original PR13 Final Determination; the second stage compares DP15 against the actual figure for 2015/16 (and forecasts for subsequent years). Differences between DP15 and the actual spend could be due to a number of reasons including: • Cost estimates being updated as the project progresses through the GRIP stages; • Unplanned reactive maintenance forcing changes to other planned work in order to remain within budget; and • Projects being deferred to later years of the control period.
Conclusion	❶ Evidence largely complete / consistent explanations with sound rationale.

3.3.4 Procedure 4

<table>
<tr><td>Definition</td><td>The processes should show for each route
<ol type="a">
expenditure variances analysed between re-profiling of activity and financial out/ under performance; there should be a clear split between financial outperformance/underperformance due to scope and between that due to cost. An opinion should be given on the extent to which Network Rail has responded to Arup’s findings in this area in 2014-15
there should be clear commentary relevant and specific for each route’s financial outperformance/underperformance and both variances and commentary on these variances should roll up to the GB level so that material variances at all levels are visible and the overall ‘story’ explained
</td></tr>
<tr><td>Results</td><td>Re-profiling vs financial out/under performance

The breakdown of renewals expenditure within each of the routes’ FPM submissions differentiates between re-profiling of activity (FPM-neutral) and financial out- or underperformance. The level of supporting numerical detail is however variable across the routes.

For most categories, renewals volumes are below planned levels. However, there are few cases where such volume reduction is reported as FPM scope outperformance. Such variances are instead recorded as FPM-neutral deferral, with the volume shortfall expected to be recovered in future years in this control period or later.

As noted in last year’s review, we do not consider it unreasonable for re-profiled activity to be reported as FPM-neutral. However, we note that this makes the implicit assumption that the re-profiled activities remain deliverable at the unit cost levels assumed in ORR’s Final Determination beyond Control Period 5 while Network Rail is predicting that costs will continue to run at levels above those assumed in the Final Determination for the remainder of the Control Period. Deferring significant volumes, as Network Rail has done, may also create problems in future years as the backlog of renewals activity becomes increasingly challenging to deliver.

Split between scope- and cost-related performance

For renewals, the mechanism for calculating FPM differentiates between scope- and cost-driven out- or underperformance. While cost-driven FPM is being reported for almost all of the larger asset categories for every route, scope-driven FPM tends to be less widespread. In particular, it has been explained to us during our review that routes classify each change to project AFC as either scope related or cost related, but not as a combination of scope and cost. For example, value engineering exercises where costs are reduced due to changes in design scope are recorded as cost FPM when both cost and scope have changed.

Qualitative commentary and minutes from meetings have been provided by the sample routes with plausible explanations for the identification of both scope- and cost-driven FPM across asset categories. The quantitative supporting evidence is less clear making it difficult to track the allocations. Nonetheless, as discussed in Procedure 7 below, based on the evidence provided (both quantitative and qualitative) the allocation of FPM to scope- or cost-driven seems reasonable. We recommend making this step of the process more transparent by clearly documenting the links between information sources (e.g. cost estimates), events on the ground (e.g. the engineering or commercial issues encountered), decision-making and the numbers that appear in the Financial Performance and Sustainability Reports.</td></tr>
</table>

	As last year, no differentiation is made between scope- and cost-driven FPM for maintenance. The management commentary provides plausible explanations for out- or underperformance; some of these suggest scope-related drivers but all variances are allocated to cost-based FPM. **Response to findings in 2014/15** Last year's report noted that "Network Rail's evidence base in support of FPM-neutral deferrals could be strengthened with analysis around the deliverability of future deferred volumes treated as FPM-neutral deferrals". Our view is that there is still room for improvement in this area. While these issues are sometimes mentioned (for instance explaining that the deferral will allow the project to align better with other work, delivering efficiency gains) this tends to be the exception rather than the norm. Last year's report also noted that the figures presented in the comparison of DP14 against actuals "are not consistent with results presented for cost and scope FPM, and tables appear to contain inconsistencies as well as missing data fields". This comment still stands. The 'Network Rail Business Plan' volumes and unit costs provided relate to DP14 and therefore the figures are not directly comparable to the figures above which use DP15. These tables still contain many missing data fields. Last year's report suggested that "a project-level build up for all routes would strengthen the evidence base for the reported variances". While some routes have provided project-specific commentary, a formal requirement for all routes to do this would be useful. This could perhaps take the form of a table (rather than being entered into the text boxes, which could continue to provide the high-level qualitative explanations) and form a summary of the link between the FPM figures summarised in the report and the underlying calculation spreadsheet. **Clear, relevant and specific commentary** The level of detail in the supporting commentary is variable. The Financial Performance and Sustainability Reports produced by the Wales and LNE routes stood out as providing very useful commentaries that identified the key projects contributing to the FPM figures and the issues encountered that are causing the out- or underperformance. Commentaries provided by some of the other routes focussed on high-level qualitative explanations without the same project-specific detail, which were more difficult to verify. However, for the routes in our sample we were able to obtain additional supporting information during our meetings and these have been documented and reviewed. **Consistency with GB level 'story'** Our review of the route level commentaries provided in the Financial Performance & Sustainability Reports and in Statement 5 found that they supported the commentaries accompanying the England & Wales and Great Britain tables. The higher level commentaries explained the overall story, referring to individual routes or projects that have contributed greatly to the national figures. The route commentaries add more detail to this overall story.
Conclusion	➌ Partial evidence with some significant gaps / inconsistencies identified.

3.3.5 Procedure 5

Definition	There has been appropriate internal review at an appropriate level of seniority of whether Network Rail's actual calculations of financial performance at a route and national level are consistent with Network Rail's stated processes and policies and the ORR's regulatory accounting guidelines.
Results	Review and challenge process are evident. Network Rail's Business Performance Management Handbook details the internal review process for financial performance calculations. The cyclical process includes: • Daily conference calls to discuss shorter term tactical operational management and attended by the Managing Director, Network Operations and Route Managing Directors. • Weekly Performance Reviews to discuss balanced scorecard route overviews including headline financial metrics, attended by Route Managing Directors. • Periodic Business Reviews covering route scorecards, issues, risks, financial drivers, financial results and FPM. • Route Business Reviews attended by Route Managing Directors, and the Managing Director, England and Wales. Network Rail has supplied meeting minutes from the Internal FPM Reviews which indicate that those responsible for route asset delivery have been challenged to demonstrate the sustainability, asset condition and performance related to the levels of maintenance and renewals activity underpinning their FPM calculations.
Conclusion	1 Evidence largely complete / consistent explanations with sound rationale.

3.3.6 Procedure 6

Definition	The commentaries are consistent with the information that has been assured above.
Results	The tables in Statement 5 are accompanied by detailed commentaries. We have reviewed these and compared them to the narratives in the Financial Performance & Sustainability Reports, discussions at route meetings, comments in other Statements, and the figures both in the Statements and in their supporting calculation spreadsheets. We have found that the explanations are generally consistent the evidence reviewed, based on reasonable logic and in line with guidance in the RAGs and FPM handbook. The commentaries accompanying the England & Wales and Great Britain tables are generally a fair reflection of the commentaries on the individual routes. The narratives could in some instances be improved by providing more route- or project-specific detail. **Statement 5a** The route-level commentaries for Statement 5a include a lot of 'generic' network-wide description (e.g. the discussion of BTP costs in Industry Costs and Rates). Reducing the space given to repetition of general statements could allow the provision of more route-specific details. **Statement 5b** The narratives accompanying Statement 5b generally provide a good summary of the explanations provided in the Financial Performance & Sustainability

	Reports. Many (although not all) of the comments mention key projects that have contributed the most to the figures being explained. **Statement 5c** The commentaries are generally consistent, based on reasonable logic and in line with assumptions set out in the FPM handbook and with explanations/support information given by NR. **Statement 5d** The commentaries on Statement 5d are very general and explain only briefly the purpose of the Route Efficiency Benefit Sharing (REBS) mechanism. The commentaries are the same for all Routes except Wessex for which some alliancing agreements existed in 2015. The explanations provided are consistent, based on reasonable logic and in line with assumptions set out in the FPM handbook.
Conclusion	② Evidence reasonable but with some gaps / inconsistencies in a few areas.

3.3.7 Procedure 7

Definition	Maintenance and renewals variances have been correctly categorised between ‘neutral’ and ‘(under)/out performance’.
Results	The categorisation of variances between neutral and under- or outperformance was discussed at the meetings we held with the sample routes. We followed this with a closer examination of three projects from each route to investigate whether the categorisation was correct. This included analysis of the routes’ calculations that populate the Financial Performance & Sustainability Reports and supporting evidence such as investment panel documentation. Our assessment concludes that variances appear to have been correctly categorised. However, the categorisation process should be made more transparent - for instance by including explanatory comments in the calculation spreadsheets wherever a categorisation decision is made and by making clearer links between the calculations and supporting evidence.
Conclusion	② Evidence reasonable but with some gaps / inconsistencies in a few areas.

3.3.8 Procedure 8

Definition	The amounts of income and expenditure used in the calculation have been correctly extracted from the underlying accounting records. The independent reporter is not required to form a view about the quality of the underlying accounting records as this forms part of the work of the external auditor.
Results	Income and expenditure totals and disaggregated figures reported in Statement 5 have been found to be consistent with other statements, with no discrepancies identified.
Conclusion	❶ Evidence largely complete / consistent explanations with sound rationale.

3.3.9 Procedure 9

Definition	The PR13 baselines used are the ones agreed by the ORR, these will be the financial targets for each route underpinning Network Rail's published CP5 Delivery Plan.
Results	Baselines for Great Britain, England & Wales and Scotland are taken from the ORR's template, which was populated with the 2015/16 PR13 figures and sent to Network Rail on 11th October 2015. The only line items that do not exactly match the ORR's figures are Enhancements (Hendy baseline replaces the original CP5 baselines) and Financing Costs (small price base conversion differences, as Statement 4 is in nominal terms). The Final Determination includes only an indicative split of the England & Wales figures by route. Therefore, the baselines for the individual routes use Network Rail's CP5 Delivery Plan, following the method that was agreed with ORR and used in last year's accounts. These calculations are performed in the spreadsheet "route restated %.xls". The spreadsheet compares (for each line item) the E&W number in the CP5 Delivery Plan against the PR13 ORR numbers from 11th Oct. Where there is difference at the E&W level, it is apportioned between the routes. This allocation is done on the basis of that route's share of the E&W total in the CP5 Delivery Plan. Each route then gets its amount from the CP5 Delivery Plan plus its share of the E&W difference. The baselines presented in Statement 5 correspond to these adjusted CP5 Delivery Plan figures. There were only some small differences in Renewals and Enhancements (Hendy baseline replaces the original CP5 baselines) and Financing Costs (small price base conversion differences, as Statement 4 is in nominal terms).
Conclusion	❶ Evidence largely complete / consistent explanations with sound rationale.

3.3.10 Procedure 10

Definition	The sub-totals and totals in the table down cast and cross cast.
Results	No material discrepancies were identified: sub-totals and totals in the tables have been found to down cast and cross cast. We identified a minor error in the formula used to calculate the total row in each table of an early draft version. Network Rail were informed and this has been corrected in the final version.
Conclusion	❶ Evidence largely complete / consistent explanations with sound rationale.

3.3.11 Procedure 11

Definition	The disaggregated amounts for England & Wales and Scotland add up to the Great Britain amounts.
Results	No material discrepancies were identified: the disaggregated amounts for England & Wales and Scotland have been found to add up to the Great Britain amounts. However, we note that there is a difference in the way that individual schemes are aggregated - for instance IEP Programme is shown separately in the England & Wales and Great Britain tables, but forms part of "Other Enhancements" in the Scotland table. So although amounts for an individual scheme appear not to reconcile initially, this is purely presentational.
Conclusion	❶ Evidence largely complete / consistent explanations with sound rationale.

3.3.12 Procedure 12

Definition	The disaggregated amounts for England & Wales operating routes add up to the England & Wales amounts.
Results	No material discrepancies were identified: the disaggregated amounts for England & Wales operating routes have been found to add up to the England & Wales amounts. We note that there is a difference in the way that individual schemes are aggregated - for instance IEP Programme is shown separately in some routes, but forms part of "Other Enhancements" in others. Although amounts for an individual scheme appear not to reconcile initially, this is purely presentational.
Conclusion	❶ Evidence largely complete / consistent explanations with sound rationale.

3.4 Response to Last Year's Recommendations

The review of the 2014/15 regulatory accounts highlighted three recommendations. This section assesses the extent to which Network Rail have implemented those suggestions.

Recommendation 1

Recommendation from 2014/15	We recommend that Network Rail provides more specific explanations of the ORR's financial reporting policies and principles within relevant sections of the FPM handbook. This should lead to a greater understanding of the purpose and objectives of the measure to those involved in the reporting process, as well as helping promote good reporting practice. We recommend that this includes direct references to relevant sections of the ORR's Regulatory Accounting Guidelines (and other policy documents where relevant), including drawing attention to the following: • Requirements around the quality of reporting systems and processes (RAGS sections 2.5 – 2.6) • Definitions of asset management "robustness" and "sustainability", and how this relates to levels of activity reported through FPM (RAGS sections 3.9, 3.56 – 3.67) • Requirements to identify and explain the causes of underspend or overspend (RAGS sections 3.24 – 3.27)

	• Rationale around adjustments relating to underdelivery of outputs (RAGS sections 3.28 – 3.55)
Assessment of Implementation	Network Rail's FPM handbooks were updated in January 2016. There are now references to the four sections in the RAGs as noted in the recommendation, and definitions of "robustness" and "sustainability" (for example, on p12 of the maintenance handbook). Detailed scenarios have also been added to the guidance as examples. However, as the ORR's Regulatory Accounting Guidelines have been updated in June 2016, some of these references may now need updating.

Recommendation 2

Recommendation from 2014/15	We recommend that Network Rail puts in place a structured plan to enhance reporting systems and procedures for maintenance and renewals FPM at route level. This would involve variances in spend being systematically analysed and categorized by "front-line" deliverers of maintenance and renewals activities. The aim would be for such analysis to become an inherent part of "business as usual" financial reporting each period by each route. Reported FPM out-/under-performance should be supported by a reasonable degree of detailed evidence in accordance with FPM principles, including usage of project-specific variance analysis or unit cost framework data where appropriate.
Assessment of Implementation	Network Rail have implemented a purpose-built system, using Hyperion, to analyse renewals variances at a project level and categorising them between FPM and non-FPM. This system is populated by the routes and Infrastructure Projects teams on a periodic basis, providing a 'bottom up' approach based on input by 'front line' deliverers. In turn, this is centrally reviewed.

Recommendation 3

Recommendation from 2014/15	We recommend that Network Rail monitors and reports the proportion of live renewals projects / maintenance spend within each route for which variance vs. budget has been correctly reported in line with FPM principles. Levels of FPM reporting compliance could be compiled as a periodic or quarterly KPI across the business, and used to compare between routes and promote improvement.
Assessment of Implementation	Monitoring is undertaken using a two-step process: first the deliverer (usually Network Rail's Infrastructure Projects team) reviews the individual project, and then the funder (e.g. the Route team) reviews the portfolio at asset level. There are periodic reports by route which form part of the Network Operations visualisation boards. Outputs from the new system are monitored and reviewed every period by an independent capex assurance team.

3.5 Conclusions

Our review has found Network Rail's reporting of financial performance in Statement 5 to be reasonable, reliable and accurate.

The principles and mechanics of the financial performance measure are clearly explained within Network Rail's handbooks, which now incorporate the recommendations from last year’s review. Discussion at Route meetings suggests that the FPM is well understood and routinely used for financial reporting by route-based teams.

Management commentaries and the narratives accompanying the regulatory accounts were found to be consistent with evidence and the supporting calculations. While there may be scope for providing greater detail, the current descriptions do not misrepresent the financial performance or position of the routes.

As noted in last year’s review, the quantitative supporting evidence is more variable and lacking in detail in some areas. Although some routes provided detailed project-level breakdowns of the renewals figures presented in the Financial Performance & Sustainability Reports, most routes provided more high-level descriptions. The FPM-neutral deferral of renewal activity in particular is not underpinned by robust, evidenced analysis. Renewals activities have been categorised into cost- and scope-driven FPM (except in the Anglia route), but all maintenance out- or underperformance is reported as cost-driven.

Although no material misstatements or concerns to warrant a qualification of the audit report were discovered, we have made recommendations for improvements which are discussed in Chapter 6.

4 Statement 14: Renewals Unit Costs, Volumes and Expenditure

4.1 Overview

Statement 14 presents renewals unit costs (RUCs) covering most areas of renewals expenditure. Figures for 144 categories of asset are reported, covering track, signalling, civils, buildings, electrification & plant, earthworks and telecoms assets. For each RUC category, Statement 14 presents the activity volume, unit cost and total cost for 2015/16, and compares this to projections of volume and cost from in Network Rail's 2015 Delivery Plan.

Network Rail has informed us that, unlike maintenance unit costs (MUCs), the Renewals Unit Costs reporting framework is still in development and is not yet used for planning or analysis within the company. Presently, RUCs are derived via a one-off set of calculations at each year-end in order to comply with the RAGs. Unit cost values are calculated for each renewals activity by dividing total expenditure by volume at a route level (and also for the England & Wales and Great Britain totals).

4.2 Methodology

Our methodology in completing this part of the review has been based around the specific review procedures set out in the project mandate (see Appendix A). This has entailed mainly numerical testing, involving checking and analysis of calculations, supporting formulae and processes and consistency of supporting data that underpin the material presented.

Key documentation for this section of the review has included:

- Network Rail Delivery Plan for volumes of work and costs.
- Network Rail Cost & Volume Handbook.
- Statements 9a, 9b, and 14 of the Regulatory Financial Statements.
- Other supporting calculation spreadsheets and management narrative.

4.3 Results

The results of our testing are presented below discussing in turn each of the audit procedures set out in the mandate. The following grading system is used to summarise the result of each procedure:

❶	Evidence largely complete / consistent explanations with sound rationale
②	Evidence reasonable but with some gaps / inconsistencies in a few areas
❸	Partial evidence with some significant gaps / inconsistencies identified
❹	Evidence contradictory or completely lacking / risk of material misstatement

4.3.1 Procedure 1

Definition	Costs from each activity have been reported in accordance with the company's Cost & Volume Handbook.
Results	Network Rail provided a spreadsheet containing detailed workings from which the reported RUCs are calculated. Actual costs captured within the spreadsheet are defined and categorised on a basis consistent with the definitions set out in Network Rail's Cost & Volume Handbook for Control Period 5, which summarises at a high level how the reporting of costs and volume for renewals is performed.
Conclusion	❶ Evidence largely complete / consistent explanations with sound rationale.

4.3.2 Procedure 2

Definition	Cost information to calculate the unit costs has been correctly extracted from the underlying accounting records and that any estimates used are reasonable. The independent reporter is not required to form a view about the quality of the underlying accounting records as this forms part of the work of the external auditor.
Results	Network Rail has extracted actual expenditure numbers at asset and sub-asset level from its financial reporting system (Hyperion). 2015/16 source cost data extracted from Hyperion has been reviewed and checked against the actual cost numbers within Network Rail's RUC calculation spreadsheet; they were found to be consistent with the reported figures. Total costs for each asset and sub-asset category within Statement 14 were reviewed against the figures in Statements 9a and 9b (which are separately validated by the external auditor) and were found to be consistent. We note that for some areas of asset renewal (mainly relating to track, stations, E&P and telecoms), Statement 14 provides a greater degree of granularity than Statement 9b with some additional renewals sub-categories split out in the table. The reporting process of these numbers is detailed in Network Rail's Cost & Volume Handbook for CP5. Network Rail provided some explanations on the process to report the actual costs, which is similar to the process to report the volumes. As the reporting of the costs in the Regulatory Accounts are to the million pound, NR had to round the numbers manually and made some adjustments to the costs when the total expenditure on an asset is one more or less than the sum of the routes on that asset. These roundings explain the discrepancies that can be observed when checking the numbers in Statement 14 against some data sources.
Conclusion	❶ Evidence largely complete / consistent explanations with sound rationale.

4.3.3 Procedure 3

Definition	Volumes of work undertaken have been correctly extracted from Network Rail's asset management information systems.
Results	Network Rail has extracted actual volume numbers at asset and sub-asset level from its financial reporting system (Hyperion). 2015/16 source volume data extracted from Hyperion has been reviewed and checked against the actual volumes within Network Rail's RUC calculation spreadsheet, they were found to be consistent with the reported figures. The reporting of renewals volumes for CP5 is detailed in the Network Rail Cost & Volume Handbook. The handbook defines the full suite of reportable activities and sets out the cost and volume reporting process for each.

	Network Rail has provided documents showing the process to report the actual volumes: - flow diagram for volume reporting showing the reporting of the volumes by the Routes in Primavera and Oracle Projects systems to the assurance process and the transfer of the volumes from the previous systems into the Hyperion financial reporting system; - report of the external audit on 2014/15 renewal volumes: some standardisation of the reporting process between routes was recommended. These data appear to have been correctly derived from Network Rail's asset management systems in accordance with the handbook. Due to roundings on some of the volumes of Statement 14, some small discrepancies were observed when checking the numbers against some data sources.
Conclusion	❶ Evidence largely complete / consistent explanations with sound rationale.

4.3.4 Procedure 4

Definition	The resulting unit costs have been correctly calculated using the information in parts (2) and (3) above.
Results	The renewals unit costs have been correctly calculated by dividing the total costs by the volume for each RUC category, when appropriate, with calculations clearly set out in the Statement 14 tables. This is compliant with the specifications in the RAGs. During the audit, some unit costs were reported missing to NR in draft versions of Statement 14, which was updated accordingly and reissued.
Conclusion	❶ Evidence largely complete / consistent explanations with sound rationale.

4.3.5 Procedure 5

Definition	All items included in the non-volume section conform to the definition for inclusion within this section as described in the Cost & Volume Handbook.
Results	Non-volume costs captured within the Statement 14 spreadsheet are defined and categorised on a basis consistent with the definitions set out in Network Rail's Cost & Volume Handbook for Control Period 5. A few items such as 'Slab Track', 'Depot Plant', and 'Network' were reported as non-volumes in the spreadsheet and as volumes in the C&V Handbook. We understand that these volumes are reported internally by Network Rail and therefore appear within the Cost & Volume Handbook but were not published in the CP5 Business Plan and consequently Network Rail do not present these for comparison as separate volume categories within its regulatory reporting.
Conclusion	② Evidence reasonable but with some gaps / inconsistencies in a few areas

4.3.6 Procedure 6

Definition	The BP14 baselines for CP5 used are the ones agreed upon and used in last year's assessment.
Results	Baseline renewal costs and volumes presented in Statement 14 are derived from Network Rail's Delivery Plan. Baseline volumes are consistent with figures in the published version of Network Rail's Delivery Plan. Baseline costs are consistent with a spreadsheet provided by Network Rail setting out the CP5 Delivery Plan cost figures for the different renewal activities. The discrepancies observed between the CP5 Delivery Plan and the volumes reported in Statement 14 are due to roundings needed to make the Routes figures sum to the England & Wales figures and for England & Wales plus Scotland to match the Great Britain table. The only key cost line where this is not the case is S&C Medium refurbishment where the total of E&W was incorrect in the CP5 Delivery Plan PDF document.
Conclusion	➊ Evidence largely complete / consistent explanations with sound rationale.

4.3.7 Procedure 7

Definition	Where applicable the sub-totals and totals in the table down cast and cross cast.
Results	Sub-totals and totals within the tables presented in Statement 14 have been found to down cast and cross cast. No material errors were found.
Conclusion	➊ Evidence largely complete / consistent explanations with sound rationale.

4.3.8 Procedure 8

Definition	Where applicable the disaggregated amounts for England and Wales and Scotland add up to the Great Britain amounts.
Results	Disaggregated amounts for England & Wales, for Scotland and each operating route have been found to add up to the Great Britain amounts. The disaggregated amounts broken down by operating route have been found to add up to the Great Britain amounts. Some small discrepancies were observed for some sub assets of Track where the sum of the Routes did not exactly reconcile with the totals of England & Wales and Great Britain due to the rounding performed on the numbers. This is considered to be immaterial as these sub assets are not reported in the Regulatory Accounts.
Conclusion	➊ Evidence largely complete / consistent explanations with sound rationale.

4.3.9 Procedure 9

Definition	Network Rail's narrative supporting the statement is reasonable and the details set out in the commentary agree to the underlying accounting records or other supporting documentation.
Results	Network Rail's narrative on Statement 14 provides commentary with regard to the volumes of activity versus its baseline plan for each different asset but does not provide any commentary on unit costs. Network Rail argues that the commentary on volumes will become less meaningful over time as the original plan for CP5 was a prediction of the future and is therefore less robust than its current estimates. Network Rail states that it considers renewals unit cost measures to be of limited use. It claims that there are substantial differences between renewal projects within each asset class. Additionally, the method of

	calculation of RUCs reduces the usefulness of the measure: the costs are recorded when incurred while the volumes are recorded on commissioning. Notwithstanding these comments, the narrative can only be considered as partially supporting the results presented given no unit cost-related commentary is provided. We consider it would be feasible for Network Rail to provide explanations as to why the variances in the unit cost figures exist, as it does on the volumes. The renewal unit costs are formulated from credible source data (albeit in a way that makes year to year comparisons less meaningful than is desirable) and are still likely to yield meaningful insights into levels of cost incurred for at least some areas of renewals activity.
Conclusion	3 Partial evidence with some significant gaps / inconsistencies identified

Completeness of the Reported Renewals Unit Costs

In addition to the procedures above, a series of checks have been performed on Statement 14 to assess its completeness. Network Rail provided a spreadsheet containing the volume and cost data of one sample route (Anglia) from Oracle Projects and Primavera, which were reconciled correctly to Hyperion. No volume or cost data was found missing when reconciled from Oracle Projects/Primavera to Hyperion. All the unit costs for which there were some volume and cost data were reported properly in Statement 14; no missing unit costs were found.

4.4 Confidence Grading Analysis

We set out the results of our confidence grading analysis for the renewals unit costs presented in Statement 14 in the table below.

Grading	Result and description	Rationale
Reliability grading	"A" - Sound textual records, procedures, investigations or analysis properly documented and recognised as the best method of assessment	The process for calculating renewals unit costs is clearly documented. This involves the total cost for each defined RUC activity being divided by the volume of work delivered. Input costs and volumes are laid out in full in the Statement 14 table. Extraction of source data feeding into the calculations has been found to be consistent with the approach described in the Cost & Volume handbook. The calculations are performed at year-end by the central finance team. On this basis, we consider the reliability grading of "A" to be representative of this process.
Accuracy grading	"2" - Data used to calculate the measure is accurate within 5%	Renewals unit costs are produced via a simple calculation (as described above). The RUC figures have been found to have been correctly computed through the Excel spreadsheet provided by Network Rail containing all of the GB, England & Wales, Scotland and route-level figures, as presented in Statement 14. No computational errors were identified. Renewals Unit Costs were calculated using the data from Hyperion, the CP5 Delivery Plan and other spreadsheets provided by Network Rail. Some minor discrepancies were observed when comparing them against

	the Renewals Unit Costs presented in Statement 14; these are explained by the manual adjustments done on volumes and costs so that the totals at GB and England & Wales levels reconcile with the sums of the Routes figures.

In summary, based on the review process described above, our confidence grading for the renewals unit costs calculated for Statement 14 is **A2.**

The full definition of all grades is presented in Appendix C.

4.5 Conclusions

Our review of Statement 14 has found that renewals unit costs have been correctly calculated and presented on a basis consistent with the RAGs and Network Rail's Cost & Volume Handbook. 2015/16 outturn volume and cost data have been correctly extracted from source data systems.

The calculation process has been found to be clearly and logically laid out within the Statement 14 tables, with figures provided for Great Britain, England & Wales and each individual route. The figures have been found to be correctly calculated with only minor discrepancies which relate to the manual adjustments made to volumes and costs to ensure that the totals at Great Britain and England & Wales levels reconcile with the sums of the Routes figures.

As noted last year, the management commentary accompanying the Statement 14 figures provides only a partial narrative, commenting on variations in volumes of work delivered but with no commentary on unit costs. Network Rail has explained that it considers renewals unit cost measures to be of limited usefulness given the variety and heterogeneous nature of renewals activities. However, we consider it would be feasible for Network Rail to provide some high-level explanation of the variances in the unit cost figures, and that these are still likely to yield meaningful insights into levels of cost incurred for at least some areas of renewals activity.

5 Spend to Save

5.1 Overview

Statement 3 of the regulatory accounts provides details of enhancement capital expenditure during the year, including Spend to Save schemes.

Spend to Save schemes are projects promoted by Network Rail that are considered self-financing, i.e. capable of providing sufficient returns on investment through cost savings or revenues to cover their costs.

In addition to the capital expenditure assumptions that the ORR made in PR13, it also allowed Network Rail to identify and pursue opportunities to invest funds intending to reduce costs or increase revenue. The Spend to Save framework allows for additional investment to be made in self-funding schemes through additions to the Regulatory Asset Base (RAB) beyond the regulatory allowance.

Due to cash-flow constraints Network Rail has decided to reduce investment in revenue generating property schemes. Four projects were eligible to be classified as Spend to Save schemes in 2015/16. The total planned investment in these four schemes was below £5 million in the year. The largest of these schemes, Mountfield, is classified as a Spend to Save scheme but the RAB additions have been logged up within the original PR13 arrangement. Earlier RAB additions for this scheme under the Spend to Save framework were reversed in 2015/16. The other three Spend to Save schemes relate to the Rail Innovation Development Centre at Melton Mowbray in which Network Rail has invested under £1 million via Spend to Save in 2015/16.

Our review considers the four schemes suitable for inclusion in the Spend to Save framework, that is, these schemes meet the criteria set out in the RAGs. However, changes to the funding route for these schemes compared to Network Rail's assumed funding route results in no RAB addition in 2015/16 under Spend to Save.

The financial information for the four projects that were categorised as Spend to Save schemes in 2015/16 is summarised in the table below. However, nothing has been added to the RAB for any of them during the year. Network Rail had accrued to its RAB an amount of around £5m representing an expected share of its planned CP5 Spend to Save investment. Due to its cash position Network Rail has informed us that the £5m it accrued in 2014/15 has been reversed in 2015/16 and that the investment in the schemes this year has been logged to the RAB under the PR13 allowances that it agreed with ORR for this type of investment.

Project Title	Project No.	Current Authority	AFC All Stages	COWD Project to Date	YTD Actual	Delivery Group
Customer Offices RIDC Melton	145484	242,000	222,811	222,811	18,064	STE
RIDC Lifting and Jacking Road	145485	441,000	441,000	441,000	441,000	STE
Enhance Asfordby Sidings	145486	291,000	190,578	190,578	190,578	STE
Mountfield	142572	7,054,999	4,956,528	4,283,413	4,283,414	Property Services

5.2 Results

This section summarises the findings from our review of each of the four schemes.

5.2.1 Customer Offices RIDC Melton

Review procedure	Arup assessment
Can you identify clearly what type the scheme is?	The Customer Offices RIDC Melton was a scheme to enhance the facilities at the Rail Innovation Development Centre at Melton Mowbray (RIDC Melton). Network Rail was provided with the facility by DfT in December 2014 in order to maximise benefit to the wider rail industry, with the facility being chosen to be the test site for the Intercity Express Programme (IEP) led by Hitachi. To facilitate this programme, several enhancements were required at the site. This project involved installing a new office space for Hitachi and any future users of the facility to occupy. As this enhancement would benefit future customers at RIDC Melton as well as Hitachi, the decision of Network Rail paying for the scheme was taken through a self-financing business case. The project is now complete.
How is it going to be paid for?	There was no funding for the RIDC sites identified in the final determination, so each site must generate sufficient income through access charges to customers to cover the operation and maintenance costs. Any additional income required to finance these schemes will be provided through increases in access charges throughout the remainder of the Control Period. The business case for each project is based on the project gaining sufficient income to give the project an NPV of 0.
Are we clear that it is not already funded as either an enhancement or a renewal?	The scheme was not included as an enhancement or renewal work in the PR13 final determination.
Has scheme been selected using a reasonable test of its value/benefits?	The scheme was reviewed and gained signatures as per the normal investment guidelines. A business case was submitted with the investment panel authority request. As noted above it was based on the project earning sufficient income to earn an NPV of 0.

What is the primary driver for the scheme?	The primary driver for the scheme is to facilitate the delivery of the Intercity Express Programme. However, the assets will be used by future customers, most notably for the Crossrail testing and commissioning programme.
Was the delivery method likely to be efficient?	The project was competitively tendered by the LNE route buying team in order to ensure the selection of an appropriate contractor at a competitive price. The works were delivered by a third party contractor and managed by NR's RIDC staff. The ongoing maintenance will be managed by the operations manager at the facility.
What was/will be built and does it deliver business benefits that were intended?	To date, the offices have all been built and have already been used by Hitachi to house 40 of their engineering and support staff for the IEP. Once this team has vacated the premises, it is anticipated that the facility will be used to house a similar support team for the Crossrail rolling stock testing and commissioning programme.
What was/will be the efficient price for the works?	[REDACTED]
Tenancy	The land for the office space is leased to Network Rail by Haworth Estates. The lease costs are paid as part of the operating expenditure of RIDC Melton.
Lease type (if any)	The lease for the scheme runs until the 1st of February 2027 with break clauses occurring in 2019 and 2023.
What should be added to the RAB and when?	Nothing is to be added to the RAB for this scheme.

5.2.2 RIDC Lifting and Jacking Road

Review procedure	Arup assessment
Can you identify clearly what type the scheme is?	The RIDC Lifting and Jacking Road was a scheme to enhance the facilities at the Rail Innovation Development Centre at Melton Mowbray (RIDC Melton). Network Rail was provided with the facility by DfT in December 2014. This provision was in order to maximise benefit to the wider rail industry, with the facility being chosen to be the test site for the Intercity Express Programme (IEP) [REDACTED]. To facilitate this programme, several enhancements were required at the site. This project involved installing a lifting and jacking facility within the workshop to enable wheelset changes to be undertaken on site. As this enhancement would benefit future customers at RIDC Melton [REDACTED], the decision of Network Rail paying for the scheme was taken through a self-financing business case. The project is now complete.
How is it going to be paid for?	There was no funding for the RIDC sites identified in the final determination, so each site must generate sufficient income through access charges to customers to cover the operation and maintenance costs. Any additional income required to finance these schemes will be provided through increases in access charges throughout the remainder of the Control Period. The business case for each project is based on the project gaining sufficient income to give the project an NPV of 0.
Are we clear that it is not already funded as either an enhancement or a renewal?	The scheme was not included as an enhancement or renewal work in the PR13 final determination.
Has scheme been selected using a reasonable test of its value/benefits?	The scheme was reviewed and gained signatures as per the normal investment guidelines. Business case calculations were submitted with the investment panel authority request.
What is the primary driver for the scheme?	The primary driver for the scheme is to facilitate the delivery of the Intercity Express Programme. However, the assets will be used by future

	customers, most notably for the Crossrail testing and commissioning programme.
Was the delivery method likely to be efficient?	The project was competitively tendered by the LNE route buying team (working with National Supply Chain) in order to ensure the selection of an appropriate contractor at a competitive price. The works were delivered by a third party contractor and managed by NR's RIDC staff. The ongoing maintenance will be managed by the operations manager at the facility.
What was/will be built and does it deliver business benefits that were intended?	To date, the lifting and jacking facility has been built. The lifting and jacking road has benefited [REDACTED] and another customer on site, [REDACTED], therefore it has already generated extra income for RIDC Melton.
What was/will be the efficient price for the works?	The total final cost for the RIDC Lifting and Jacking Road project was [REDACTED] with the project being delivered in line with the Authority or under.
Tenancy	The land for the office space is leased to Network Rail by [REDACTED]. The lease costs are paid as part of the operating expenditure of RIDC Melton. Since the buildings are not currently owned by NR and re-instatement of the site back to the original configuration is a requirements of the existing lease.
Lease type (if any)	The lease for the scheme runs until the 1st of February 2027 with break clauses occurring in 2019 and 2023.
What should be added to the RAB and when?	Nothing is to be added to the RAB for this scheme.

5.2.3 Enhance Asfordby Sidings

Review procedure	Arup assessment
Can you identify clearly what type the scheme is?	Enhancing Asfordby Sidings was a scheme comprised of the enhancement of the facilities at the Rail Innovation Development Centre at Melton Mowbray (RIDC Melton). Network Rail was provided with the facility by DfT in December 2014 to maximise benefit to the wider rail industry, with the facility being chosen to be the test site for the Intercity Express Programme (IED) led by [REDACTED]. To facilitate this programme, several enhancements were required at the site. This project involved increasing the capacity of sidings the enable the storage of Class 800 (IEP) trains alongside a significant number of 'S' stock London Underground trains which are also being tested and commissioned at the site. As this enhancement would benefit future customers at RIDC Melton as well as [REDACTED], the decision of Network Rail paying for the scheme was taken through a self-financing business case. The project is now complete.
How is it going to be paid for?	There was no funding for the RIDC sites identified in the final determination, so each site must generate sufficient income through access charges to customers to cover the operation and maintenance costs. Any additional income required to finance these schemes will be provided through increases in access charges throughout the remainder of the Control Period. The business case for each project is based on the project gaining sufficient income to give the project an NPV of 0.
Are we clear that it is not already funded as either an enhancement or a renewal?	The scheme was not included as an enhancement or renewal work in the PR13 final determination.

Has scheme been selected using a reasonable test of its value/benefits?	The scheme was reviewed and gained signatures as per the normal investment guidelines. Business case calculations were submitted with the investment panel authority request.
What is the primary driver for the scheme?	The primary driver for the scheme is to facilitate the delivery of the Intercity Express Programme. However, the assets will be used by future customers, most notably for the Crossrail testing and commissioning programme.
Was the delivery method likely to be efficient?	The project was competitively tendered by the LNE route buying team (working with National Supply Chain) in order to ensure the selection of an appropriate contractor at a competitive price. The works were delivered by a third party contractor and managed by NR's RIDC staff. The ongoing maintenance will be managed by the operations manager at the facility.
What was/will be built and does it deliver business benefits that were intended?	The sidings have all been built. The increased sidings capacity has allowed Hitachi to store units close to the workshop facilities on site and has resulted in no vehicles needing to be stored on the test line. This has allowed for the maximum use of the test line during the hours of operation.
What was/will be the efficient price for the works?	The total final cost for the Asfordby Sidings project was [REDACTED]. The work delivered for Asfordby Sidings was significantly less that the amount authorised due to lower than expected contractor costs.
Tenancy	Although originally the lease for the sidings resided with TfL, this expired in March 2015. The land for the sidings is now leased to Network Rail by [REDACTED]. The lease costs are paid as part of the operating expenditure of RIDC Melton.
Lease type (if any)	The lease for the scheme runs until the 1st of February 2027 with break clauses occurring in 2019 and 2023.
What should be added to the RAB and when?	Nothing is to be added to the RAB for this scheme.

5.2.4 Mountfield

The Mountfield scheme involves the acquisition of more than 100 rail freight sites by Network Rail from three freight operating companies. The aim is to help Network Rail make better use of the network, providing improved access to freight operators and adding capacity at critical points on the East Coast and West Coast main lines.

The project was reviewed as part of last year's audit. As it is now nearly complete, and the work done in 2015/16 is relatively small, the assessment made in last year's report still stands[4]. The rest of this section summarises key changes in the year 2015/16.

The purchase of the sites has now been completed; the acquired sites have been absorbed into Network Rail's portfolio and are managed as normal. [REDACTED] was spent in 2015/16 relating [REDACTED]. There is some remaining work, which will be completed by route renewals teams in 2016/17. This work will be overseen by Simon Harding, who works alongside Network Operations (Freight) in a finance capacity.

[4] L4AR001: Review of 2014/15 Regulatory Accounts, Section 7.4.1

5.3 Conclusions

Our review has found that the four schemes are suitable Spend to Save schemes, meeting the criteria set out in the RAGs. However, as noted above, changes to the level of investment in such schemes compared to assumptions made in previous years means that no amounts have been added to the RAB in 2015/16.

6 Recommendations

Our review has not found any material misstatements or any major concerns that justify qualifications to the audit letter. However, we discuss below some recommendations for areas in which there is room for improvement.

Recommendation 1: Unit Costs Calculations

Costs and volumes are currently not recorded on the same basis, which limits the usefulness of the unit cost as a performance indicator. We understand that volumes are recognised on substantial completion[5] whereas costs are recognised on an accruals basis[6]; this creates a potential misalignment when calculating unit costs. As a consequence, the comparability of unit costs between routes or between years is of limited value for the purpose of unit cost benchmarking.

While we are entirely satisfied that the records presented in the regulatory accounts are in accordance with the RAGs, we recommend that the methodology for the recording of costs and volumes is aligned such that both costs and volumes are recorded for the purpose of benchmarking on substantial scheme completion. This will allow a meaningful unit cost to be calculated. We raised this issue with Network Rail and ORR at the Emerging Issues Meeting on 6th June 2016, and they have agreed to continue to work together to resolve this.

Recommendation 2: Quality of Supporting Calculations

When we have spoken to Network Rail, it is clear from their detailed explanations that they have a thorough understanding of the FPM figures and the reasons for any decisions that have been made. However, there remains a lack of clarity in the physical evidence base provided, which in many cases is not well documented or sufficiently detailed.

Adopting a 'Spreadsheet Modelling Best Practice" approach to the supporting calculations would be beneficial. This could, for example, use some of the processes outlined in the DfT's report "Quality Assurance of Analytical Modelling"[7]. Key features might include:

a) The use of links rather than pasted values to help the audit trail and to make updates easier. Where this is not possible, the filepath of the source should be noted.

b) Brief text descriptions of the more complex calculations so they can be understood by other team members (or auditors).

c) Logically laid out calculations with good use of colour coding (possibly with a degree of standardisation across teams).

d) Minimising manual entry and hidden rows.

[5] As noted in the Cost & Volume Handbook CP5 v3.0
[6] As noted in the Regulatory Accounting Guidelines May 2016
[7] Department for Transport, April 2013 (Updated September 2014)

e) Provision of supporting evidence (or a brief summary of the evidence) at each manual decision point in the calculation process.

This could improve the transparency of the method of calculation and, given that many of the calculations will need to be performed every year and go through a number of revisions, would save time.

Recommendation 3: Quality of the Financial Performance & Sustainability Reports

In addition to the suggestions in Recommendation 2, the Financial Performance & Sustainability Reports could benefit from the following:

a) Where breakdowns of figures are presented (e.g. in the In-Year Movements in Planned Initiatives charts or in the commentaries) they are often not at a ‘useful’ level of disaggregation, i.e. individual projects or locations. The report provided by the Wales route stood out as being very good in this regard. An alteration to the template that requires routes to provide such breakdowns would be useful.

b) Underlying calculations are not provided with the packs, so follow-up data requests and discussions are required in order to check that variances have been correctly categorised between ‘neutral’ and ‘(under)/out performance’ (Procedure 7). We recommend that these calculations are supplied with the packs and, in line with Recommendation 2, that they include supporting narrative to explain manual decision points (e.g. the categorisation between neutral, cost-driven FPM and scope-driven FPM) and make the links to supporting evidence clearer.

c) The Analysis of Track Renewals section includes figures for “Network Rail Business Plan” which we gather is not DP15. It would be more useful to show the latest Delivery Plan figures so that the volumes can be compared to the Actual figures.

d) We note that the Total Cost column in the Analysis of Track Renewals section has been incorrectly placed as part of the “Network Rail Business Plan” (blue) table rather than the “Actual” (green) table.

e) The Key Performance Indicator charts are pasted as images and too small to interpret clearly. In some cases they lack enough supplementary information to make them self-explanatory e.g. axis labels. Overlaps between the charts have in some instances truncated data series, thereby obscuring the true message of the chart.

Recommendation 4: Rounding

Figures in Statements 5 and 14 for the individual routes are rounded. Rather than simply displaying the values to the nearest million, the actual values are adjusted. This is done to ensure that the sum of the rounded numbers match the England & Wales and Great Britain totals but the method is not transparent and does not seem to follow a pre-determined procedure. It breaks the audit trail and produces extra ‘differences’ where two numbers that should match do not.

Although the impact is clearly small, we would recommend reviewing the way in which rounding is performed, as this could reduce the opportunity for errors and also be less time consuming.

This was discussed at the Emerging Issues Meeting on 6th June 2016. ORR and Network Rail agreed to decide on an approach for next year.

Recommendation 5: Audit Timescales

There appears to be a mismatch between the timing of review meetings, the availability of key documents and the audit deliverables. For example, some Financial Performance and Sustainability Reports were only provided one working day before the scheduled route meetings.

We recommend reviewing the timescales in which the Statements and supporting calculations are produced. This was noted at the Emerging Issues Meeting on 6th June 2016; Network Rail confirmed that they intend to phase their reviews differently next year to allow some elements to be completed (and therefore ready for review) earlier in the audit programme.

Appendix A – ORR Mandate

Mandate for Independent Reporter draft

Title	CP5 regulatory financial statements 2015-16
Unique Mandate Reference Number	L4AR002
Date	17th March 2016
ORR Lot Lead	Nigel Fisher
ORR Lead for this inquiry	Geoffrey Charin
Network Rail Lot Lead	Jonathan Haskins
Network Rail lead for this inquiry	Paul Marshall

Background

Condition 11 of Network Rail's licence requires the licence holder to prepare regulatory financial statements in relation to itself and, unless ORR otherwise consents, to Network Rail Infrastructure Finance. These must be prepared in accordance with Condition 11 and any Regulatory Accounting Guidelines issued by ORR from time to time.

Purpose

The objective of the independent reporter's review is to determine the reliability and accuracy of the information presented in certain sections of Network Rail's regulatory financial statements set out within this mandate.

The reporter should highlight areas of concern or non-compliance to Network Rail in a timely manner to allow necessary adjustments to FPM to be made in advance of the Regulatory financial statements being finalised. We expect an open and honest dialogue so that all parties can arrive at a consensus of financial performance in good time to meet the year end timetable. This approach is consistent with how the external auditor is expected to operate

Scope

The latest version of the CP5 regulatory accounting guidelines (RAGs) specifies that the work of the independent reporters will generally include the following regulatory financial statements at both a national level (GB, England & Wales and Scotland) and for each operating route within England & Wales:

Statement	Description
5	Financial performance
14	Renewals volumes, unit costs and expenditure;

In addition the reporter is required to establish the accuracy and suitability of Network Rail's 'Spend to Save' scheme where it relates to renewals as described in the Final Determination (section 12.173-12.176 pp443-4)[8]

[8] http://orr.gov.uk/__data/assets/pdf_file/0011/452/pr13-final-determination.pdf

The other regulatory financial statements are outside of the scope of this mandate. The independent reporter is not required to form a view about the quality of the underlying accounting records as this forms part of the work of the external auditor.

Methodology

The reporter should comply with *International standard on review engagements 2400 (revised)- Engagements to review historical financial statements*, with the addition of the procedures below. ISRE 2400 applies to limited assurance engagements which are not conducted by the auditor of an entity. Any departure from the standard should be agreed with ORR.

Materiality

Whilst materiality is usually considered in the context of statutory financial reporting, the concept is fundamental to any financial information including regulatory financial reporting.

ICAEW guidance on reporting to regulators of regulated entities states

36. Materiality is considered in ISA (UK and Ireland) 320 (Materiality in planning and performing an audit) and ISA (UK and Ireland) 450 (Evaluation of misstatements identified during the audit). ISA 320 explains that although there is no definition of materiality:

- Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;
- Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
- Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

37. Materiality is a matter of professional judgement for the Independent Accountants/auditors, based on their understanding of the circumstances of the engagement and communications with the addressees of their report.

It further states "Where the Regulator is an addressee to the Independent Accountants' report, the Regulator may specify, with supporting reasons, particular factors that it considers to be material in the context of the Regulatory Accounts and the Independent Accountants' report."[9]

Given the large sums involved in the FPM calculation and that bonus payments are dependent on the result of this calculation, we view the accuracy of Statement 5 to be material and that the independent reporter should take this into account when designing their review procedures and performing their review of Network Rail's regulatory financial statements. This comparison should be both to the PR13 baseline as in previous years, and to Business Plan 2015 as it is the comparison to the targets derived from this Business Plan that is used to determine the amounts payable under Network Rail's bonus schemes.

[9] https://www.icaew.com/en/about-icaew/what-we-do/technical-releases/audit-technical-releases

The reporter should also have regard to Regulatory Accounting Guidelines paragraphs 2.6 and 2.12 regarding the accuracy of information and adequacy of explanations supporting significant variances and where sampling is undertaken should adopt a statistical approach that is capable of extrapolating any errors with reasonable confidence. The Regulator should agree that the methodology to be used and the size of the sampling selected is reasonable and in accordance with accepted business practice. How these feed into the final grading system should be transparent and clear.

Minimum procedures

The following are suggested as the minimum procedures that should be undertaken by the independent reporter to provide an appropriate level of assurance.

The independent reporter may propose alternative or additional review procedures that it considers necessary to provide the assurance that ORR is seeking. In this case the independent reporter should discuss its proposed approach with both Network Rail and ORR before the work is undertaken.

For the Statement 5, section 7; Arup to provide, as part of their proposal, worked examples of their methodology to show how they will reach their conclusions.

Statement 5: Total financial performance (including statements 5 a-5c)

Management commentary

It was clear to both ORR and Network Rail in CP4 that the quality of management commentary is an important component of Network Rail's regulatory financial statements, specifically for its explanations of efficiency improvements and financial performance. Therefore, in addition to quantifying the variances between actual income and expenditure and the assumptions in our PR13 determination, our CP5 regulatory accounting guidelines also require Network Rail to identify the main reasons for variances and in particular the extent to which variances may be the result of financial out or under performance. This is important because the explanation of variances helps us understand how Network Rail is managing its business compared to the assumptions in our PR13 determination.

Because of this reporting requirement, the independent reporter should review whether the management commentary supporting Statement 5 provides a reasonable explanation of the financial out or under performance reported by Network Rail. This will require the use of judgement, in particular about whether the explanations provided by Network Rail are consistent with the independent reporter's understanding of whether the company's financial performance has been achieved on a sustainable basis.

The independent reporter should assess whether the management commentary supporting the geographically disaggregated statements is consistent with that for the company overall.[10]

[10] An example of an inconsistency could be if Network Rail's commentary focussed on unit cost savings, but the underlying records show that the savings were due to Network Rail having undertaken a different mix of work.

Last year, the independent reporter made three recommendations relating to Statement 5 (see Chapter 8, L4AR001: Review of 2014/15 Regulatory Accounts). The reporter should also assess Network Rail's implementation of these recommendations

Specific procedures

The following are suggested as the minimum procedures that should be undertaken. Confirm whether:

1. Network Rail has clearly documented policies for the recognition of financial performance that are consistent with the ORR's regulatory accounting guidelines;
2. Network Rail has clearly documented processes for calculating financial performance within which assumptions are clearly laid out and which demonstrate consistency with documented policies; these processes should exist both at the route and national level.
3. the calculation is performed across the necessary stages for each route for example:
    a) a comparison of PR13 to BP14 and from BP14 to the latest Business Plan; and
    b) a comparison of these to actual / forecast

   the aim being to clearly show the progression from the determination to the latest plan but not prescribing the way this is achieved.

4. the processes should show for each route:
    a) expenditure variances analysed between re-profiling of activity and financial out/ under performance; there should be a clear split between financial outperformance/underperformance due to scope and between that due to cost. An opinion should be given on the extent to which Network Rail has responded to Arup's findings in this area in 2014-15
    b) there should be clear commentary relevant and specific for each route's financial outperformance/underperformance and both variances and commentary on these variances should roll up to the GB level so that material variances at all levels are visible and the overall 'story' explained.
5. there has been appropriate internal review at an appropriate level of seniority of whether Network Rail's actual calculations of financial performance at a route and national level are consistent with Network Rail's stated processes and policies and the ORR's regulatory accounting guidelines;
6. the commentaries are consistent with the information that has been assured above;
7. maintenance and renewals variances have been correctly categorised between 'neutral' and '(under)/out performance'
8. the amounts of income and expenditure used in the calculation have been correctly extracted from the underlying accounting records. The independent reporter is not required to form a view about the quality of the underlying accounting records as this forms part of the work of the external auditor;

9. the PR13 baselines used are the ones agreed by the ORR, these will be the financial targets for each route underpinning Network Rail's published CP5 Delivery Plan;
10. the sub-totals and totals in the table down cast and cross cast;
11. the disaggregated amounts for England & Wales and Scotland add up to the Great Britain amounts; and
12. the disaggregated amounts for England & Wales operating routes add up to the England & Wales amounts.

Statement 14: Renewals unit costs, volumes and expenditure

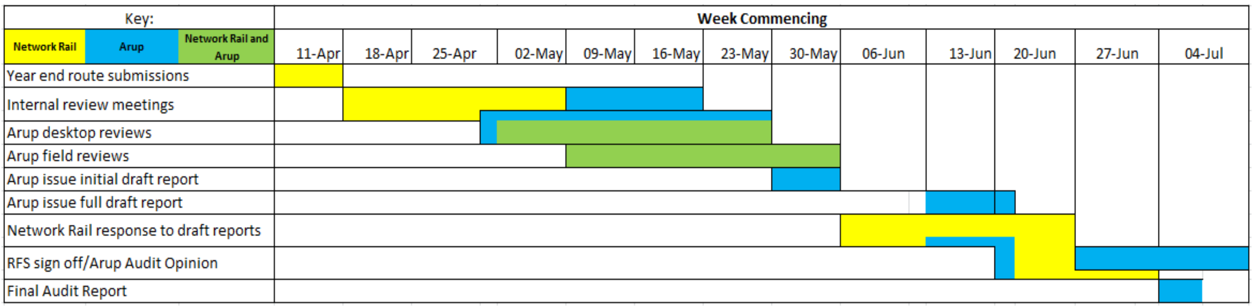
The reporter should assess the accuracy, reliability and completeness of reported renewals unit costs in accordance with its confidence grading system, in particular whether:

1. costs for each activity have been reported in accordance with the company's Cost & Volume Handbook;
2. cost information to calculate the unit costs has been correctly extracted from the underlying accounting records and that any estimates used are reasonable. The independent reporter is not required to form a view about the quality of the underlying accounting records as this forms part of the work of the external auditor;
3. volumes of work undertaken have been correctly extracted from the Network Rail’s asset management information systems;
4. the resulting unit costs have been correctly calculated using the information in parts (2) and (3) above;
5. all items included in the non-volume section conform to the definition for inclusion within this section as described in the C&V Handbook
6. the BP14 baselines for CP5 used are the ones agreed upon and used in last year’s assessment;
7. where applicable the sub-totals and totals in the table down cast and cross cast;
8. where applicable the disaggregated amounts for England and Wales and Scotland add up to the Great Britain amounts; and
9. Network Rail’s narrative supporting the statement is reasonable and the details set out in the commentary agree to the underlying accounting records or other supporting documentation

Timescales and deliverables

- Emerging key issues and initial draft report: end May 2016
- Interim Findings meeting by 9th June 2016
- Full draft report issued by 20th June 2016
- Audit opinion issued 30th June
- Final report issued by 6th July 2016

Detailed timetable for year-end:-



Related work

The statutory auditors review of some statements within the RFS, other independent reporter work as appropriate.

Independent Reporter Proposal

The Reporter shall prepare a proposal for review by the ORR and Network Rail on the basis of this mandate. ORR and Network Rail will review the proposal with reference to the criteria for selection – see attached guidance document.

The final approved proposal will form part of the mandate and shall be attached to this document.

It is anticipated that the work under this mandate should take approximately X man days. The reporter should take cognisance of this in preparation of the proposal. The proposal will detail methodology, tasks, programme, deliverables, resources and costs (including expenses).

The Reporter shall provide qualified personnel with direct experience in the respective disciplines to be approved by the ORR and Network Rail. The contractor is asked to submit details of the previous experience and qualifications of such personnel as part of their proposal.

Appendix 1 – Joint ORR and Network Rail Guidance to Reporters

1. The purpose of this document is to describe the trilateral relationship between ORR, Network Rail and each Reporter. It sets out in a practical context what both ORR and Network Rail expect from Reporters, and seeks to encourage best practice. This will help Reporters to deliver work in a way which meets these expectations and requirements. These requirements will be taken into account as part of the Reporter Framework (as provided to Reporters).
2. This guidance is owned and updated as necessary jointly by ORR and Network Rail. In the event of any discrepancy between this document and the Reporter contract, the latter will prevail. This guidance does not provide an exhaustive list of responsibilities and should Reporters wish to discuss these guidelines further they should contact the following for a trilateral discussion:
    - Andy Lewis for ORR; and
    - Jonathan Haskins for NR.

The trilateral relationship

3. Licence Condition 13 (LC13) of Network Rail network licence states:

    - "The role of the Reporter is to provide ORR with independent, professional opinions and advice relating to Network Rail's provision or contemplated provision of railway services, with a view to ORR relying on those opinions or advice in the discharge by ORR of its functions under, or in consequence of, the Act. Where appropriate, ORR shall give the licence holder an opportunity to make representations on those opinions or advice before relying on them."

4. Reporters should be familiar with the obligations as set out in LC13 and the terms of the contract.

5. For the avoidance of doubt, in delivering this role, ORR and Network Rail expect that Reporters will also add value to Network Rail in helping it to improve its performance and business as provider of railway services, wherever possible. However, it is recognised that this is not the primary purpose of the Reporter under the Licence and that this may not always be possible to deliver each mandate.

Role & duties of the reporters

6. Reporters must provide an independent view and remain impartial throughout the review.

    For example:

    - information should be shared equally and at the same time with both clients. Any correspondence or clarifications sought by Reporters should also be dealt with in the same way; and
    - communication between all three parties should be open e.g. both ORR and Network Rail should be invited to or made aware of meetings or discussions even if the meeting is more appropriate with only one client.

Identifying Reporter work

7. ORR will identify instances where there is a requirement to engage a Reporter. In practical terms, this is likely to arise from on-going discussions with Network Rail and in most cases (except urgent or exceptional cases) the potential for engagement of Reporters will have been identified in advance.

Mandates – Reporter Proposals

8. Clause 4 of the contract sets out the key requirements around provision of services. Requirements for reporter work normally arise from the day to day discussion of issues between ORR and Network Rail.

9. ORR will prepare a draft mandate for each piece of work and will in most cases agree this with Network Rail.

10. Mandates will be presented in a standard format for consistency and will clearly set out:

    - the purpose;
    - the scope;
    - why the review is necessary;

- what it will achieve;
- the expected outputs; and
- timescales for providing reports.

11. Once agreed with Network Rail, ORR will email the mandate to the relevant Reporter(s), asking for comments and a proposal for the work, which should include costs and CVs for the proposed Reporter team. The Reporter has seven working days to respond with a proposal or such other timescale as determined by ORR. Every proposal must include:
    - costs;
    - resources;
    - CVs of the proposed mandate team – when providing proposals, Reporters should make the most efficient use of their resources including the most appropriate make-up of the review team;
    - methodology for delivering the aims of the mandate;
    - timescales;
    - framework of meetings, including a tripartite findings meeting before issue of the draft report;
    - expected deliverables and a concise explanation of how the aims of the mandate will be met; and
    - for larger scale reporter studies, the project management approach and project plans should be made explicit
12. Where there are multiple Reporters on a Lot, the ORR and Network Rail will use the following criteria to determine which Reporter they will select to conduct the work:

Procedure for Call Off under the Framework Agreements

Where more than one Contractor has been selected for any particular lot, ORR and Network Rail will allocate mandates on the basis of the following criteria:

1. The expertise required is only available from one source. This may be due to ownership of exclusive design rights or patents.
2. Where the mandate constitutes follow up work, which is directly related to a recently completed study.
3. The Contractor which demonstrates the greatest expertise in the subject matter of the mandate or the approach required.
4. The Contractor's performance against the performance framework
5. An overall assessment of value for money based on cost and complexity of work.

If the ORR and Network Rail cannot determine the most appropriate Contractor for a mandate using the above criteria, ORR and Network Rail will conduct a mini-tender with the Contractors who have been awarded the relevant lot using the following criteria in order to determine the most economically advantageous proposal:

1. The Contractor demonstrates sufficient knowledge of subject matter and possesses the technical skills, resource and competencies required for the work.
2. Contractor Costs.
3. The Contractor demonstrates innovation and value for money in its proposal.
4. The Contractor's performance against the performance framework.

13. Prior to conducting such a mini-tender, ORR and Network Rail will inform Contractors of the relative weighting of the above criteria and of any additional sub-criteria applicable in the context of a particular mandate.

14. ORR and Network Rail will endeavour to discuss the proposals received and to confirm by e-mail within **five working days** that the proposal is acceptable (or otherwise). There may be circumstances where ORR and Network Rail need longer to respond.

15. ORR will then formally instruct the reporter to start work, and the reporter will arrange a start-up meeting with key representatives from both ORR and Network Rail.

Mandates – During Delivery

16. The following sets out some key points regarding conduct of any inquiry. Reporters must provide an independent view and remain impartial throughout the inquiry. They should expect to discuss their progress and findings trilaterally with ORR and Network Rail and for some challenge to be given – particularly in relation to the factual accuracy of the findings.

Costs and expenses

17. If additional funds are required to deliver a mandate beyond those agreed at the outset, a timely proposal and justification must be given to ORR and Network Rail (as soon as the issue arises). The Reporter should notify ORR and Network Rail who will discuss and respond in a reasonable timescale. Additional work (and cost) must not proceed without approval.

18. Any reasonably incurred expenses will be reimbursed by Network Rail. Only expenses that have been incurred in accordance with Network Rail's expenses policy will be paid. It should be specifically noted that reporters must use standard class travel and plan journeys in advance as much as possible. In addition no claims for lunch will be processed even if submitted. In the event that a Reporter is working on a 'call out' during the night which takes them into the morning, the Reporter will be eligible to claim up [REDACTED]. No other scenario qualifies for claiming breakfast. Hotel accommodation costs will only be paid up to the maximum rate limit (per person per night, including VAT) as set out in Network Rail's expenses policy.

19. All invoices should be sent to Katherine Bird at Network Rail prior to being sent to Network Rail Accounts Payable.

Amendment to mandates

20. For practical reasons it may be necessary for a mandate to be revised once work has commenced or awarded. For the avoidance of doubt this will not lead to the ORR and

Network Rail seeking to re-run the award of the mandate unless ORR and Network Rail agree that the revision constitutes a material change to the original mandate.

Meetings

21. Unless otherwise directed, all key meetings must be trilateral and both parties should be made aware of any other meetings taking place.
22. The Reporter should take minutes of meetings, which should be provided to all parties within 7 working days.

Issues or concerns

23. Should a situation arise whereby either ORR or Network Rail is dissatisfied with the quality of a piece of work, we will explain clearly our reasons, gain approval from the other client and then, if we deem appropriate, may request the Reporter to re-do that part of work at no additional cost.
24. Should the Reporter encounter any issues with an inquiry (review) the Reporter should notify:
    - Andy Lewis for ORR
    - Jonathan Haskins for NR

Reports

The report document

25. **All** Reports must include an 'Executive Summary' which should be written clearly, concisely and highlight key findings and key recommendations.
26. The full reports should also be written concisely in plain English, and should provide a brief 'Introduction' outlining the aims of the mandate and how these have been met. They should provide further detail on what is mentioned in the Executive Summary and there should not be any material points raised in the main report which have not already been mentioned in the Executive Summary.
27. Where there is commercially sensitive information in the report, the Executive Summary will be published on ORR's website, with any necessary redactions, instead of the full report. Otherwise, usually the full report will be published unless any redactions are appropriate due to a Freedom of Information Act exemption.

Recommendations

28. A recommendation is a specific action that the Reporter considers, following its analysis, should be undertaken by either Network Rail, or any other party. While the majority of recommendations are likely to be for Network Rail, not all need to be.
29. Reporters should make all recommendations SMART (Specific, Measureable, Achievable, Realistic and Timebound). The Reporter should:
    - provide a clear description of the recommendation and the benefit that implementation will deliver;
    - outline the evidence which is required in order for the recommendation to be closed out; and

- discuss and agree a target date for completion of the recommendation with ORR and Network Rail.

30. Recommendations should only be included in the report if they actually add value to either ORR or Network Rail or another industry party and the benefits are sufficient to justify implementation. It is acceptable for a report not to include recommendations, as long as key requirements of the mandate have been met (e.g. if an inquiry finds that Network Rail is fully compliant with its requirements). A smaller number of well-targeted and SMART recommendations which will deliver tangible improvements is preferable to a large number of general recommendations.
31. In order to add further value, the report may also include observations on areas for improvement which do not need to be captured in a formal Recommendation if they are not central to delivery of the mandate requirements.
32. Recommendations will be tracked by the Reporter which generated them.

Payment

33. Reporters must include the purchase order number, and unique mandate reference (UMR) number for work when invoicing Network Rail for payment.
34. The clients can query invoices and have the right to check timesheets (and expenses) and investigate work before payment is agreed.

Post-mandate review

35. The clients will provide feedback on the work carried out, having assessed performance using the Performance Framework on a per mandate basis. This will reflect any issues or concerns raised with the Reporter during delivery of the mandate.
36. The clients will also hold formal feedback sessions with each Reporter every six months to review progress.

Appendix B – Incoming Document List

Document Title / Description	File Name	Date Received	Received From
Network Rail Financial Performance Measure Handbook	Various pdfs	26/04/2016	Andy Child
ORR Regulatory Accounting Guidelines	NR CP5 Regulatory Accounting Guidelines.pdf	26/04/2016	NR Website
Network Rail Cost & Volume Handbook CP5	C&V Handbook version 3-0.pdf	26/04/2016	Andy Child
List of NR Spend to Save Schemes to be assessed and any reports that explain what they entail.	Spend to Save Projects.xlsx	26/04/2016	Andy Child
Investment Panel documentation Route Anglia	Various pdfs and spreadsheets	28/04/2016	Andy Child
Investment Panel documentation Route Scotland	Various pdfs and spreadsheets	28/04/2016	Andy Child
Investment Panel documentation Route Wales	Various pdfs and spreadsheets	28/04/2016	Andy Child
Investment Panel documentation Route Wessex	Various pdfs and spreadsheets	28/04/2016	Andy Child
Quarterly Management Board Review Documentation Anglia	Various pdfs	04/05/2016	Andy Child
Quarterly Management Board Review Documentation Scotland	Various pdfs	04/05/2016	Andy Child
Quarterly Management Board Review Documentation Wales	Various pdfs	04/05/2016	Andy Child
Quarterly Management Board Review Documentation Wessex	Various pdfs	04/05/2016	Andy Child
Hendy Baseline	P13 vs Hendy from MR.xlsx	09/05/2016	Liam Rattigan
File note on Crossrail funding	20140403 File note on CRL interim funding extension for Project team.doc	09/05/2016	Liam Rattigan
Inflation rates	RPI for grant income FTAC.msg	09/05/2016	Liam Rattigan
Schedule 4 calculations	Schedule 4 year end.xlsx	09/05/2016	Liam Rattigan
Schedule 4 baselines	S4 baseline from SF new#.xls	09/05/2016	Liam Rattigan
Missed outputs calculation	Missed Outputs.xlsx	09/05/2016	Ed Vout
REBS published baseline	REBS published baselines.pdf	09/05/2016	Liam Rattigan
REBS CP5 Guide (ORR)	rebs-cp5-guide-ORR.pdf	09/05/2016	Liam Rattigan
DP14 pdf	DP14 - latest published.pdf	09/05/2016	Liam Rattigan
RUCs.xlsx	RUCs.xlsx	09/05/2016	Liam Rattigan
Reactive Maintenance	RM tracker1516.xlsx	10/05/2016	Liam Rattigan
REBS calculation (including missed outputs calcs)	REBS Calculation 2015-16.xlsx	10/05/2016	Ed Vout
Schedule 8 payments	Schedule 8 ToC by route and period.xlsx	10/05/2016	Ed Vout
Delivery Plan	Delivery Plan.pdf	11/05/2016	Ed Vout
Business Performance Management Handbook	BPMF Handbook v1.1.pdf	12/05/2016	Andy Child
Financial Performance and Sustainability Report Scotland	Scotland FPM Schedules 15 16 220416 Final V7.xls	13/05/2016	Andy Child

Financial Performance and Sustainability Report Wessex	Wessex FPM Schedules 2015 16_Final v3.xlsx	13/05/2016	Liam Rattigan
Renewals Total Costs (Baselines) for Statement 14	FD to BP to budget (LR).xlsb	13/05/2016	Ed Vout
Statement 14 processes	L1AR003 Assessment of Renewal Volumes Issue.pdf & DP - excel.xlsx	13/05/2016	Phil Duffield
ORR numbers	Template from ORR (JT 11Oct) Fy1516.xlsx	16/05/2016	Ed Vout
Statement 14 updates	Master Statement 14.xlsx	16/05/2016	Ed Vout
Scotland slides from meeting	1516 review.pptx	16/05/2016	Ben Edwards
Statement 5a supporting document	HS1 income shortfall.xls	17/05/2016	Liam Rattigan
Statement 5a supporting document	FPM route split 1516.xls	17/05/2016	Liam Rattigan
Statement 5a supporting document	Opex and Income REGACC.xlsx	17/05/2016	Liam Rattigan
201415 reg accounts	Master File 2014-2015 v2.xls	18/05/2016	Ed Vout
REBS calcs updates	REBS Calculation 2015-16.xlsx	18/05/2016	Ed Vout
Periodic Finance Pack FPM Summary by Route	FPM summary by route.pdf	18/05/2016	Andy Child
Financial Performance and Sustainability Report Wales	Wales FPM Schedules 2015 16 V5 19 05 Final.xls	20/05/2016	Andy Child
Updated Statements 14, 9a and 9b	Master.xlsx	20/05/2016	Ed Vout
Updated Actual costs and volumes for Statement 14	RUCs.xlsx	20/05/2016	Ed Vout
Updated Statement 14	Working.xlsx	20/05/2016	Ed Vout
Financial Performance and Sustainability Report Anglia	ANGLIA FPM final Schedules 2015 16 Final.xls	24/05/2016	Andy Child
Scotland follow-up sample project information	Various docs	25/05/2016	Ben Edwards
Financial Performance and Sustainability Report London North West	Final LNW FPM Schedules 2015 16V2.xlsx	26/05/2016	Andy Child
Draft Update of ORR Regulatory Accounting Guidelines	2015-16 CP5 RAGS_updated 26 May 16.docx	27/05/2016	Paul Darby (ORR)
Financial Performance and Sustainability Report East Midlands	East Mids FPM Schedules 2015 16 310516.xls	31/05/2016	Andy Child
Financial Performance and Sustainability Report London North East	LNE FPM Schedules 15 16 310516.xls	31/05/2016	Andy Child
Wales follow-up sample project information	Wales MV Renewals MFMA FPM template Final for ARUP v2.xlsx	31/05/2016	Gareth James
Financial Performance and Sustainability Report Kent	Kent FPM Schedules 1516 v5.xlsx	01/06/2016	Andy Child
Financial Performance and Sustainability Report Sussex	Sussex FPM Schedules 1516 v3.xls	01/06/2016	Andy Child
Statement 5 Baselines	route restated %.xls	01/06/2016	Ed Vout
Management narrative to support figures contained in Statement 14	Statement 14 Comms - Network Wide.docx	02/06/2016	Ed Vout

Statement 14 Narratives	Statement 14 Comms - Network Wide.docx	02/06/2016	Ed Vout
Anglia follow-up sample project information	Various docs	02/06/2016	Chris Weller
Statement 5 Commentaries	Various docs	06/06/2016	Ed Vout
Financial Performance and Sustainability Report Western	Western FPM Schedules 2015-16 V5 ARUP FINAL.xls	07/06/2016	Andy Child
Stat14: Volumes and Costs from Oracle Projects	FY16 Cost and Vols.xlsx	07/06/2016	Ashanthi De Silva
Minutes of the Route FPM Meetings - Route Scotland	Scotland Internal FPM Review Minutes - 240416.pdf	09/06/2016	Andy Child
Wessex follow-up sample project information	Various docs	09/06/2016	Andy Child
Implementation of last year's recommendations	FPM reporting process updates for Arup 14mar.pptx	09/06/2016	Andy Child
REBS calcs updates	REBS Calculation 2015-16.xlsx	10/06/2016	Ed Vout
Final Statements	Master File 2015-16 Received 10.06.16.xlsx	10/06/2016	Ed Vout
Final Commentaries	Various docs	10/06/2016	Ed Vout
Minutes of the Route FPM Meetings - Route Anglia	Anglia Internal FPM Review Minutes - 060516 - draft.pdf	16/06/16	Andy Child
Minutes of the Route FPM Meetings - Route Wales	Wales Internal FPM Review Minutes - 060516 - draft.pdf	16/06/16	Andy Child
Minutes of the Route FPM Meetings - Route Wessex	Wessex Internal FPM Review Minutes - 270416 - draft.pdf	16/06/16	Andy Child
Statements 1-14 as presented in the regulatory accounts	Master File 2015-16 Received 16.06.16	16/06/2016	Ed Vout
Supporting calculations for Statements 5 and 14.	Workings 2015-16 Received 16.06.16	16/06/2016	Ed Vout
Statement 5a supporting document	RF11 Feb16 retrieves - Network Wide projects more uc.xls	16/06/2016	Ed Vout

Appendix C – Confidence Grading Definitions

Our review of unit costs presented in Statement 14 has included a confidence grading analysis. This is an assessment of data reliability and accuracy using an alpha-numeric scoring system that is based on the definitions set out below (as included in the proposal).

System reliability grading system

System Reliability Band	Description
A	Sound textual records, procedures, investigations or analysis properly documented and recognised as the best method of assessment.
B	As A but with minor shortcomings. Examples include old assessment, some missing documentation, some reliance on unconfirmed reports, some use of extrapolation.
C	Extrapolation from limited sample for which Grade A or B data is available.
D	Unconfirmed verbal reports, cursory inspections or analysis.

Notes:

1. System reliability is a measure of the overall reliability, quality, robustness and integrity of the system that produces the data.
2. Some examples of the potential shortcomings include old assessment, missing documentation, insufficient internal verification and undocumented reliance on third-party data.

Accuracy grading system

Accuracy Band	Description
1*	Data used to calculate the measure is accurate to within 0.1%
1	Data used to calculate the measure is accurate to within 1%
2	Data used to calculate the measure is accurate to within 5%
3	Data used to calculate the measure is accurate to within 10%
4	Data used to calculate the measure is accurate to within 25%
5	Data used to calculate the measure is accurate to within 50%
6	Data used to calculate the measure is inaccurate by more than 50%
X	Data accuracy cannot be measured

Notes:

1. Accuracy is a measure of the closeness of the data used in the system to the true values.
2. Accuracy is defined at the 95% confidence level - i.e. the true value of 95% of the data points will be in the accuracy bands defined above.