Audit Observation Response

TfGM has provided a response to four of the observations in the Audit observations letter. The four observations are the Brand quantification of soft benefits, Sensitivity analysis, Funding and affordability and Timeliness of Information.

Soft Benefits – Unified Brand

1.1 The auditor notes, that over the course of the audit, TfGM had a number of discussions relating to the soft benefits, including benefits derived from unified branding of bus services. Whilst the auditor does not dispute that unified branding could generate economic benefits, the auditor notes the evidence was based on data derived over 20 years ago and that the source data does not appear to be directly relevant, as it was based upon a study into branding benefits of Hail and Ride. TfGM was aware of this and applied the brand valuation because a) it was derived from a recognised central government transport source b) as acknowledged in the audit observation it was republished by DfT in 2009 without caveat and c) it is not uncommon in appraisals to make use of studies of a range of ages where they represent the most relevant research in a particular area. In addition to this, as noted in the audit observations in order that TfGM can be more certain of the economic and financial benefits as it develops the detail of the franchising proposition, TfGM intends to commission a new study to further examine unified brand.

1.2 TfGM believe that the valuation of unified brand is reasonable and appropriate in the Assessment. This is because the valuation is considered conservative as many of the benefit streams expected to flow from unification were not included in the monetised value. TfGM believe the unification of the GM Bus network under a single unified brand is a fundamental component of the franchising scheme and that it will have beneficial impacts in the following areas:

- Passengers will benefit from greater simplicity and ease of use of the bus system;
- Passengers will feel greater trust and confidence that results from greater public accountability for decision making; and
- There will be a place making benefit for GM associated with the creation of a single bus brand.

1.3 As noted in the audit observation, if all branding benefits were removed from the Assessment, the Net Present Value of the Franchising option still exceeds that of the Partnership option.

Sensitivities

Sensitivities – mitigations and downside

1.4 As noted in the report to the GMCA, the Assessment sets out the risks to GMCA of the proposed Franchising Scheme in that it takes on the risk that income, particularly farebox revenues, is sufficient to pay for franchised services (Strategic Case Section 8.4; Commercial Case Section 24; Financial Case Section 42.1 and 42.4.7). The financial forecasts include a quantified allowance for specific risks that accompany the Franchising Scheme (Section 42.4), and there are sensitivities presented in the Economic and Financial cases showing how the forecast outcomes would be different if key assumptions and trends varied – for instance 'exogenous' assumptions in Greater Manchester population forecasts or car ownership forecasts and franchising 'scheme specific' assumptions such as the assumed profit margin required by franchised operators (Sections 15.5 and 42.7).

1.5 Variations in some of the long-term trends tested in the Financial Case sensitivities could have significant effects on the bus network over the period to 2051 and, as noted, some of these factors are 'exogenous' whereby the GMCA would have limited influence or control of these trends.

1.6 TfGM explains the mitigations available to the GMCA in the Assessment Conclusion at sections 64.1.5 - 64.1.7. TfGM provided additional information to the Auditor through clarification on the 'levers' and mitigating responses that would be available to GMCA in the event that a 'downside' scenario materialised. GMCA should be fully aware of the mitigating responses when considering the scheme.

1.7 The mitigating responses would be both operational – through reducing the size of the network and / or increasing fares – and financial by allocating more funding to support services. Therefore a 'downside' scenario would necessitate prioritisation decisions to be made by GMCA, in line with its public accountability and control of key policy decisions under the proposed franchising scheme, around the level of services, fares and funding in order to achieve a balanced budget. Whilst the financial pressures on the bus market would be likely to be similar in different market scenarios, if the Franchising Scheme were not implemented, these risks and decisions would to a large extent remain with current operators.

1.8 The auditor further noted that many of the sensitivity tests do not reflect a network size adjustment in either the reference or option cases. The reason for this was because there are a number of different prioritisation approaches that GMCA could take to mitigating a downside scenario as set out in the paragraph above, and network reduction might not be the chosen approach. The results presented in the Economic case show that the sensitives, prior to undertaking mitigating actions, would not change the comparison between the options in value for money terms. The results presented in the Financial Case show what the cost impact would be, prior to undertaking mitigating actions, to GMCA over the appraisal period under franchising. As noted the GMCA could undertake mitigating actions as set out in the previous paragraph.

Sensitivities - additional sensitivities

1.9 The auditor notes two additional areas of sensitivity testing that could have been reported in the Assessment – whether a network change process would be less 'efficient' under Franchising than it is in the current market structure, and the overall length of the appraisal period.

1.10 The sensitivity testing could assess the impact of a less fluid contract change regime than envisaged. This would have a greater effect in the scenario of needing to make reductions to the network than taking advantage of new opportunities and increasing the network. TfGM believe the sensitivity test would not be informative for decision makers because it is not clear what the reasons would be for such an effect and if it were to exist, what the extent would be likely to be (in order to calibrate a meaningful sensitivity test). TfGM have considered the key factors involved in a network change process and concluded that a) the contract change mechanism, assumed within the assessment is deliverable b) the approach to contract change is , common to other similar franchise contracts both in the UK and internationally, thus validating the approach being adopted c) TfGM is satisfied it has sufficient information on how costs would change with network reductions. On the upside, it could also be the case that an authority looking at the network as a whole could make changes more efficiently (i.e. in a less damaging fashion in terms of overall patronage) but a sensitivity was similarly not undertaken on this. This was because it is difficult to decide the scale of such an effect to define a credible test. TfGM will maintain the assumption regarding the efficiency of the network change process under close review during any subsequent planning activities, including finalisation of network change processes and franchise contracts, to ensure it remains valid.

1.11 The auditor noted that the Assessment includes a sensitivity test for a longer appraisal period than 30 years but did not incorporate a sensitivity which was for a shorter period than 30 years and suggested this impact could have been tested.

1.12 TfGM did not undertake this sensitivity test as a) the appraisal period was already considerably shorter than the 60 years usually adopted in WebTAG transport appraisals b) franchising has been in place for more than 30 years in London and in other major cities where it has been introduced and c) it did not believe a 15 year market change was a valid sensitivity as a market change would be i) enduring (as set out in the Assessment at 13.1.5) and ii) the sensitivity would not change the conclusions of the economic case.

1.13 Nonetheless, in view of the auditor's observation, TfGM undertook this sensitivity test as part of audit clarifications and shared the results with the auditor. The results indicate that whilst the Net Present Value and Benefit Cost Ratio of the proposed franchising scheme are reduced (due to the shorter period to accrue benefits), the Value for Money rating and conclusions of the economic case remain unaltered.

Sensitivities – combined downside and 'switching value' analysis

1.14 The auditor also raises the point that in their view it is often desirable, although not essential, to undertake 'switching value' and combined downside scenarios in a conventional business case analysis. A switching value would illustrate what assumption values would need to be in order for the preference or ranking of options to 'switch'. Combined downside scenarios would combine together a number of the individual downside scenarios. TfGM's view, which is also acknowledged by the auditor, is this is a) not mandated by Green Book or other guidance and 'adding up' a set of downside sensitivities is not general practice in Green Book business cases in general or transport specific business cases b) some of the sensitivities are likely to be negatively correlated (e.g. in this case an increase in walking and cycling and an increase in use of cars for these journeys); and c) its applicability and the value of the output would be limited as many of the sensitivities applied would likely impact all options to a similar degree.

Funding

1.15 The observation report includes reference to a specific point on the auditor's interpretation of the Financial Case Guidance. The auditor has interpreted the Guidance to mean that an annual breakdown of funding sources (or 'budget available' to the GMCA) should be provided in either graphical or tabular format for each ‘relevant year’, in particular where additional funding is required over the proposed transition period.

1.16 TfGM included in the Financial Case of the Assessment the additional funding requirement and associated annual profile of this requirement over the transition period and set out a range of credible funding sources which, in aggregate, exceed the additional funding requirement to implement the proposed scheme over the proposed transition period. TfGM considered this information to be sufficient to give consideration to how the GMCA could afford to make and operate the proposed franchising scheme.

1.17 In response to the auditor’s observation however, TfGM has subsequently provided a more detailed profile of funding and the GMCA report sets out the preferred funding scenario for the GMCA to approve (section 5 of the GMCA report) for the purposes of consulting upon the proposed franchising scheme. The preferred funding scenario includes an annual profile of funds which, subject to GMCA’s approval, meets the auditor’s interpretation of this point.

Timeliness of Information

1.18 The auditor observes the timeliness of information used as the basis of the analysis and that it is sourced from 2016/17. The auditor acknowledges more recent information is now available and is satisfied that TfGM has acted reasonably in using 2016/17 data given constraints in collating information from a number of different sources, including information provided by Operators.

1.19 It should be noted that this observation refers to the base year (2016/17) of the models used and the associated data inputs for this base year period. Where appropriate, TfGM have used more up to date information to ensure that previous assumptions still hold. For instance, the quantum of network benefits was reduced because of ongoing changes to the network, using information available from 2019, and forecasting this change into the future.