Finance Directorate Strategic Plan

March 2019

Contents

1. Purpose, role & vision

1.1. Purpose

The Finance team brings together key business areas of the corporate core. It provides leadership and strategy, compliance and governance and group wide professional services.

1.2. Role

There are seven key functions within the Finance area that deliver a variety of leadership, governance, and service roles:

- Group Finance
- Business Review Team
- Planning and Regulation
- Internal Audit and Risk
- Corporate Finance
- Corporate Commercial

1.3. Vision

Our vision for the Finance team is that we consistently operate as a trusted strategic partner delivering high quality professional services and solid financial infrastructure throughout the organisation.

CP6 will be delivered; including improved efficiencies and commercial transactions underpinned by rigorous planning. We will deliver on the 5 Cs. The Directorate will transform to support a commercially focused as well as operational business.

2. Objectives & stakeholder priorities

2.1. Stakeholders & priorities

The Directorate has a wide variety of internal and external stakeholders.

The function provides services across the whole business and owns core policies and processes, as well as providing company-wide governance. Engagement is led separately within each functional area through mainly informal contacts, particularly through Route Managing Directors and Route Finance Directors and in some teams through account lead relationships with key internal customers and stakeholder groups.

A number of key external stakeholder relationships are managed within the function including with the DfT, HMT and the ORR. Relationships are managed through a series of formal engagements supplemented through regular, senior level informal contacts. Whilst their key priorities generally relate to the wider business, feedback has been used to shape the function's CP6 objectives.

Routes are the customers of a number of core services provided by the team including:

- 3rd party commitments advice
- Business development support
- Private financing advice
- Insurance and Claims management
- Accounting services
- Audit and Risk support
- Regulatory support.

The Routes have a number of common requirements from these specialist services. Notably that the services provided are high quality and delivered at a competitive cost.

The team also owns key corporate processes that the Routes and other business areas are required to comply with. These include:

- Business planning
- Financial reporting
- Financial control policies including authority to incur, invest, commit.

DfT are Network Rail's shareholder and major customer. They set the policy environment for rail, are a major funder of the business and specify our outcomes over each 5 year Control Period. There is therefore, strong alignment of objectives between Network Rail and the DfT. Overall government relations are coordinated by the team and there are strong interfaces between various parts of the CFO team and the DfT.

ORR is the independent economic and safety regulator for Britain's railway. ORR's key economic regulatory priorities for CP6 will centre on route-based regulation. Setting outputs and revenue at a route and SO (System Operator) level will support our strategy for increased devolution and further embed the role of route businesses and the SO. ORR intends to place scorecards at the heart of its regulatory framework in CP6. ORR proposes an enhanced role for reputation in CP6 as a regulatory tool through the comparison of routes' and the SO performance.

ORR will focus on supporting greater stakeholder involvement in the development and agreement of our plans, standing behind this process with its role and duties in CP6 remaining unchanged. ORR needs to ensure that the financial framework it sets for CP6 supports its move to greater route-level regulation and reflects the impact of our reclassification as a public sector arm's length body in 2014. The overall relationship between Network Rail and ORR is managed through Planning and Regulation with additional strategic working relationships between ORR, HMT and the business.

2.2. Specific objectives

The views of external stakeholders play a core role in shaping the company and function strategy. The specific objectives unpin the company's CP6 objectives and highlight the function's core role in delivery. The objectives include:

- Deliver CP6 within the agreed funding.
- Improve Value for Money and efficiency of the overall business.
- Increase the amount of 3rd party funded projects. If a third party has a particular project that they would like to take forward, and is in a position to do so, then the most effective model may be for them to take on responsibility for the funding, design, and build. We would advise on standards and on compatibility with, and protection of, the existing rail network.
- Increased amount of 3rd party financed schemes. We know there is considerable private sector appetite to invest in long-life secure assets such as railways. We have established a team to identify suitable opportunities for this.
- Embed effective and deeper devolution including route-based regulation within the business. From 2019, we will see the next major step change in devolution, with each route (including the Freight and National Passenger Operator route and the System Operator) having a separate regulatory determination from the ORR.
- Lead a successful CP7 periodic review process, shape the Strategic Business Plan.
- Meet our Finance vision set out above.

3. What Finance is

3.1. Structure

Group Finance is accountable for financial reporting and control. It sets accounting and reporting policies to enable consistent reporting throughout the Group, it monitors integrity of reported financial information and ensures accounts meet standards and requirements. Group Finance is accountable for the framework of financial control governing the organisation including the investment approval process. The team delivers centralised transactional accounting services across the organisation.

It also determines the optimal tax strategy and negotiates with insurance suppliers for group coverage. Additionally, it manages corporate Business Intelligence (BI) systems and provides financial support for the centre.

Business Review Team leads the development of the business plan and group budget, setting the policies and procedures for planning and budgeting. It manages the whole business performance reporting and the business performance management framework. BRT leads the development of scorecards and the governance of corporate KPIs. It also provides financial support for Group decisions.

Planning and Regulation leads the periodic review process including shaping the Strategic Business Plan. A large part of the role of P&R is to develop policy and influence the shape of the regulatory and contractual framework (including scorecards, charges and incentives, licence reform, track access contracts, financial framework, reporting, monitoring and enforcement) and leading reform to the regulatory and contractual framework, as required. P&R is accountable for leading Network Rail's relationship with ORR and facilitates the relationship with government including DfT and HMT.

Internal Audit and Risk provides the Executive Committee, the Audit and Risk Committee and ultimately the Board with independent assurance on the design and operation of the system of internal control. Internal Audit also investigates fraudulent and ethics incidents. The Group Risk team owns the enterprise risk management framework for the business to identify, analyse, monitor and report risks at three levels in the business. Group Risk is also a centre of excellence that supports and advises the business, the Executive Committee and the Audit and Risk Committee on good practice.

Corporate Finance manages the company's cash and working capital, historic and future borrowing to maintain liquidity. This includes the management of the DfT borrowing facility with the DfT and the historic portfolio of bonds and derivatives. The team also lead project financing for the organisation. This team was created toward the end of CP5 and has focused primarily on the asset sales that will include the lead for project financing and business development/funding capture practice and reporting in future

Corporate Commercial provides commercial policy, advice, services, and stewardship for commitment risks, primarily for 3rd party investment in the network and major projects. The team develops commercial frameworks, bespoke arrangements and approaches for commercial governance processes for commitments.

Legal & Corporate Services (LCS) works as an integral part of the business to help achieve Network Rail's strategy and objectives by managing and reducing legal, business, financial and reputational risk, being customer and safety focused and providing value for money. The team sets policy and standards; provides level 2 assurance; provides governance; manages risk; trains and develops capability in the business, supported by appropriate tools; provides subject matter expertise; holds accountability for compliance with identified pieces of legislation; and offers professional advisory services.

3.2. Operating model – present & future

The Finance function is a key part of the corporate centre.

There are no plans to change the core structure of the team in CP6. The structure is likely to evolve over time reflecting changing business needs, priorities and opportunities.

There are a number of identified factors which will change the services or delivery over CP6.

Increase in 3rd Party funding and financing

The Hansford Review identified a number of barriers that prevent third parties building on, and investing in our network. The review made a number of recommendations which we are implementing. The finance team are leading the response.

Supporting a move to a greater value and variety of 3rd party involvement, we are strengthening both the major transaction, corporate commercial teams.

Introduction of future technology to automate finance processes.

External benchmarking highlighted the wider finance function's strong current efficiency performance. It is likely however that advances in technology over the next few years will bring opportunities to drive further savings. Advances in robotics are anticipated which will allow repeatable tasks to be automated relatively simply. Management reporting will be increasingly delivered through Analytics technology.

A provisional efficiency has been included in plan for this opportunity.

Increased use of Shared Services

Migration of transaction activities to Shared Services is anticipated to continue.

A provisional efficiency has been included in the plan for this opportunity but will require additional as yet un-agreed services to transfer to realise. In practice, any headcount reduction will manifest itself across the separate business finance areas.

4. Risks, opportunities, constraints & assumptions

Summary of objectives

No.	Key constraints, risks and opportunities	What we plan to do	Owner	Timescale (start/ finish)
1.	**Efficiency delivery in the business is behind target in CP6 leading to funding pressure requiring deferral of activity into CP7. (R/O)**	• Provide analytical and reporting capability to support development and delivery of CP6 efficiency programme. • Embed fishbone analysis techniques to understand and control cost factors. • Strengthen governance processes including the establishment of Company and Route cost control rooms.	Group Finance	Ongoing
2.	**Our investment propositions are not sufficiently attractive to obtain the targeted levels of third party funding or financing leading to potential improvements not being delivered. (R/O).**	• Deliver the Hansford recommendations including: - Strengthening asset protection capability - Increasing visibility of investment opportunities - Reviewing commercial approach and risk appetite - Strengthen governance processes to understand and manage risk. • Strengthen project finance and third party contracting capability.	Corporate Commercial, Treasury, Major Transactions	Ongoing
3.	**Routes do not deliver obligations from Routes based regulation. (R)**	• Strengthen Route awareness of regulatory processes and capability with P&R support. • Work with ORR to ensure fit for purpose regulatory regime.	P&R	March 2020 (then ongoing)
4.	**CP7 settlement does not provide enough funding to deliver the required investment or sets undeliverable targets. (R)**	• Increase DfT, HMT, ORR understanding of value from continued and increased investment. • Strengthen company planning capability to better understand the benefits from investment and increase the reliability and credibility of our plans.	P&R, BRT	Ongoing (SOFA 2022, PR 2023)
5.	**Technology (Analytics and Robotics) does not provide the anticipated functional efficiency benefits (R/O)**	• Engagement with external market to understand evolving technology opportunities. • Collaborative working with Route Services IT to develop delivery capability.	Group Finance	Implementation 2021
6.	**Increased complexity of work or increased demands from the business on time resources (R)**	• Review regularly and be clear on contingent options to remain within the plan, set clear priorities of work.	All areas	Ongoing

5. Expenditure & Efficiency

5.1. Cost and volume summary

Unit of measure		CP5	CP6						CP7	
		18/19	19/20	24/25	21/22	22/23	23/24	CP6	24/25	25/26
Renewals	£m									
Controllable opex	£m	60.2	40.0	41.3	42.9	43.2	44.2	211.5	44.2	44.2
Non-controllable industry costs	£m	108.6	112.5	115.8	120.2	123.9	126.7	599.0	126.7	126.7
Total	£m	168.8	152.5	157.1	163.1	167.0	170.9	810.6	170.9	170.9
Permanent Headcount		368	386	383	384	384	385	385	385	385
Agency		5	4	5	5	5	5	5	5	5
Total headcount		373	390	388	389	389	390	390	390	390

Basis for costs

Core opex base drops by £20m pa from CP5 due to no expected asset sales costs. We expect to remain compliant in CP5. This will mean we will have achieved circa £4.7M of additional efficiencies in the CP, significantly challenging our operation. CP6 costs also include expected Apprentice Levy costs. Headcount in year 1 CP6 includes transfer of STE finance team.

Summary of costs by team or activity within the function

Activity/team	CP6 total (£m)	Comments
Group Finance	76.9	Systems, Accounting services, Ops Reporting, Graduates, CFO, RHT, Treasury
Group Finance (NC)	486.8	BTP statutory charge
Business Review Team	22.4	NR Business Planning Reporting and Review
Planning & Regulation	14.9	Leads the periodic review process including shaping the Strategic Business Plan
Planning & Regulation (NC)	112.2	P&R non controllable costs, reporter fees, safety levy and RDG Membership
Internal Audit & Risk	36.0	Executive Committee, the Audit & Risk Committee and ultimately the Board with independent assurance on the design and operation of the system of internal control
Corporate Finance	9.6	Major transaction works including additional scope
Funding Projects	£0	Assumed no additional asset sale cost in CP6
Corporate Commercial	11.6	Includes new OR request
Legal & Corporate Services	40.1	Policy & standards; assurance & governance; subject matter expertise; professional advisory services.
Total	**810.6**	

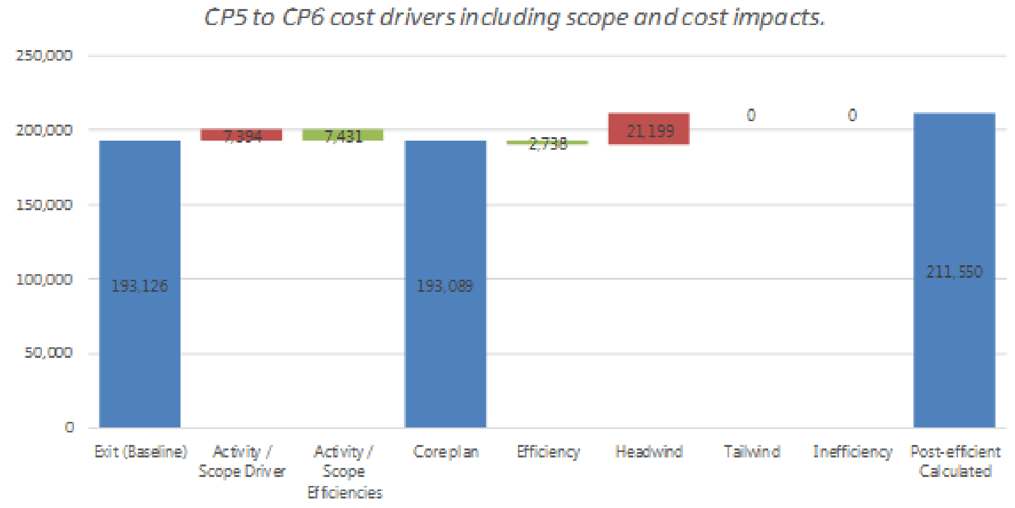
5.2. Route Business Scotland details

	CP5	CP6					CP6 total	CP7	
	18/19	19/20	20/21	21/22	22/23	23/24		24/25	25/26
National Cost (£m)		44.4	44.6	46.3	46.7	47.9	229.8	47.9	**47.9**
Scotland Cost (£m)		4.2	4.1	4.3	4.4	4.5	21.4	4.5	4.5
Scotland (%)		9.4%	9.3%	9.7%	9.8%	10.1%	9.3%	10.1%	10.1%
Basis for allocation to Route Business Scotland	Headcount and supporting costs , supporting Scotland split by heads.								
Activity	Group Finance (inc Accounting services, BI, Tax, Audit, Grads, reporting Business Review Team), Planning & Regulation, Internal Audit, Treasury, Tax, Corporate Commercial, Legal, (also includes Transformation and Efficiency function)								

	CP5	CP6					CP6 total	CP7	
	18/19	19/20	20/21	21/22	22/23	23/24		24/25	25/26
National Cost (£m)		112.5	115.8	120.2	123.9	126.7	599.0	126.7	126.7
Scotland Cost (£m)		10.3	10.6	11.1	11.3	11.6	54.8	11.6	11.6
Scotland (%)		9.2%	9.4%	9.8%	10.1%	10.3%	9.1%	10.3%	10.3%
Basis for allocation to Route Business Scotland	BTP split based on incidents in 16/17, ORR split evenly across routes								
Activity	BTP & ORR								

5.3. Cost drivers, headwinds and efficiency

Summary of cost changes between CP5 and CP6. CP5 close £193.1m, Scope drivers and efficiencies have no net impact in CP5 (Asset sales down, team size up during CP including transfer from Transformation & Efficiency & FOI. Efficiencies of £2.7m to deliver during CP6 in line with targets. £21.2m inflationary headwind.



Summary of Finance efficiency Controllable costs

Totex (O,M,R)	CP5	CP6					CP6 total	CP7	
	18/19	19/20	20/21	21/22	22/23	23/24		24/25	25/26
Pre-efficient plan[1] (£m)	**60.2**	**40.5**	**38.0**	**38.2**	**38.4**	**38.1**	**193.1**	**38.1**	**38.1**
Activity/scope efficiencies (%)	0%	0%	0%	0%	0%	0%	0%	0%	0%
Core plan (£m)	**60.2**	**40.5**	**38.0**	**38.2**	**38.4**	**38.1**	**193.1**	**38.1**	**38.1**
Head winds (%)	0%	1%	8%	12%	15%	19%	7%	19%	19%
Efficiency (%)	0%	0%	0%	0%	4%	4%	1%	0%	0%
Tailwinds (%)	0%	0%	0%	0%	0%	0%	0%	0%	0%
Inefficiency (%)	0%	0%	0%	0%	0%	0%	0%	0%	0%
Post-HW, post-Eff spend (£m)	**60.2**	**40.9**	**41.0**	**42.6**	**42.9**	**44.0**	**211.5**	**44.0**	**44.0**

Efficiencies in CP6 of £2.7m, 1% predominately seen through increased use of technology and robotics. Headwinds in CP6 of 7% relate to the impact of inflation on cost base.

[1] Note that pre-efficient plan is equivalent to core CP6 plan + 2a (activity/scope efficiencies) in the waterfall

Headwinds and efficiency by theme

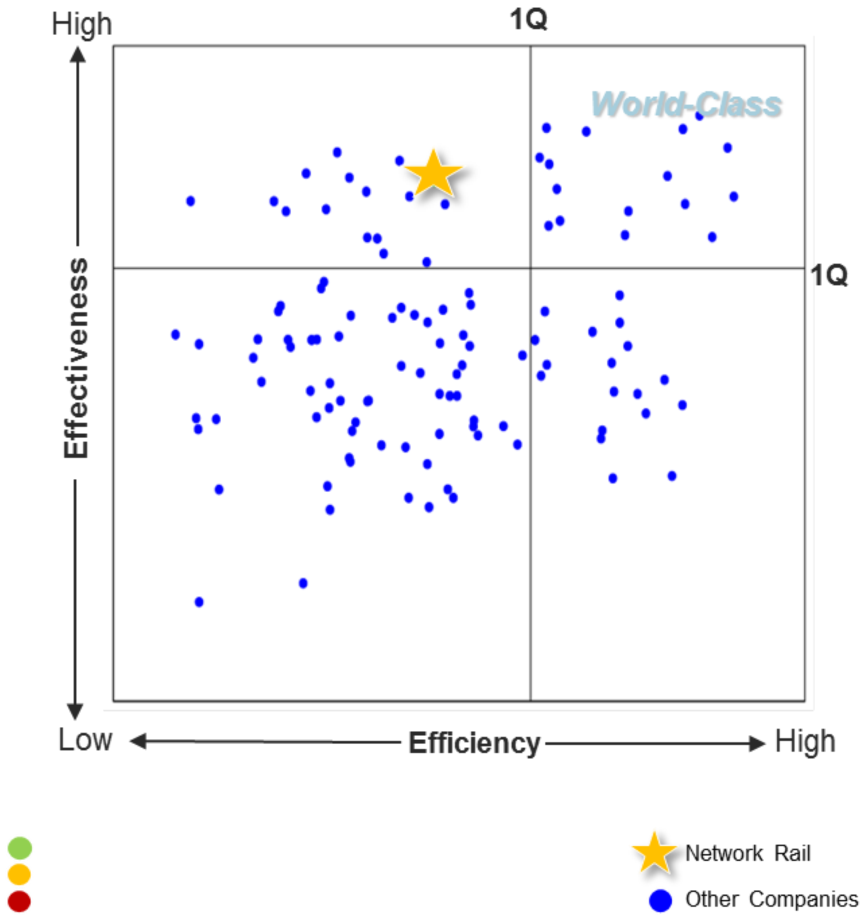
Theme	Area	Description	Net % change
Technology (5) & Other	Efficiency (5a)	CP5 has seen Finance deliver circa £4.7M efficiencies including additional CP challenges, this makes our CP6 starting position challenging. Transformation of finance, investment in technology/robotics expected to produce reduced head count specifically in process roles within core finance teams. Impacting heavily from year 4&5 CP6. **£2.7m.** Finance has considered further headcount reductions, but this would impact the level and scope of the service and be contrary to requests from customers for additional resource in the team. Finance is lean and CP5-compliant and additionally will have achieved circa £4.7M of efficiencies including the recent RF2 challenge and an additional over delivery in RF6. Payroll costs are main % of total cost. **£0M Benefit** Finance has considered further cost reductions in non-staff costs. Non-staff costs are only small % of total cost. The team has been streamlined through CP5 and has delivered significant efficiencies in line with and in addition to target. Efficiencies will continue to be targeted, but it is not possible to commit to further savings on non-staff costs at this stage. **£0M Benefit.** Total CP6 Efficiency £2.7m	Total efficiency 1%
	Headwind (9d)	View that no risk holds enough certainty that it warrants a headwind status. More elements fall into risk range on our base. We have spent a long time assessing all risks and have built them into our risk range within our submission. This holds items like further government changes that drive increased levels of staffing hours. It is felt these are best fit risk status opposed to headwinds. Inflation on baseline costs is being shown as a headwind £21.2m	

Relevant benchmarks

A benchmarking exercise was carried out by the Hackett Group over the first half of 2017 of the full company finance activity. The report highlighted strong performance in efficiency and effectiveness.

EFFECTIVENESS

- Analysis staff experienced in both Finance and operations
- Balanced scorecard utilization
- Analytical focus on proactive decision making vs. historical
- Percent of analyst time spent collecting and compiling data
- Transaction rework rates
- Reporting Self-Service
- Forecast reliability
- Comprehensive investment strategy
- Credit sales collected in terms
- Financial analysts seen as business partners



EFFICIENCY

- Process Cost as a % of Revenue
- Transaction Processing process cost as a % of Revenue
- Control and Risk Management process cost as a % of Revenue
- Business Analysis process cost as a % of Revenue
- Cycle time - Days to close
- Cycle time - A/P invoices
- Cycle time - A/R remittances
- Days to complete the budget
- Average days to bill a customer
- Tax Management process cost per legal entity
- Business performance reporting productivity

5.4. Risk and uncertainty in the CP6 plan

This section provides an explanation of the how we have built up our overall plan and sets out our estimate of the degree of financial uncertainty within this plan.

Pre-efficient costs in our plan are based on ‘current rates’ but include any additional scope needed to deliver the outputs in the plan. We have used CP5 exit rates for support, operations and maintenance expenditure forecasts. Drivers of rate increases (headwinds/inefficiencies), or rate reductions (efficiencies/tailwinds), where there is a reasonable expectation they will occur, have been identified separately from the core CP6 plan.

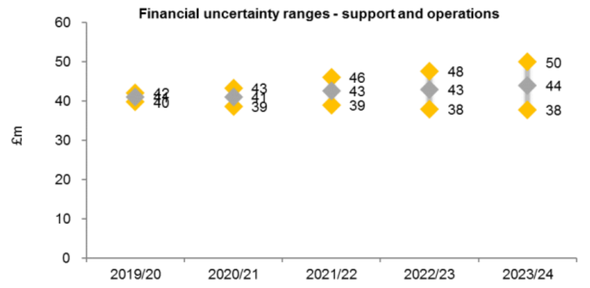
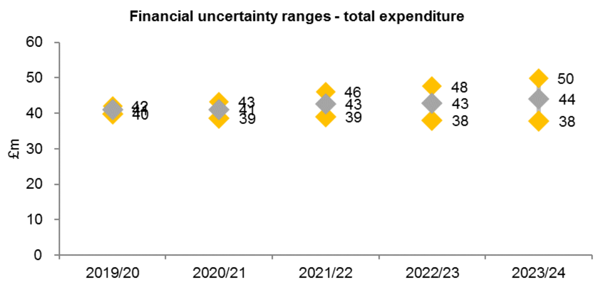
The combination of our core CP6 plan, headwinds/tailwinds and efficiencies/inefficiencies is our ‘submission’ and represents the ‘most likely outcome’ for CP6. The content of our plans reflects the funding that we understand to be available in CP6. We consider this plan to be realistic and, therefore, deliverable in CP6.

Current unit rates are likely to include some risks that were not originally included in CP5 plans but that have materialised during the current control period. As a result of this approach, it is likely that some risk and uncertainty is already included in our core CP6 plan, as we have not sought to remove the impact of these unplanned events from our unit rate estimates.

The plans have been set at an estimated mean scenario. The plan has clear risk as it relies on the development and implementation of technology. Although the plan should be deliverable to the forecast costs, output may suffer. However, this uncertainty varies between expenditure areas. The main drivers of uncertainty in our plan are identified in the table below.

5.5. Uncertainty ranges for CP6

The information in the table below, presents our estimate of the overall range of uncertainty across our expenditure and income for CP6. We have also identified the main drivers of the uncertainty ranges. The information in this table is based on the detailed inputs provided in our opex, renewals and income submissions. Headwinds/tailwinds and efficiencies/inefficiencies are included in the spot estimates.

Area	Potential range (low – spot – high)	Summary of key drivers of the uncertainty range	% of range	
		Driver of range	Lower %	Upper %
Support and Operations		Core risk within the plan sit around efficiencies that relate to new tech that may not yet exist	-7%	6%
Total expenditure		Core risk within the plan sit around efficiencies that relate to new tech that may not yet exist	-7%	6%

6. Sign-off

- This document and accompanying templates are owned by Paul Marshall.
- Submission of this document indicates confirmation that:
- all appropriate level 1 assurance activities have been undertaken (see separate advice on definition of level 1 assurance);
- the Group Financial Controller is satisfied with the quality, currency and appropriateness of the content of this document as well as the cost, volume and activity projections to which it refers;
- the signatories are satisfied that the plan has been assessed as deliverable, subject to the assumptions articulated in Appendix B.

Authorised by:

Paul Marshall

Group Financial Controller

07/02/19

Michael Murphy

Finance Director

07/02/19

Appendix A N/A

Appendix B Key assumptions

Ref no.	Topic (e.g. dependency, deliverability, climate etc.)	Assumption	Areas of spend impacted (e.g. all opex, single team, all spend etc.)	Is this a change of assumption for CP6?
	Organisational structure and demand	No significant organisational re-structuring and the volume of day-to-day work generated in CP6 will remain broadly consistent with CP5.	Opex: if the organisational structure changes significantly and/or the volume of work increases or decreases over a sustained period compared to demand in CP5 (for example the team receives a greater level of audits, route requests or regulator reporting) then team size may need to be reviewed	**No change vs CP5**
	Future Technology	It is assumed that finance technology advances over the next 7 years with expected increases in work supported by robotics and analytical solutions. NR assumes we will follow this trend.	If volume of work increases and Robotics are not enabled, our efficiencies will be at risk combined with our base numbers.	**Change vs CP5**
	Extensive further devolution	Finance remains a central function, focussed on its customers, but not devolved to Route businesses.	Opex: devolution of the team to the business may require additional resource in the company. Core elements of Finance could not devolve.	**No change vs CP5**
	Significant incident	There is no exceptional incident requiring substantial additional in-house resource over a long period.	Opex: additional resource (possibly significant additional resource) may be required in the long term.	**No change vs CP5**
	Medium incident	There is no medium-sized incident or change requiring additional in-house resource.	Opex: additional resource may be required in the medium term.	**No change vs CP5**

Ref no.	Topic (e.g. dependency, deliverability, climate etc.)	Assumption	Areas of spend impacted (e.g. all opex, single team, all spend etc.)	Is this a change of assumption for CP6?
	Substantial change in law or governance requirements	There is no substantial change in law or governance requirements that impact the organisation. For example CP5 saw reclassification of Network Rail and the organisation becoming subject to the FOI Act).	Opex: additional resource required.	**No change vs CP5**
	Significant project support	Large projects can be covered using current in house resource (or any additional in house resource is funded by the business). For example property disposals.	Opex: demand can be spiky, so a level of fixed term support may be needed during CP6.	**No change vs CP5**
	Functional Support	Other Corporate Support functions provide finance with same levels of support in CP6 as in CP5.	Opex: additional resource.	**No change vs CP5**
	Team size	The size of the team is correct to deliver what is needed for the business.	Opex: additional resource.	**No change vs CP5**
	Team Training	Training budget is the correct level to deliver the training finance needs to function and deliver to plan in CP6.	Opex: additional budget required if training need increases	**No change vs CP5**
	Accommodation	Office accommodation overhead for finance continues to be provided and funded by the business.	Opex: if we are not able to use existing accommodation, finance would need to source and fund this.	**No change vs CP5**

Appendix C N/A

Appendix D Scenario Planning

Part 1: decrease in total remaining expenditure for CP6
This section describes the impact of a 10% decrease in expenditure across CP6 based on all risk funding has been exhausted.

Area of spend	Outstanding CP6 expenditure	Maximum potential saving	Risk of curtailing expenditure				Comment on impacts/issues
			Safety	Performance	Sustainability	Reputation	
Group Finance	£67.3M	£6.7M	G	A	G	R	
Business Review Team	£20.6M	£2.0M	G	A	G	R	
Planning & Regulation	£13.8M	£1.3M	G	A	G	R	
Internal Audit & Risk	£33.2M	£3.3M	G	G	G	R	
Corporate Finance	£8.6M	£0.8M	G	G	G	R	
Corporate Commercial	£10.8M	£1.0M	G	G	G	R	
Total							

<u>Key to risk colours</u>

G: no additional risk
A: some additional risk
R: considerable additional risk

Appendix E N/A

Appendix F N/A

Appendix G Glossary of terms