4 Financial framework

4.1. The relationship of Ulsterbus and Citybus with their holding company (NITHC) and with the DOE (NI) is described in paragraphs 2.1 to 2.5. The holding company does not set financial or other targets for the bus companies and the DOE (NI)'s attempt to establish a more direct relationship with the bus companies was ruled ultra vires.

4.2. In this chapter we present the financial results of Ulsterbus and Citybus and provide a consolidation of their results to show an overview. We consider how the financial position has been achieved and its effects on the companies' operations. We continue by commenting on the financial control systems, including budgeting and management accounting.

4.3. The consolidated profit and loss accounts shown in Table 4.3 (see paragraph 4.7) show a loss on bus operations in each of the last five years. Ulsterbus has produced operating profits which are more than offset by Citybus operating losses. Government grants and compensation (see paragraphs 4.10 to 4.13) and interest on the companies' substantial cash deposits and investments have turned the consolidated operating loss into a satisfactory consolidated net profit in all years.

4.4. The income arising from the capital Government grant for the purchase of new buses and compensation for buses destroyed or damaged in the course of civil disorder is shown in Tables 4.1, 4.2 and 4.3. The value of the grants claimed in each year is shown in Table 4.6.

4.5. Ulsterbus, which operates the country routes in Northern Ireland, including routes running into Belfast, has operated at a profit in all but one of the last five years. There is a Black Taxi operation in Londonderry but this does not have the significant adverse impact on the Ulsterbus results that the Black Taxis in Belfast have had on those of Citybus. The grant income, compensation for damages and income from investments further increase the profit. Table 4.1 summarises the Ulsterbus profit and loss accounts for the last five years.

TABLE 4.1 **Ulsterbus: summarised profit and loss accounts**

					£'000
	1983/84	*1984/85*	*1985/86*	*1986/87*	*1987/88*
Turnover	27,519	28,313	30,123	29,220	31,845
Operating profit/(loss)	546	(539)	677	620	1,413
Capital grant transferred to income	999	1,012	1,142	1,297	1,514
Compensation for damages arising from civil disorder	112	93	132	96	163
Profit on bus activities	1,657	566	1,951	2,013	3,090
Interest and other income from investments	644	615	739	1,017	774
Profit before tax	2,301	1,181	2,690	3,030	3,864

Source: MMC based on data from Ulsterbus.

4.6. Citybus, which operates the bus routes within the city of Belfast, has made an operating loss in each of the last five years. The company told us that fares evasion (see paragraph 9.51) and competition from the Black Taxis (see paragraph 9.54) were the major causes of these losses. The operating loss is reduced by grant income and compensation and interest received from investments. Table 4.2 summarises the Citybus profit and loss accounts for the last five years.

TABLE 4.2 **Citybus: summarised profit and loss accounts**

					£'000
	1983/84	*1984/85*	*1985/86*	*1986/87*	*1987/88*
Turnover	10,534	11,155	11,875	10,887	11,065
Operating loss	(807)	(831)	(849)	(1,717)	(2,329)
Capital grant transferred to income	452	440	424	381	369
Compensation for damages arising from civil disorder	136	351	83	133	388
Loss on bus activities	(219)	(40)	(342)	(1,203)	(1,572)
Interest and other income from investments	192	273	369	452	330
(Loss)/profit before tax	(27)	233	27	(751)	(1,242)

Source: MMC based on data from Citybus.

4.7. As the two companies have the same strategic and financial objectives and the same senior management we have prepared consolidated accounts. Table 4.3 shows how the consolidated operating loss is turned into a profit on bus activities by grant income and compensation. Interest and other income from investments further improve the profit.

TABLE 4.3 **Ulsterbus and Citybus: consolidated profit and loss accounts**

					£'000
	1983/84	*1984/85*	*1985/86*	*1986/87*	*1987/88*
Turnover	38,063	39,468	41,998	40,107	42,910
Operating loss	(261)	(1,370)	(172)	(1,097)	(916)
Capital grants transferred to income	1,451	1,452	1,566	1,678	1,883
Compensation for damages arising from civil disorder	248	444	215	229	551
Profit on bus activities	1,438	526	1,609	810	1,518
Interest and other income from investments	836	888	1,108	1,469	1,104
Profit before tax	2,274	1,414	2,717	2,279	2,622

Source: MMC based on data from Ulsterbus and Citybus.

4.8. The consolidated balance sheets in Table 4.4 show a small increase as between 1984 and 1988 for the capital employed in bus activities. However, there is a considerable increase in cash and investments, which have grown from £6,648,000 in 1984 to £11,216,000 in 1988. In 1988 they represented 35 per cent of the net assets.

TABLE 4.4 **Ulsterbus and Citybus: consolidated balance sheets**

					£'000
	1984	*1985*	*1986*	*1987*	*1988*
Tangible assets	19,826	20,029	20,088	19,834	23,110
Stock and debtors less liabilities	(288)	(1,356)	(2,663)	(2,777)	(3,106)
Investment in Flexibus	-	-	249	249	749
Capital employed in bus activities	19,538	18,673	17,674	17,306	20,753
Cash and investments	6,648	7,615	10,211	11,572	11,216
	26,186	26,288	27,885	28,878	31,969
Capital and reserves	24,228	24,679	25,845	27,288	30,579
Deferred taxation	1,958	1,609	2,040	1,590	1,390
Provision for insurance claims	1,198	1,591	1,561	1,714	2,195
Assets of the insurance fund	(1,198)	(1,591)	(1,561)	(1,714)	(2,195)
	26,186	26,288	27,885	28,878	31,969

Source: MMC based on data from Ulsterbus and Citybus.

4.9. Table 4.5 shows how the cash inflows have been generated in the last three years. Even in 1988 when there was a large capital expenditure programme and investment in Flexibus the adverse cash flow was limited to £356,000.

TABLE 4.5 **Ulsterbus and Citybus: summarised source and application of funds**

			£'000
	1985/86	*1986/87*	*1987/88*
Source of funds			
Generated within the companies:			
Profit before tax	2,717	2,279	2,622
Depreciation less capital grant transferred to profit and loss account	2,314	2,317	2,703
Sale and compensation for damages to fixed assets	50	216	657
Reduction in working capital	719	406	242
	5,800	5,218	6,224
Funds from other sources:			
Capital grants received	1,838	1,630	3,815
Additional share capital for Citybus	350	250	-
Total source of funds	7,988	7,098	10,039
Application of funds			
Purchase of fixed assets	(4,054)	(4,113)	(8,686)
Investment in Flexibus	(249)	-	(500)
Purchase of goodwill	(15)	-	(34)
Tax paid	(824)	(1,374)	(1,175)
Dividends	(250)	(250)	-
Total application of funds	(5,392)	(5,737)	(10,395)
Net movement of funds represented by an increase/ (decrease) in cash and investments	2,596	1,361	(356)

Source: MMC based on data from Ulsterbus and Citybus.

Grants from the DOE (NI)

4.10. The cash flow of the bus companies is improved by a capital grant made by the DOE (NI). The grant is 50 per cent of the cost of each new bus purchased. Within the United Kingdom this grant was 50 per cent up to 1980 but was then phased out in stages up to 1984. Public sector support in the United Kingdom usually takes the form of grants by local authorities towards the cost of specifically identified uncommercial services. Ulsterbus and Citybus receive no support of this type. The General Consumer Council for Northern Ireland told us that it considered the present system of Government support for Ulsterbus and Citybus to be poorly targeted and in need of replacement by some form of revenue subsidy such as subsidies for routes where buses were underutilised. The value of the capital grants received by the bus companies is shown in Table 4.6.

TABLE 4.6 **Ulsterbus and Citybus: capital grants from the DOE (NI)**

					£'000
	1983/84	*1984/85*	*1985/86*	*1986/87*	*1987/88*
Claims based on new buses purchased	3,058	2,900	3,676	3,260	7,630
50 per cent grant claimed from the DOE (NI)	1,529	1,450	1,838	1,630	3,815

Source: MMC based on information from Ulsterbus and Citybus.

4.11. The capital grants are taken into the profit and loss account as income by spreading the grant in equal instalments over the depreciation life of the bus. This is in accordance with normal accounting practice. The amounts included in the Ulsterbus, Citybus and consolidated profit and loss accounts are shown in Tables 4.1, 4.2 and 4.3.

Compensation for damage caused by civil disorder

4.12. The Northern Ireland Office (NIO) compensates the companies for malicious damage to buses arising from events attributable to civil disorder. This can range from bus windows broken by stoning to buses hijacked and totally destroyed, usually by burning. The number of buses totally destroyed in each of the last five years and the compensation received is shown in Table 4.7.

TABLE 4.7 **Number of buses destroyed and compensation received**

					Number of buses destroyed
	1983/84	*1984/85*	*1985/86*	*1986/87*	*1987/88*
Ulsterbus	16	12	19	13	26
Citybus	15	37	10	13	53
	31	49	29	26	79
					£'000
Surplus arising on compensation for buses destroyed	181	293	140	143	366

Source: MMC based on data from Ulsterbus and Citybus.

These receipts are part of the compensation for damages shown in the profit and loss accounts in Tables 4.1, 4.2 and 4.3.

4.13. In addition to the compensation for buses destroyed the companies are reimbursed for the consequential loss. The present formula agreed between the NIO and the companies for calculating the consequential loss is based on the total company costs for the financial year less those costs associated directly with running the buses (drivers' wages, oil and maintenance). The remaining costs are divided by the annual bus days (number of buses owned multiplied by 365) to give a cost of consequential loss per bus day. Ninety days' compensation is allowed. Each claim becomes 90 multiplied by agreed daily rate. The consequential loss compensation received by the companies in each of the last five years is shown in Table 4.8.

TABLE 4.8 **Consequential loss compensation received by Ulsterbus and Citybus**

					£'000
	1983/84	*1984/85*	*1985/86*	*1986/87*	*1987/88*
Ulsterbus	17	32	35	35	50
Citybus	50	119	40	51	135
	67	151	75	86	185

Source: MMC based on data supplied by Ulsterbus and Citybus.

These receipts are part of the compensation for damages shown in the profit and loss accounts in Tables 4.1, 4.2 and 4.3.

Insurance

4.14. The companies operate their own scheme of self-insurance. This scheme covers all the normal types of insurance, including employer's liability, public liability, motor and other forms of accident insurance. For each type of insurance there is also a `catastrophe' policy with a major insurance company. These policies insure the bus companies against abnormal losses: for example, the employer's liability policy covers claims in excess of a total annual aggregate cost of £250,000 and the motor policy covers claims in excess of £150,000 for an accident. The companies charge the estimated cost of `self-insured' accidents against profits in the year the accident occurs. However, some time may elapse before final settlement is agreed. Table 4.9 shows the amounts charged to the profit and loss account. The balance sheets in Table 4.4 show the amounts of insurance claims unpaid at each year end, and the value of the fund the companies hold to meet the outstanding insurance claims.

TABLE 4.9 **Cost of insurance (self-insurance claims and catastrophe premiums)**

					£'000
	1983/84	*1984/85*	*1985/86*	*1986/87*	*1987/88*
Ulsterbus	325	860	509	654	860
Citybus	168	186	297	268	463
	493	1,046	806	922	1,323

Source: Ulsterbus and Citybus.

Budgeting

4.15. Each year a budget is prepared during the two months prior to the start of the financial year. Separate budgets are prepared for Ulsterbus and Citybus. The budget includes the planned revenue, costs and capital expenditure for the year, analysed by major types of income, operating costs and overheads. The budgets are not analysed into individual cost centres (bus depots) within the companies.

4.16. The budget is prepared by the Company Secretary and his staff. The first step is for a capital expenditure budget to be prepared. This includes projects for new buildings, new buses and plant for use in the workshops. Following Board approval for the capital expenditure budget the Company Secretary prepares budgets for the operating costs and overheads. The method used in setting these budgets is to take the current levels of expenditure and include increases for inflation and wage settlements. Further adjustments are then made to allow for known or expected changes in the pattern of operations. Finally the revenue budgets are set. These are based on current levels of income increased by the fare rises planned for the coming year. The fare rises are decided by senior management and are set at levels which they judge will be acceptable to the public and provide levels of profit consistent with the companies' financial requirements.

Capital expenditure

4.17. In addition to approval of the total capital expenditure budget individual capital projects costing more than £50,000 are submitted to the Board. These proposals are usually for the modernisation of bus depots. No financial appraisals and forecasts of income are submitted. An exception to the general pattern occurred in 1987 when four minibuses were purchased for use on the route from Belfast to Aldergrove airport. In this case a financial appraisal was prepared to demonstrate the cost savings to be expected from substitution of minicoaches for full-size coaches. Purchase of new buses is normally treated as a replacement programme and no financial appraisal prepared. Table 4.10 shows the high proportion of the total capital expenditure which is spent on buses. The various bus manufacturers' prices and performance of their new models is being continuously evaluated. However, the need for model standardisation of the bus fleet makes it inappropriate for comparisons of manufacturers' prices to be made each year. The role of price comparisons is further reduced by the importance which has to be given to operational requirements such as size mix, eg mini or single- deck buses and standardisation of buses to maintain workshop efficiency. Investment appraisal of capital expenditure is considered in more detail in Chapter 6.

TABLE 4.10 **Ulsterbus and Citybus: capital expenditure (excluding receipts from sale of surplus assets)**

£'000

	1983/84	*1984/85*	*1985/86*	*1986/87*	*1987/88*
Buildings	577	408	107	97	626
Buses and other vehicles*	3,210	3,136	3,641	3,738	7,464
Plant and machinery	158	361	306	278	596
	3,945	3,905	4,054	4,113	8,686

Source: Ulsterbus and Citybus.

*Cost of buses is before deduction of the 50 per cent capital grant from the DOE (NI), and compensation for buses destroyed in civil disorder.

Management accounts

4.18. Management accounts are prepared for the 13 four-weekly accounting periods. They take the form of a profit and loss account for each company with supporting statements providing an analysis of expenditure into the major types of operating costs and overheads. The reports provide a comparison of budget with actual results at company level, but the profit and loss accounts and supporting cost statements prepared for each bus depot do not include budgets. The depot results are monitored by comparison with the previous year's figures. No separate overhead reports are prepared for each of the headquarters functional cost centres such as marketing, accounting, personnel or administration, nor are separate reports prepared for each of the two central maintenance workshops, so the total cost of these functions is less clearly analysed and reported than those of the depots.

Route costings (profit and loss accounts for individual routes)

4.19. The companies do not analyse depot profit and loss accounts into results for individual bus routes. Until recently the method of collecting and recording cash fares made it difficult to identify receipts with individual routes. The new Wayfarer ticket machines being installed by Ulsterbus overcome this difficulty and it is now possible to prepare route costing statements. Income from sources such as season tickets still has to be allocated to routes according to a formula. A method of charging direct costs is to use formulae such as standard cost per route mile and bus driver hours as appropriate. The companies' view is that route costing contains inaccuracies and is a less effective method of controlling costs than the depot profit and loss accounts which report expenditure as it is incurred and to the manager responsible. However, a route costing matches the standard cost of the route with income earned and identifies the financial importance of the route within the depot's operational network, whereas the depot profit and loss account informs management of the total profitability of the cost centre and provides details of actual cost and overheads. The two reports have different functions and complement each other.

4.20. The companies recognise that if the existing capital grants were to be replaced with a form of route subsidy a route costing system would be necessary and could be introduced. However, there is no such current intention on the part of the DOE (NI) known to the companies. The companies say that they would not use a route costing system based on `standard' cost per mile because a more sophisticated system using actual depot costs per vehicle, per driver and for mileage variables only, per mile would give much more reliable results.

Auditing

4.21. The auditors of Ulsterbus and Citybus audit the annual accounts of the companies in accordance with the requirements of the Companies (Northern Ireland) Order 1986.

4.22. The companies have two full-time internal auditors who report to the Company Secretary. The auditors make regular visits to all depots and check the financial and operational records at the depots. Their reports to the Company Secretary form the basis of his report to the Area Manager concerned. In addition to the internal auditors the headquarters Accounts Department has two staff employed checking the cash revenue returns received from depots.

Financial performance

4.23. The companies have been successful in controlling their costs and have reduced the cost per bus mile in real terms, as shown in Table 4.11.

TABLE 4.11 **Cost per bus mile**

	1983/84	*1984/85*	*1985/86*	*1986/87*	*1987/88*
Ulsterbus					
Bus miles (million)	26.6	26.5	26.6	25.5	26.7
Company costs (£ million)	25.2	27.1	27.4	26.2	28.0
Cost per bus mile (£)	0.95	1.02	1.03	1.03	1.05
Cost per bus mile at 1987/88 prices (£)	1.14	1.16	1.11	1.07	1.05
Citybus					
Bus miles (million)	7.3	7.4	7.5	7.3	7.5
Company costs (£ million)	10.5	10.9	11.8	11.6	12.3
Cost per bus mile (£)	1.44	1.47	1.59	1.60	1.64
Cost per bus mile at 1987/88 prices (£)	1.73	1.67	1.72	1.70	1.64

Source: MMC from data supplied by Ulsterbus and Citybus.

4.24. The increase in millions of bus miles during the same period has been small, Citybus growing from 7.3 in 1984 to 7.5 in 1988 and Ulsterbus from 26.6 to 26.7. The improvement in real terms comes from spending less rather than obtaining more bus miles for the same cost.

CONCLUSIONS AND RECOMMENDATIONS

Financial objectives

4.25. The combined results of the two companies show a profit before tax for each of the last five years. These results arise from small profits on bus activities enhanced by interest and other income earned on substantial cash balances held by the companies. Hitherto, the DOE (NI) and NITHC have set no precise financial targets or efficiency measures of the type laid down in the 1978 White Paper on nationalised industries (Cmnd 7131). We understand, however, that this matter is currently in hand (see paragraph 2.63). We recommend that the financial aims of the companies should be formally defined and incorporated in the companies' objectives.

4.26. We recommend that the two bus companies should operate within the financial framework laid down in the 1978 White Paper on nationalised industries (Cmnd 7131). This was summarised in the 1988 Public Expenditure White Paper (Cm 288-1, Chapter 4, paragraph 9). It would involve having:

(a) a financial target expressed in the form of a current cost operating profit (ie profit before interest and taxation) expressed as a percentage of net assets valued at replacement cost. Cash and investments and the income earned thereon would be excluded from the calculation (but bus grant and compensation included). This target rate of return should be fixed for an appropriate number of years;

(b) a series of performance aims for the same period relating to costs and standards of service. The latter should not be reduced in order to achieve the financial target;

(c) a pricing (fares) policy related to the financial target; and

(d) investment appraisal to ensure that the companies aim at earning on their new investment programmes a rate of return as prescribed by the Treasury.

Grants from the DOE (NI)

4.27. At present the DOE (NI) makes a 50 per cent grant towards the purchase cost of new buses which acts as a network subsidy. This method has the advantage of being simple and economical for both the DOE (NI) and the bus companies to administer. The grant is not directly matched to the needs of bus users and may also lead to excessive investment in new buses, though there is no evidence of this to date. An alternative method used on the mainland is for individual services to be subsidised, the services being granted by way of competitive tendering. The tendering system is more complex and difficult to administer than the capital grants. We do not consider it the most suitable system for Northern Ireland under present circumstances. We therefore recommend that the current system of capital grants should not be changed at this time.

Self-insurance scheme

4.28. The companies operate their own self-insurance scheme to meet the cost of accident claims for damages arising from the companies' activities. The scheme is effective and economical. Nevertheless we recommend that regular, comparative quotations should be obtained from insurance companies to ensure that self-insurance continues to provide value for money.

Budgeting

4.29. Preparation of the annual capital and revenue budget is very largely an accountancy- based exercise carried out by the Company Secretary and his staff. Budgets are prepared only for the total operations of Ulsterbus and Citybus. We recommend that each company's budget should be analysed into budgets for individual depots, maintenance workshops and headquarters cost centres, and that operating managers should become involved in this process. The companies told us of the difficulty likely to arise in training managers to participate in the budgeting process. We recommend that this problem should be addressed by splitting the devolution process into two stages. In the first year the Company Secretary will continue to prepare the budget but he will include budgets for each depot and cost centre. Operating managers will then gain a year's experience in the use of budgets in measuring their performance. In the second year managers should use their newly-acquired experience to participate in the budget-setting process and accept responsibility for their budgets.

Management accounting

4.30. The headquarters costs are currently reported as a single cost centre; we recommend that these costs should be analysed in the management accounts into the main functional cost centres such as marketing, accounting, personnel and administration.

Route costing

4.31. The companies do not prepare route costings as part of their management accounting system. Indeed 1977/78 was the last occasion on which route costings of the year's results were prepared. We consider that the introduction of Wayfarer, together with the expansion of the companies' computer system, provide an opportunity for route costing to be introduced into the monthly management accounting system.

4.32. The companies told us of the difficulties of allocating `off-bus' revenue (such as season tickets) to individual routes. A degree of estimation has to be accepted in this process. However, rules which take into account local circumstances but can also be applied consistently across the whole bus network and from year to year should provide an acceptable analysis of route revenue.

4.33. When route costings have been prepared in the past the companies have found it difficult to achieve an acceptable degree of accuracy in the allocation of overheads and charging of direct costs to individual routes. We consider that only direct costs should be charged to routes.

4.34. We recommend that the companies should introduce a form of route costing which enables the contribution of each route to be calculated and compared with that of other routes in the network.