



Office of Rail Regulation
Independent Reporter Services (Part C)

Part C Reporter Mandate CN014

Review of Network Rail's process to
capture enhancement costs Phase 2

Final Report



23 January 2012



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Glossary

Abbreviation	Name
AFC	Anticipated Final Cost
CAF	Cost Analysis Framework
DfT	Department for Transport
GRIP	Guide to Railway Investment Projects
IIP	Initial Industry Plan
LTPF	Long Term Planning Forecast
ORR	Office of Rail Regulation
PR08	Periodic Review 2008
PR13	Periodic Review 2013
RVfM	Rail Value for Money
RWI	Repeatable Work Item
SBP	Strategic Business Plan
UCM	Unit Cost Model
VfM	Value for Money



Executive summary

Introduction

In August 2011, the Office of Rail Regulation (ORR) asked Nichols as the Independent Reporter (Part C) (“the Reporter”), to undertake a follow-up to its Phase 1 review of Network Rail’s current and planned processes and practices for capturing and benchmarking enhancement costs information. This Phase 2 review builds upon the analysis and findings of Phase 1 and considers the progress made by Network Rail towards providing efficient cost estimates for enhancement projects proposed for the next periodic review (Periodic Review 2013 (PR13)).

This review forms part of the regime for progressive assurance that is being set up between the ORR and Network Rail. The ORR wants the Reporter to comment upon the adequacy of this regime and whether it is likely to deliver what is required of it.

Furthermore, this review comments specifically on the current adequacy of Network Rail’s use of non-rail and international (including non-European) benchmarks, which was identified as an area of deficiency in Phase 1.

Approach and context

We used a four-stage methodology to undertake the work during September, October and November 2011, the first of which involved scoping and planning the review. In the second stage, we collected evidence, consolidated and reviewed data and held meetings and interviews with key stakeholders. In the third stage we tested and analysed the findings from the previous stages, allowing us to form conclusions and develop recommendations. In the final stage we discussed our initial findings and recommendations with Network Rail and the ORR and prepared a draft report for consideration. This was followed by this final report.



There have been a number of rail and other infrastructure studies that provide the wider context for this review. The McNulty value-for-money study¹ has heightened stakeholder expectations for the rail industry to deliver significant efficiency savings through Control Period 5 (CP5). The ORR Reporter (Part A) mandate AO/015 Network Rail Bottom-Up Benchmarking Programme Audit (by Arup) has yet to be finalised but is likely to find limited evidence of quantitative benchmarking. Where appropriate, we have made a direct link between our work and the outcomes of these studies.

Progress against Phase 1 recommendations

Over the twelve months since the Phase 1 review, positive steps have been made towards improving the transparency and openness of information flows between Network Rail and the ORR. Information requirements have been specified on a stage-by-stage basis, but the ORR has yet to provide Network Rail with a comprehensive statement of its information requirements through to PR13. The ORR and Network Rail have yet to fully define and agree a regime of progressive assurance.

There may be affordability issues for the CP5 Development Fund which may make it may be necessary or simply appropriate to prioritise and focus effort on specific schemes to optimise the CP5 development process.

Good progress had been made in respect of enhancement costs data capture and the development of a Unit Cost Model (UCM), but further work is required to improve coverage and to focus upon the effective application of the model to inform early stage estimates. Where an appropriate level of coverage and scope is available, Network Rail plans to use the UCM to inform early stage estimates for PR13. The model will add further value in the medium term in supporting the realisation of procurement efficiencies throughout Control Period 5 (CP5).

Some positive progress has been made in respect of enhancement costs benchmarking in recent months and there is a current focus on the development of an 'efficiency trajectory'. The international benchmarking and non-rail benchmarking of enhancement costs remain in their infancy with limited tangible outputs to date. Based on evidence gathered, enhancement costs benchmarking will not meet the current expectations of the ORR and those raised by the McNulty report.

The ORR holds the expectation that Network Rail will adopt a more focused approach to obtaining international benchmarks outside Europe. An exercise should be undertaken to identify the international

¹ Realising the Potential of GB Rail – Final Independent Report of the Rail Value for Money Study' (May 2011)



railways, and key programme and projects within which are a 'best' fit in terms of typical types of work to match GB enhancements projects and which can provide comparators for cost efficient delivery.

Dedicated teams have been established to focus upon internal cost data capture and external costs benchmarking. Whilst there is some cross-team working, there is limited evidence of a formal and integrated approach towards PR13. This could be improved with the appointment of a single point of senior management responsibility; a recommendation of the Phase 1 review.

The Phase 1 review identified seventeen recommendations. To date, we have recommended that four should be closed whilst the others remain open and on-going. These are carried forward in the Phase 2 recommendations.

Conclusions - importance of progressive assurance

We believe that enhancement costs data capture and benchmarking is unlikely to deliver a comprehensive data set to support the ORR's assessment of Network Rail's final PR13 submission. Establishing a robust regime of progressive assurance is therefore of heightened importance.

In readiness for its final determination upon the efficiency of Network Rail's final PR13 submission, the ORR and Network Rail should establish formal governance and reporting arrangements to ensure that ORR is able to track and fully understand the emerging basis of Network Rail's final submission. The Phase 2 recommendations set out the requirements for the improved arrangements.

The ORR should in parallel with the Phase 2 recommendations for process improvements seek more immediate confidence that Network Rail's 2013 SBP submission for CP5 enhancement projects will comprise the most cost effective portfolio of schemes to deliver the required outputs, and that those schemes will be costed in an effective and efficient manner.

Phase 2 recommendations

There is one new recommendation from this review and some key recommendations from Phase 1 that remain open.

- (1) The ORR should seek more immediate confidence that Network Rail's 2013 SBP submission for CP5 enhancement projects is on course to deliver the most cost effective portfolio of schemes to deliver the required outputs, and that those schemes will be costed in an effective and efficient manner.



Key Recommendations carried forward from Phase 1

- (2) Network Rail should bring together under a single point of senior management direction the benchmarking of external enhancement costs, internal enhancement costs data capture and enhancements cost estimating and manage these activities as an integrated programme.
- (3) Network Rail should alert the ORR at the earliest opportunity should stakeholder expectations for the benchmarking of international rail and UK non-rail enhancement costs prove to be difficult or impossible to realise in practice so that those expectations can be managed accordingly.
- (4) The ORR should clarify immediately to Network Rail its known information requirements in an appropriate level of detail for all stages of the PR13 process and refine these requirements over time through a formal change control process within a robust progressive assurance regime.
- (5) Once the ORR has informed Network Rail of its information requirements in an appropriate level of detail for the PR13 process, Network Rail should advise ORR immediately whether or not they consider their internal enhancement costs capture and external enhancements costs benchmarking processes and practices to be sufficient to fulfil the ORR's known information requirements for PR13.
- (6) The ORR and Network Rail should establish formal governance and reporting arrangements for progressive assurance to ensure that ORR is able to track and fully understand the emerging basis of Network Rail's final submission, namely:
 - agree and document precisely what they mean by a regime of progressive assurance for enhancement projects as soon as possible
 - establish as part of a regime of progressive assurance for enhancement projects much tighter governance and reporting regimes, and consider how DfT might be involved with this process
 - establish as part of a regime of progressive assurance for enhancement projects a periodic reporting regime in which the ORR and Network Rail base their respective decisions upon 'one version of the truth'.
 - appoint an independent facilitator of the regime of progressive assurance for enhancement projects to help improve the openness and efficacy of shared data that informs the PR13 process.



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