



Office of Rail Regulation

Independent Reporter (Part C)

Part C Reporter Mandate CN010

Review of Network Rail's process to
capture enhancement costs Phase 1

Executive Summary



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Introduction

In September 2010, the Office of Rail Regulation (ORR) asked Nichols, as the Independent Reporter (Part C), to review Network Rail's current and planned processes and practices for capturing and benchmarking enhancement costs information. Our mandate included a requirement to provide advice on whether Network Rail's planned approach would provide progressive assurance to the ORR and ultimately deliver information that could be used effectively in the next periodic review (Periodic Review 2013 (PR13)). This included how Network Rail intended to draw on information produced by use of the Control Period 5 (CP5) Development Fund.

Our approach

We used a four-stage methodology to undertake the work, during October and November 2010, 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. Then, we moved into the third stage where we tested and analysed the findings from the earlier stages, formed our conclusions and developed recommendations. In the final stage, we discussed our initial findings and recommendations with Network Rail and the ORR, shared a draft report with them and produced this report.

A wider context

A number of rail and other infrastructure studies and reviews that could be linked to this mandate have been carried out or are shortly to conclude. Many of these studies and reviews have focused on operations, maintenance and renewals costs, rather than on enhancement costs. They provide a wider context within which this review has been undertaken, although this review is specifically focused on cost capture and benchmarking. Where appropriate, we have made a direct link between our work and the outcomes of these studies.

Internal enhancement costs capture

Network Rail has committed to a significant transformation change programme to drive efficiency in the way it develops and delivers projects. As part of this, the Efficient Infrastructure Delivery (EID) Programme has been established to identify and realise business efficiencies in CP4.

Network Rail is evolving its unit cost model (UCM) - originally led by work on operations, maintenance and renewals works - to record the forecast and actual costs of enhancement projects as they move through the project lifecycle. A vital ingredient of this initiative has been the creation and roll-out across the business of a standardised cost breakdown structure that, for the first time within Network Rail, allows enhancement costs to be captured in a consistent way.

The cost capture process is governed by a cost analysis framework (CAF) in which templates 4 and 7 follow GRIP Stage Gate 4 and three months after GRIP Stage Gate 6 respectively. The capture of enhancement costs data at CAF 4 and CAF 7 will be mandated and tracked as part of Network Rail's new commercial process.

External enhancement costs benchmarking

The main focus of Network Rail's international rail cost benchmarking is upon operations, maintenance and renewals costs, rather than on enhancement costs. Capture of actual internal enhancement costs and benchmarking against external enhancement costs are not fully integrated and therefore the full potential of so doing is not being exploited.

Network Rail engages predominantly with international rail infrastructure owners and managers via 'benchmarking clubs' and through an increasing number of bi-lateral arrangements. International benchmarking practices have yet to mature and certain key international players, such as Deutsche Bahn in Germany, appear either reluctant or unwilling to participate in these activities.

At present, Network Rail is unable to use effectively international rail or UK non-rail enhancement costs benchmarks to inform its enhancement cost estimates. As currently conceived by Network Rail, it is unlikely that benchmarking against external enhancement costs will mature sufficiently in time to make a meaningful contribution to the progressive assurance of PR13 enhancement costs.

The more immediate potential is in using benchmarking of external enhancement costs benchmarks to identify potential opportunities for step changes in cost efficiency and performance. It is likely to take some time before international benchmarks can be used to make absolute cost comparisons, but it is realistic to expect their use to identify situations where there is a significant difference between an estimate and relevant international equivalents.

CP5 Development Fund

The CP4 Delivery Plan includes provision of a CP5 Development Fund of £55m to be invested across the CP4 period to develop schemes considered likely to be required and funded for delivery during CP5. It remains unclear whether this fund will be sufficient to prepare schemes to the appropriate level of maturity before the CP5 Determination is made.

We believe that Network Rail and the ORR may have different expectations of the level of maturity of enhancement cost estimates that will be available at the Initial Strategic Business Plan (ISBP) (this is now to be called the Initial Industry Plan (IIP)) and the Strategic Business Plan (SBP) for CP5. Network Rail currently expects to achieve only GRIP Stage Gate 2 level of maturity for estimates for schemes to be taken forward at ISBP, compared with the ORR's expectation of GRIP Stage Gate 3 maturity. Furthermore, we suspect that GRIP Stage Gate 4 level of maturity estimates required by the ORR for schemes to be taken forward at SBP will not be achievable in practice.

It is possible that a blanket requirement for all schemes to be progressed to the SBP with a GRIP Stage Gate 4 estimate may be unaffordable within the current level of funding for the CP5 Development Fund. As a consequence, it may be necessary to prioritise and focus effort on specific schemes to optimise cost estimate assurance throughout the CP5 development process.

ORR requirements for PR13 and progressive assurance

Network Rail is currently working without visibility of the ORR's information requirements for PR13 as these have not yet been published. (Since completion of the work on this report, we understand that the ORR has released draft guidance on the ISBP – now to be called the IIP.) Until such time as they are made known, Network Rail is unable to optimise its development process for PR13 and to work with maximum efficiency.

The ORR and Network Rail will need to agree exactly what is meant by a regime of progressive assurance. Given the uncertainties that may present themselves during the PR13 process (for example, future funding constraints or possible changes in industry structure), we have recommended an open, transparent and incremental approach to progressive assurance. That way both the ORR and Network Rail would be well placed to react to external influences from a common and complete level of understanding.

Principal recommendations

We have identified eight principal recommendations that we consider to be most important and relevant to the success of the PR13 process:

- (1) The ongoing initiatives by Network Rail to improve processes and practices for capture of enhancement costs data should be concluded and embedded, backed up by defined policy, documented procedures and detailed work instructions.
- (2) The use of the Unit Cost Model to inform early stage estimates of enhancement costs should become a mandatory requirement of Network Rail's new commercial process in enhancement cost estimating and be embodied in the formal process.
- (3) Benchmarking of external enhancement costs, internal enhancement costs data capture and enhancement cost estimating should be brought together under a single point of responsibility and managed as a programme.
- (4) Strict rules and methodologies for benchmarking of external enhancement costs need to be established and agreed amongst the participants of 'benchmarking clubs' to ensure that like-for-like and meaningful comparisons can be made.
- (5) The ORR should make known to Network Rail at the earliest opportunity its information requirements for all stages of the PR13 process.
- (6) Once the ORR has informed Network Rail of its information requirements for the PR13 process, Network Rail should test whether its internal costs capture and external costs benchmarking processes and practices will be sufficient to fulfil the ORR information requirements for PR13.
- (7) Network Rail and the ORR should agree and document precisely what they mean by a regime of progressive assurance as soon as possible.
- (8) The progressive assurance regime should be one in which Network Rail owns the process but the ORR is engaged and observes the 'real time' development of the emerging outcome – that is, it should be a shared journey with mutual trust and with independent facilitation.



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