

John Larkinson
Chief Executive

Andrew Haines
Chief Executive, Network Rail
[By email]

Dear Andrew,

28 March 2019

Network Rail's preparedness to deliver efficiently in CP6

Because poor planning caused a number of the problems with Network Rail's renewals delivery and efficiency in CP5, we required Network Rail to demonstrate that it is better prepared to deliver efficiently from the start of CP6.

In our November 2018 Network Rail Monitors, we reported that Network Rail had made progress in its efficiency planning for CP6 compared to that point in the run up to CP5¹.

However:

- there were different levels of maturity and uncertainty about routes' efficiency plans;
- there was a lack of clarity about how some of the most significant initiatives will generate genuine efficiencies that can be robustly measured; and
- Network Rail's internal process for tracking the progress of routes' efficiency plans needed to develop to understand fully how they are being implemented.

We expected to see further continuous progress over the next few months. This letter summarises the findings of our follow-up review. It also provides an update on the other leading indicators of efficient delivery that we reported on in our November Monitors.

As you know, there can be no let-up in the focus that Network Rail needs to put on delivering the efficiency improvements. Network Rail has received an 18% increase in funding for operating, maintaining and renewing the rail network in CP6 and this was based on firm commitments on improving efficiency.

Summary of our findings

Overall, we consider that Network Rail is better prepared to deliver efficiency improvements over the next five years than it was at this point before the start of CP5. There has been an important change to routes developing and owning their own CP6 business plans, a strengthening of central monitoring and oversight and there are more opportunities for route comparisons.

¹ See http://orr.gov.uk/data/assets/pdf_file/0010/39835/network-rail-monitor-2018-19-q1-2.pdf.

Consistent with our PR18 determination, our view remains that the £3.1bn of efficiency improvements that Network Rail intends to deliver in CP6 remains appropriate, both in terms of the overall amount and the initiatives that routes and central teams are pursuing. It is important that Network Rail's routes have bought into the delivery of these efficiency improvements. This buy in from Network Rail is a considerable difference to the position at the start of CP5.

Our review identified areas where improvements should be made to efficiency plans and the related processes for monitoring their delivery. In particular, Network Rail was unable to provide clearly documented planning of proposed efficiencies for several efficiency plans that we reviewed. We consider that changes that are implemented through usual business processes should be supported by clear plans. We also consider that routes' forecast efficiencies for the same business changes should be calculated on a consistent basis².

Network Rail is improving the management information that it uses to monitor the progress of its efficiency plans, including consistent reporting on efficiencies across routes. This is important because having consistent information for comparing routes' performance is vital for closing the gaps between routes. We consider that more should be done by Network Rail to set out Network Rail's confidence in the delivery of routes' efficiency targets, including downside risks and opportunities to outperform.

Network Rail also needs to undertake further work to determine how it will deliver £0.4bn of unspecified 'stretch' efficiency, though we do not expect the majority of this to be delivered until the second half of the control period.

We acknowledge that Network Rail is making improvements. It has increased the resource of its central efficiency monitoring team which is working with routes to agree consistent approaches for reporting efficiency improvements. It is also developing its tools for assessing the development of routes' efficiency plans.

In our November Monitors, we reported on routes' preparations for 2019-20 around engineering access to the railway, renewals workbanks and maintenance resource. Network Rail's Period 11 data on other leading indicators shows that routes have made progress since then, although a lot remains to be done in some areas. This partly reflects problems with the available management information that we reported on in our November Monitors.

We have considered the possible effects of the results of your recent 100-day review. It is important for Network Rail to improve the service that it provides for passengers and freight users. However, there is a risk that the proposed changes to the accountability of routes and regions and the work Network Rail is doing to make these changes, could undermine the delivery of its CP6 efficiency plans, particularly in 2019-20.

One of the problems with Network Rail's efficiency in CP5 was that routes were expected to deliver efficiency targets that had been set centrally. In contrast, one of the positives about Network Rail's planning for CP6 has been that strategic business plans have been developed by the routes themselves, they own them and they are now accountable for delivering their own plans. Changes to route responsibilities could undermine this ownership and accountability. We are working with Network Rail to understand how it intends to avoid this.

² We acknowledge that Network Rail created a Benefits Calculation Working Group (BCWG) in August 2018. This group is working to ensure consistent reporting of efficiencies across routes.

Our review included looking separately at Network Rail's Scotland route. We did not find any material differences for Scotland. We note that Jeremy Westlake meets with the Department for Transport, HM Treasury and UK Government Investments on a quarterly basis to discuss finance related matters including progress in delivering efficiency improvements. We suggest that this arrangement could be replicated with Transport Scotland to improve accountability to Scottish funders. Network Rail could also supply Transport Scotland with more financial information.

There has been extensive engagement between our teams during which Network Rail has found it difficult to provide assurance on its progress. We have recently discussed the findings of our review with Jeremy Westlake. Network Rail now recognises that there is a lack of assurance over the deliverability of its CP6 efficiency plans and has acknowledged that there are areas for improvement.

We have required Network Rail to set out what it will do differently over the next few months and to put in place an action plan that will show how these improvements will be delivered. We will schedule a high-level meeting to review the plan and Network Rail will report on its progress to us. This will assist us in monitoring these improvements.

We will continue our work of reviewing Network Rail's preparations for CP6 over the next few months. We will cover routes' CP6 efficiency plans in our June quarterly route challenge meetings and will focus on how our specific concerns have been addressed. We will also follow up our recent work with an in depth review of the efficiency plans of one route over the next few weeks, followed by a series of in depth reviews of other routes in the autumn. Based on our recent discussions with Scotland route, we intend to review that route first, focusing on preparations and governance for delivering efficiently in the first two years of CP6.

We will report on Network Rail's preparations to deliver efficiently in CP6 in our July and November Network Rail Monitors. As we have discussed, efficiency improvements are fundamental and we will take licence enforcement action should this be required.

Yours sincerely,



John Larkinson
Chief Executive

Copied to:

Oliver Mulvey, Department for Transport
Bill Reeve, Transport Scotland

Annex – Detailed findings from our review

Background: The CP6 efficiency challenge

Our PR18 final determination³ concluded that Network Rail should be able to make £3.1bn of gross efficiencies offset by £0.5bn of headwinds in CP6, the five-year period starting 1 April 2019⁴.

Network Rail has summarised how it intends to improve its efficiency in CP6 in an internal business-wide CP6 efficiencies portfolio overview document. Network Rail has shared this document with us. It describes the initiatives that Network Rail is developing across 17 efficiency themes. These initiatives total £2.7bn, with an additional £0.4bn of stretch efficiencies. Although Network Rail is confident that it can deliver the additional £0.4bn, it has stated that it does not have well developed plans for delivering these additional efficiencies.

The biggest efficiencies that Network Rail is aiming to deliver in CP6 are through:

- 1) improved contracting strategies (£0.6bn);
- 2) 'Better Every Day' (£0.3bn);
- 3) new technologies reducing scope (£0.3bn);
- 4) optimisation of access (£0.3bn);
- 5) early contractor involvement (£0.3bn); and
- 6) improved workbank stability (£0.2bn).

Our previous review looked at these initiatives at a high level. In this review, we have looked at these initiatives in further detail, to gain a deeper understanding.

Scope and methodology

The purpose of our review was to understand Network Rail's progress in developing its CP6 efficiency plans, as summarised in its efficiency portfolio document. Our approach encompassed a review of group-wide documents, sample testing of individual efficiency plans (route-led and centrally-led) and meetings with Network Rail's central group FP&A team. We specifically included the Scotland route in our review to provide assurance to Scottish funders and stakeholders.

We selected our sample of efficiency plans from the six largest efficiency themes listed above. For each efficiency plan that we tested, we requested documented evidence of:

1. Explanation of the business change that will result in an efficiency improvement.
2. How the value of the forecast efficiency has been calculated.
3. Quantification of uncertainty around the valuation of the efficiency.
4. How progress in implementing the business changes will be measured
5. Identification of risks to the delivery of the efficiency and intended approach to manage these risks, including for example, the use of a risk log.
6. How delivery of the efficiency plan will be governed including Board-level oversight.

³ See <http://orr.gov.uk/rail/economic-regulation/regulation-of-network-rail/price-controls/periodic-review-2018/publications/final-determination>.

⁴ In 2017-18 prices.

Results

Sample selection

We used the CP6 efficiencies portfolio overview document as the starting point to select a sample of efficiency plans to review. Of the £2.7bn of efficiency initiatives set out in this document, Network Rail was only able to provide a detailed breakdown for £1.2bn of the initiatives. We remain unclear about the level of detailed planning supporting the remaining £1.5bn that Network Rail has said are at an earlier stage of development.

Network Rail is also planning to deliver an additional £0.4bn of stretch efficiencies. Although the company is confident that it can deliver the additional £0.4bn, it has stated that it does not yet have well developed plans for delivering these additional efficiencies.

For our sample, we selected twelve efficiency plans totalling £460m from the information supporting the efficiency portfolio document. It included route-led and centrally-led plans.

1. Documentation of business changes underpinning forecast efficiency

For most of our sample, Network Rail was unable to provide clearly documented explanations of the business changes that are expected to result in efficiency improvements.

Network Rail has explained that the lack of clear documentation is because much of the sample that we selected was for process improvements that it intends to implement through usual business processes, rather than through discrete projects. As such, Network Rail considers that extensive documentation of usual business process improvements is unnecessary because the changes are well understood by the relevant experts within the business.

We would expect different efficiency plans to have varying levels of documentation explaining what the specific business changes are that should result in an efficiency improvement. However, even for the simplest changes implemented through usual business processes, we would expect the intended business change to be sufficiently clear to enable informed observers to understand whether the proposed change represents a genuine efficiency or a change in output. We consider that documentation of the business changes underpinning planned efficiencies needs to improve to support any efficiencies that Network Rail may seek to recognise during CP6.

2. Calculation of forecast efficiencies

For most of our sample, Network Rail was unable to provide a clear calculation for the forecast efficiency, even though the amount of the forecast efficiency was often quite precise.

Network Rail has explained that this is because much of the sample that we selected was for process improvements that it intends to implement through business as usual, rather than from discrete projects. As such, Network Rail considers that it is appropriate that the forecast efficiency has been based on expert judgement rather than a detailed calculation. We identified one area where two routes have used different approaches for calculating the forecast efficiency from the implementation of the same new technology, resulting in significantly different efficiency forecasts.

We would expect the sophistication of the calculations of forecast efficiency to vary depending on the nature of the business change. However, even for the simplest changes implemented through usual business processes, we would expect clearly documented calculations that demonstrate why the forecast level of efficiency is reasonable. We also consider that routes and the central teams should adopt a consistent approach for valuing efficiencies relating to the same business changes.

Network Rail established a Benefits Calculation Working Group (BCWG) in August 2018. The purpose of the group is to agree a methodology for reporting efficiencies in a consistent manner across routes and the central teams. We support the work of this group although it does not address our concern about the lack of clear supporting documentation of the forecast efficiencies in the sample of plans that we reviewed. It is important that Network Rail's BCWG develop a consistent methodology for routes and the central teams to use in their reporting of all material efficiency improvements by the end of the first year of CP6.

3. Uncertainty around the calculation of forecast efficiencies

For each efficiency plan in our sample, Network Rail was unable to provide a clear analysis of the uncertainty of the calculation of forecast efficiencies. It is therefore not clear how uncertainties around the valuation of efficiencies have been considered by Network Rail.

We understand that routes provide an uncertainty rating for efficiencies but we have not seen detailed explanations or calculations to support this. Network Rail has stated that it is planning to implement a self-certified evaluation process for routes, which will give routes and the central teams the opportunity to express their uncertainty around efficiency calculations.

We consider that the current lack of awareness of the uncertainty around the level of forecast efficiencies is concerning as it risks misleading observers about Network Rail's confidence in the level of overall efficiency that it may achieve.

4. Monitoring progress in implementing efficiency plans

Our review has found different levels of documentation explaining how the implementation of efficiency plans will be monitored by the business. In some cases, we have seen evidence of sound project planning including clearly defined project milestones. In other cases, we have seen no documentation. Network Rail has said that the projects without robust efficiency plans are usual business processes where it considers that an implementation framework would be excessive. In our view, changes that are implemented through usual business processes should be supported by clear plans.

5. Risk management

Our review has found evidence of sound risk management for the centrally-led efficiency plans that we reviewed including description of risks, evaluation of likelihood and impact of the risk materialising, and mitigation factors. However, we have found that routes' efficiency plans do not generally have clearly documented approaches for risk management. Routes have developed different approaches for managing the risk that their efficiency plans may not deliver their expected outcomes in aggregate. In our view, the quality of routes' documentation of risk management is variable and needs to improve in some areas.

6. Governance and oversight

Project-level governance

Similar to our comments about risk management, our review has found that there are significant variations between the documentation of governance of individual efficiency plans. Some teams have been able to provide clear evidence of governance, for example, one route provided an efficiencies governance programme pack, which clearly outlines governance structure, assessment of delivery reporting and treatment of risks and opportunities. However, others have been unable to provide evidence of oversight of the initiatives that we reviewed.

Network Rail executive and board-level oversight

Network Rail established an executive-led Efficiencies Assurance Board in 2018 to oversee the delivery of efficiency improvements in CP6. We have reviewed the board's terms of reference and have seen evidence of meeting agendas, minutes and actions. We welcome the creation of the Efficiencies Assurance Board and consider that it should provide an important internal challenge to routes about the delivery of their efficiency plans in CP6.

Since mid-2018, Network Rail has produced a periodic (four-weekly) leading indicators report. This report summarises Network Rail's progress in its preparations to deliver efficiently in 2019-20, the first year of CP6. We have reported on this information in our recent Network Rail Monitors.

The leading indicators report includes opex and capex efficiency trackers. These summarise the maturity of routes' 2019-20 efficiency plans based on whether efficiency plans have defined owners and milestone plans. As summarised in the following table, the efficiency trackers appear to show that progress in developing efficiency plans appears to have deteriorated over recent periods. Network Rail has stated that the apparent decline in the confidence / maturity of its efficiency plans for 2019-20 is due to changes to and subsequent problems with the information that routes are required to provide to support the efficiency trackers, rather than with problems with the quality of routes' plans themselves.

Network Rail's confidence / maturity of its efficiency plans for 2019-20

Confidence / maturity of efficiency plan		>80%	50%-80%	<50%	
	Great Britain			Scotland	
As reported at:	Opex	Capex		Opex	Capex
Period 1	20%	n/a		0%	n/a
Period 2	84%	n/a		81%	n/a
Period 3	83%	44%		81%	50%
Period 4	81%	86%		81%	92%
Period 5	81%	86%		81%	92%
Period 6	76%	86%		81%	92%
Period 7	73%	86%		81%	92%
Period 8	59%	86%		27%	92%
Period 9	59%	38%		27%	100%
Period 10	76%	38%		24%	100%

Source: Our own analysis of Network Rail leading indicators reports

We consider that the efficiency trackers do not capture sufficient information to fully understand the progress and risks around routes' efficiency plans and that this is further complicated by the problems with routes populating these trackers.

Network Rail has acknowledged the limitation of its current efficiency trackers. It is currently developing other tools for the reporting on the progress of its efficiency plans. We support the development of this improved management information. But we consider that more should be done to report confidence in the delivery of routes' efficiency targets, including downside risks and opportunities to outperform.

Other leading indicators of efficient delivery

In our November Monitors, we also reported on routes' preparations for 2019-20 around engineering access to the railway, renewals workbanks and maintenance resource. Our review was based on management information up to Period 7. We concluded that preparations were more advanced than at that stage in the run up to CP5. However, there was more to do and that we expected further continuous progress before the start of CP6.

Network Rail's latest (Period 11) data shows that routes have made progress since Period 7, although a lot remains to be done in some areas. This partly reflects problems with the available management information.

Booking of Disruptive possessions

Routes appear to be on track for booking the disruptive access to the network required for planned engineering work in 2019-20. Nationally, 70% of forecast disruptive possessions in 2019-20 have been booked in Network Rail's possession planning system, compared to Network Rail's 57% internal target. As explained in our November Monitor, we consider that this measure understates the level of routes' planned network possessions and that Network Rail should do more to distinguish between planned and unplanned network possessions.

Renewals planning

Nationally, 97% of renewals projects for 2019-20 (by value) have been entered into Network Rail's project management system (Oracle). However, only 38% had completed detailed designs and had received financial authorisation for delivery by the end of Period 11, compared to 21% at the time of our November Monitor, and Network Rail's internal target of 60%. We are concerned that further progress has not been made.

Maintenance capacity

Network Rail intends to recruit around 682 additional full time employees in 2018-19 to ensure that it has adequate capacity to deliver a planned increase in maintenance activities for 2019-20 (at the time of our November Monitor, the planned increase was 630 full time employees). To date, it has only recruited 10% of these additional roles (the same as reported in our November Monitors). We reported in our November Monitors that routes appeared to have adequate plans and capacity to manage the increase in resource. Given the subsequent lack of progress up to Period 11, we are concerned about whether routes will deliver their plans to increase maintenance headcount early in 2019-20.