Treasury Minutes on the Fortieth to Forty-second Reports from the Committee of Public Accounts 2005-2006

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TREASURY MINUTES DATED 13 JULY 2006 ON THE FORTIETH TO FORTY-SECOND REPORTS FROM THE COMMITTEE OF PUBLIC ACCOUNTS, SESSION 2005-2006

Fortieth Report

Environment Agency

Efficiency in water resource management

The Environment Agency regulates the abstraction of water by farmers, industry and water companies to check water levels and to monitor impacts on the local environment. It recovers the full cost of this water resource management, some £114 million in 2003-04, through abstraction charges levied on licence holders. Improvements in efficiency reduce the licence fee and, ultimately, could result in lower costs to consumers. On the basis of a report by the Comptroller and Auditor General, *Efficiency in water resource management* (HC 73, Session 2005-06) the Committee took evidence from the Environment Agency on its progress in managing costs and how it could minimise the charges levied on abstractors.

PAC conclusion (i): The Agency claims to have achieved efficiency savings of around 3% per year for the last three years, but is only now putting in place management information systems which will enable it to cost its activities more rigorously. Without such information, the Agency cannot be well positioned to identify and implement efficiency savings, or to make sure that costs are apportioned appropriately between its activities.

2. The Environment Agency (the Agency) has invested more than £20m over the last three years in improving its information systems, particularly in getting better financial information. This has enabled it to demonstrate substantial improvements in the efficiency of our operations over that time. The information systems will continue to be developed to make sure fit for purpose data is produced to ensure efficiency gains are maximised and that the full costs of delivering activities and outcomes are known.

3. The Agency is now starting to get the information it needs for planning, budgeting and performance management. The Agency delivered 3% efficiency savings in 2004-05 and will have exceeded that figure (provisionally 4% but not yet audited) in 2005-06. Cashable efficiency gains have been required year on year to meet annual pay and price inflation amounting to circa £40m in 2005-06. Similarly, efficiency gains have been used to offset increases in charges as part of the annual charging rounds.

4. The Agency also has a performance management system in place which allows it to review on a monthly basis how it is performing against a series of objectives agreed with Defra at the beginning of the financial year.

PAC conclusion (ii): The Agency's implementation plans for activity based costing systems are likely to take two more years to complete, though the project to improve management information systems started in 2001. The Agency is seeking to build capacity in the organisation and achieve cultural changes, but nevertheless the rate of progress is slow. It should set targets for completion of the project, and determine how the additional management information available will be used to streamline activities where appropriate.

5. In order to derive activity based costing information it is obviously necessary to have the systems in place to provide that information. The Agency believed that it was imperative that its £20m investment in IT systems should yield the benefits which it wanted. Specifying and designing the IT so that it did what the Agency needed took time but the Agency believes that it was time well spent.

6. The Agency now has the systems it needs and they are beginning to yield the detailed data which the Agency requires. The Agency is prioritising its approach so that it is concentrating first on those activity areas where there are already major efficiency initiatives happening. The data will then enable the Agency to establish auditable baselines against which future efficiencies can be measured. The Agency does already have a great deal of cost information relating to its functions and it has used this to great effect during the past few years to achieve efficiencies across the Environment Agency.

PAC conclusion (iii): The Agency has also been slow to implement an Asset Management Strategy, despite being responsible for assets with a replacement value of over £20 billion and annual upkeep, maintenance and renewal costs of £400-£500 million. The Agency should appoint someone with appropriate expertise to own and lead this important area of activity, with a brief to secure the savings which ought to be deliverable from better asset management.

7. The Agency undertook to adopt improved Asset Management practices in a Strategy for Flood Risk Management approved by the Environment Agency Board in May 2003. During 2004 the Agency sought to ensure clear strategic leadership of Asset Management through the recruitment of an individual with proven external expertise. Unfortunately, the Agency was unable to attract a suitable candidate. Subsequently the Agency developed internal skills with support from external consultancy expertise. This has led to the preparation of a Strategy for Asset Management and the appointment of a Head of Asset Management for Flood Risk Management. Both have been in place since April 2006.

8. The Agency did not stand still during preparation of the Strategy, it used early output and lessons learned by others, to help shape ongoing business improvements, which include:

- use of risk based asset inspections
- changes in our business planning processes to improve the links between funding and outcomes.
- a nationally accessible Asset Register linking a database to a Geographical Information System.
- use of activity based costing within our financial systems.

9. The work on developing the Strategy included talking to others operators of infrastructure assets. From this the Agency has identified that it leads in use of sustainable material and environmental practices.

10. The Agency's Strategy and its implementation plan will help it to build upon the recent progress and improve its Asset Management performance enabling the Agency to spend its money more effectively and thereby release efficiencies. The lessons learnt from managing flood assets will be applied to the other assets owned and operated by the Environment Agency.

PAC conclusion (iv): The Agency should streamline its water resource management activities by:

Vesting oversight of the network in a single team so that pressures to increase the number of monitoring sites receive appropriate challenge and there is clear consideration of whether other sites can be removed;

Employing risk based techniques to determine the number of site visits needed; and

Looking to automate such activities where it is cost effective to do so.

11. The National Audit Office concluded that "the Agency provides a well-managed and professional (water resources) service." A member (Mr. Sadiq Khan) of the PAC re-stated that conclusion. The specific issues identified by the NAO and the PAC are being addressed as follows.

(i) *Single team*. The Agency's monitoring work is led by a single team in each operational Area. The Agency has set up panels to oversee the development of its monitoring network and to scrutinise proposals for new sites. For a number of years the Agency has used a process to prioritise spend and to ensure that it invests to meet operational and environmental needs.

(ii) *Risk-based techniques*. The Agency is piloting an approach to reduce the number of visits to sites (to measure river flows and levels, or groundwater levels) according to risk. It must take care because many of these sites are used for flood warning and the Agency cannot take chances with its ability to warn people of potential flood risk. The Agency's capital investment programme is already driven by risk.

(iii) *Automation*. Over the last three years the Agency has invested £12 m in telemetry to enable it to improve its service and retrieve information from remote sites without having to visit them so often. The Agency plans to spend a further £8m on this over the next 7 years. The Agency invested £4m in a new IT system which is delivering £1m a year savings and allows the Agency to hold one of the largest hydrometric data archives in the world. All of the Agency's sites (6,000) that it monitors continuously have electronic data logging. The Agency uses leading edge technology for flow measurement and it is constantly testing new equipment to make it more efficient and data recovery more reliable.

PAC conclusion (v): Costs have been incorrectly allocated between water resource and flood management activities. Where the costs of its activities are recovered through fees, the Agency should deploy rigorous cost allocation processes annually to avoid either over or under charging. The Agency should act promptly to reallocate to flood management any costs which have been incorrectly charged to its water resource management activities.

12. Some of the Agency's water-related operations such as hydrometry are closely linked across a wide range of our activities and although carried out primarily for the benefit of one purpose also benefit another.

13. The Agency had found that under its previous financial systems, there was scope for different practices within its policies on cost allocation where water resources management and flood defence were both benefiting from the same operations. During the implementation of the Agency's new financial systems over the past two years, it has sought to ensure that its cost allocation methods are equitable and are consistently applied. The Agency began reallocating costs during 2005-06 and has refined the transfer in 2006-07.

PAC conclusion (vi): There is a mis-match between licence fee charges and the availability of water in some regions of England. The Agency should consider whether the current practice of cost recovery by region is appropriate or whether national cost recovery would be more equitable and efficient. The Agency should provide fee paying abstractors with information on the make up of their charges each year to provide greater transparency and impetus for making the service efficient.

14. The differences in the Agency's regional charges reflect the varying levels of expenditure it incurs in each Region in order to fulfil its duties on the management of water resources. There is a parallel here with the wide variations in water companies' charges. Any move to a national level of charge would result in cross-subsidisation of areas of the country where the Agency incurs higher expenditure to deal with higher pressures on water resources. Licence holders in some regions would experience hefty increases in charges (up to 50%), and the move could potentially conflict with the Water Framework Directive, under which charging by river basin districts could be expected. During the Agency's first stage consultation on a revised charging scheme in early 2004, it sought views on a change from regional to national standard charges.

15. The majority of consultees who responded were against a national basis for the Agency's base charges, commenting that the regional approach maintains the link between local abstractors and the Agency's operational costs in each region. However, the Agency encountered mixed views during a second consultation (autumn 2005) which dealt with the national recovery of costs for compensating the holders of damaging abstraction. Although there was some support for recovering compensation costs on a national basis, the Agency also received significant objection to the approach. With the support of Ministers the Agency is about to undertake a final consultation which will consider a regional basis for compensation recovery.

16. The Agency is working with representatives of the water industry on ideas for improving the transparency of its charges and is designing a package of information on the make-up of its charges.

Forty-first Report

Department for Transport

The South Eastern Passenger Rail Franchise

In June 2003, the Strategic Rail Authority (SRA) announced it would be terminating Connex South Eastern's (CSE's) franchise for providing passenger rail services in Kent, parts of Sussex and South East London within six months and transferring the franchise to an SRA subsidiary. The SRA decided to terminate the franchise to protect taxpayers' money and passenger delivery. On the basis of a report by the Comptroller and Auditor General, *The South Eastern Passenger Rail Franchise* (HC 457, Session 2005-06) the Committee took evidence from the Department for Transport, the SRA, South Eastern Trains and Connex Transport on the impact of CSE's financial difficulties, the SRA's decision to terminate the franchise and how taxpayers' interests were protected.

PAC conclusion (i): The cause of Connex South Eastern's (CSE's) financial difficulties lay in an ambitious franchise bid which the Strategic Rail Authority's (SRA's) predecessor, the Office of Passenger Rail Franchising (OPRAF) accepted in line with its policy of awarding franchises to bidders requiring the least public subsidy. The termination of CSE's franchise shows that franchising cannot transfer to train operating companies all the financial risks of operating trains. To reduce the risk of future franchise failures, the Department should base franchise award decisions on a balanced and transparent assessment of costs and the realism and deliverability of the assumptions and plans on which a bid is based.

2. The Department agrees with the Committee that franchise award decisions should be based on a balance of considerations. It will not be the Department's practice to let future franchises on price alone. Instead, the approach will be to specify the minimum requirements that any bidder must satisfy, covering everything from the timetable to keeping stations clean and safe. Any bids that fail to comply on that basis will be rejected. Those remaining will be judged against the two criteria prescribed in the Rail White Paper: price and improvements in reliability.

3. The Department would not accept a bid that was clearly unrealistic. However, the difficulty, as the Committee's third conclusion recognises, is that forecasts of revenue, especially in the later years of a franchise, will inevitably be subject to a significant degree of uncertainty. The Department's intention will certainly be to assess bids realistically. At the same time, we aim to encourage private sector innovation through the franchising process. Rejecting a bid simply because a tenderer's forecasts are more optimistic than the Department's carries the risk that genuine opportunities to reduce cost to the taxpayer or to secure improvements for passengers may be lost.

PAC conclusion (ii): OPRAF recognised at the time of franchise award that CSE's bid was ambitious, but neither OPRAF nor the SRA adapted their franchise monitoring to manage the associated risks. The Department should identify train operating companies at greatest risk of financial or operational failure, target its monitoring accordingly and use variations against key performance measures as an 'early warning system' of problems arising.

4. The Department agrees with the Committee about the importance of effective monitoring. The franchise agreement with CSE only required the company to have a formal meeting with the SRA once a quarter. Since the award of the CSE franchise, a new Template Franchise Agreement has been implemented. This new Template requires Train Operating Companies (TOCs) to have monthly meetings with the Department to review their financial and operational performance and consider future financial projections. The monthly reviews include full year forecasts which are monitored by both finance and franchise managers within the Department for adverse trends or other warning signs of anything that might present a risk to future viability.

5. Under the new Template the Department also now requires TOCs to submit their business plans for review immediately before a new franchise commences and annually thereafter. A revised business plan is also required if a TOC believes that prospective financial results are going to be materially different from those forecast in the most recent business plan.

6. Existing franchises will be progressively moved to agreements of this type as they come to an end and new franchises are awarded.

7. The Department's franchise management teams use a risk identification process which identifies all types of risk in relation to a franchise, including both financial and operational risks, having regard to both passenger and taxpayer interests. As part of the monthly review process, each TOC is classified according to its financial risk status. TOCs are also grouped by owning company to check for emerging patterns across the main owning groups. A new system of financial risk assessment has been adopted since the Committee's report. It is in two parts, addressing both long-term and short-term prospects. The ratings are as follows:

Long term

- **Green –** the franchise appears able to operate within the long-term franchise budget in all years and there is no other reason to expect the franchise not to continue to complete its term without additional financial support;

- **Amber –** there is material uncertainty as to whether the franchise will be able to operate within the long-term budget or the franchise appears likely to fail unless funding of up to £25m above the long-term franchise budget in any rail year is provided *or* there is material uncertainty as to whether the franchise will fail for financial reasons other than a shortage of funds (for example, failure to maintain the performance bond);

- **Red –** the franchise appears likely to fail unless substantial (in excess of £25m in any rail year) additional funding above the long-term financial budget is provided *or* the franchise appears likely to fail for other financial reasons (for example, failure to maintain the performance bond).

Short term

- **1 –** the franchise appears able to operate within the agreed budget/forecast;

- **2 –** there is material uncertainty as to whether the franchise is able to operate within the agreed budget/forecast *or* there is expected to be an additional call on the Department's resources but that call is expected to be less than £10m in any discrete rail year;

- **3 –** there is expected to be an additional call on the Department's resources and the size of the additional call is expected to exceed £10m in any discrete rail year.

PAC conclusion (iii): Periodic viability reviews during the lifetime of the franchise would have detected CSE's emerging financial difficulties more quickly. At the point of franchise award, not all developments which may impact on passenger revenues and operating costs across the franchise term can be foreseen with certainty. The Department should carry out continuing viability reviews at appropriate points throughout franchises and discuss the results with train operating companies to achieve a common understanding of the strengths and weaknesses of the franchise going forward.

8. The Department agrees. Its procedures include a mechanism for noting any concerns that arise from its scrutiny of the monthly TOC reports. Issues of this sort are raised in the monthly meetings with the TOC which are attended by the Department's franchise manager and finance representatives of both the Department and the TOC. These meetings with TOCs are minuted as though they were formal Board meetings, ensuring that the discussions are both formal and formally minuted.

9. The issues to be covered by the monthly meetings are set out in detail in the new franchise agreements. They include a range of standard financial ratios (return on capital employed; vehicle miles; farebox and total income; operating costs and turnover; net profit and turnover; turnover excluding subsidy per employee; and operating profit per employee) designed to ensure that any causes for concern, whether short or long term, are identified at an early stage.

PAC conclusion (iv): The proposed provision of further subsidies to CSE of £183 million for 2004-06 was not made conditional on identified improvements in financial management, controls and reporting. Where a franchisee is required to take remedial actions, the Department should make provision of further subsidy conditional on delivery of the remedial actions required. It should specify the time periods allowed for implementation and agree with the franchisee how improvements in performance will be measured.

10. The Department's aim is to let franchises which are robustly specified and funded at the outset to TOCs which have the financial strength to deliver. It does not intend that franchises should be renegotiated in mid-term, and therefore the question of the conditionality of further subsidy should not arise. But the Department agrees with the Committee's underlying concern that subsidy should not be paid unless a TOC delivers the franchise as specified. That is a condition which is being imposed in franchises, and which applies throughout the life of the franchise.

PAC conclusion (v): The costs of terminating CSE's franchise amounted to some £6.4 million, making termination a costly option. The Department's franchise management procedures should therefore set out a range of remedial actions, and the criteria and circumstances in which they would be applicable, together with some consideration of the potential costs, risks and benefits of each option.

11. TOCs are already required to lodge a performance bond with the Department at the start of a franchise. The sum varies from case to case but is typically several tens of millions of pounds. The bond is returnable at the end of the franchise if performance has been satisfactory. If, however, the franchise were terminated, the bond would be an immediate source of funds to which the Department could turn.

12. For the longer term, the Department accepts the Committee's advice that it should have in place a range of remedial actions and is considering what more might be done in this area. It notes the Committee's view that the SRA could have recovered more than it did from Connex. But, as the Committee's next conclusion recognises, the SRA was negotiating with Connex to ensure an orderly handover of the franchise and had a legitimate concern not to jeopardise those discussions solely in order to maximise short term financial return.

PAC conclusion (vi): The SRA recovered only £2.8 million of its £6.4 million losses, liabilities and expenses from CSE's Performance Bond of £19.5 million because it was concerned that further action might lead to CSE's insolvency, potentially triggering liabilities to rolling stock leasing companies (ROSCOs). In practice, the SRA entered into agreements with the ROSCOs to guarantee future lease payments to secure the continued availability of rolling stock to SET and its successor. The Department should take a more robust line on cost recovery in future.

13. The Department recognises that the SRA's decision not to press for full recovery was one which had to be made by balancing a range of conflicting considerations and which formed just one part of a complex transaction. It nevertheless accepts the need to take as robust a line as possible in such circumstances in future. At the same time, it will seek in any future case to press on the ROSCOs the point that it is unlikely to be in their own commercial interests to exercise their rights to terminate rolling stock leases and so forgo future rental income.

PAC conclusion (vii): The SRA spent some £2 million on consultants' reviews of CSE's financial performance, but a failure to specify clearly the work required led to duplication of effort and unnecessary expenditure. When commissioning consultants, the Department should specify clearly what is required, and how findings should be reported and shared, including with the franchisee.

14. The Department accepts the Committee's recommendation. The standard arrangements under which it engages consultants incorporate mechanisms designed to ensure that the nature and scope of the advice required is made clear at the time the contract is let. The Department will nevertheless consider the scope for further tightening of this aspect of the franchise procedures in the light of the Committee's findings.

PAC conclusion (viii): Misunderstandings arose between the SRA and CSE, reflecting ineffective communications and a lack of mutual trust. Train operating companies and the Department should have open dialogue and transparency in their dealings at all times. When franchise difficulties arise the Department may need to consider putting in place special measures to strengthen communications such as taking advice from a skilled arbitration service to forge effective negotiation and open communication between the parties.

15. The need to streamline communications between the various parts of the rail industry was a central theme of the reforms introduced under the Railways Act 2005. The Department therefore believes that a framework for improved communications and a better understanding of the respective roles of the parties concerned is already in place. At the same time, the Department does not rule out the possible need for more formal arbitration in the particular circumstances of a franchise termination and will consider this further in reviewing its contingency planning later this year.

PAC conclusion (ix): The Department's franchise management and monitoring will only be effective if staff have the necessary skills to interpret and question financial information. The Department should put in place the right resources and skills to provide robust, risk based monitoring to avoid another case of late identification of franchise failure.

16. The Department accepts the need to have enough qualified and well trained staff to manage franchises effectively. It is confident that its current structure provides for this, and that the monitoring arrangements described above are sufficiently robust to enable a failing franchise to be identified at an early stage. The special circumstances of franchise termination, should they arise, are likely to lead to a need for more, and more specialist, staff. It would not be cost effective to have these extra staff on hand at all times simply to allow for the possibility that it might be necessary to terminate a franchise. The Department therefore maintains a call-off contract with a specialist consultant which allows staff with the necessary skills to be brought in at short notice if operator of last resort arrangements are required.

PAC conclusion (x): Overall, the transfer of CSE's operations to SET went smoothly and led to improvements in passenger services. The Department should reflect the lessons of the CSE case in its franchise termination contingency plan, and also in its franchising and monitoring activities.

17. The Department believes that the franchise monitoring and management arrangements it has put in place since taking over responsibility for franchises from the SRA are both appropriate and proportionate. Having been put in place since the time of the Connex termination, those arrangements reflect lessons learned in the immediate aftermath of that case. The Department accepts the Committee's recommendation that the existing arrangements should be kept under review in the light of both the Committee's own comments and future developments in the franchising field.

Forty-second Report

Office of Fair Trading

Enforcing competition in markets

One of the main ways the Government aims to increase the UK's productivity is through increasing competition. The Office of Fair Trading (OFT) is the UK's main competition enforcement body. Its annual budget, currently £56 million, has grown by over 70% since 2000 and its responsibilities for enforcing competition in the UK economy have also been extended. On the basis of a report by the Comptroller and Auditor General, *The Office of Fair Trading: Enforcing Competition in Markets* (HC 593, Session 2005-06) the Committee took evidence from the OFT on its priorities, management of investigations and its economic impact.

2. An internal transformation programme has been established since the National Audit Office (NAO) report and Public Accounts Committee (the Committee) hearing to ensure the OFT is able to rise to future challenges and maximise its positive impact. This means that the OFT is currently in a period of significant cultural and structural change. The detailed implementation of some responses may be subject to change as an outcome of the OFT's transformation programme, without losing the objective of the recommendation.

PAC conclusion (i): The OFT has been too reliant on complaints as a source for its competition enforcement work. The OFT should start a greater proportion of its investigations on its own initiative, rather than waiting for a relevant complaint. It should also be ready to stop cases if they are not strong enough to continue.

3. OFT accepts the Committee's findings and recognises that prioritisation will help OFT maximise its impact given finite resources. In response to the Committee's conclusion and OFT changes already being implemented OFT has undertaken a number of actions, and is developing others.

4. OFT is currently developing proposals for strengthening its use of market intelligence in addition to seeking to maximise its use of internal intelligence and sectoral expertise.

5. OFT is consolidating its work on establishing a Preliminary Investigation Unit (PIU) to ensure that intelligence from complaints and other parts of the OFT is used effectively to focus its competition enforcement activity. It expects this work to be showing benefits from September 2006 (subject to any refinements from the transformation programme).

6. Whilst actual roles and responsibilities going forward will be subject to any outcomes of the transformation programme the appointment of a Senior Director (Competition Casework) has meant that the new prioritisation criteria are applied more rigorously and consistently to all new and existing cases. OFT is reviewing its policies on opening and closing cases to ensure that resources are utilised as efficiently and effectively as possible. It expects this review to be completed shortly. Senior staff are now involved at a much earlier stage of the investigation to ensure the investigation of cases is stopped where the evidence is weak.

7. Re-prioritisation of cases in the past six months has already delivered a more efficient reallocation of resource. As part of OFT's transformation programme OFT is considering how it can develop prioritisation further in order that it focuses its work around the areas of highest impact.

PAC conclusion (ii): The OFT has no database of intelligence to support its investigations. The OFT needs to supplement information from competition complaints with data from other sources such as the new Consumer Direct helpline and the work of Trading Standards officers across the UK. A database would help it to do so efficiently.

8. OFT accepts the Committee's conclusion. It agrees that a database or databases of intelligence are likely to allow it to access intelligence more efficiently. OFT recognises that better intelligence will help it establish its priorities and inform its market studies, enforcement and other work and enable it to measure the effects of this work on consumer welfare. It is taking a number of steps in response to the Committee's conclusion and OFT changes already being implemented.

9. A working group has been set up specifically to consider market intelligence, including competition and other complaints and the information available from Consumer Direct. Additionally, OFT is developing a knowledge management strategy whose aim is to build excellent knowledge management behaviours and support systems within OFT. OFT aims to have developed a comprehensive market intelligence strategy and developed an implementation plan for delivering that strategy in close collaboration with the knowledge management workstrand by March 2007.

10. OFT will also be looking at how it records and monitors key data from its competition casework. This will include ensuring that it makes the most of incoming data and ensuring that key information informs own initiative work.

PAC conclusion (iii): The OFT suffers from high staff turnover, and many employees do not have sufficient experience to deal with complicated cases. The OFT should focus on supporting staff better, with broader training including project management and investigation skills, and a complete, up-to-date guidance manual.

11. OFT accepts the Committee's finding that it should focus on supporting staff better and is undertaking a number of actions, set out below to address the Committee's recommendations. OFT is pleased to advise the Committee that staff turnover has fallen - specifically, staff leaving the division (including internal transfer) reduced from 20.1% in 2004-05 to 14% in 2005-06.

12. OFT intends to address the current inflexibilities of pay and grading by reviewing its salary structures. It aims to have implemented a new system by October 2006.

13. Flexible ways of working based on project teams are being introduced. Specifically, case teams are being assembled to combine the right mix of experience and skills and OFT is adopting targeted use of external staff (e.g. paralegals) in specific cases where staff departure has scope to impact on the timescales or quality of casework.

14. Developing staff skills and developing leaders and managers are key workstrands of OFT's transformation programme. OFT is implementing a skills training programme for competition case handlers. The majority of the division's staff have now attended the first part of that programme – case specific project management training. OFT intends to commence delivery of the next phase of its skills training strategy for competition case handlers by the end of financial year 2006-07.

15. Most of the division's senior management have completed coaching training to enable them to provide additional support to junior members of staff.

16. Revision of the Procedures Manual continues. Four key elements of the revised manual were issued earlier in the year. OFT continues to prepare guidance on a range of other issues and expects to have completed its revision of the Manual by the end of 2006.

PAC conclusion (iv): Small case teams are a cause of the OFT's long timescales on cases. The OFT should employ larger teams on its investigations. In small teams, the loss of important members of staff endangers the investigation's progress. Larger teams will reduce this risk and bring a broader range of skills and experience to the investigation.

17. OFT accepts the Committee's conclusion and is implementing fundamental changes to its approach to all case management. A number of steps have been put in place to ensure more effective delivery of cases, better succession planning within teams and cost effectiveness in handling competition cases.

18. Larger case teams are now built around the specific skills needed for the case/project.

19. Three projects have been initiated which will help us improve, covering:

a) case timetables;
b) case management framework; and
c) case team composition.

All projects are due to be completed by April 2007. Effective project delivery is a key workstrand in OFT's transformation programme.

20. As part of project c), case team composition, OFT intends to build on emerging practices and make proposals on how it can make better (and more frequent) use of counsel, paralegal and consultancy staff at appropriate moments in the casework process in order to improve both quality and timeliness.

21. These proposals will also ensure that more junior staff receive greater support from more experienced case handlers.

PAC conclusion (v): At present, the OFT does not work to any deadlines. The target timescales on its website are completely unrealistic and are never met. The OFT should have amended these deadlines as soon as it realised they were not achievable. It should now set clear and realistic timetables for each case.

PAC conclusion (vi): The OFT does not publish information about performance against timescales. This lack of transparency limits effective scrutiny, making it difficult for Parliament to assess the OFT's operation against expectations. The OFT should publish its performance against its timescales.

22. OFT accepts the Committee's findings to both conclusions subject to clarifying that it has internal deadlines. In light of the NAO and Committee's findings OFT is committed to improving the timeliness of its investigations and communicating timescales more systematically.

23. The out of date timescales have been removed from the OFT's website. Work on alternatives has started and OFT intends to publish revised indicative timescales by April 2007.

24. However, the different characteristics of each competition case mean that it would be impractical for OFT to publish a timescale which could be met in all cases. As the NAO recognised, the time within which OFT can complete cases can be affected by a number of external factors which are outside OFT's control.

25. In parallel with completion of its work on timescales (see paragraph 21 above) OFT will consider how it can improve communication of its performance against those timescales in a more systematic and accessible fashion.

26. In the interim to provide greater transparency, OFT intends to publish historic average timescales for specific stages of an investigation for competition cases and to repeat this annually.

PAC conclusion (vii): The OFT's investigations create uncertainty for the companies involved. There is scope for different interpretations of competition law, and companies face uncertainty over how the OFT will analyse a market. The OFT should reduce this uncertainty by sharing its analysis with companies earlier in an investigation.

27. OFT agrees with the Committee's findings, subject to comments in paragraph 28 below concerning sharing its analysis. Although, in a number of cases OFT has communicated openly with the parties involved, it accepts that there is scope for greater consistency in the frequency and standard of communication across all cases.

28. However, with regard to sharing its analysis of the market with parties earlier in an investigation, (and although this may be appropriate in some instances), it does not believe that it can commit to do this in all cases, in particular cartels. Where OFT is investigating a cartel it must take great care not to disclose the existence of the investigation where this might result in the destruction of evidence relating to the cartel. It also does not expect to be able to disclose information which might put (individual) witnesses at risk. It is also bound by a duty of non-disclosure under part 9 of the Enterprise Act 2002 which, although it has a number of exceptions, limits the extent to which OFT can share its analysis with parties.

29. Within these constraints however, OFT is committed to engaging with parties more openly and transparently to the extent this is possible. As part of this process it has recently issued guidance on involving third parties in competition Act investigations, *Involving third parties in Competition Act investigations – incorporating guidance on the submission of complaints* 75/06 published 12 April 2006. This can be found on OFT's website at www.oft.gov.uk/News/Press+releases/2006/75-06.

PAC conclusion (viii): The OFT does not use its powers to compel companies to provide information. The OFT can impose criminal penalties if companies do not provide information. It has not used the penalties as it considers them heavy-handed. It should use them where companies wilfully obstruct an investigation and should explore with the DTI whether it can raise civil penalties against companies in less serious circumstances.

30. OFT accepts the Committee's findings. So far, in general, powers short of criminal charges have proved adequate but OFT will consider bringing criminal proceedings in the most serious cases of non-compliance. For less serious cases it will explore with the DTI the potential for raising civil penalties against companies.

31. The Committee's finding raises a more general question of companies' adherence to information requests. To address this problem OFT has taken further steps to ensure that all information requests are clear, precise and well formulated - particularly where these requests are made using statutory powers. Accordingly, all formal information requests (requests which companies must respond to) are reviewed by an Assistant Director or above before they are sent.

32. OFT is currently conducting a thorough review of its practice in relation to formal requests for information with a view to establishing best practice for future information requests. It is aiming to have completed this review by March 2007. OFT will take on board the Committee's findings during the review.

33. OFT will consider a variety of approaches to improving its practice in this area. For example, it will consider the viability and legality of an approach that requires the replying firm to identify the individual(s) responsible for submitting the statutory response so that OFT can ensure responsibility for their accuracy.

PAC conclusion (ix): The OFT can make an important contribution to increasing productivity and deterring anti-competitive behaviour. Its preliminary estimate of consumer benefit from its investigations (£110m over five years) does not include wider economic effects. The OFT should consider further research to gain a clearer understanding of these broader deterrent and productivity effects and how they might be enhanced.

34. OFT accepts the Committee's findings. OFT would like to clarify that the estimated consumer benefit from its investigations (£110m over five years) is a preliminary 'lower bound' estimate. This means that under reasonable assumptions applied by other competition authorities or supported by recent academic literature, it is highly unlikely that less than its estimate has been saved. OFT is however, currently developing an improved evaluation methodology which it hopes will be released across the office so that it can be incorporated in its casework and published by the end of 2006-07. OFT expects that this new evaluation methodology will be used to look at a representative cross-section of its cases to give an overall value for money indicator.

35. In co-operation with Department of Trade and Industry (DTI) and the Competition Commission (CC) OFT has, since the Committee hearing, awarded a research project into the deterrent effect of action it has taken under the Competition Act 1998. This research will also include some analysis of the costs of interacting with OFT during Competition Act 1998 investigations which will assist it in assessing the burden on business. The results of this project will be delivered at the end of October 2006 and OFT aims to publish by the end of 2006.

36. Although OFT looks for dynamic productivity and innovation effects when conducting market evaluations, it does not intend conducting separate research focussing solely on productivity at this stage. OFT is however, currently reviewing generally the link between competition and productivity and examining how it can further use productivity measures to help inform the prioritisation and evaluation of OFT work. Although this work (which includes carrying out a literature review) is still at an early stage OFT hopes to have completed it by the end of 2006.

PAC conclusion (x): The OFT is an organisation in transition, which has yet to demonstrate that it can make effective use of the substantial extra resources it has been given. The Committee will wish to return to these issues in due course to see what progress has been made and how well the OFT has implemented the Committee's recommendations.

37. OFT accepts the Committee's findings. OFT is committed to expending considerable effort, over the next two years, into more objective and comprehensive evaluation of its direct impact and what it has achieved through influencing others to ensure that its work continues to represent excellent value for money.

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