

A Review of Economic Regulators' Impact Assessments – for the House of Lords Select Committee on Regulators



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Summary

1 Impact assessment is a tool for assessing the need for and the impact of a proposed regulation. Used well, impact assessment can lead to a better understanding of the consequences of a regulation and thus encourage evidence-based decision making. Impact assessment also increases the transparency and accountability of policy-making because reasoning is exposed to challenge both internally and from interested stakeholders. The National Audit Office has reviewed the quality of the impact assessments produced by Government departments for the last four years.

2 In March 2007 we were invited by the House of Lords Select Committee on Regulators to review the way that impact assessment is performed by five regulators: Ofcom; Ofgem; Ofwat; Postcomm; and the Office of Rail Regulation (ORR). This report sets out each regulator's approach to impact assessment (Part One); reviews the quality of a sample of their impact assessment documents (Part Two); and considers the framework that regulators have established for developing impact assessment documents and how the process fits into their wider policy development cycle (Part Three).

Overall conclusion

3 All five regulators have made the impact assessment process an integral part of their policy making by using it to consult iteratively with their stakeholders. There are, however, weaknesses in the quality of the impact assessment documents that some regulators are producing. To improve quality, regulators need to strengthen their analyses of costs and benefits and routinely set out how a policy's impact will be measured post-implementation.

Key findings

Regulators' approach to impact assessment

4 **Of the five regulators, only Ofcom and Ofgem have a statutory duty to carry out an impact assessment on important policy proposals.** These two regulators routinely produce formal impact assessment documents as part of the policy-making process. Furthermore, only Ofgem is producing self-contained impact assessments equivalent to those produced by Government departments. Ofwat, Postcomm and ORR use consultation documents in similar circumstances, which contain much of the same information, but in some cases less detailed analysis. (Paragraphs 1.2 to 1.3 and 1.6)

5 **The nature of regulators' statutory duties and their roles mean that they do not use impact assessment in the same way as Government departments.** For Government departments, an analysis of costs and benefits should form the basis of their decision to implement, or amend, regulations. Regulators use such analysis to inform decisions but, ultimately, decisions are taken within their own statutory framework and not on a 'net benefit' test. In addition, regulators' interventions are not always driven by identifying a market failure. On many occasions regulators' impact assessments deal with commitments already given by Government, the European Union, or are necessitated by their statutory duty. The primary focus, therefore, is often on how the regulation should be implemented. (Paragraphs 1.4 to 1.5)

Quality of impact assessment documents

6 The transparency of regulators' impact assessment documents is often impaired by fragmented structures and excessive length. Six of the ten impact assessments we reviewed had 'room for improvement' in their presentation. Regulators had set out the objective of the impact assessment, the problem to be addressed and the final recommendation of the assessments. This information was, however, frequently difficult to locate. (Paragraphs 2.4 to 2.5)

7 Regulators have used consultation effectively in developing policy. We rated all ten consultation exercises as 'good quality'. We also found many examples of good practice including the use of focus groups, industry workshops, regional road shows, and expert panels. (Paragraph 2.7)

8 Regulators are not routinely producing good quality, proportionate analyses of costs and benefits. Two of the ten assessments had 'serious defects' in their analysis, with six more having 'room for improvement'. Only Ofcom's two assessments contained 'good quality' analysis. Regulators had all undertaken some qualitative analysis. However, two common weaknesses in the impact assessments we reviewed were a lack of meaningful comparisons between alternatives or an appropriate level of quantitative analysis. There are a number of circumstances where a regulator's quantitative analysis might create misleading certainty and in these circumstances qualitative analysis has an important role. It may not be possible to carry out quantitative analysis because estimates cannot be made robustly or sufficient data is not available. It is also possible that it would not be proportionate. However, the performance of some quantitative analysis, or at the very least an explanation of why this is not possible, would have been appropriate. (Paragraphs 2.8 to 2.10)

9 Regulators are not consistently using impact assessments to set out how they intend to measure a policy's impact post-implementation. Only two out of ten impact assessments gave firm details of how they intended to measure the success of the proposed policy. (Paragraph 2.11)

Use of impact assessment in the policy making process

10 The regulators all appear to have successfully integrated the impact assessment process into their policy development. They use the impact assessment process to consult in an iterative way with stakeholders in order to re-formulate and refine policy proposals. This should allow the evidence gathered to influence decision-making. (Paragraphs 3.8 to 3.13)

11 Ofcom and Ofgem currently have guidance and training on how to produce formal impact assessments. Ofwat is revising its guidance, which was originally produced in 2001 but not used regularly. Postcomm is developing written guidance. ORR is committed to keeping its approach under continual review. (Paragraphs 3.2 to 3.7)

Recommendations

A Whilst working within their statutory duties, regulators should ensure that important decisions are taken on the basis of proportionate, objective analysis as well as stakeholder views. If not, there is a risk that regulators may not fully understand the impacts of the proposed policy or method of implementation. Regulators should, therefore, ensure that the principles of impact assessment are embedded in both their processes and the documents they produce.

B In order to improve the quality of impact assessment documents, regulators should:

- produce impact assessments that ensure that key information is easy to find, and either sign-posts or summarises additional analysis or technical information;
- ensure that impact assessments contain a proportionate analysis of costs and benefits using quantitative estimates where they can be made robustly and making clear comparisons between options; and
- set out clearly when and how they intend to measure a policy's impact.

C In order to ensure that the quality of their impact assessments improves, regulators should find a way of sharing good practice regularly. There is already some evidence of this occurring. Ofwat and Postcomm are developing formal, written impact assessment guidance with the cooperation of Ofcom and Ofgem respectively.

Regulators' approach to impact assessment

1.1 This part examines the approach that the regulators take to impact assessment. We found:

- two of the five regulators, Ofgem and Ofcom, have a statutory duty to produce impact assessments on important policy proposals;
- the nature of regulators' roles and their statutory duties mean that they do not approach impact assessment in the same way as Government departments; and
- although the Government accepted a Better Regulation Task Force recommendation that all independent regulators should produce impact assessments, only the two regulators with the statutory duty are routinely performing them. All the regulators do, however, produce consultation documents which seek to achieve the same purpose and contain much of the same information as impact assessments.

The requirement to produce impact assessments

1.2 Of the five regulators we reviewed, only Ofcom and Ofgem have a statutory duty to produce impact assessments on important policy proposals. Ofcom and Ofgem are also required to publish a list of impact assessments undertaken in their annual report and a summary of decisions taken in relation to proposals where assessments were carried out. The other three regulators – ORR, Postcomm and Ofwat – do not have a statutory duty to produce impact assessments.

1.3 In October 2003, the Better Regulation Task Force published a report¹ recommending that all independent regulators should produce impact assessments. It specified that these should be made

available for public scrutiny or if not, the regulators should explain why they decided not to produce an impact assessment. The Government accepted this recommendation in February 2004.

Approach to impact assessment in the regulators

1.4 The requirement of regulators to work within their statutory duties means that they do not necessarily use impact assessments in the same way as Government departments. The biggest difference concerns their use of cost-benefit analysis. For Government departments, an analysis of costs and benefits will usually form the basis of the decision to implement or amend regulations. For regulators, such analysis is used to inform decisions but, ultimately, they are taken within the framework of their statutory duties and not solely an analysis of costs and benefits.

1.5 The nature of the regulators' roles is also important. Regulators' interventions may be driven by identifying a market failure, the achievement of their statutory duties or may deal with commitments already given by Government or the European Union. Larger policy proposals may also be made by the body's sponsoring Government Departments, who will produce the appropriate impact assessments.² This should not, however, prevent regulators from producing their own impact assessment on how the policy should be implemented or cooperating with the relevant sponsoring department to produce one. For example, Ofwat produced a series of impact assessments on how it would implement various aspects of the Water Act 2003, working closely with DEFRA and the Welsh Assembly Government.

1. Better Regulation Task Force, *Independent Regulators*, October 2003.

2. For example, the DfT has made policy proposals and impact assessments for: The Railways (Interoperability) Regulations 2006; Health and Safety (Enforcing Authority for railways and other guided transport systems) Regulations 2006; The Railways Act 1993 (Determination of Turnover) Order 2005.

3. In the case of Ofcom's two impact assessments, and Postcomm's impact assessment on 'Pricing in Proportion', we considered both consultation documents and formal impact assessment documents together.

4. ORR's approach of using consultations was supported by evidence given to the House of Lords Select Committee on Regulators by the industry (1 May 2007) and the Department for Transport (15 May 2007).

1.6 Only Ofcom and Ofgem, who both have a statutory duty to produce impact assessments, are regularly undertaking them. Ofgem produces self-contained, formal impact assessments – equivalent to those produced by Government departments – and uses these as part of its wider consultation process. Ofcom's impact assessment documents are incorporated into its consultation documents. The regulators have some discretion as to how to intervene and Ofwat, ORR and Postcomm all produce consultation documents which perform many of the same functions as an impact assessment, but not all. They do, however, set out the problem to be addressed, the policy options, some analysis and a summary of the comments and opinions of the stakeholders in a similar way to a formal impact assessment. **Figure 1** sets out the number of formal impact assessments undertaken by each regulator in 2006-07 and 2005-06 and **Figure 2** sets out the number of consultations undertaken over the period.

1.7 Where no formal impact assessments were produced by a regulator we assessed consultation documents against our criteria as though they were formal impact assessments³ acknowledging that such consultations did not set out to be impact assessments. The term "impact assessment" is used in this report to refer collectively to both types of document.

1.8 In the near future Ofwat aims to start producing impact assessments more regularly and is close to revising its guidance. Postcomm will produce impact assessments where it thinks appropriate and is developing guidance. At present, ORR uses a process of consultations which are intended to achieve the same objectives. ORR believes that this approach is more suited to its own needs and those of its stakeholders,⁴ and has committed to keeping its consultation processes under continuous review.

1 Number of formal impact assessments undertaken in 2006-07 and 2005-06

Regulator	Number of impact assessments published 2006-07	Number of impact assessments published 2005-06
Ofcom	46	40
Ofgem	13	12
Ofwat	0	3
Postcomm	0	1
ORR	0	0

NOTES

1 Multiple impact assessments on the same subject only counted once. For example, in 2005-06 Ofwat completed six impact assessments on the implementation of the Water Act 2003.

2 Ofwat, Postcomm and ORR use consultation documents to set out their assessment of the impacts of policy options.

Source: Figures provided by the regulators

2 Number of consultations undertaken in 2006-07 and 2005-06

Regulator	Number of consultations published 2006-07	Number of consultations published 2005-06
Ofcom	63	63
Ofgem	65	80
Ofwat	12	12
Postcomm	16	22
ORR	23	22

NOTES

1 Multiple consultations on the same subject counted once.

2 Ofwat, Postcomm and ORR use consultation documents to set out their assessment of the impacts of policy options.

3 The ORR figures do not include statutory consultations e.g. for track access applications.

Source: Figures provided by the regulators

Quality of impact assessments

2.1 This part sets out the results of our analysis of a sample of impact assessments from each of the five regulators. We assessed the impact assessments against our evaluative criteria and found that the quality was mixed. Our results demonstrate that:

- there is 'room for improvement' in the presentation of impact assessments which, in many instances, had fragmented structures and were overly long;
- regulators' use of consultation in developing policy was consistently strong;
- regulators' assessment of costs and benefits was a weakness – with room to improve the standard of analysis by providing more systematic and quantitative assessments of the impacts of different policy options; and
- there was insufficient consideration of the impact of policy changes post-implementation – with often limited coverage of the steps needed to monitor and evaluate new regulation.

Evaluation of impact assessments

2.2 Our examination focused on five economic regulators: Ofcom; Postcomm; Ofgem; Ofwat; and ORR. We evaluated a sample of ten recent impact assessments, two from each regulator. **Figure 3 overleaf** lists the impact assessments contained in our sample and provides a brief description of each. The criteria used to assess the impact assessments is set out in **Figure 4 on page 11** and we have used a traffic light system to present the results. Appendix 1 provides the scores for individual impact assessments and Appendix 2 outlines further details of our methodology.

2.3 Every impact assessment that we examined contained elements of good quality analysis. There was, however, 'room for improvement' in all of the assessments we reviewed (Appendix 1). **Figure 5 on page 11** sets out the regulators' performance against our evaluative criteria.

Presentation of impact assessments

2.4 For the policy making process to be transparent, it is important that the analysis in an impact assessment is set out clearly, concisely and put in the appropriate context. We found that the necessary information on scope, purpose and recommendations were supplied within impact assessment documents. However, six out of ten impact assessments in our sample had 'room for improvement' because key information was difficult to find.

2.5 Key information was difficult to locate within the impact assessments for a number of reasons. They were poorly structured, repetitive and it was sometimes unclear how the different documents making up the impact assessments related to each other. One of the impact assessments we reviewed, which was of interest not just to industry but also to the general public, totalled in excess of 450 pages. The fact that impact assessments were made up of multiple documents may reflect the iterative nature of the process and complexity of the issues addressed. However, impact assessments are easier to read and understand if they summarise, or at least sign-post key contextual information and analysis. See **Figure 6 on page 11** for an example of good practice.

3 Sample of impact assessments examined by the National Audit Office

Impact Assessment	Brief Description
ORR Rebate Mechanisms for Investors in Large-scale Network Enhancements	Considers a proposal to create a financial mechanism that enables investors to recover some of the costs of financing a project from other parties, particularly commercial competitors, that will use it. (Note: The ORR's Final Conclusions document was not available at the time of the initial examination. Its contents have, however, been taken into account in our assessments.)
ORR's Sustainable Development and Environmental Duties	Considers proposals to help ORR address its statutory duty to contribute to sustainable development.
Postcomm 'Pricing in Proportion'	Examines Royal Mail's proposal to change its pricing structure from one based primarily on the weight of a mail item to another primarily based on size.
Royal Mail Price and Service Quality Review	Considers a final proposal on price and quality of service of the Royal Mail's regulated activities.
Ofcom TV Advertising Standards for Food and Drink Products to Children	Examines whether to strengthen the rules on the television advertising of food which is high in fat, salt or sugar to children.
Amendment of Wireless Telegraphy exemption regulations	Examines a proposal to amend the Wireless Telegraphy (Exemption) Regulations 2003 to allow new types of equipment to operate on a licence-exempt basis and to amend the frequency bands and equipment which are subject to licence exemption.
Ofgem Publication of Near Real Time Data at UK sub-terminals	Examines a proposal to improve transparency in the gas market by requiring the publication of more information about the gas supplies coming onto the network.
Gas Safety Checks and Information	Considers a review of the provision of free gas safety checks to customers who can not afford to pay and of gas safety information to all customers.
Ofwat Water Undertakers' New Conditions of Appointment	Examines one aspect of a large policy proposal on the implementation of the licensing provisions of the Water Act 2003 – the conditions of appointment for water companies which provide water to a defined geographical area.
Setting Water and Sewerage Price Limits	Considers whether the period of time between price reviews should be changed to a longer or shorter time than the current five year cycle.

Source: Information provided by the regulators

4 The criteria used to evaluate impact assessments

Presentation

The regulators should set out a clear explanation of the problem they are seeking to address, the objectives that they wish to achieve through the introduction of a new policy proposal, and their final recommendations in light of the analysis presented. In addition, we considered whether the text was of a proportionate length and suitably structured so as to allow readers to easily access and understand it.

Consultation

Although the regulators are not bound by the Cabinet Office guidelines on consultation issued for government departments, we used this as a 'good practice' comparison. The guidance stipulates that all new policy proposals should have written consultation which allows 12 weeks for response, and that consultation responses are published on their websites. We also considered other work undertaken by the regulators to obtain the views of stakeholders.

Assessment of Costs and Benefits

The regulators should supply information on the likely impacts of the policy proposal as well as identifying who would be affected. Our examination focused not just on the quantitative evidence base contained in the impact assessments, but also the qualitative evidence. This included evidence supplied by stakeholders, who may be best placed to identify the costs, if not the benefits, likely to result from any changes in regulation. Where quantitative evidence was not given, we looked to see if the reason for not providing this was given clearly for stakeholders to comment on. We also looked at the range of options that had been considered in the analysis and if the assessment took into account uncertainty in the data and calculations.

Monitoring and Evaluation

Detailed implementation and delivery plans should be included for the recommended option in the final impact assessment along with the proposed approach for monitoring and evaluation.

Source: Information provided by the regulators

5 National Audit Office analysis of impact assessments

	Presentation	Consultation	Costs and Benefits	Monitoring and Evaluation	NOTES
Green	4	10	2	2	<p>1 A 'green' assessment indicates good quality analysis; 'amber' indicates some good assessment but room for improvement; and 'red' indicates some major weaknesses in the analysis.</p> <p>2 Each impact assessment has been assessed against four criteria (see Appendix 2) and this table presents the aggregate results for the ten assessments reviewed against these criteria.</p>
Amber	6	0	6	6	
Red	0	0	2	2	

Source: National Audit Office

6 Good practice example – Ofgem: Publication of Near Real Time Data at UK sub-terminals

- There is an overview paragraph on the front page of the final impact assessment briefly setting out the problem, objectives, final recommendation and main stakeholder views.
- A 'Context' section sets out how this impact assessment document fits in with the previous two iterations of the impact assessment and an 'Associated Documents' section lists any other related documents which might be of interest.
- A summary table of costs and benefits is presented in the main text of the document as well as the 'Summary' section at the beginning of the document.
- There is a summary at the beginning of each chapter.
- The final impact assessment is 53 pages long and can be read as a stand alone document or related to the other documents.

Source: Information provided by the regulators

2.6 In May 2007 the Better Regulation Executive introduced new guidance which seeks to encourage conciseness and greater consistency in presentation. It stipulates that information on the problem under consideration, policy objectives, the options considered and preferred option are set out in a template at the front of the report.

Consultation

2.7 Consultation is an integral part of policy development and the impact assessment process. Stakeholders hold valuable information which aids the development of policy and is key to implementation. We found that consultation was the key strength in the use of impact assessments of the regulators. All ten were rated as being 'good quality' and we found many examples of good practice. These included the use of focus groups, industry workshops, regional road shows, expert technical groups, and input from external consultants. See **Figure 7** for an example of good practice.

Assessment of costs and benefits

2.8 The fundamental objective of impact assessments is to deliver evidence-based policy-making. While it may not always be appropriate for a regulator to carry out full cost-benefit analysis, a proportionate analysis of the likely impacts of a policy is at the heart of good impact assessment. While we found two examples of good practice in Ofcom's impact assessments, generally regulators' assessment of costs and benefits was the most significant weakness in the impact assessments we reviewed. We found that two had 'serious weaknesses' and a further six had 'room for improvement'. See **Figure 8** for an example of good practice.

2.9 Of the ten impact assessments we looked at, only the four assessments performed by Ofcom and Ofgem set out their analysis in a systematic way within a separate 'Cost Benefit' section. The consideration of the impacts in the other six

assessments was ad hoc and spread throughout the text, which made a sound comparison of the different policy options difficult. Although regulators had all undertaken some qualitative analysis in their impact assessments, the lack of quantitative analysis was another common weakness. There are a number of circumstances where a regulator will be unable to perform quantitative analysis without creating misleading certainty and in these circumstances qualitative analysis has an important role. It may not be possible to carry out quantitative analysis because estimates cannot be made robustly or sufficient data is not available. It is also possible that it would not be proportionate. However, the performance of some quantitative analysis, or at the very least an explanation of why this was not possible, would also have been appropriate.

7 Good practice example – Ofcom: TV advertising of food and drink to children

- An independent survey of existing relevant research was commissioned in 2004, and updated in 2005, before the proposal options were formed.
- Formal consultation was conducted over a three month period in spring 2006 and a 2nd one month consultation on an updated consultation document was held in late autumn 2006.
- There were 1097 responses to first consultation: 114 from a wide range of interested groups e.g. consumer bodies, advertisers, health bodies, broadcasters and children's organisations; 655 responses from private individuals.
- An independent research consultancy was commissioned to gauge the public's response to these proposals in a series of deliberative workshops.
- Stakeholders were invited to present their own options and to comment on the model and data used to assess the proposed policy options
- A summary of consultation responses was published alongside the regulator's responses.
- The stakeholders' input led to a revised model and data to analyse the impacts of the different options as well as the analysis of several new options.

Source: National Audit Office

2.10 The role of cost-benefit analysis in informing the economic regulators' decisions differs from Government departments, as the regulators work within their statutory duties and do not take policy decisions on the basis of assessing which option offers the greatest benefit (paragraph 1.4). Cost-benefit analysis is a tool that a regulator can use to inform consultations when it is appropriate or possible to use it but, consistent with its statutory duties, a regulator's key arbiter between options must be to balance public interest objectives. It is, though, important for regulators to undertake an objective assessment of the evidence and provide this to stakeholders to enable them to make informed judgements.

Monitoring and evaluation

2.11 It is important that impact assessments go further than considering the expected costs and benefits of a new policy. It should also consider how actual impacts will be monitored. Our evaluation illustrates that performance in this area was mixed. Only two impact assessments set out how they would measure the outcomes of the policy changes in detail, while another three impact assessments stated their intention to do so, providing some discussion of their criteria for success. Due to their close relationship with stakeholders, especially the industry, it may be that regulators are likely to have large amounts of informal feed-back on their policy changes. It is still important, however, to set out how they intend to collect evidence and critically evaluate outcomes from a wide-range of angles. See **Figure 9** for an example of good practice.

8 Good practice example – TV advertising of food and drink to children

- Each of the eight suggested options has been analysed.
- Detailed qualitative and quantitative data is presented in separate analysis sections.
- This includes information on the methodology for estimating the impacts of the policy options and an analysis to confirm the robustness of the economic modelling results.
- Additional research data and information on how the quantitative analysis was calculated is given in the annexes.
- A variety of groups which are likely to benefit and those likely to bear the costs are distinguished and the impacts presented in a way which allows the 'winners' and 'losers' of the different options to be identified.
- A range of costs and benefits is calculated for each option (i.e. a low, central and high estimate).
- A summary table of costs, benefits and efficiency of the policy options provided.

Source: National Audit Office

9 Good practice example – Pricing in Proportion

- The next steps of the implementation of the proposal are set out with a time table and including a draft of the new licence conditions in an annex.
- Plans to review the actual outcome (i.e. actual prices) in 2006-07 compared to the proposed outcome (i.e. proposed prices) to ensure price neutrality.

Source: National Audit Office

Use of impact assessment in the policy making process

3.1 This part examines the extent to which regulators provide policy makers with a framework that supports evidence-based policy making. It also considers the role of impact assessments in influencing the regulators’ policy development. We found that:

- Ofcom and Ofgem currently have formal guidance and training for policy teams on how to produce impact assessments. Ofwat and Postcomm are developing new written guidance; and
- the impact assessment process appears to be well integrated into policy development, and therefore offers a real opportunity to influence policy outcomes.

The support provided to policy teams

3.2 In order to produce good quality impact assessments, regulators need to provide policy teams with a framework that supports evidence-based policy making. In order to achieve this, regulators should develop guidance, provide training and support for teams, and establish a robust quality control process. **Figure 10** summarises the support that each regulator has provided.

Guidance

3.3 Ofcom and Ofgem have written guidance on how to produce impact assessments. The guidance includes information on the regulator’s legal and strategic commitment to impact assessment, when an impact assessment should be produced, and the stages involved. Ofcom also has a handbook on impact assessment, mostly focusing on how to assess impacts, which was produced by Europe Economics. The remaining three regulators do not use formal written guidance. These regulators do, however, have some information on associated issues such as project management and consultation procedures. Ofwat’s guidance, which was produced in 2001 and has been under review since its duties were changed in the Water Act 2003, is not regularly used. Ofwat and Postcomm are in the process of developing formal written impact assessment guidance with the cooperation of Ofcom and Ofgem respectively.

3.4 Each of the ten policy teams we interviewed was aware of Better Regulation Executive guidance. There is also an indication from policy officials that the Cabinet Office’s Guidelines on consultation, at least the 12 weeks stipulation, has been taken on board, although regulators often preferred to adopt an iterative approach with several slightly shorter consultations.

10 Support provided to policy teams

Regulator	Written guidance produced	Formal training provided	Specialist support provided	Internal challenge process
Ofcom	Yes	Yes	Yes	Yes
Ofgem	Yes	Yes	Yes	Yes
ORR	No	No	Yes	Yes
Postcomm	No	No	Yes	Yes
Ofwat	Yes ¹	No	Yes	Yes

NOTE

1 Ofwat produced guidance in 2001, which has been under review since its duties were changed in the Water Act 2003. They are now close to concluding revised guidance to take into account the new duties it was given in 2005 in relation to consumer protection and sustainability.

Source: National Audit Office

Training

3.5 Ofgem and Ofcom have formal training on producing impact assessments for key members of the policy development teams. Ofcom has trained some 130 people through thirteen training sessions, which are run jointly by the internal Better Regulation expert and external consultants. The other three regulators have not developed a standardised training scheme for either impact assessment or consultation. Ofwat, ORR and Postcomm seek to raise standards through a combination of on-the job training, coaching and support. ORR believes as a smaller regulator, that, this approach offers better value for money for them than creating a standardised training course for all staff.

Support for policy teams

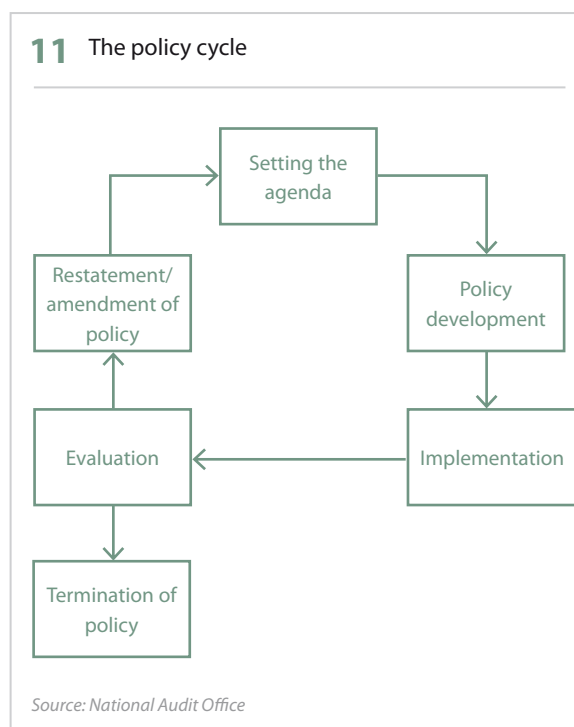
3.6 There appears to be a sufficient level of internal and external support for policy teams conducting impact assessments. This includes access to legal teams, economists and external consultants in all five regulators. However, on the evidence of Part two, access to economists does not always appear to be leading to satisfactory attempts to analyse costs and benefits (paragraphs 2.8 to 2.10). Each of the regulators also has some form of general Better Regulation or impact assessment support, which ranges between impact assessment 'champions' in every policy team, a dedicated Better Regulation team and a single Better Regulation expert.

Internal challenge

3.7 Each regulator has a different approach to scrutinising policy proposals and the accompanying impact assessments. However, all regulators do have systems that incorporate various levels of internal challenge. These include peer review within the policy team developing the impact assessment; various levels of management scrutiny; specialist scrutiny by economists; competition or legal teams; and board level challenge. At various points along this process policies will also go out for formal consultation, i.e. an external challenge or informal external opinion will be sought.

The role of impact assessment in the policy making process

3.8 In order for an impact assessment to be considered successful it should influence the regulator's decision making. It is therefore not sufficient for an impact assessment to be excellent in terms of its presentation and content. The impact assessment framework aims to provide a tool for more effective decision making at various stages throughout the policy cycle (**Figure 11**).



5. All ten impact assessments summarised not only the stakeholders' responses but also the regulator's response to these.

Agenda setting

3.9 The question of whether a new regulation is required or an existing regulation is appropriate, ought to be considered at the earliest stages of the policy cycle. In our previous reviews of Government departments, the NAO has often found that impact assessments are started late in the policy cycle and rarely challenge the need for regulatory intervention.

3.10 Of the ten impact assessments we reviewed in our sample, seven were on policy commitments already given either by Government, the European Union or necessitated by the statutory duty of the regulator. For example, Ofwat's proposal on Undertakers' conditions of appointment was part of a package to implement the Water Act 2003 (**Figure 12**). Other policy proposals can originate from the regulators but still may be widely considered before the formal impact assessment process begins. For example, the origin of Ofgem's proposal on 'Publication of Near Real Time Data at UK sub-terminals' came from a combination of a suggestion by a stakeholder and from within Ofgem (**Figure 13**).

3.11 The source of policy proposals may restrict the ability of the impact assessments to satisfactorily challenge the need for regulation as the agenda-setting stage can take place before they are started. However, the iterative nature of regulators' impact assessment processes means that they are used to consider policy options and do influence the policy-making process, even if they are not challenging the need for regulation itself.

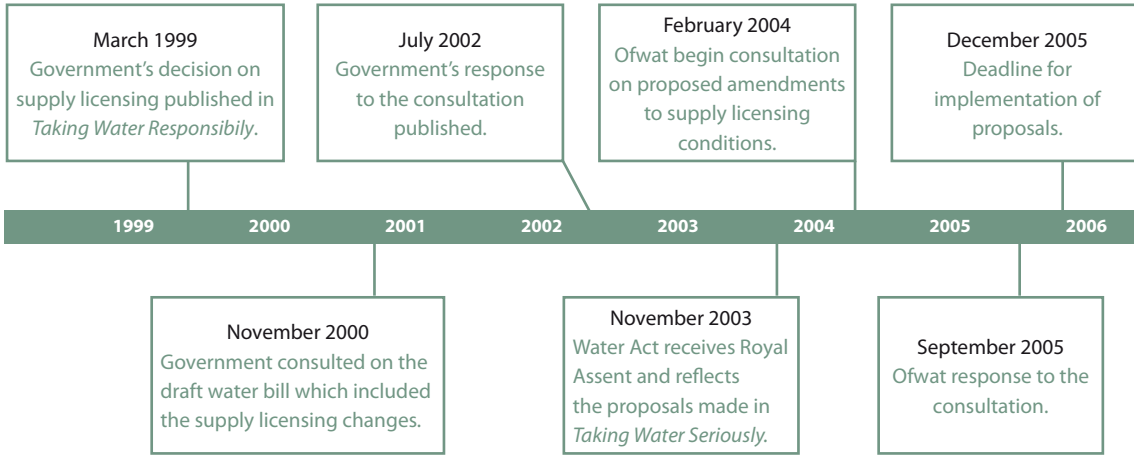
Policy development

3.12 Consultation is an integral part of policy development and the impact assessment process. It can help to ensure that stakeholders engage with policy making and understand and accept the resulting regulations. As discussed in Part Two, our evaluation indicates that consultation is a key strength. In particular, eight of the ten impact assessments had more than one round of consultation and four had three or more rounds during the policy development stage. The iterative approach taken by regulators is encouraging because a common criticism of impact assessments is that they are seen by policy makers as a one-off event rather than a process. When combined with the apparent weight given to the stakeholder responses,⁵ this gives some encouraging indications of influence.

Implementation and evaluation

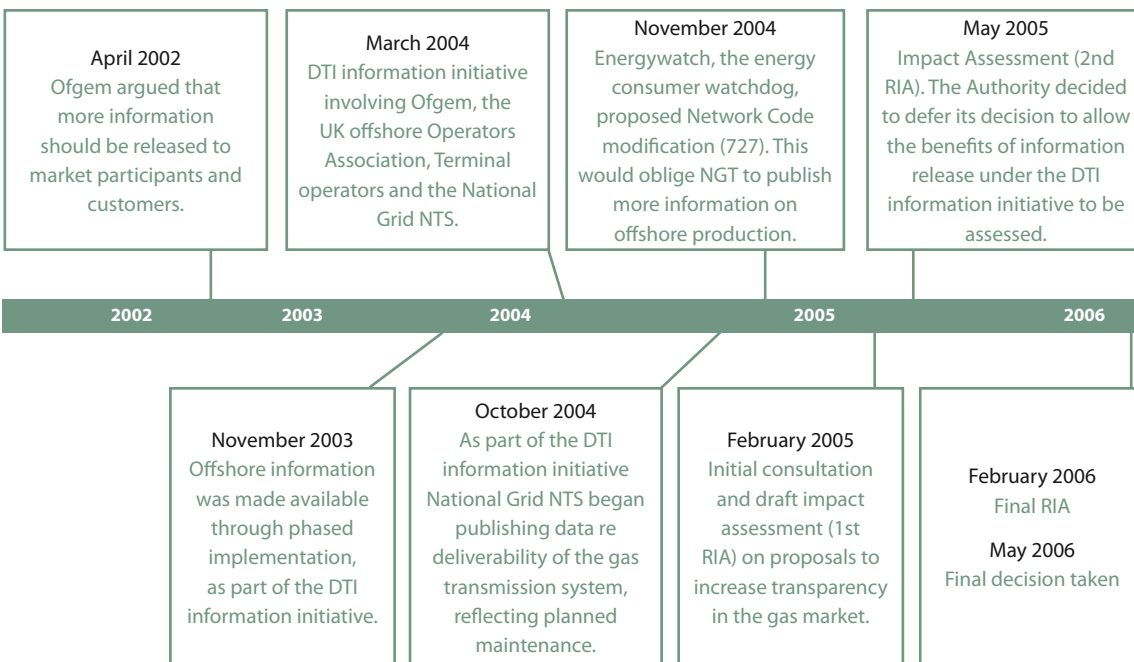
3.13 Evaluation completes the policy cycle and allows policy officials to ascertain the extent to which a policy's objectives have been achieved; assess the accuracy of the expected impacts; and identify any unintended or unforeseen consequences. Feedback from reviews can allow policy teams to identify where improvements can be made to optimise the benefit delivered or to reduce the regulatory burden. However, as illustrated in Part Two, this is rarely done in a systematic or proactive way. Often reviews of policies are not undertaken unless a problem is flagged up either by Government or stakeholders.

12 Timeline for Ofwat's implementation of the Water Supply licensing regulations



Source: Ofwat

13 Timeline for Ofgem's proposal for offshore gas disclosure



Source: Ofgem

Evaluation of NAO sample of impact assessments

We assessed two impact assessments from each regulator against our evaluative criteria. This part sets out the results of our analysis for each impact assessment within our sample of ten. We have not attempted to form any judgement on the performance of each individual regulator on the basis of reviewing two of their impact assessments. However, the results have been used in aggregate to highlight areas where regulators are generally performing well and others where there is room for improvement (See Part Two).

Of the five regulators, only Ofcom and Ofgem routinely produce formal impact assessment documents as part of the policy-making process. Ofwat, Postcomm and ORR use consultation documents in similar circumstances, which contain much of the same information, but in some cases less detailed analysis. Where no formal impact assessments were produced by a regulator we assessed consultation documents against our criteria as though they were formal impact assessments. Ofwat told us that its consultation processes did not set out to meet all our criteria.

Traffic light assessment of regulatory impact assessments

	Presentation	Consultation	Costs and Benefits	Monitoring and Evaluation
ORR				
Rebate Mechanisms for Investors in Large-scale Network Enhancements	●	●	● ¹	●
ORR's Sustainable Development and Environmental Duties	●	●	●	●
Postcomm				
'Pricing in Proportion'	●	●	●	●
Royal Mail Price and Service Quality Review	●	●	●	●
Ofcom				
TV Advertising Standards for Food and Drink Products to Children	●	●	●	●
Amendment of Wireless Telegraphy exemption regulations	●	●	●	●
Ofgem				
Publication of Near Real Time Data at UK sub-terminals	●	●	●	●
Gas Safety Checks and Information	●	●	●	●
Ofwat				
Water Undertakers' New Conditions of appointment	●	●	●	●
Setting Water and Sewerage Price Limits	●	●	● ²	●

NOTES

1 ORR believes strongly that the approach it took in relation to the rebate mechanism was appropriate in the circumstances given the problems in quantifying benefits ex ante. It believes that any attempt at quantification, no matter how novel the method used, would likely have led to spurious accuracy and would have potentially skewed the debate. ORR has committed to an ex-post review of costs and benefits after a year or when there is some objective evidence to review.

2 Ofwat told us that its consultation had not included quantification of costs and benefits because to do so properly would have been tantamount to doing a full price review and might not have been in consumers' interests. It agreed, however, that it would have been helpful to have explained this in the consultation.

3 A 'green' assessment indicates good quality analysis; 'amber' indicates some good assessment but room for improvement; and 'red' indicates some major weaknesses in the analysis.

4 Each impact assessment is assessed against four criteria (see Appendix 2) and this table presents the results of the total number of individual assessments against these criteria.

Source: National Audit Office

Scope and methodology

6. For the latest evaluation see: National Audit Office, Evaluation of Regulatory Impact Assessment 2006-07 HC 606 July 2007.

In March 2007 we were invited by the House of Lords Select Committee on Regulators to review the way that impact assessment is performed by five regulators: Ofcom; Ofgem; ORR; Ofwat; and Postcomm. The review will form part of a major enquiry that the Committee is undertaking into the UK's major economic regulators and their collective impact on the UK economy. The Committee expect to publish its final report in early November.

We considered three key issues:-

- Are regulators producing high quality impact assessments?
- Have regulators provided their policy teams with a framework that supports evidence-based policy making?
- Are the impact assessments that regulators are producing influencing policy development?

Evaluation of the quality of impact assessments

We reviewed a sample of ten impact assessments, two from each regulator completed in either 2005-06 or 2006-07. One impact assessment was chosen by the regulator and one by the NAO. A list of the impact assessments is provided in Figure 3 and again in Appendix 1.

The impact assessments were reviewed using the evaluative criteria adapted from those we have developed in four years of evaluating impact assessments produced by government departments.⁶ The questions cover four main areas of the impact assessment process and are outlined in **Figure 14 overleaf**. Two of the criteria that we have used in the past to evaluate impact assessments produced by departments, 'compliance' and 'competition', have been omitted from this study because they were thought less relevant in this new context. This is because, in general, the role of the regulators is to maintain/increase competition and so the policy proposals were in many instances entirely concerned with matters of competition by default. Similarly, the close relationship between the regulators and their often relatively few industry stakeholders, as well as the nature of many of the proposals (e.g. changes in licences for industry) mean that 100% compliance could be expected in a high number of cases.

We employed a very wide and flexible understanding of what represented an impact assessment as only one regulator, Ofgem, produced stand-alone impact assessment documents. Therefore, in all other cases consultation documents which outlined the policy problem and proposed options for the benefit of the stakeholders were evaluated. As the impact assessment/consultation process was found to be iterative it was usually necessary to include more than one document in our analysis and on several occasions three or even four documents.

Have regulators provided their policy makers with a framework that supports evidence-based policy making?

We examined the support in place to assist policy makers in developing high quality impact assessments, including written guidance, training, specialist support for teams and internal challenge procedures. We held semi-structured interviews with key members of staff in each of the policy teams who produced the impact assessments in our sample. We carried out unstructured interviews with Better Regulation experts at each regulator. We also reviewed the guidance provided by regulators to their policy teams.

Are the impact assessments that regulators are producing influencing policy development?

We examined the way that impact assessments are influencing regulator's decision making. We held semi-structured interviews with key members of staff in each of the policy teams who produced the impact assessments in our sample. We carried out unstructured interviews with Better Regulation experts at each regulator. We also researched the source of policy proposals to establish whether they originated from prior commitments by Government, the European Union or were necessitated by the regulator's statutory duty.

14 Four areas covered in RIA evaluation

Framework of questions for the evaluation of impact assessments

Presentation

- Were the objectives for the regulation clear?
- Was the problem defined clearly?
- Were clear recommendations made which were supported by evidence?
- Was the RIA of a proportionate length and easy to understand?

Consultation

- Was consultation carried out for a suitable length of time?
- Were appropriate techniques used?
- Were all interested stakeholders consulted?
- Were the results of consultation used appropriately?

Costs and Benefits

- Were all likely, realistic and relevant impacts identified as well as those who would be affected?
- Were costs and benefits quantified, and where not, was qualitative analysis provided?
- Did the assessment take account of uncertainty?
- Were the costs and benefits of a range of options considered?

Monitoring and Evaluation

- Were there details of the next steps in the process including how the policy change would be implemented?
- Did the impact assessment contain procedures for monitoring and evaluating the extent to which the proposal meets its objectives?
- Did the impact assessment provide a reporting timescale for evaluations?

Source: National Audit Office

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