



**Memo**

**From: Paul Priestly  
Permanent Secretary**

**Our Ref: PSSDRD 62/10**

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**cc Lian Patterson**

**Date: 17 February 2010**

**To: Jackie Henry  
Peter Dixon  
Glenn Thompson**

**INDEPENDENT REVIEW OF PROCUREMENT GOVERNANCE IN NI WATER**

I have now had the opportunity to review the draft Report, focusing mainly on the facts and findings. As DRD Accounting Officer, I have concerns that the Report does not address the core issue as outlined in the Terms of Reference.

2. While the Report identifies that there have been governance failures on the part of NI Water, it seems to me that the emphasis is actually on what the IRT has seen as failures in the Shareholder role. I fear this undue emphasis could easily lead an impartial reader to conclude that the company's failures rest squarely with the Department. The Report refers to DRD having "contributed to the creation of a governance environment that has contributed to the circumstances in which the governance failures noted ... have occurred". This appears to me to offer a 'get-out clause' for the Board of NI Water in terms of its corporate responsibility for the specific procurement governance failures which happened within the company. I have to ask whether this is really the conclusion the IRT wishes to be drawn from the review; and, if so, does it really address the core problem? If not, then you may wish to consider revising the Report and shifting the balance back onto the core issue and where responsibility for the procurement governance failures lies.
3. One of the reasons for asking the IRT to undertake this review was to have some clarity about the cause of the identified failures and an independent view as to where responsibility lies. I am afraid that the current draft does not provide this clarity. On this basis it would be difficult, on the back of the Report (and I acknowledge that I have not seen your proposed recommendations), to clearly advise the Minister on the necessary actions in moving

forward. I would therefore ask you to reconsider the Report with a view to clarifying your findings and following these through into your recommendations.

4. Turning now to the more detailed drafting, the Report fully recognises the issues faced by NI Water in relation to the complex governance arrangements. However, it fails to recognise the difficulties experienced by DRD officials in trying to administer a changing, governance and regulatory regime developed under Direct Rule Ministers. This has been in an environment where the devolved administration has been reluctant to implement the decisions of Direct Rule Ministers. The consequent difficulties were manifested in a number of ways which served to prevent the Department from initiating action in accordance with best practice corporate governance arrangements. I believe that these issues need to be addressed in order to bring balance and fairness to the Report.

5. For the IRT's benefit the Department has provided additional supporting evidence at Annex 1. This contains an extract from Section 4.3 of the Report with further Departmental evidence inserted in blue text below each of the key findings. I hope that the IRT will take these comments on board in order to present a more accurate picture of the situation. To assist the Panel, some suggested text revisions are also included in the Annex in red. You will note that in one suggested revision we have again emphasised the Department's "support and encouragement" for Laurence Mackenzie in his role both as Chief Executive and Accounting Officer. I would hope that Laurence would confirm that this has been the Department's position since his appointment.

6. I copied to you yesterday a summary of the ongoing Internal Audit work, including early findings from the "deep-dive" exercise. Although the Chairman had not agreed to provide this detail, as there appears to be evidence of further failures, I would expect the IRT to take these into account before finalising the Report. For the record, I regarded this as an unhelpful approach on the part of the Chairman, particularly in the light of concerns that have been expressed about what might be perceived as the Board's interference with the ongoing Internal Audit investigations. I do believe the IRT is entitled to comment on these issues as you see fit and have no objection to you making clear that the DRD Accounting Officer shared with you a report on the early preliminary findings of the "deep-dive" exercise.

Extracts from Independent Panel Report

2.2 ..... DRD, as the sole shareholder in NIW, set a number of objectives for the new company, to:

*It would be preferable if this sentence was amended to read:*

Under Direct Rule Ministers, DRD, as the sole shareholder in NIW, set a number of objectives for the new company, to:

2.3.1..... In the planning for vesting the new GoCo, DRD adopted the Shareholder Executive (SE) model for the discharge of its shareholder function.

*Again it would be preferable if this sentence was amended to read:*

In the planning for vesting the new GoCo, under Direct Rule Ministers the DRD adopted the Shareholder Executive (SE) model for the discharge of its shareholder function.

## 2.5 Recent Development

The IRT became aware of a serious disconnect between the NIW Board and its Chief Executive over the way the Contracts Approval report had been notified to the Shareholder without consideration by the NIW Board. The NIW Chief Executive had initially tendered his resignation and had subsequently withdrawn this. In the interim, the IRT has been told that the position had worsened and is now irreconcilable. Whilst this matter is outside our scope we are concerned about the severe difficulty this situation causes in enabling the Shareholder and NIW to put in place the necessary remedial action plan to implement our recommendations.

*The term 'serious disconnect' is rather anodyne and technocratic. Why not call it what it is – a 'breakdown in the relationship'? Suggest that the above paragraph is couched in more neutral terms such as;*

It became clear to the IRT that there were differing views within NIW about the seriousness of the issues which were contained in the Contracts Approval report. The Board said ..... The Chief Executive said..... This situation now appears to the IRT to be irreconcilable and should not be allowed to continue.

*It may be more appropriate to place the above para in Section 3.*

## **2.6 Summary**

It is clear that NIW has been operating in a complex and dynamic business context since vesting and that the changes in the composition of the Board and senior management have not been helpful in ensuring stability. The recent disconnect between the NIW Board and its Chief Executive is very serious and must be rectified.

*The word 'disconnect' again. Should call it a 'breakdown'. The recommendation leading on from this should point clearly to how the IRT sees this 'serious' situation being 'rectified'.*

## **4.3 Findings**

A key issue for NIW has been and continues to be the confusion over organisational strategy and the status of the organisation as both a GoCo and an NDPB. This has created an incredibly complex governance and stakeholder environment involving the Utility Regulator, the SU, and from 2008-09, the additional overlay of NDPB accountability requirements. In addition to the complexity of the model, evidence presented to the IRT has highlighted the significant resource commitment required across the entire governance system to maintain the model. This governance structure is heavily demanding on both DRD and NIW and is reflective of the increased public accountability.

*The Report recognises the issues faced by NI Water in relation to the complex governance arrangements but fails to recognise the impact on the Department of seeking to manage the Shareholder role against a complex political backdrop. The Report acknowledges the impact of the departure of Senior Executives and Non-Executives in NI Water, however, it fails to do likewise in respect of the Shareholder. It was not until September 2008 that the Shareholder function was at full capacity. Before then the posts were covered by a series of acting up, double jobbing arrangements and vacancies from Permanent Secretary to Grade 7 inclusive.*

IRT's key finding for DRD as Shareholder relates to its slow speed of response to the following events:

- strengthening NED capacity and ensuring this was in line with good governance;

#### **Additional evidence**

Mindful of adhering to best practice in corporate governance, in September 2007 Departmental Officials had prepared a submission for the Minister containing advice on the appointment of Interim Non-Executive Directors to the NIW Board for 6-12 months, pending the outcome of the Independent Panel Review. However, the Minister's Special Advisor made it clear that the Minister was concerned, that such appointments would amount to a "statement of intent" on his part. As a result no new Non-Executive was to be appointed while the Review was ongoing.

The Panel Report was published in late January 2008 and the Department acted quickly to launch the public appointments process in early February and adhered to a tight timetable to make the appointments in early July 2008.

- appointing a new Chief Executive following the Chair's appointment into dual role; and

#### **Additional Evidence**

It is NI Water's responsibility to appoint the Chief Executive. However, under the governance arrangements, DRD is required to secure DFP approval to NIW Board Remuneration. As a result, in advance of any advertising of the post, the proposals for the remuneration of the new Chief Executive post were referred to DFP on 21 August 2008. DFP did not convey its approval until 7 November 2008. The competition was launched during week commencing 11 November 2008.

Following the competition, the Shareholder Consent to Laurence Mackenzie's appointment issued to NI Water on 11 March 2009. The fact that the position was not filled until 27 July was as a result of the need for a period of notice to be served with the former employer.

- appointing the Chief Executive of NIW as Accounting Officer immediately following reclassification of the organisation as an NDPB.

#### **Additional Evidence**

The re-classification of NIW as an NDPB was signalled in earnest to the Department in October 2008. The correspondence from DFP at that time indicated that the re-classification was for PE purposes only and "in all other respects, such as the status of the GoCo and its governance, there is no change".

The Department worked closely with DFP until January 2009 to clearly understand the implications of the re-classification and to seek to minimise the impact on NI Water. The burden of analysis and risk fell to the Department rather than the company. It was probably at year-end and indeed finalisation of the DRD Accounts in June 2009 before the full implications of the re-classification were clearly understood. By then a decision had already been taken to appoint the new Chief Executive as Accounting Officer.

Delay in each of these contributed to the creation of a governance environment that has contributed to the circumstances in which the governance failures noted in the previous section have occurred.

*The evidence provided above would indicate that the delays referred to by the IRT were not within the control of, or as a result of inaction by, DRD officials. The issues referred to were as a result of the complex political environment surrounding the decisions to delay the introduction of charging coupled with an Independent Review of the Water Reform Programme. The eventual outcome resulted in the re-classification of NI Water.*

*The IRT text above appears to offer a 'get out clause' for the failures within NI Water. The Department has provided suggested text in red below to address this.*

*In terms of DRD's role in the Internal Audit environment of NIW we consider DRD was initially slow to act to ensure that NIW was taking internal audit matters seriously.*

#### **Additional Evidence**

In terms of DRD's role in the Internal Audit environment of NIW it was difficult for the Department to come to a view because of the delay in receipt of Assurance Statements and Internal Audit Reports. The Mid-Year Assurance Statement for 2007/08 was not provided until 2 April 2008. It was 28 July 2008 when the Internal Audit Opinion for 2007/08 was

raised with the Department. It was not until 29 August 2008 that the first of the Internal Audit Reports were provided to the Shareholder.

By this time Paul Priestly had already written to the Chairman (22 May 2008) to supplement the governance arrangements. He identified that the Non-Executives and the Audit Committee have a crucial role to play in the accountability of the Company. He requested details of the Internal Audit Programme developed and approved by the Audit Committee for both the 2007/08 and 2008/09 financial years. He asked that the necessary arrangements be put in place in order to ensure that, as a matter of course, all Internal Audit Reports, Periodic Reports and Updates are issued to the Shareholder Unit as soon as they have been issued to the Company in final form. He also asked that the Shareholder Unit be provided with the minutes of Audit Committee Meetings (these are still not provided). It was also requested that NIW should also draw to the Shareholder Unit's attention any significant issues of concern which have been raised by the Audit Committee. The Shareholder Unit should also be provided with the external auditor's management letter.

*Taking all of the additional evidence into account perhaps the following text could be considered by the IRT to replace this section of the Report:*

As a result of the complex political environment surrounding the Water Reform programme it was not always possible for DRD officials to act immediately to secure best practice corporate governance arrangements for NI Water. This meant that there was a delay in strengthening NED capacity on the Board until the outcome of the Independent Water Reform Panel's work was known. The commencement of appointment of the new Chief Executive was delayed whilst seeking to secure DFP approval to the remuneration package. The full implications of the reclassification of NI Water as an NDPB, and the consequent need for the appointment of the NI Water CEO as Accounting Officer did not become clear until June 2009. In terms of the Internal Audit environment within NI Water it was difficult for the Department to come to an early view because of the delay in receipt of Assurance Statements and Internal Audit Reports.

These delays contributed to the creation of a governance environment that has contributed to the circumstances in which the governance failures noted in the previous section have occurred. However, this is no excuse for the failures in procurement which have been identified within NI Water.

7. If you require any further information on the detailed evidence please contact  
Barbara Faloon.

[signed]

PAUL PRIESTLY