



CONTROLLER AND AUDITOR-GENERAL
Tumuaki o te Mana Arotake

Letter to the Chief Executives

Planning to meet the forecast demand for drinking water in Auckland.

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Chief Executive
Watercare Services Limited
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Dear Doug and Mark

Governance of Watercare Services Limited

I am carrying out a performance audit to determine how effectively Auckland water services are being managed now and for the future. Water services are delivered to Auckland ratepayers by Watercare Services Limited (Watercare) on behalf of Auckland Council (the Council).

The audit covers Watercare's:

- Standard of customer service;
- planning to meet future demand for water;
- asset management planning; and
- funding and pricing arrangements for water and wastewater services.

It will consider whether the governance arrangements for Watercare that the Council is putting in place are efficient and fit for purpose.

Because there are developments under way in each of these areas, I am reporting now with initial observations, and suggestions which Watercare and the Council might consider as work proceeds. We intend to review progress made late in 2011, and report further in 2012.

My report is in two parts – this letter which concerns the governance matters, and a report on the other issues entitled Planning to meet the forecast demand for drinking water in Auckland.

Review of governance arrangements

It is important that the Council has strong and appropriate governance arrangements for Watercare (and the Council's council-controlled organisations or CCOs), both because the effective delivery of water services is central to the well-being of Auckland and because the Council is politically responsible for the company's activities.

In considering this question, we have interviewed Councillor Northey as chairperson of the Council's Accountability and Performance Committee, Councillor Hartley as chairperson of the Council's Regional Development and Operations Committee, senior management at Watercare, and senior staff at the Council responsible for monitoring the Council's CCOs and council organisations. We have considered:

- The relevant legislation;
- the Mayor's letter of expectations to Watercare dated 15 February 2011;
- Watercare's draft statement of corporate intent;
- Watercare's draft asset management and funding plans;
- the Council's draft accountability policy for substantive CCOs; and
- a draft monitoring framework for the Council's CCOs (focused particularly on Watercare and Auckland Transport) prepared for the Council by Auckland University's Centre of Infrastructure, through Auckland Uniservices Limited.

Governance framework

The general governance framework for Watercare is set out in legislation. The essential elements of that framework are:

- The Council owns Watercare. It appoints the company's directors. Watercare is a council organisation, but will become a CCO on 1 July 2012.
- Watercare is accountable to the Council. It must consult the Council on its draft statement of corporate intent (SCI) and report half-yearly to the Council on its operations (in practice, it will report quarterly as if it were already a CCO).
- In addition, Watercare must consult the Council on draft asset management and funding plans.
- Watercare must "give effect to" the relevant aspects of the Council's long-term plan, and "act consistently" with any other plan of the Council "to the extent specified in writing by the governing body of Council".
- Watercare derives its funding from ratepayers through water and wastewater charges. It is not funded by the Council as shareholder; nor does the Council purchase its services. Watercare pays no dividend to the Council.

Governance arrangements set up by Auckland Council

Expectations

The Council's expectations of its CCOs are outlined in its draft accountability policy for substantive CCOs and, in relation to Watercare, specified in greater detail in the Mayor's letter of expectations dated 15 February 2011. The draft policy, which is required by legislation, identifies CCOs as partners in the delivery of the Council's objectives and priorities for Auckland. The draft document from the Auckland University Centre of Infrastructure provides more detail on a framework and associated measures that could sit under the strategic priorities.

The letter of expectations was intended to guide Watercare's strategic direction and assist in the development of its SCI. The letter ranges broadly from high-level expectations (such as the "one Council" and "no surprises" policies, transparency, and fiscal prudence) that define the relationship with the Council and the behaviour required of a public entity to more operational matters and detailed expectations for the SCI.

The letter of expectations sets out the parts of the draft Annual Plan with which Watercare must act consistently – a list of key strategic projects relevant to Watercare – and identifies strategic priorities that support the Mayor's vision for Auckland:

- Focusing on demand management, conservation, environmental quality, and sustainability initiatives, including reducing pollution in harbours;
- reviewing options for wastewater treatment in outlying communities; and
- "working with people" about unpaid accounts, rather than taking punitive action.

Institutional arrangements

The governing body of the Council has set up the following institutional arrangements:

- The Accountability and Performance Committee (a committee comprising all councillors) reviews the performance of Watercare and the CCOs quarterly.
- The CCO Strategy Review Sub-committee, chaired by the Mayor, is a sub-committee of the Accountability and Performance Committee and is responsible for reviewing and commenting on CCOs' draft SCIs and Statements of Intent (SOIs).
- A panel for appointing directors to the Watercare board, comprising the Chairperson of the Watercare board, two councillors and the chief executive of the Council, makes recommendations to the CCO Strategy Review Sub-committee.
- There are bi-monthly meetings between the Mayor and the Chairperson and chief executive of Watercare (and each CCO).

Our expectations

We expect a framework for governance and accountability that:

- Reflects the importance of Watercare to Auckland and to the Council;
- enables councillors to pursue their political interest in the Watercare business openly and transparently;
- offers opportunity for genuine engagement between the Council and Watercare, at appropriate intervals and at the appropriate level of seniority, on the Council's strategy and priorities and on Watercare's business performance and risks;
- enables adequate consideration of Watercare's draft SCI and its draft asset management and funding plans;
- complies with the relevant legislation; and
- does not impose a "compliance burden".

Our view

In our view, the formal structure the Council has set up for the governance and accountability of Watercare should meet those expectations.

A committee of Council dedicated to the accountability and performance of Watercare and the CCOs will meet each entity quarterly. We understand that the time allocated at the first quarterly review was adequate for proper engagement.

The Accountability and Performance Committee has established a sub-committee, chaired by the Mayor, to focus on CCO strategy – primarily the consultation on draft SCI/SOIs and, in the case of Watercare, its draft asset management and funding plans. The sub-committee was also responsible for appointing directors to Watercare's board, a process that appears to have worked well.

Both committees operate according to the Council's standing orders and the relevant legislation. They are generally open to the public (although the appointment of directors to the Watercare board was appropriately dealt with in a session from which the public were excluded).

There are also bi-monthly meetings between the Mayor and the Council's chief executive and the Chairperson and chief executive of Watercare. Such meetings provide a less formal opportunity for discussing issues of business performance and risk.

The accountability framework meets legislative requirements. Although the legislation requires Watercare to report on its performance only half-yearly, it has volunteered to report quarterly.

Risks

We see two risks:

- That Watercare's independence from the Council is threatened or circumscribed in some way, particularly if there were general ratepayer dissatisfaction with Watercare's performance on any matter that gave rise to heightened political concern; and
- the creation of a "compliance burden" through the imposition of informal requirements.

The governance arrangements are clear and seem both efficient and effective. In our view, they should be robust enough to obviate the first risk.

The second risk is that, over time, the Council's engagement with Watercare on its day-to-day business of providing water services becomes mixed with the Council's governance of Watercare as a wholly-owned subsidiary. Such a confusion of relationships could give rise to requirements for additional reporting by Watercare that go beyond what councillors need to know to discharge their governance role. We consider it important that the Council keeps the "business partner" and governance roles separate.

We note that the governance arrangements for Watercare and the CCOs are only just starting to operate and have yet to be tested. We suggest that the Council periodically review those governance arrangements to ensure that they continue to work as designed.

Yours sincerely

Lyn Provost
Controller and Auditor-General