



**Northern Ireland
Assembly**

**PUBLIC ACCOUNTS
COMMITTEE**

**OFFICIAL REPORT
(Hansard)**

**Northern Ireland Audit Office
Memorandum on Governance of
Northern Ireland Water**

1 July 2010

NORTHERN IRELAND ASSEMBLY

PUBLIC ACCOUNTS COMMITTEE

Northern Ireland Audit Office Memorandum on Governance of
Northern Ireland Water

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Members present for all or part of the proceedings:

Mr Paul Maskey (Chairperson)
Mr Roy Beggs (Deputy Chairperson)
Lord Browne
Mr John Dallat
Mr David Hilditch
Mr Patsy McGlone
Mr Mitchel McLaughlin
Ms Dawn Purvis
Mr Jim Shannon

Witnesses:

Ms Lian Patterson) Department for Regional Development
Mr Paul Priestly)

Ms Nicola Brennan) Northern Ireland Water
Mr Laurence MacKenzie)

Also in attendance:

Mr Kieran Donnelly) Comptroller and Auditor General
Ms Fiona Hamill) Treasury Officer of Accounts

The Chairperson (Mr P Maskey):

We will now move to consider evidence on the Audit Office's memorandum on procurement and governance in NI Water. Given that no member has declared an interest, we will proceed.

Mr Paul Priestly, the accounting officer for the Department for Regional Development (DRD) is before the Committee again today. You are very welcome to what is your second evidence session in a week, and I thank you for being so accommodating to the Committee's work programme.

Before I ask you to introduce your colleagues, I advise the witnesses that many questions will be asked today in what could be a long session. I ask you to answer the questions as fully and as succinctly as possible. It is important that you speak up and answer the questions, as issues were raised last week about some answers being long-winded and some of the questions not being answered at all. Today's session is very important, but it is equally important that we get it right and that the questions are answered.

Mr Paul Priestly (Department for Regional Development):

Thank you, Chairman. With me today is Lian Patterson, the senior finance director in the Department for Regional Development, who also has responsibility for water policy in the Department. Also with me is Laurence MacKenzie, the chief executive of Northern Ireland Water, and Nicola Brennan, the head of internal audit in Northern Ireland Water.

The Chairperson:

Thank you. At the outset, I want to make it clear that we are not here to reach conclusions on individuals. The Committee will consider the independent review team's (IRT) report on procurement and governance in NI Water and the associated memorandum that the Comptroller and Auditor General produced. We will follow the same format that was used last week. I will ask the first few questions. I would be grateful if answers to those questions were succinct.

We have seen copies of the internal audit deep-dive reports. Some of the findings are staggering. There are numerous examples of improper or unauthorised use of non-competitive contracts, contracts extended beyond the permitted period, and use of suppliers on a repeat basis by raising quotations, rather than holding a proper competition. Since our Committee was

established, we have not dealt with a more serious case of complete disregard for public sector ethics. Mr Priestly, I understand that a number of reviews are ongoing. Can you please summarise the main findings and tell us what remains to be done?

Mr Priestly:

From the outset, I acknowledge that the events that the Committee is considering today are shocking, indefensible and unacceptable. As you noted, the Executive's policy is that competitive tendering is the way to demonstrate value for money. These failures in Northern Ireland Water, where there was a total of 73 procurements by single-tender action at a total value of £28.4 million, are, rightly, to be condemned, and we have been let down by those charged with the stewardship of Northern Ireland Water.

As to the action taken, as the Committee knows, the Minister removed four non-executive directors from the board of Northern Ireland Water. The Minister announced yesterday the appointment of four interim non-executive directors to an interim board. Since the IRT report, we have completed the deep-dive audit and we have published the results of the deep-dive audit on the DRD website. We have completed the mapping exercise to determine which senior executives in Northern Ireland Water are responsible for those failures. That has led to disciplinary action against four individuals. Laurence MacKenzie and I have together drawn up a detailed action plan to implement all the recommendations in the independent review team's report. As recommended by the independent review team, DRD is now represented at the Northern Ireland Water audit committee. The Minister also announced yesterday that he is examining the overall governance arrangements in Northern Ireland Water. We have taken swift action to try to put things right. I am not going to hide my disappointment at the events that have taken place. We feel that we have now a firm basis to prevent any recurrence.

The Chairperson:

I appreciate your last comments. You said that you have taken swift action, but how long has this been going on?

Mr Priestly:

Failures have been going on for three years in a history of procurements by single-tender action.

The Chairperson:

Has it not been going on longer than that? Some of the reports state that some of the single-tender procurements have been going on since 2004. You, as accounting officer, said that swift action was taken.

Mr Priestly:

I meant that we have taken swift action since the issues were exposed and drawn to our attention. The scale and magnitude of what was going on was drawn to my attention on 18 January by Laurence MacKenzie as the accounting officer of Northern Ireland Water. At that point, I decided that there needed to be an urgent independent review, and I got the Minister's agreement to set up the independent review team. That was established very quickly and launched on 20 January to get to the bottom of what had gone wrong and to identify where responsibility and accountability lay. The review team delivered its final report to me on 18 February. Once I became aware of the problem, swift action was taken.

The Chairperson:

As accounting officer, do you not think that it was your responsibility to have found that out before then? I know that it was brought to your attention following the recent appointment of Mr MacKenzie, but given that you are the accounting officer in the Department, was it not your job to have found it out prior to that point?

Mr Priestly:

As I have said several times to the Committee, I accept that I have a responsibility to ensure that Northern Ireland Water spends public money with due regularity and propriety and achieves value for money. However, I am not responsible for the day-to-day operations and management of that company. As the Minister said in his statement to the Assembly, at no time was a "red

flag” raised to the Department. Those issues were never raised through any of processes and procedures that the Department has in place for Northern Ireland Water, such as the quarterly shareholder meetings or assurance statements.

The Chairperson:

Again I ask you to be brief. As the Department’s accounting officer, can you tell us whether it was a failure on your behalf not to have found that out?

Mr Priestly:

I do not believe that it is a failure. It is regrettable that it did not happen. The arrangements were in place, but it was not identified.

The Chairperson:

Do you feel that the arrangements did not work?

Mr Priestly:

I think that we were let down by the board and executives of Northern Ireland Water. They signed off assurance statements that assured us that there were no issues in those areas.

The Chairperson:

I will be as brief as you have been, because I know that other members want to ask questions. My questions are about setting the scene. The Department was given assurances, and audits were conducted of NI Water over the years that the Department will have signed off. Was the issue not identified at any stage in the reports that you received from NI Water?

Mr Priestly:

There is a history to the Department’s being denied access to the company’s internal audit

reports. When I became the permanent secretary of the Department in December 2007, I had a number of concerns about those arrangements, and I decided that I would stiffen the governance and accountability arrangements. There was some blowback from the board of Northern Ireland Water at my attempts to do that, and I ended up asking the previous Comptroller and Auditor General to accompany me to a meeting with the board to explain that public money was involved and that the Comptroller and Auditor General and his office could follow that money back to the point of its expenditure. I subsequently wrote to the board and said —

The Chairperson:

Does that mean that you had no control over the board?

Mr Priestly:

In what sense do you mean “control”?

The Chairperson:

You had to bring someone else along with you to meetings, as the board was not adhering to your requests.

Mr Priestly:

No. I put my case to the board as the accounting officer and told them what I wanted to achieve and what I required to provide me with assurances about the control environment in Northern Ireland Water. There was some pushback against that. I brought the previous Comptroller and Auditor General with me to reinforce the arguments that I was making. Thereafter, I insisted that it happen. At that point, I also insisted that we had access to the company’s internal audit reports, yet it still took a number of months before we finally got access.

The Chairperson:

Should action have been taken sooner rather than later?

Mr Priestly:

Absolutely; it should have been taken before I arrived in the Department. When I arrived, I saw those issues as weaknesses, and I set about tackling them. It is regrettable that it took so long to achieve the result that we wanted.

The Chairperson:

It is very regrettable. However, it is your responsibility as the accounting officer in the Department to redeem that.

Moving on, page 18 of the report from the independent review team concludes that the breakdown in the governance framework was primarily the responsibility of the board of the NI Water board and the executives. If that is the case, what is your role?

Mr Priestly:

The Department's role as a shareholder in Northern Ireland Water is to oversee and scrutinise it. As I said, I do not duck my ultimate responsibility for providing assurances on the company's regularity and propriety of expenditure and its achievement of value for money. I accept that that is my responsibility. However, I am not responsible for the day-to-day spending of that money, or for the operation and management of the company. We entrusted the stewardship of the company to the board and its executives. When the problems were brought to light, I believe that I took swift and appropriate action.

The Chairperson:

Therefore, you, as accounting officer, do not believe that you had any responsibility to ensure that those issues were addressed sooner or, at least, to investigate and establish what was going wrong?

Mr Priestly:

It is regrettable that it took so long for those issues to come to light. I am not sure whether, apart from taking over the management and running of the company, I could have been any more successful in getting to the bottom of the issues.

The Chairperson:

I want to change tack for a moment. I will turn now to Mr MacKenzie. It certainly seems to me that you have had a particularly difficult time as chief executive of NI Water. I understand that, in your attempts to get to the bottom of some of the procurement issues, you did not always find that you had the full support of the board. I understand that, at one stage, you felt obliged to tender your resignation. Perhaps you could talk us through the difficulties that you have had since your appointment and how you have been able to deal with them.

Mr Laurence MacKenzie (Northern Ireland Water):

If you do not mind, Chairman, I will go through the sequence of events to explain how it all happened.

On 27 July, I joined Northern Ireland Water. Prior to that, I had been with Viridian for almost a decade. For most of that time, I headed up Northern Ireland Electricity. The reason that I moved on was because I felt that I needed a fresh challenge. I certainly found one. When I applied for the job, I did not expect to be appointed to the post of accounting officer. By the time that I had taken up the role, however, the company's reclassification to a non-departmental public body (NDPB) had happened.

On my second day in post, Mr Priestly made me aware that he intended to appoint me as accounting officer. I did not really know what an accounting officer was. I had to do some fast reading to understand what my responsibilities were. I realised quickly that I would carry personal responsibility. I took that very seriously.

As far as the procurement and governance issue is concerned, my antennae went up on 10 August. Therefore, I joined on 27 July, and my antennae went up on 10 August. I got an e-mail from an individual who worked in the organisation that stated that that person wanted to award a named individual the contract continuation for 2010-11, which was 130 days at £775 a day. The person stated that that figure represented good value for money. When I did the arithmetic, more than £100,000 did not seem to me to be good value for money.

I then became aware of further potential irregularities with the same individual, whereby a success fee had been negotiated for work that the individual was doing on another contract. Therefore, at that point, I decided that the right thing to do was to ask the head of internal audit to conduct an investigation. Around a month later, we essentially found that a single-tender action had been awarded to that individual. The way that the mechanism works is that a single-tender action for any amount up to £250,000 can be approved internally. For anything above that amount, the onus is on the company to approach DRD to ask for approval. From the work that had been done, it was obvious to me that no one had approached DRD to seek approval, either for the £600,000-odd of expenditure that had been incurred by that individual and, in particular, for the success fee, that is, savings that were identified in the particular contract but not delivered.

At that point in time, the individual told us that they had identified savings of £23 million. If you multiply £23 million by 6%, you get a very large number. I immediately brought the matter to the then chairman of Northern Ireland Water and, concurrently, made the departmental accounting officer aware of the findings. To be fair, I had made them aware as soon as my antennae had gone up in August/September.

I will read from board minutes that followed that report.

“The chairman noted that in his view a success-fee arrangement of 6% on the value of the sum recovered was not unusual in a commercial environment.”

In my world, “recovered” is different from “identified”. At that meeting, I confirmed my intention of

continuing to look at contracts to see whether there were others. I was working on the basis that if there was one there could be others. I was generally surprised that the issue was not regarded as unusual in the organisation. I asked Nicola Brennan to undertake the first review, which was the contracts approval audit, which proved a difficult and time-consuming process. I received a first draft in the week commencing 11 January, and there was still some work to be done on it. However, the report highlighted the significance of the emerging issues.

I asked Nicola to circulate a draft to the executive management and call a meeting for Friday 15 January to go through the report. On top of the success fee of £775, I began to regard these as very serious issues. I did not have a good weekend, as I thought about what I was to face on Monday morning. I was concerned about several things, and, given the seriousness of the issues, I felt it appropriate to demonstrate how seriously I was taking them by tendering my resignation.

On the Monday, I circulated a summary report to the board and later that morning to the accounting officer in DRD; I also made the accounting officer aware of my resignation. I met the accounting officer the next day and was very reassured by the support of DRD. It asked me to withdraw my resignation, which I did when I saw the support that I was getting from the Department, as opposed to what I saw internally.

We commissioned further work, which is known as the deep-dive audit. The rest is a matter of record. There was £28 million of irregular expenditure for which we cannot demonstrate value for money, spanning 78 contracts, all of which predate my time in post. I regard the findings as deeply disturbing and the failings are largely indefensible.

This is desperate stuff. I have met some great people in my time at Northern Ireland Water who have had no part in these issues; they get up in the morning and want to do a good job. I am really sorry that once again we are in the spotlight for such an issue.

The Chairperson:

Thank you. It is unfortunate. We would not hold these inquiries if we did not have to, but unfortunately we must.

The main point is that these are not small amounts of money, but millions of pounds. As you said yourself, £28 million was spent in irregular contracts. It is an awful amount of money. It surprises me that it was spotted within weeks, but in the years before it was not spotted or brought to attention. That is also highly irregular. That is one of the questions that we should ask, and some of our members will try to tease out further information as this evidence session continues. That is the sort of question on which we need to focus.

Mr McGlone:

I want a fuller grasp of the sequence of events. We hear what you say to us, and I do not dispute the bona fides of your account. Are these occurrences subject to criminal proceedings or will any further investigations be conducted? Are they likely to turn up in any form in court?

Mr MacKenzie:

There is no evidence of fraud.

Mr McGlone:

That was not my question.

Mr Priestly:

No criminal or court proceedings are pending.

Mr McGlone:

Has any of the parties taken court action?

Mr Priestly:

No.

Mr McGlone:

That is OK. Mr MacKenzie has given his account. However, Mr Priestly, you said, if I picked you up rightly, that you noticed issues about the place when you came in. I am anxious to know the issues that you noticed, the issues that he noticed, whether there was a synchronicity, compatibility or a read-across, and why it took so long to come to the point that Mr MacKenzie, if it was as he said it was, started to uncover things that had not previously been uncovered.

Mr Priestly:

When I became permanent secretary, I was concerned about the Department's oversight of Northern Ireland Water; I did not think that it was sharp enough. Let me be candid with you: my first quarterly shareholder meeting came very shortly after my appointment as permanent secretary. It would have been usual for the permanent secretary to chair that meeting, but I did not chair it; the person who had been acting permanent secretary chaired it.

I heard a series of issues: we have not agreed the budget for this year; we have not had access to internal audit reports; we have not had the mid-year assurance statement; we have not had access to the risk register. That rang alarm bells. I said that when I became chairman of this meeting, that would change. I will read from the record of the first meeting that I did chair —

Mr McGlone:

When was that?

Mr Priestly:

It was 8 May.

Mr McGlone:

Two thousand and seven?

Mr Priestly:

Two thousand and eight. The meetings take place quarterly. I continued by saying that I thought that further quarterly shareholder meetings should focus on the health of the company, its strategic direction, and its plan for delivering on its strategy. I wanted improved sharing of information by both parties. In that context, I expressed concern that the 2007-08 budget had not yet been approved and that the 2008-09 budget had not yet delivered. That would have left the Department and Northern Ireland Water very vulnerable in front of the PAC or the Regional Development Committee.

In reply, the then chief executive said that she felt that my tone was recriminatory. I said that it was not intended to be recriminatory but candid. If I could not say that to them in a quarterly shareholder meeting, where could I say it?

Mr McGlone:

With regard to minutes, all we want is the factual accuracy of what went on as opposed to the exchanges between individuals and the exchange, intemperate or otherwise, that may have taken place. We understand the concept of a Go-co and shareholders. How frequently did DRD or the Department of Finance and Personnel (DFP) audit NI Water?

Ms Lian Patterson (Department for Regional Development):

When the Go-co was set up in April 2007 it was responsible for its own internal audit function and so could no longer draw on the internal audit function that would previously have been provided by the Department when it was the Water Service.

Therefore, as a new organisation in April 2007 it set up its own internal and external audit

functions. Its internal audit function was contracted out to Ernst & Young, a private firm of accountants, for the first two years, 2007-08 and 2008-09. At that time, the audit committee of NIW was responsible for liaising with Ernst & Young in agreeing the amount of internal audit time, which was decided as 360 days in the first year.

The shareholder unit had a role to see the internal audit plans but had no role at that time to approve them. Under Go-co status, that would have been the role of an audit committee because it was an operational activity. The internal audit function was set up, contracted out, and run for the first two years by an external firm.

Mr McGlone:

Therefore the Department conducted no audits of NI Water in that period. Am I quite correct in saying that?

Ms Patterson:

You are correct in saying that.

Mr McGlone:

Secondly, I believe that you said that it was the Department's role to see internal audits. Chairman, it would be useful to find out how many times the Department saw those internal audits.

Ms Patterson:

The Go-co was set up in such a way that the Department would not have had a right to do internal audits; the Go-co had to have its own internal audit function and committee.

As regards the Department's interaction in receiving internal audit reports, in 2007-08, which was the year that the company was established, there was tardiness in getting internal audit reports — that was raised with the company at the time — and in getting the mid-year assurance statement. Therefore six months into the Go-co's establishment, there should have been a mid-year assurance statement that started to give a read out as to the findings against internal audit reports. That mid-year assurance statement, which would normally have been expected by September or October 2007, did not come through until April 2008.

That was one of the triggers for the permanent secretary to write to the chairman in May, stating that such a late delivery was unsatisfactory and that the Department needed to have full access to all internal and external audit reports. After the letter came a response from the company and a bit more pushing back. In August 2008, the shareholder unit received the first internal audit reports since the company was established in April 2007. Since then, it has been receiving internal audit reports.

Controls were set up for the Department to engage with NIW's audit committee, whose chairperson I meet twice a year. Furthermore, the director of the shareholder unit meets the person who has responsibility for corporate governance in the company to get a read-out on internal audit.

Although the Department did not have a role in approving the audit plan, it could influence it. One area in which we felt that there was a need for more internal audit was the business improvement programme, through which a significant amount of money had been spent in the first three years. Therefore, the Department pushed back and got additions made to the internal audit plan to cover business improvement. Therefore, we influenced improvement where we believed that there was a weakness in the internal audit plan.

Mr McLaughlin:

I want to make two points that relate to the current topic of discussion; there will be more detailed

questions to come. NIW has been through significant transformation and changes of direction. With regard to governance failings, are we talking about a long-standing culture that goes much further back than the move towards privatisation that populated the new arrangements; or are we talking about governance that developed or proved to be faulty in the context of the more recent vintage of changes that took place during the past four or five years?

Mr Priestly:

From evidence that I have seen as accounting officer, I would say that there is an element of both. Something seems to have happened when Northern Ireland Water became a Go-co, as though it thought that controls were removed. I kept hearing that “we are operating commercially”. I kept pushing back against that and saying that because they were receiving hundreds of millions of pounds of public money, the rules on regularity, propriety and value for money continued to apply. Laurence, what did you find?

Mr MacKenzie:

I agree with Mr Priestly. I had spent a great deal of time in the private sector. When I came to Northern Ireland Water, I saw an organisation that believed that it was in the private sector and behaved accordingly, without actually knowing how the private sector operated.

Mr McLaughlin:

That sounds like many Departments.

Mr MacKenzie:

I say that coming from an environment where there had been robust controls and where procurement was taken seriously and was approved at the appropriate level. Therefore, I believe that the culture in the company was that it believed that it had been freed of its shackles.

One of the things that surprised me was a reluctance to engage with the Department; I was told

from early on to keep it at arm's length. I recall a non-executive colleague telling me to watch them. He told me a story about the frog that boiled: they will make the water nice and warm for you and keep making it warmer and warmer; you will get friendly with them until one day they boil you; therefore do not tell them too much. There was definitely a culture of reticence about telling the Department anything.

Mr Priestly:

I will add just one point to that. For that reason, when setting up the independent review team, I was keen to have someone from the commercial world on it to tackle head-on the question of whether these people were operating commercially. He said to me privately that if they were in the commercial sector, I as chief executive would personally have to sign off any expenditure of more than £10,000. There would be no independent review; the door would be open and they would be asked to go through it.

Mr McLaughlin:

That is precisely why I am interested in this discussion. It seems that alarm bells were not going off. I would have thought that, given the precipitate change of attitudes to accountability, particularly with respect to public money, that you, with your management structures and oversight role, would have recognised immediately that there had been a significant change from how the Water Service had been held to account in the past. The fact that alarm bells did not sound indicates to me that the pre-existing culture had been transposed onto the new arrangements.

Mr Priestly:

As I have tried to explain, I arrived in the Department in December 2007; alarm bells did go off, and I started to sharpen governance and accountability. The letter to the then chairman focused on access to assurance statements, the audit committee, the audit programme, access to internal audit reports, risk management in Northern Ireland Water, business cases and post-project evaluations. These are serious issues that I was concerned about.

Mr McLaughlin:

On 29 May 2008, in a different inquiry, you told the Committee that:

“I have taken steps to reinforce my role as the departmental accounting officer and to seek... assurances from the company that it is spending public money wisely and that it has in place proper systems of internal control and risk management.”

Do you stand over that statement today?

Mr Priestly:

That is what I was trying to do.

Mr McLaughlin:

You did not tell us that you were trying: you said that you had put in place those new arrangements.

Mr Priestly:

I had put them in place. However, it is a truism that one can put in place all the arrangements that one wants, but if there is not the will to operate them, if there is a culture of keeping the Department at arm's length and denying it information, how does one get those arrangements to work?

Ms Patterson:

In the assurance statement of 2008-09, we specifically asked for an additional clause to cover adherence to financial delegations set out in the original governance letter. The assurance that was provided by NIW in that year stated that NIW policy relating to the financial delegations had been applied in a format consistent with the governance letter and that NIW was not aware of any significant areas in relation to the financial delegations to which it had not previously drawn attention.

Therefore the Department had asked for the additional assurance and NIW had given an affirmation against giving it.

Mr McLaughlin:

Let me give you something else to consider: on 28 May 2008, the chief executive, Katherine Bryan, resigned. You appeared before the Committee the following day to assure us that you had taken steps. On 1 June 2008, Chris Mellor doubled up as the chairperson and interim chief executive, and that appointment was approved by you.

Mr Priestly:

It was approved by the Minister.

Mr McLaughlin:

I am sorry? The Minister approved that appointment over your head? Did you give him a different recommendation? I do not like that answer. What recommendation did you give him?

Mr Priestly:

The recommendation to the Minister was that Mr Mellor should double up as chief executive and chairperson.

Mr McLaughlin:

That is what I asked you.

Mr Priestly:

That is not best practice, but it is not unusual for a short period in such circumstances. We expected it to be a reasonably short period.

Mr McLaughlin:

Was that one of the steps that you introduced to tighten governance and control?

Mr Priestly:

No.

Mr McLaughlin:

The Minister announced several interim appointments to take NIW forward in the short term; he also called for a re-examination of its business and governance model. Do you accept that the business model under which NIW operates has been a disaster and a complete failure?

Mr Priestly:

No. I do not accept that failure in one area of governance means that the running of the entire organisation was a disaster. As we said at last week's hearing, Northern Ireland Water has a good history of achievement in investment, in its capital programme, in waste and water treatment plants and in producing credible results in drinking and waste-water quality.

Mr McLaughlin:

Are you prepared to consider an alternative to the existing arrangements, or is your mind made up?

Mr Priestly:

All options are open; ultimately, however, those are policy decisions for the Minister.

The Chairperson:

I find it highly offensive that NI Water has treated the Department almost as an arm's-length

company. It is definitely a case of the tail wagging the dog, and that was allowed to happen under the watch of the Department's permanent secretary.

Mr Hilditch:

I had a couple of questions on the tightening of the governance and control arrangements in Northern Ireland Water; however, Mitchel has already dealt with those issues, and I will ask some questions on contracts instead.

Page 11 of the independent review team's report concludes that expenditure to date against contractor A, who was appointed under a single-tender award, was £660,000, with further claims of more than £900,000. Why was that contract awarded using the single-tender award process?

Mr Priestly:

Mr MacKenzie spoke about that contract earlier and understands the detail of it. I will hand over to him to answer that question.

Mr MacKenzie:

That contract was originally let on 10 April 2007 to someone who had previously been on secondment from the Strategic Investment Board (SIB) to advise NI Water on PPP contracts. When that arrangement came to an end the then chief executive of NI Water entered into a single-tender action with that contractor. The chief executive had a financial delegation of £250,000 and, therefore, she was quite entitled to enter a single-tender action. The Department should have been approached before the expenditure exceeded £250,000 in May 2008, and approval sought for the contract to continue.

Mr Hilditch:

Who is contractor A?

Mr MacKenzie:

It is an organisation known as Contracting Out LLP.

Mr Hilditch:

What initiated your investigation of that contract?

Mr MacKenzie:

As I said, 13 or 14 days after I joined NI Water, I received an e-mail from an executive asking me to approve a further 130 days' work for that contractor at £775 a day. That raised my antennae.

Mr Hilditch:

Will you provide a copy of the internal audit report into that contract?

Mr MacKenzie:

Yes.

The Chairperson:

Will that be sent to the Committee?

Mr MacKenzie:

Yes.

Mr Hilditch:

Expenditure that was not approved is irregular. How much irregular expenditure has been incurred by NI Water to date?

Ms Nicola Brennan (Northern Ireland Water):

Nine hundred and ninety-nine thousand pounds was paid in full. No further payments are due.

Mr Hilditch:

Were any contracts awarded to companies with a connection to the chair or to any other board members?

Mr MacKenzie:

None that has not been declared. A small contract for £20,000 was let to an organisation the chairman of which was a non-executive director. He quite properly declared his interest, and the contract was properly tendered for.

Mr Hilditch:

Can details of that be forwarded?

Mr MacKenzie:

Yes.

Mr Hilditch:

OK. Were any of those transactions recorded in NI Water's accounts?

Ms Brennan:

They were.

Mr Hilditch:

OK. Were any contracts awarded to staff members or former staff members of NI Water or the

Water Service?

Mr MacKenzie:

Strictly speaking, no. However, to answer the question directly: the principal of Contracting Out LLP had been a member of Water Service's management board and carried the title of PPP director. Although that individual was on secondment from SIB, she carried all the influence that an employee might have had.

Mr Hilditch:

Therefore the answer to that question could also be yes.

Mr MacKenzie:

Sorry; I was a bit long-winded.

Mr Priestly:

It certainly gives rise to a perception.

Mr Hilditch:

Yes, it does indeed. Can details of that, too, be forwarded to us for further consideration?

Mr MacKenzie:

Yes.

Mr McLaughlin:

Just for the record, PPP —

Mr MacKenzie:

Public-private partnership.

Mr McLaughlin:

I have an idea what it was. Could you tell us just for the record?

Mr MacKenzie:

Public-private partnership. The alpha and omega of public-private partnerships.

Mr Hilditch:

How does the organisation deal now with perceived conflicts of interest? Is a policy in place?

Mr MacKenzie:

A register of board members' interests is kept; they are not allowed to participate in discussions in which they have a conflict of interest. That register is maintained by the company secretary and updated quarterly.

Mr Dallat:

Mr Priestly, as a long-serving member of the Public Accounts Committee, I know that this is not the first time that your Department has had to explain away financial disasters, embarrassments, and things that should not have happened. You will remember the Belfast-Bangor railway and the £13 million that went missing, and accounts put in skips and all that. How can you come back and explain yet another complete cock-up in how you manage your off-shoot organisations?

Mr Priestly:

I am not in the least trying to explain the matter away; I said that it was reprehensible, deplorable,

and insupportable. It happened, and I have sought, as accounting officer, to take due action to put things right, to find out where the blame lies, and to deal with it appropriately. I will not defend what happened. It should not have happened. It is unacceptable.

Our purpose is to assure you that we will ensure that it will not happen again and that we will learn the lessons and apply them across the Department to our other arm's-length bodies.

Mr Dallat:

You took appropriate action with the board of the executive directors. Was the accounting officer among those?

Mr MacKenzie:

That is me.

Mr Dallat:

Well, you told me earlier that you had offered your resignation; that did not surprise me. What surprised me was that you did not resign.

Mr Priestly:

Laurence had been with the company for a couple of months; he had uncovered this and brought it to my attention and I was shocked when he did. He told me that he had resigned. I asked him the reasons why he had resigned, and I said to him: "This is foolish, Laurence; it is you who are uncovering this malpractice." I assured him that I would take the matter seriously and that we would put in place an independent review that would quickly produce a report to get to the bottom of the affair.

On that basis and with my agreement, he decided to try to withdraw his resignation. The board of Northern Ireland Water contacted me to say that it was minded to refuse to allow him to withdraw his resignation. I said that, if the board did that, I would get the Minister to get Mr MacKenzie kept on the board and that Mr MacKenzie could not be allowed to resign.

Mr McLaughlin:

That is very interesting, but I want to finish the point. I take some reassurance from the support that you offered to Mr MacKenzie. However, you reported to your board that you had uncovered a very serious issue, but the board did not support you. Is that not what provoked your resignation? When you offered your resignation the board accepted it, but now Mr Priestly tells us that some board members said that they were of a mind not to accept your retraction. It is a very interesting little sequence, is it not?

Mr Priestly:

May I develop the point? The chairman and other members of the board approached me and said that I was overreacting. My reaction was that they did not seem to understand the seriousness of the matter: public money was involved and what happened should not have happened. However, I could not persuade them of that.

Mr McLaughlin:

Do you think that they did not understand?

Mr Priestly:

There is evidence that they did not.

Mr Dallat:

I am trying to work out where the decisions were made. There was a dinner, or nosh-up, on 14 October that you, Mr MacKenzie, and the regulator attended. Is it normal practice for you and

the regulator to sit round a table?

Mr MacKenzie:

I think that the dinner to which you refer was when the regulator invited me to dinner in his offices at which other utility people were present.

Mr Dallat:

It must be a good-sized office. Before we go any further, can you tell us what appointments process was used for the interim board?

Ms Patterson:

The process was designed to get a mixture of people from a range of backgrounds. The interim board is expected to sit for up to nine months, because we intend to advertise by public appointment to appoint a permanent board. Meanwhile, the interim board is expected to hit the ground running, as it is important that it has the confidence of the consumer and the public.

In deciding the skills that we wanted for the interim board, we determined that there were four categories: the chairperson; a consumers' representative; someone with commercial experience and acumen; and someone with experience of public sector accountability, as NI Water is now an NDPB for public expenditure (PE) purposes.

The appointments process was used to identify those four skills. People who fit into each of those skill sets were interviewed by a panel comprising the permanent secretary, myself, and an independent assessor from the office of Felicity Huston, the Commissioner for Public Appointments. We have made sure to outline very clearly to those interviewed what membership of the interim board will entail. That will not be an easy role. We have also made sure and that they feel comfortable taking that role on. That has taken some weeks.

We provided advice to the Minister on recommendations for the panel, and this week he appointed the four members of the interim board.

Mr Dallat:

Therefore, the Minister more or less ticked the boxes.

Ms Patterson:

Absolutely not. The Minister felt that some of the panel's recommendations were not appropriate for a particular skill. The Minister has a role to ensure that the person appointed to represent the consumer is someone that he feels has the skills to do so.

Mr Dallat:

Did all the appointees respond to a public advertisement?

Ms Patterson:

No. Given the urgency —

Mr Dallat:

How on earth did they know to apply?

Ms Patterson:

I will clarify, if I may. The appointments process was discussed with Felicity Huston and the office of the Commissioner for Public Appointments. Given the urgency of getting an interim board in place and that the public appointments would be for a relatively short period, the competition for the interim board sits outside the normal full competition process. However, the appointments process for the permanent board will be done through the normal process of public

advertisement, and it is expected to be launched quite soon.

Mr Dallat:

I find that astonishing. I spend a great deal of time in my older years travelling eastern Europe to discover how such things happened prior to the fall of the Iron Curtain.

Mr McGlone:

Did the Commissioner for Public Appointments approach you at any stage about the process that the Department was using for public appointments? If she did, what advice did she give you?

Mr Priestly:

I am sorry; did she approach me —

Mr McGlone:

Did she speak to you about public appointments?

Mr Priestly:

On this —

Mr McGlone:

Just bear with me. I asked whether Felicity Huston spoke to you personally about DRD's public appointments process.

Mr Priestly:

I have met with Felicity Huston on several occasions to discuss the public appointments process

that Northern Ireland Water uses. However, I cannot remember specific details or dates.

Mr McGlone:

She can.

Mr Priestly:

That is fine.

Mr McGlone:

She voiced serious concerns to the Committee about the appointments process that DRD was following. You referred to guidelines; she referred to process and proper procedures. Anyway, we will park that matter there.

Mr MacKenzie, did any of your executive or non-executive directors, members of the board or senior staff in NI Water draw your attention to concerns about NI Water's procurement practices?

Mr MacKenzie:

No.

Mr McGlone:

No.

Mr Dallat:

What is your view of consultants and how they are appointed?

Mr MacKenzie:

My personal view is that an organisation learns more by doing things for itself than by asking consultants.

Mr Dallat:

In an e-mail that you sent to Peter Dixon on 16 November you say:

“There are some sensitive souls in here. For example, I say that all future consultancy expenditure has to be approved, In advance, by me — they tell me I am being autocratic — I say — get used to It!”

I am trying to —

Mr MacKenzie:

Given that I was concerned about the level of consultancy expenditure, one of the things that I did on taking up the post was to get the financial delegations so that management consultancy expenditure had to be approved by me to get costs under control.

Mr Dallat:

Unfortunately, Northern Ireland Water was not always as sensitive about consultants. How much money was spent on consulting houses when setting up the governance arrangements for NI Water?

Mr MacKenzie:

I do not have that information; I was not —

Mr Dallat:

Not to worry; I will tell you: somewhere in the region of £46 million. Subsequent to all that

public money being spent, a partner in Deloitte was brought on to your review team. Surely that was a conflict of interest.

Mr Priestly:

Along with Lian, I advised the Minister about the composition of the independent review team. I will take you through our considerations. First, several of the big accountancy firms were caught up in the single-tender actions, so I could not look to them for an appointee. Secondly, the matter was urgent. Thirdly, Deloitte was not involved in the matter; therefore, we turned to it. I think that we got the right public sector appointment in the person from Deloitte; he is a person of great professionalism and integrity.

Mr Dallat:

Are you saying that there was no conflict of interests, even though £6 million was spent on the company from which you brought that person? Come on.

Ms Patterson:

A further reason was the limited list from which an appointee could be chosen. Ernst and Young were the internal auditors of the company, and KPMG were the external auditors. Therefore, those companies were excluded because of a conflict of interest. Several accountancy firms, including PricewaterhouseCoopers and Deloitte, were involved when the Go-co was set up. There is a limited family of large accountancy firms in Belfast. Of the four that we looked at, three were already contracted out.

Ms Purvis:

You quoted from e-mail correspondence between Mr MacKenzie and Peter Dixon. What was the date of that e-mail?

Mr Dallat:

It was dated 16 November 2009.

Ms Purvis:

On the back of that, Chairperson, I raised the point with the regulator last week that Peter Dixon was to head up the independent review team. What is the nature of Mr MacKenzie's relationship with Mr Dixon, given that they were exchanging e-mails and that Peter Dixon then appears on the independent review team?

Mr MacKenzie:

Peter Dixon and I were both chief executives of utilities. We have a relationship, we have common interests and we are regulated by the same regulator. He is a business acquaintance of mine; no more than that. I do not socialise with Peter Dixon. I think that I have met him for coffee three or four times since I took up the post, but I do not socialise with him or anything like that.

Ms Purvis:

Did the permanent secretary not see a conflict of interest in that?

Mr Priestly:

I did not consult Laurence or anyone else on the appointment of the independent review team. Lian and I did it, and we did it very quickly. Laurence informed me about these things on 18 January, and an independent review team was launched on 20 January. My desire was to get to the bottom of this as quickly as possible.

Ms Purvis:

Did you not see any conflict of interest in that?

Mr Priestly:

I know many people in the business community in Northern Ireland, and I have known Peter Dixon as a business contact for a couple of years. This is a very small place, so it is inevitable that people will know each other. The judgement to make is whether these people are professional and have high integrity and whether they undertook an evidence-based review. I think that the answer to the last question is yes — the review was evidence based. They reached their conclusions on the basis of evidence.

Ms Purvis:

That was not the question that I asked. I asked whether you thought that there was a conflict of interest.

Mr Priestly:

No, I do not believe that there was a conflict of interest.

Mr Dallat:

You were both chief executives. That is very formal. Another e-mail reads:

“Peter

How would you be fixed for a ‘catch up’ next week? Lots going on!...

Would work for me

I need help from friends at the minute.

Hope things are fine with you now.”

That is not a formal letter between two chief executives. I have several more e-mails here that clearly state that you and Peter Dixon are chums.

Mr MacKenzie:

He is a business acquaintance.

Mr Dallat:

It is all here.

Mr MacKenzie:

He is a good friend, in the sense that he is a business acquaintance.

Mr Dallat:

That is not what you told us a minute ago.

Mr MacKenzie:

Apart from the occasional meeting for coffee, he is not a person that I socialise with.

Mr Dallat:

Chairperson, I can tell you that the language in that e-mail is that of really good friends. Perhaps we will move on.

Mr Priestly, paragraph 4 of the independent review team's report states that, prior to the contracts approval review, each member of the executive team gave an assurance that, as far as they were aware, the rules were being followed. Did the executive team have no idea what was going on in the organisation, or was it being economical with the truth?

Mr Priestly:

I think that it was the latter. At several points in this hearing, we have alluded to a culture in the

organisation of people thinking that they were behaving commercially and that what they were doing was within the rules. It clearly was not. When Laurence arrived, he asked those executives for that assurance. I will hand over to him to say what he had in mind.

Mr MacKenzie:

At my first board meeting, which was on the day after I arrived, an issue arose about something that had come to the board that day that it had not previously seen. The board asked me to get an assurance from each of the executives to the effect that there was nothing that the board should be aware of that it was not aware of and that there was nothing that the Department should be aware of that it was not made aware of. I got signed returns from each of them stating that they were aware of nothing.

Mr Priestly:

I think that it is worth adding that those issues will have to be addressed in the ongoing disciplinary action.

Mr Dallat:

Mr Priestly, the purpose of establishing NI Water as a Go-co was to allow it to operate freely in a commercial and competitive environment. Given that, how do you explain the widespread use of the single-contract awards that prevented the proper competition that was referred to earlier?

Mr Priestly:

I will not try to defend the heavy use of single-tender actions. From the start of this hearing, I have said that I find that to be indefensible. It came as a shock to me when the extent of the issue and the financial sums that were involved were revealed.

Mr Dallat:

Four years ago, a convoy of Transit vans was moving up and down the motorways and everyone

was in employment. For the past year and a half, those vans have been sitting parked. Many belong to small-time contractors, who desperately needed the opportunity to tender for scarce work. It never even occurred to you to enquire whether there were opportunities in the former Water Service for them. Is that what you are telling me?

Mr Priestly:

That is not what I am telling you. I am telling you that the practices that were followed are unacceptable and shocking. I am also saying that we should not damn the whole of Northern Ireland Water for that one area of lack of compliance with policy and procedure on operational expenditure.

Mr Dallat:

Given that £28 million was involved, it is not only Northern Ireland Water that is damned; every Government Department is smeared by news like this. We have been in a new political arrangement here since 1998. People accepted that and believed that that was the end of anything that might have happened in the past, yet you are sitting here in 2010 with no explanation of why that was not discovered. That is what you are telling me.

Mr Priestly:

I am not saying that. You have a report by the independent review team, which gives you the explanation.

Mr Dallat:

Fairness and equality are the cornerstones of public sector ethics. However, in many cases, genuine suppliers had not been given the opportunity to bid. You seem to have no explanation for that, but we will move on. How independent is the independent review team? Is it signed up to the chief executive?

Mr Priestly:

Sorry, I do not follow the question. What do you mean by “is it signed up to the chief executive”?

Mr Dallat:

I did not intend to go into that, but I will now. One of the non-executive directors, Mr Donald Price, was retained, while the others were sacked and their names smeared all over the place. Why was that?

Mr Priestly:

In considering and advising the Minister on the action to be taken against the non-executive directors, we were required by law to treat each of them as individuals. I have to tell you that Don Price’s attitude and approach were different to those of the other non-executive directors. He recognised the seriousness of the situation, and he wanted to be part of addressing it. He is also recognised in the independent review team’s report as having done good work on the audit committee, where he flagged up such issues. He made it clear that he wanted to be part of putting the situation right, and the Minister judged that he should stay as a non-executive director.

Mr Dallat:

Therefore, is it true that he signed an undertaking to give unequivocal support to the chief executive officer (CEO) in implementing any outcomes that resulted from the independent review team’s report?

Mr Priestly:

The Minister asked Don Price to give him three assurances, one of which was that he would support the chief executive in implementing the independent review team’s recommendations.

Mr Dallat:

Did he sign that?

Mr Priestly:

He gave the assurance.

Mr Dallat:

Did he sign it?

Mr Priestly:

He wrote a letter to the Minister in which he said that he was happy to agree to those conditions.

Mr Dallat:

Did the other non-executive directors not do that?

Mr Priestly:

I am not following you.

Mr McGlone:

You will in a minute.

Mr Dallat:

You will in a minute, do not worry. It would be good for the Public Accounts Committee to see that letter, which was signed. In fact, it would be a good idea for us to see all the correspondence, so that we, as an independent body, could make an independent assessment of what is going on in

Northern Ireland Water. I have nothing more to add at the minute.

Mr McGlone:

I have a supplementary point on what has become a material issue. I have e-mail correspondence from Donald Price that is dated 21 February 2010. It refers to the fact that:

“-The issues reflect non-adherence to procedures rather than lack of a control/governance framework

-This non-adherence to procedures was not picked up by Internal Audit(despite 3 Audits on Procurement in 2009) nor were they picked up by Halcrow and at no time were they reflected in reports or assurance statements to the Board.

Despite this, the Panel from the outset has seemed determined to find Governance failures by the Board rather than working with the Board to ensure the necessary corrective actions.”

I presume that the reference to “the Panel” is the independent review team.

However, in the light of what you said, I am trying to figure out why Mr Price would apparently do a volte-face in such a short space of time. I am also wondering why he would sign a letter and retain his position on the board, given what he said in that e-mail. The Committee will come to the audit later, but I am anxious to hear your views on that. It is material to the Committee’s deliberations today and to the shenanigans that seemed to have been going on.

Mr Priestly:

I can answer only on the actions that the Department took and on the judgement and the advice that was given to the Minister. I have explained why the Minister decided that Don Price should be kept on the board of Northern Ireland Water.

Mr Dallat:

Are you saying that you still do not know what is going on in Northern Ireland Water?

Mr McGlone:

It is apparent that you do not.

Mr Priestly:

I think that that is unfair.

Mr McGlone:

Quite frankly, sir, you are sitting here today and we are asking you questions. While £28·4 million was being thrown out the door, you were sitting about the place for two years. Mr MacKenzie then came on the scene, and we are now trying to establish and get to the bottom of what happened. The Committee is here to represent the public interest.

Given the way that this is being played out today, you would think that the Department had absolutely no financial control over a Go-co into which it was pouring millions of pounds. No audits were carried out, and we will find out later on who was responsible for that. What was going on? Was this governance, or was someone just playing games?

Mr Dallat:

It seems as though it was Christmas every day.

Lord Browne:

I want to address my first question to the Treasury Officer of Accounts. The Committee has heard about NI Water's extensive use of single-tender awards. Indeed, 78 such contracts were awarded at a cost of some £28·4 million. It would be useful to know how that compares with the rest of the public sector. Are any central records kept of the type of contracts that are awarded?

Ms Fiona Hamill (Treasury Officer of Accounts):

No. I asked that question in advance of today's hearing, and we do not hold a central listing of Departments' single-tender action decisions. Departmental accounting officers are responsible for signing off on those decisions.

Lord Browne:

Would it be advisable to retain such records in the future?

Ms Hamill:

That is the sort of recommendation that the procurement board will look at.

Lord Browne:

I note that DFP issued detailed comprehensive guidance on the award of single-tender contracts for the first time this week. Why has it taken four years for that guidance to be issued?

Ms Hamill:

I think that that guidance was issued for the purposes of clarity. As a result of the Northern Ireland Water situation and some previous cases that the Committee has examined, it became clear that Departments and public bodies required further clarification. That guidance was prepared by Central Procurement Directorate and agreed by the procurement board.

Lord Browne:

Thank you, Fiona. Mr Priestly, it is clear from appendices 1 to 3 of the contracts approval report that many consultants were engaged in staff substitution. Everyone would agree that that represents very poor value for money. How did that come about, because it seems quite irregular?

Mr Priestly:

I do not want to keep falling back on the defence that Northern Ireland Water was operating at arm's-length. I was not responsible for its day-to-day management and operations; Ministers deliberately set it at arm's-length. I agree with you that the evidence points to an overdependence on management consultants and on using them for staff substitution. When I became permanent secretary, I worked with Northern Ireland Water to try to get it to drive down its use of consultants. We did that with some success; we at least began the process, and when Laurence MacKenzie came along, that accelerated.

Lord Browne:

Were the consultancy posts widely advertised?

Mr MacKenzie:

I think that a number of them were, because they were done on the basis of a single-tender action.

Lord Browne:

Were the appointments made on strict job criteria?

Mr MacKenzie:

I do not know, because I was not there. The people who were involved would have had the skills to do the job. However, it was probably costing far more to pay a consultant to perform the role of a normal member of staff than to employ a member of staff.

Lord Browne:

Therefore, the organisation employed a lot of consultants. Will you provide the Committee with a list of all staff substitutions by number, value, company, post held and the length of tenure from the date of the establishment of Northern Ireland Water in April 2007?

Mr MacKenzie:

Certainly.

Lord Browne:

How do you regard value for money? What was the additional cost of using contract staff in those posts instead of having full-time employees?

Mr MacKenzie:

We will give you as good an estimate of that as we can.

Lord Browne:

I will return to the award of single-tender contracts. Regardless of the individual facts, if it was discovered that board members constructed those contracts knowing that they would need to be extended and that the eventual costs of those contracts would be above the tendering threshold, would that, in your opinion, constitute fraud or corruption?

Mr MacKenzie:

The answer is no.

Mr McLaughlin:

In those circumstances, even if you were satisfied, would you think it prudent to refer it to the anti-fraud unit in the Department to protect the public money interest?

Mr MacKenzie:

If I thought that there were kickbacks or anything like that I certainly would, but no evidence of that was found.

Mr McLaughlin:

Fair enough. Mr Priestly, do you have the same view?

Mr Priestly:

My view is that that is evidence of lazy and bad practice. It is almost allowing a contractor to get into the lifeblood of the organisation. They are providing a service, which may be a very good service, but it is not proper public contracting. Our policy is that there should be competition.

Mr McLaughlin:

Should I take that as a no and that you would not think it necessary to refer it to the anti-fraud unit?

Mr Priestly:

There has to be at least prima facie evidence of a fraud before it should be referred.

Lord Browne:

I note from paragraph 4.1 of the Comptroller and Auditor General's memorandum that PricewaterhouseCoopers (PWC) conducted the independent review of centre of procurement excellence (CoPE) status. Was PWC the recipient of any single-tender award contract?

Mr Priestly:

PWC was the recipient of the single-tender award that has the highest value in this whole affair.

Lord Browne:

How much did it receive in total?

Ms Brennan:

There were actually three single-tender actions that we found to have been awarded to PWC, and they totalled £2.2 million.

Lord Browne:

According to page 27 of the deep-dive report into operating expenditure, PWC also carried out a strategic review of procurement in Northern Ireland Water. Is that included in that £2.2 million?

Ms Brennan:

That particular piece of work was awarded through due process. It was not a single-tender action.

Lord Browne:

It was not a single-tender award, but PWC received money for it.

Ms Brennan:

It did.

Lord Browne:

Following up on that, and this is another question for Fiona, how do you explain the appointment of PWC to conduct the accreditation of Northern Ireland Water as a CoPE in 2009, given that, as we have just heard, it benefitted significantly from what we now know to have been a flawed tendering regime? We have also heard that PWC conducted the strategic review.

Ms Hamill:

The appointment of PwCs to undertake the reassessment of CoPEs in 2009 would have been a separate procurement exercise carried out by the central procurement division; it would have had

no tie-in to any specific departmental organisation or body.

In that respect, all local consultancy firms would have expected to have been a supplier of services to just about every other government body. Therefore, it would not have been an issue, as the Central Procurement Directorate is part of DFP rather than DRD or Northern Ireland Water. Therefore it would not have been picked up.

Lord Browne:

Do you not agree that anyone concerned with ensuring that public money was spent wisely would be of the opinion that a review of how contracts were awarded could not be carried out by the very company that was awarded those contracts?

Ms Hamill:

A review of how contracts were awarded was the Northern Ireland Water deep review.

Lord Browne:

I am trying to comprehend how —

Ms Hamill:

That would not have been a basis of the decision. If CPD had been aware that there were issues and concerns about a supplier, those issues and concerns would have been taken into consideration appropriately within public procurement practices. I am not aware that CPD had any concerns at the time that it awarded the contract for the CoPE assessment exercise. I would need to let the other witnesses speak to the separate exercise of the review of Northern Ireland Water procurement.

Lord Browne:

I am just struggling to comprehend how anyone could be of the opinion that Northern Ireland Water should not have informed DFP that PricewaterhouseCoopers was in receipt of so many of the very contracts that it was asked to review and therefore give DFP the chance to appoint a more suitable company. I cannot understand the board's reason for not speaking up. Why did DRD, for example, as the sole shareholder, not force that issue?

Ms Hamill:

I understand your concern. It is worth noting that contracts at Northern Ireland Water as a Go-co held with a consultancy practice locally would not have been reported through the normal consultancy reporting cycle. PWCs is a core provider of generally very good services to public bodies; it would be expected to be seen as a supplier.

Lord Browne:

Do you agree that future reviews of the administration and activities of Northern Ireland Water should not be carried out by individuals or firms that have been awarded a contract by that very company? Would that not be better?

Ms Hamill:

I will take that concern back for Northern Ireland Water and for advice from the Central Procurement Directorate.

Mr Beggs:

In the deep-dive review of the operation expenditure there appears to be a serious problem with the accuracy and completeness of contract records. Given that some dates on the database were wrong, that one contract was not even on the database, and some expenditure was posted against wrong contractors, how were you ever going to get a good contract management system?. It was not an effective system.

Mr Priestly:

I do not understand that database. It is owned by Northern Ireland Water, so I will have to hand over to Ms Brennan.

Ms Brennan:

Northern Ireland Water was in the process of setting up a contracts database when we were looking at that area; that is why it was not complete and did not have all the contractor details on it. Indeed, one recommendation that we made was that the database become fully populated.

Mr Beggs:

Are you saying that you were operating with all those contracts and you did not have a central point until the deep-dive review?

Ms Brennan:

That was ongoing because it was a new process.

Mr Beggs:

It was obviously needed. Mr Priestly, I notice in the independent review team's report that Northern Ireland Water's senior personnel were trying to minimise the significance of the findings and rationalising events. I can interpret that in one of two ways: either NIW had no idea about public sector procurement policies or it was trying to minimise the failings that had occurred. What was your reading of what it was doing?

Mr Priestly:

My reading was the same as yours: NIW did not seem to recognise or acknowledge the seriousness of the failures. When I pointed out their seriousness, I got reactions such as: this is a company in transition and we are trying to operate commercially. I answered that this is public money that must be spent with regularity and propriety and we must be able to demonstrate value

for money. I sent a private e-mail to Chris Mellor, expressing the fear that he and his non-executive colleagues did not understand the seriousness of the matter. Several of them sent me quite threatening letters that looked as though they had been written by lawyers, asking whether I thought them unfit to be non-executive directors.

Mr Beggs:

Did those people receive training? They should have needed minimal training as they were appointed at board level. However, if they all came from outside the public sector and had no experience of public sector accountability issues, they should have received training. Were they aware that you expected them to be accountable for their actions in that way?

Mr Priestly:

Some were from the public sector; they had a great deal of experience and plenty of training.

Mr Beggs:

Mr MacKenzie said that the directors were unaware of the procurement policy that operated in the public sector. Equally, I would have thought that private sector procurement would want value for money, competitive tenders, and good value for shareholders. What was your sense of this? How strange was this to you?

Mr MacKenzie:

It was strange; it was not what I had been used to in my earlier career.

Mr Beggs:

That says a great deal about the limited experience of those people and how they were appointed; it strikes me that they did not have sufficient experience and that they did not adopt the training that they should have had.

Mr McGlone:

I want to make a point about what Roy has touched on. We are focusing on non-executive directors and issues of training. Hearing this would almost scare those of us who have served on boards. Having served on a board, I know that board members rely on the executive directors and the full-time paid officials of the company or the body that you serve on to provide you with detailed professional information. All a board member can do is base his judgement on what is presented to him.

Mr Beggs:

Neither does one rely on those who say “our experts said”. If you think that they are failing, it is up to you as a board member to step in. That is your responsibility.

Mr McGlone:

— there has been internal and external audit.

Mr Beggs:

No. A board member is appointed to be responsible; it is up to him to exercise that responsibility, irrespective of what officers working to him say or do; otherwise he need not be on the board. I have another question for Mr MacKenzie.

Mr McLaughlin:

I have another supplementary question, arising from Mr Beggs’s earlier question. Mr Priestly, you interpreted correspondence from board members as somewhat threatening. Did you respond to it?

Mr Priestly:

After taking legal advice.

Mr McLaughlin:

Can you share that correspondence with the Committee?

Mr Beggs:

I thank Mr MacKenzie for his integrity in bringing this issue forward so that it has reached the public domain; it could easily have been hidden away by new policies and buried in the past. I wish to thank you for exposing it and tendering your resignation to force the issue.

How will you address what seems to have been a deeply embedded culture of poor purchasing and bad practice in Northern Ireland Water so that we can have confidence in its future performance?

Mr MacKenzie:

We have taken several actions since those matters became apparent. We looked at the documentation to guide people along the right path, as it were, and refined it, revised it, put it into simple language and used flow charts, and so on, to point out decision points; we also ran seven training sessions, several of which I attended, for management to point out its responsibilities and how the process ought to work. We told people that if they were in any doubt about whether they were following the rules, they must stop and ask; they should not do something that could catch them out later.

The issue has been significant for the organisation, and people are responding to that. Every day, I see people ask what the correct procurement process is and ensuring that they follow it. It has been a big shock to the organisation.

Mr Beggs:

I take it that that was a practice used in the private sector, never mind the public sector. Is that correct?

Mr MacKenzie:

Yes. In my previous job we had definite financial delegations; people knew what they were allowed to spend and what they were allowed to authorise; they knew the process. It is a matter of putting that robust process in place in NIW.

Mr Beggs:

Page 22 of the review team's report indicates that the full complement of non-executive directors was not in place between July 2007 and July 2008. Did that place additional pressure on board members? Why was the board allowed to be without a full complement for a year?

Mr Priestly:

I accept that not having a full complement of non-executive directors did impose additional pressure. When I became permanent secretary in December, I asked why we were not at full complement. I was told that the Minister had taken the decision that while the Assembly and Executive were considering the independent water review panel's report, he did not want us to appoint additional non-executive directors because he thought that that would give the impression of pre-empting the Assembly and Executive's decisions on the report. As soon as those decisions were taken, which, I believe, was in January, I sought the Minister's agreement to appoint additional non-executives. We went through the public-appointments process, and it took until July 2008 to appoint additional non-executive members.

Mr Beggs:

Was no consideration given to appointing interim board members to fill those places?

Mr Priestly:

We had discussions with the Minister at which options were discussed, although I cannot remember everything that was discussed at the time. However, I remember asking whether we had sufficient non-executive capacity on the board.

Mr Beggs:

Page 17 of the report states that the chairperson of the audit committee resigned in July 2007 and was not replaced; that occurred while Northern Ireland Water was waiting for the outcome of the independent review. A new audit committee chairperson was not appointed until November 2008, which meant that the committee was without a chairperson for almost 17 months. What happened to the audit committee during that period?

Ms Brennan:

There actually was a chairperson. When Rose Hynes resigned, John Ballard, who was another non-executive director at the time, took over the chairmanship of the audit committee.

Mr Beggs:

Did it continue to meet as regularly as it had done previously?

Ms Brennan:

Yes.

Mr Beggs:

Was it not inappropriate for the chief executive to be on the audit committee so that it would have a quorum? The audit committee scrutinised the chairman and chief executive while he sat on the committee. Was that issue not raised?

Mr Priestly:

My understanding was that while he was acting chief executive, the chairman was not a member of the audit committee; he was an attendee at audit committee meetings.

Mr Beggs:

If he was an attendee, he would not be counted in the quorum. Is that not correct?

Ms Brennan:

Presumably he was counted as a part of the quorum. I am not sure about that, but the committee was operating.

Mr Beggs:

He was either part of the quorum or he was not. That is another aspect of governance that needs to be clarified, not only for this case but for other situations.

Mr Shannon:

If this were a boxing tournament, Paul, you would have been knocked out in the first round. There are many issues for which you must answer.

In the report, Northern Ireland Water is an accredited CoPE, yet the independent review team says that Northern Ireland Water failed to follow its own procedures for authorising single-tender action contracts, and it failed to observe EU regulations for advertising contracts and extending contracts. This is the second time that this Committee has observed significant procurement failures — last time was with an education board. What confidence can the Committee, and the tax payers of Northern Ireland, have in a CoPE accreditation process that could not at any stage identify Northern Ireland Water's failure to follow elementary good practice?

Mr Priestly:

I cannot take issue with that: it calls into question the credibility of the process for accrediting CoPEs. For that reason, the procurement board has agreed with the Department that a review will take place of Northern Ireland Water's CoPE status. We will conduct a gateway-type review to

look into the issue and determine whether it should retain its CoPE status or whether it needs to improve — and what exactly needs to improve — in order to retain CoPE status.

Ms Hamill:

I can add to that answer. On the wider NICS spectrum, rather than just focusing on Northern Ireland Water, the procurement board is responding to concerns about this and other cases. It has asked Central Procurement Directorate to review the CoPE assessment methodology and to report to the procurement board this November with a recommendation on how the assessment process for CoPEs can be strengthened and to look at how we can build assurance — and, in particular, audit assurance — into that process to ensure that not only has the CoPE processes but that the organisation is compliant with them. The methodology will be revised and reported on in November.

Mr McLaughlin:

I am please to hear that; it was reported to the Finance Committee yesterday. When was that decided? I have a suspicion that it may have something to do with today's business.

Ms Hamill:

Recommendations for an NICS-wide review went before the procurement board's meeting on 17 June. The procurement board does not meet frequently as it is chaired by the Minister, but it was at that meeting that the decision was taken.

Mr Priestly:

Was the review of Northern Ireland Water referred to?

Mr McLaughlin:

The review is to apply across the board.

Ms Hamill:

The approach to the review of Northern Ireland CoPE status was agreed at that meeting.

Mr Shannon:

I thank Fiona for that information.

The Finance and Personnel Department has looked into this as well and has referred to public procurement practice generally in the Northern Ireland public sector. It also commented that it was inappropriate to consider the remarks of the detailed assessment of any of the CoPEs. What we are saying is that there will have to be changes.

The report also gave the impression that an in-depth review had been carried out. I cite two passages from the CoPE review of September 2009 to which Paul or his team can respond. Paragraph 2.34 states —

“In assessing the level of accountability in public procurement within the CoPE organisations, an assessment of the existence of approval hierarchies to manage financial risk, payment of orders, payment authorisation was scrutinised. In addition, evidence of proper working procedures was examined, especially with regard to how a preferred/suitable method of procurement was decided, as well as supplier and product selection including subsequent engagement and payment.”

There is an impression that an in-depth review was carried out. I quote also 2.54 that:

“The extent to which CoPEs meet the EU Directives and UK regulations and how they document decisions for selecting restricted and negotiated contracts was reviewed. NAO audit reports, CoPE procurement procedures and evidence of contracts awarded were reviewed. This was an area where all the CoPEs performed well.”

I am glad that there will be a review. I ask this question of Lian and PricewaterhouseCoopers: were you caught out in that process, and were you, perhaps, holding things back? I have written here: “half-hearted attempt to review”.

Mr Priestly:

A half-hearted attempt to review?

Mr Shannon:

I am not happy, and I do not think that the Committee is happy, that the report gives the impression that an in-depth review was carried out when it was not.

Mr Priestly:

I cannot answer for the CoPE review that took place at Northern Ireland Water. What I can say is that Laurence and the Department are working hand in hand to improve arrangements, and we will ensure that the review of Northern Ireland Water's CoPE status is just that: does it have the skills, training, procedures and practices to conduct proper procurement. Otherwise, it casts doubt on the credibility of the CoPE arrangement.

Mr Shannon:

I think so, too, and we need that assurance for our own confidence in the process. Time will tell whether that delivers, although I hope that it will.

Your report refers to a training programme for all managers and staff in important issues such as the creation of business cases, tendering processes, financial delegations, payments and the collation of management information. Training in all those areas is very important. The report also states that Northern Ireland Water scored 87 out of 100 in the "people procurement expertise and people procurement competency". The company was given exemplar status.

Sometimes, as an elected representative, you take a wee snippet of a word. I have an English dictionary in my desk, and I looked up "exemplar". The definition, and this is an interesting one, is a group of superheroes from Marvel Comics, or, referring to the Latin, a model or a book to copy. What were they: superheroes from the Marvel Comics or Latin students in white gowns?

Perhaps you can tell us what exemplar status means.

The independent review team found problems with purchasing and has since introduced a programme to address that, namely the system that led to exemplar status. How can that be applied when CoPE scored so highly?

Mr MacKenzie:

There were failings; not everyone followed the right process.

Mr Priestly:

We are talking about a proportion of procurement on operational expenditure that was irregular; let us be in no doubt about that. However, I am reluctant to damn the whole organisation. Northern Ireland Water has a huge capital programme; it does a great deal of capital procurement, and none of the work that Laurence and Nicola did showed any problems with that. Indeed, there is a good deal of other operational expenditure procurement that has been fine. We should not damn the whole organisation because of that one block of failures, regrettable and reprehensible though they were.

Mr Shannon:

We are not damning the whole organisation; we are pointing out the parts of it that failed. Failures of such magnitude raise concern. When I think of the term “deep dive”, I think of an intense audit report that goes into almost forensic detail.

In 1999, a three-year contract was awarded to a consultant called Atkins, and it was extended on numerous occasions without any further competition. Perhaps you could tell us how that could happen and why there was never, at any stage, any competition in relation to that procurement.

Mr Priestly:

It happens because of lazy and improper practice and because a contractor gets into the lifeblood of the organisation and makes themselves indispensable; it is not defensible and it should not happen. Contracts should not be extended beyond their natural life unless there is a clause in the contract to enable that to happen; even then, it should be exceptional. Our policy is that competitive tendering is the way to drive value for money. I will not try to defend those practices.

Mr Shannon:

How much in total was paid to Atkins under that contract from March 2002 when the original contract expired? It would be good to have those figures on record.

Mr MacKenzie:

Four point four million pounds.

Mr Shannon:

How much was paid after 2007?

Ms Brennan:

After 2007, the Atkins contract was split into two separate pieces of work. Another area of the company took over one piece, and the total value that has been incurred since April 2007 with Atkins is £6.6 million over those two pieces, which were extended beyond the permitted contract period.

Mr Shannon:

On the Atkins contract, then, if I have got the figures right, we are talking about £11 million. Is that correct?

Ms Brennan:

We would have to come back and confirm the pre-2007 figure because we do not have it to hand.

Mr Shannon:

If you can come back to the Committee, we will put those figures on record.

Mr McLaughlin:

Why was the contract split?

Ms Brennan:

You might have noticed in the report that there was an issue where there was a scope change to the contract in 2003. The contract was originally for what are known as water zonal studies, and in 2003 there was an addition to the contract to provide construction project management services. In 2007, asset management took over the water zonal studies, which originally happened in the engineering and procurement directorate; therefore the expenditure was split between one area of the business and another post-2007.

Mr McLaughlin:

I may have asked the wrong question; I am sure that we can come up with an explanation. Why was it, with hindsight, a good decision? Did it circumvent, say, the procurement and competition guidelines? Should that decision have been taken? Could it have been done in a more appropriate fashion?

Ms Brennan:

It should have been re-tendered once the contract expired in March 2002.

Mr Shannon:

My last question relates to the archived contracts. Every one of the 46 contracts had been extended beyond the permitted period, and other serious breaches were identified. Will you do any work on this on the basis of the information that you have received? Will further work be done to identify all breaches in the archived contracts and, indeed, any of the live contracts still to be examined?

Ms Brennan:

What you refer to is contract extensions. Although “archived” means that those contracts are no longer in use, when we carried out the audit work we examined them because they were in existence during the Go-co period and had stopped at some point in the past three years.

Therefore, none of the 46 contracts that you mentioned is still in use.

We have identified that a small number of other contracts from the live contracts database are still running on contract extensions outside the permitted term, and, following our audit report, the procurement department took steps to put re-tenders out to market. Of the six live contracts, five are already under way and are due to be awarded by November 2010 at the latest, because the Official Journal of the European Union (OJEU) process means that it takes four to five months to award a contract. Therefore, corrective actions are under way.

Mr Shannon:

Do you have a definitive figure for the total amount of unapproved or improper expenditure for the archived contracts? You must have some idea.

Mr Priestly:

The total figure that I gave at the outset was that there were 73 contracts, with £28.4 million having been spent.

Mr MacKenzie:

Yes, that is the total quantum of everything.

Mr Shannon:

Should those contracts have been published in the European journal?

Mr Priestly:

A number of contracts should have been advertised on a Europe-wide basis.

Mr MacKenzie:

There is a threshold, which is roughly £300,000. The figure must be converted from euro to sterling, but, roughly, all utility contracts with a value of over £300,000 must be advertised in the European journal and be open to competition.

Mr Shannon:

Did we lose out on potential savings because the contracts were not published in the European journal?

Mr MacKenzie:

Those contracts did not go to tender; therefore, it is impossible to demonstrate whether the best value for money was achieved.

Mr McLaughlin:

The Commissioner for Public Appointments produced two audit reports on your Department's public appointments process. The first, which was in 2006-07, considered the appointment of the chairperson of the Harbour Commissioners, and the second, which was in 2007-08, examined the

appointment of two NIW non-executive directors. Both audits raised concerns about the way that DRD handled probity and conflict of interest. The commissioner's report on NI Water stated that:

"A probity issue arose at interview in relation to one candidate. There is *no clear evidence or record* that this issue was fully explored to identify whether the candidate met the standards required".

The report continued:

"The Minister was not subsequently advised of the probity issue in the submission and this left him fully exposed to embarrassment had he exercised his right to appoint this particular candidate."

As the accounting officer, can you tell us whether you consider that the defective appointment procedures that your Department operated go some way towards explaining the subsequent need to dismiss four board members?

Mr Priestly:

I will resist the temptation to return to the issue of probity. However, probity issues were fully considered and raised with the Minister, and the person concerned was not appointed, because probity ruled him out. If you look carefully at the commissioner's report, you will see that she said that those matters were presented to the Minister orally, rather than being documented and given to him on paper. However, probity was considered and taken into account during the decision-making process.

Mr McLaughlin:

Is that an appropriate way for that to be managed? Would it not have been helpful to have some form of record, if, for example, the candidate felt discriminated against?

Mr Priestly:

The commissioner certainly took that view and said in her report that such matters should be documented in future.

Mr McLaughlin:

Do you accept that they should be documented?

Mr Priestly:

I am simply taking issue with the perception in her comments that probity was not considered or raised with the Minister.

Mr McLaughlin:

We have established that good practice is that such matters should be documented. Could you answer my initial question?

Mr Priestly:

In the appointments to which you are referring, we have learned the lessons. Probity issues were discussed and documented.

Mr McLaughlin:

Does that mean that you do not accept that the appointments process was defective?

Mr Priestly:

No, because there were no probity issues with the non-executive directors whom we appointed at the time.

Mr McLaughlin:

Do you think that the process stands up to examination, is defensible and should continue?

Mr Priestly:

I thought that the process that we used at that time to appoint those two non-executive directors was good. The reflection that I would make and the lessons that we have learned are that we made too much of a fuss about the candidates' having to meet all the criteria. In fact, it was too complicated; they were made to fill in forms that, I think, the commissioner concluded were excessive.

Mr McLaughlin:

It could be my fault, but I am having difficulty understanding this. If the interview and appointment process has been amended, in what way was it amended and what was the rationale for making those amendments?

Mr Priestly:

We learned the lesson from the first appointments process, after we were criticised for not documenting on record that issues to do with probity and conflict of interest were raised with every candidate. We offered the Minister written advice, which was supplemented by my telling him that there was a conflict of interest and a probity issue that I thought rendered the candidate unappointable. In a subsequent competition, I asked the commissioner's appointee to the panel to pursue conflict-of-interest and probity issues. Those were documented and reported where relevant. In the advice that was given to the Minister and of the successful candidates, I do not believe that any of them had conflict or probity issues that would have rendered them unappointable.

Mr McLaughlin:

Are such issues explored at interview stage?

Mr Priestly:

Absolutely.

Mr McLaughlin:

What was over-complicated? That is what confused me. What do you not do now that you did then?

Mr Priestly:

The specification for all the criteria that candidates had to meet was far too complex. When criteria are specified, people are required to demonstrate that they meet each of them. They were being faced with an application form that was overwhelming, and the commissioner's view was that that was, first, unnecessary and, secondly, overwhelming for people and would put them off applying. That is the lesson that we have tried to learn.

Mr McLaughlin:

I am sorry for being so obtuse. You and the commissioner have now closed any initial gap and addressed those reservations. In the appointments process for the remaining non-executives and the chair, are the issues dealt with by the new and amended process that you and the commissioner have signed off on?

Mr Priestly:

I am not clear who you mean by the "remaining non-executives and the chair".

Mr McLaughlin:

In the continuing process going forward, are there a set of protocols or guidelines that are robust and have been signed off by the commissioner in particular?

Mr Priestly:

I do not think that they have been formally signed off, but we have taken the report that she gave us and implemented the points that she made. I am reasonably assured that we will comply with what she has said we must do.

Mr McLaughlin:

Mr Chris Mellor was the former chairperson and interim CEO. The Minister dismissed him and other board members from their positions, who, I am sure, would describe that as fairly robust action. We have heard some of the detail on what started that chain of events. Do you feel that, in your position as accounting officer, you adequately advised the Minister when recommending those individuals in the first instance?

Mr Priestly:

In fact, I was not the permanent secretary at the time that those recommendations were made. To answer on behalf of the Department, I looked at the advice that was put forward at the time, and I felt that it was adequate.

Mr McLaughlin:

What was the gap between their appointment and your coming into office? I may have got confused; was it a couple of months?

Mr Priestly:

I am sorry, I do not know when Chris Mellor was appointed.

Ms Patterson:

February 2006.

Mr Priestly:

I am told that he was appointed in February 2006, and I arrived in the Department in December 2007. I was there for the appointment of two non-executive directors following earlier discussion about the need to increase non-executive capacity. That was when Declan Gormley and Don Price were appointed to the board.

Mr McLaughlin:

Mr Mellor had previously worked as the chief executive of Anglian Water Group (AWG), which is the owner of Anglian Water. When interviewing Mr Mellor, was the Department aware of media reports that he had been dismissed from that position?

Mr Priestly:

The Department was aware.

Mr McLaughlin:

Was it aware at the time?

Mr Priestly:

Yes.

Mr McLaughlin:

What reference checks did the Department carry out for that appointment? Is that a matter of record?

Mr Priestly:

I cannot say, but we can check and let you know.

Mr McLaughlin:

Will you, please? Did the Department address past performance at the interview stage?

Mr Priestly:

Again, we will have to check.

Mr McLaughlin:

You would expect that it would have, especially if you are telling us that it was aware that he had been dismissed from his previous post.

Mr Priestly:

I cannot say, and I would prefer to give you a factual reply.

Mr McLaughlin:

That is OK; I would prefer that too. Will you send us that information? Given the catalogue of issues that is detailed in the report and as the departmental accounting officer with ultimate responsibility for the public finances that are under your ambit, would you say that you now have a robust and sufficient insight into the governance, accounting and performance of NIW?

Mr Priestly:

I feel that I am in a stronger position now than I was when I took up my post, but never say never. Touch wood that we do not get into that situation again. I feel that we are in a stronger position with the chief executive that we now have. However, as I said, I have found the revelations that have come out since last autumn to be shocking. You work with people believing that they are being professional and have high integrity, but I have to tell the Committee that, at various points during this affair, we four witnesses have felt exposed and vulnerable. I have found myself having to give support to Laurence, Lian and Nicola. I have found myself going to the Comptroller and Auditor General for support and asking whether I am doing the right thing, and,

thankfully, I am being encouraged that I am doing the right thing.

It has been difficult for the people who thought that they were doing the right thing to feel that we are not and that we are almost victimised. I am not looking for your sympathy, but it has been tough.

Mr McLaughlin:

I intended to ask you a question that was derailed somewhat by some earlier discussions, so I will not revisit it, but one issue came from that. Do you know whether Mr Mellor holds any other public appointments?

Mr Priestly:

He does, yes.

Mr McLaughlin:

Here?

Mr Priestly:

Not in Northern Ireland.

Mr McLaughlin:

Can we have some detail on that for our report?

Ms Purvis:

After Northern Ireland Water was reclassified as an NDPB, what changes were made to your

control over the company?

Ms Patterson:

I will track back to the history of the classification, because it is important. When the Office for National Statistics (ONS) first reclassified Northern Ireland Water in October 2008, the Department was told that the company was being reclassified for public expenditure purposes only and that, for all other areas, NIW would remain as a Go-co and the governance arrangements would not be changed. However, a few months after that, in January 2009, when we came to finalise the year accounts for 2008-09, it became clear that the reclassification meant that there would be a budgetary pressure, which was £38 million in that year. At that stage, the Department realised that, even though the advice was that the reclassification was for PE purposes and not for governance, that could not have been the case. That was because if the reclassification were to bring budgetary pressures and would mean that we would need to make bids in monitoring rounds, we felt that it went further than being for PE purposes.

Once that became more apparent, we started to work through how it would play out. There are a lot of difficulties with managing the hybrid, as we call it, which means that the company is a Go-co under company law but an NDPB for public expenditure purposes. For example, a Go-co that operates in the way intended will not be affected by, for example, cuts to public expenditure, because its budget will be protected for three years through the price control process that the regulator sets. That is an example of the type of issue that arises when one body has two different statuses or is two animals. There are an awful lot of complexities in trying to manage through that process.

At that stage, in June 2009, it struck us that we needed to harness NIW's public sector spending much more because of the need to monitor its budget much more closely. Previously, the Department did not need to keep such a tight rein on the company's budget. Under previous Go-co rules, NIW could have teamed and laden and brought money from one year to another. Now that it is part of the PE system, it is subject to the same rules as every Government Department. It receives a budget each year, and, if it spends more than that, that is considered an

overspend. For those reasons, we took the decision to appoint a sub-accounting officer, and we tried to manage that much more closely when Laurence MacKenzie came in as chief executive.

Ms Purvis:

Given that it took nine months to appoint a sub-accounting officer, was there a lot of uncertainty about the NDPB status?

Ms Patterson:

Yes, there was. As I said, the initial indication was that the reclassification was for PE purposes, which effectively would have meant that it was entered differently on the Treasury database. However, reclassification should not have affected the company's governance structures, because NIW's board is a board under company law, and the PE aspect takes it to a different place in how it spends its money. To answer the question directly, there were an awful lot of complex issues. I accept that that appointment appeared to take a long time, but we got a clear idea of what was involved only as we went through each stage.

Ms Purvis:

Why was the chief executive not appointed as a sub-accounting officer anyway, given that, prior to reclassification, Northern Ireland Water received significant amounts of public funds from the outset?

Ms Patterson:

When NIW was established as a Go-co, the governance letter was set up in agreement with the Treasury, DFP, the Strategic Investment Board, the Department and NIW as a Go-co. That governance letter outlined, effectively, the rules by which the Go-co and the Department would operate its controls over spend. I do not want the Committee to think that, because there was no accounting officer status, nothing was in place. The governance letter clearly set out the roles and responsibilities of each side. When it became more apparent that NIW no longer had the flexibilities that it used to have to manage its budget, it became necessary to appoint a sub-

accounting officer. However, it was always required to follow the appropriate rules on regularity and propriety that all bodies that spend public money have to. That happened from the outset.

Mr Priestly:

When Lian and I came to the conclusion that it was sensible to designate the chief executive as a sub-accounting officer, we still had to argue that through, even in the Department, to see how it fitted against the governance letter. We continued to argue that it did not make sense and that, if the body is termed an NDPB and treated like an NDPB, it is essential that the chief executive is appointed as a sub-accounting officer. That took a bit of time.

Ms Purvis:

Page 13 of the IRT report says that many of the failures to follow procurement procedures pre-date the Go-co status, when the former Water Service was an executive agency in the Department. Why did your Department not identify those fundamental failures in procurement prior to the production of the contracts approval internal audit report?

Mr Priestly:

I am sorry; I simply cannot answer that. I do not know why they had not been approved.

Ms Purvis:

Are you going to investigate why they have not been found?

Ms Patterson:

The scope of the review was to go back to the start of April 2007. We looked at the internal audit work that was done in the former Water Service before vesting, and we looked retrospectively at the coverage that was given to areas such as procurement. My analysis is that there seemed to be adequate internal audit, but I am afraid that I cannot give a further or firmer answer as to why that was the case.

Ms Purvis:

You obviously looked at DRD internal audit reports at the time. Are you planning a more forensic internal audit of the procurement procedures that were in place prior to 2007?

Ms Patterson:

We do not intend to do that at this stage, because things continue to evolve in approaches to auditing. Our focus would be on ensuring that our current auditing covers what is currently happening.

Ms Purvis:

I have a number of other issues on governance and internal audit that I would like to clarify, just so that I can have the process clear in my mind. One of the issues that I looked at in the report was the number of meetings between DRD officials and those from Northern Ireland Water. Mr MacKenzie, how often did the full board of Northern Ireland Water meet in a year?

Mr MacKenzie:

It met on 10 occasions. There were supplementary meetings —

Ms Purvis:

The full board met on 10 occasions. Mr Priestly said at the start of the meeting that DRD was not involved in the day-to-day running of the company and non-executive directors were not involved in that either. However, on reading the independent review team's report, I find it striking that departmental officials had 80 meetings a year with Northern Ireland Water, yet the full board had 10 meetings a year.

The outcome was that four board members were sacked. It seems to me that there is an imbalance in there somewhere, in that in its oversight role, the Department for Regional Development had 80 meetings a year, yet in its oversight role, the full board had 10 meetings a

year. There is something wrong in that. I just want to explore that a bit further, Mr MacKenzie. Who was responsible for the extension of contract A? Who sent you the e-mail?

Mr MacKenzie:

The person concerned was the then commercial director of the organisation.

Ms Purvis:

Can you name him?

Mr MacKenzie:

His name is David Gilmour.

Ms Purvis:

What happened to that individual?

Mr MacKenzie:

That individual is no longer in the organisation.

Ms Purvis:

Was he sacked or did he resign?

Mr MacKenzie:

We went through a restructuring exercise, and his post was made redundant.

Ms Purvis:

Can you explain the governance mechanisms that are in place for the board and procurement processes and procedures?

Mr MacKenzie:

It was not a standing item on the board agenda. The board would have been aware of, and had a role in, approving any single-tender action worth over £250,000. It would have had a role in approving contracts with a value of over £10 million.

Ms Purvis:

What mechanism was in place to ensure that the board had a clear picture of procurement administration?

Mr MacKenzie:

The board would have been made aware of exceptions as they arose, but, in my time there, it had not asked for any particular information on procurement.

Ms Purvis:

Does that mean that the board would have expected that people would have come to it with particular contracts, sign-offs or approvals?

Mr MacKenzie:

Yes.

Mr Priestly:

Further to that, it is the board's responsibility to put in place the control framework and to

monitor it.

Ms Purvis:

I know that; I just want to explore something else. If there had been breaches in procurement administration, how would the board have known about them?

Mr MacKenzie:

It would know by their being pointed out by an internal audit or, in the case that we are looking at, through my advising it.

Ms Purvis:

Does that mean that, up to that point, the internal audits had not brought any administrative breaches to the board's attention?

Mr MacKenzie:

There was an internal audit of procurement in the summer of 2009, and that recommended some improvements.

Ms Purvis:

How did the board react to that?

Me MacKenzie:

The report would have gone to the audit committee.

Ms Brennan:

It did go to the audit committee.

Ms Purvis:

How did the board react to that?

Mr MacKenzie:

The board's audit committee saw the report. The route is that the audit reports go to the audit committee and the chairman of the audit committee updates the board on what happened in the committee.

Ms Purvis:

Does that mean that the board would not have had full sight of the audit report and would have depended on an update from the chairman of the audit committee?

Mr MacKenzie:

Yes.

Ms Purvis:

Did the board decide on a plan of action, or did the chairman of the audit committee ask the board to recommend one?

Mr MacKenzie:

The audit report contains recommendations for improvement, and management responds to those recommendations and agrees to make them within a specified time.

Ms Purvis:

When you received the e-mail on 10 August, you initiated a review of the contract. Is that right?

Mr MacKenzie:

Yes. That is right.

Ms Purvis:

When you discovered irregularities in the contract, did you report that to the full board?

Mr MacKenzie:

I reported it to the chairman, who wrote a note to the full board. When I became aware of the issues, which was when I got the report in October, I sent a summary of them to the chairman and said that I had found those issues. He advised the non-executive directors about the issue.

Ms Purvis:

What did the board do?

Mr MacKenzie:

That was in mid-October. There was a board meeting at the end of October at which the matter was considered. I think that the senior independent non-executive director read the report prior to the meeting. I was not party to it, but I understand that he and the chairman had a discussion. The board discussed the matter at the end of October, and I said that the action that I was taking forward was very clear, which was to continue with the contracts approval review. That was around 28 October.

Ms Purvis:

What did the board do? Did it support you in taking that action?

Mr MacKenzie:

The board was supportive of me taking that action forward, and I said that I would report back to

it in due course.

Ms Purvis:

Therefore, did the board support the internal audit review of contracts approval?

Mr MacKenzie:

Yes.

Ms Purvis:

When you became aware of the findings of the draft contracts approval, to whom did you report?

Mr MacKenzie:

I sent a note to the chairman, and, on the same day, I advised the permanent secretary.

Ms Purvis:

Did you advise the full board or any of the rest of the board, or was it just the chairman?

Mr MacKenzie:

I think that I circulated a note to the full board.

Ms Purvis:

Therefore, you did circulate a note to the full board that day. Was the full board was aware of the draft findings?

Mr MacKenzie:

Yes.

Ms Purvis:

When did it get sight of the full report?

Mr MacKenzie:

I gave the full report to the chairman that day.

Ms Purvis:

When did the full board have sight of the full report?

Mr MacKenzie:

I assume, although I cannot be sure, that the chairman circulated it to the board that week.

Ms Purvis:

I am trying to find out how the board failed to act in all this.

Mr MacKenzie:

I am not saying that the board failed to act. That is not a judgement that I made. I am saying that when the board became aware that I had made the permanent secretary aware of the findings, the chairman expressed to me that the board was very dissatisfied.

Ms Purvis:

These are issues with potential conflict.

Ms Purvis:

The board had written to DRD about a potential conflict between the chief executive's accounting officer role and his role as a director of the company. In the board's opinion, the way that you were acting around that meant that your accounting officer role took precedence over your role as director of the company.

Mr MacKenzie:

I felt that, as an accounting officer, I had to be completely transparent with the departmental accounting officer about the issues that were emerging.

Ms Purvis:

To whom did you tender your resignation?

Mr MacKenzie:

To the chairman.

Ms Purvis:

What did the chairman say?

Mr MacKenzie:

He said that he was bitterly disappointed that I was resigning; he thought that I had made a positive start in the job.

Ms Purvis:

Did he ask you to reconsider your resignation?

Mr MacKenzie:

He said that he would not share the fact that I had resigned with other board members and that he would come to Northern Ireland on the Wednesday to discuss the matter with me.

Ms Purvis:

Therefore he had not accepted your resignation.

Mr MacKenzie:

He had not.

Ms Purvis:

Did he explain to you that he believed that you had acted inappropriately in not first informing the board of your findings?

Mr MacKenzie:

He said that he thought that I should have told the board and let it deal with the matter and, in due course, let the Department know about the issue.

Ms Purvis:

Were there any procurement failures when you were the head of Northern Ireland Electricity?

Mr MacKenzie:

Not that I recall.

Ms Purvis:

When did you withdraw your resignation?

Mr MacKenzie:

As I recall, I resigned on the Monday, and I withdrew my resignation on the Wednesday evening.

Ms Purvis:

Why did you do that?

Mr MacKenzie:

I withdrew my resignation because I was buoyed up by the support from the Department.

Ms Purvis:

Did the Department offer to sack a number of non-executive directors to your satisfaction?

Mr MacKenzie:

It did not.

Ms Purvis:

What assurances did the Department give you for you to remain in post?

Mr MacKenzie:

It said that it felt that I was the person who was bringing those matters to the surface and that it would support me in continuing to do that.

Ms Purvis:

Did that include a report headed by your friend Peter Dixon?

Mr MacKenzie:

The permanent secretary suggested Peter Dixon. I use the term “friend” loosely; as I said, he is a business acquaintance. During the independent review, my relationship or otherwise with Peter Dixon was raised. The permanent secretary asked me about the matter, and I put on record the details of that relationship. I am sure that that is available for the Committee.

Ms Purvis:

Mr Priestly, how did you distinguish between the five non-executive directors when you made a recommendation to the Minister to sack four of them?

Mr Priestly:

That recommendation was based on what was said in the independent review team’s report about the good work that Don Price had done as chairperson of the audit committee. It was based on how Don Price had reacted to the independent review team’s creation, on how seriously he took the failings, and on his wish to be part of addressing those failings.

Ms Purvis:

Do you not think that the other non-executive directors had taken the issues seriously, given that the whole board supported Mr MacKenzie in his actions and in taking the issue forward?

Mr Priestly:

I can only repeat what I said to the Committee earlier in this hearing: the chairman of Northern Ireland Water was telling me that I was over-reacting, that the problem was not serious and that there were explanations for all the failures; he did not believe that the internal audit report was as serious as had been made out. As I said, I am happy to provide the Committee with an exchange of e-mails in which I told Chris Mellor that I feared that he and his non-executive colleagues did not understand the seriousness of the matter.

Ms Purvis:

How did you select the panel for the independent review?

Mr Priestly:

First, I was after people with the right skills, professionalism and integrity. I also wanted someone who had accountancy skills. We have been through how the choice was limited with regard to the accountancy firms that were involved in auditing Northern Ireland Water or which were involved in the single-tender actions. Therefore, I resolved that we should go for the public sector partner of Deloitte.

Secondly, I was after someone who had been a public sector accounting officer who would therefore understand that role and who would understand regularity, propriety and value for money. I went through various candidates until I found one who was prepared to take the job. Some of them were, shall we say, reluctant to get involved.

Finally, part of what was coming back to me was the fact that, “we were operating commercially”. I was keen to have someone from a private sector utility who could address that issue.

Ms Purvis:

You are operating commercially and being audited publicly? You just said, “we were operating commercially”.

Mr Priestly:

No.

Ms Purvis:

You did.

Mr Priestly:

With respect, perhaps I garbled my words, but what was being said to me by the non-executive directors and others was, “we were operating commercially”. That caused me concern, because they are dealing with hundreds of millions of pounds of public money.

Ms Purvis:

How much was the panel paid for the report?

Mr Priestly:

Forty-two thousand pounds.

Ms Purvis:

For how many days’ work?

Ms Patterson:

Twenty days in one case, 22 days in another case, and the third person did not receive payment; therefore I do not have the details of the days involved.

Ms Purvis:

Therefore it was about 22 days’ work in total.

Ms Patterson:

Yes.

Ms Purvis:

Does that include expenses and secretarial expenses?

Ms Patterson:

It includes expenses for those individuals. There was another, much lower, cost for secretarial expenses, which I can provide to the Committee.

Ms Purvis:

I would like to see that.

I am concerned about the e-mail that Patsy McGlone read out earlier from Don Price stating:

“the Panel from the outset has seemed determined to find Governance failures by the Board”.

That calls into question the whole report. What changes did you seek to the draft report, Mr Priestly?

Mr Priestly:

As part of the process of consulting, the Department, Northern Ireland Water and its chief executive circulated a first-draft report, and I responded on behalf of the Department raising some concerns.

Ms Purvis:

What changes did you seek to the report?

Mr Priestly:

I thought that I had that information with me. However, I wrote to the panel saying that I thought that the report was not clear enough in identifying where responsibility and accountability should lie. If memory serves, there was an annex that highlighted several factual errors and proposed drafting changes.

Ms Purvis:

I would appreciate it if you could forward those changes to the Committee. Thank you.

I am uncomfortable — as, I am sure, are other members — with the process as it has been outlined. The report found that there was an appropriate framework of financial delegation in place; that the board had driven improvements in procurement; and that it had received assurances from the executive team. However, I fail to understand, given that the report also cannot find out who was responsible for the breaches, that four non-executive directors were sacked.

I put it to Mr Priestly that the Department and the Minister could not deal with the flak from another chief executive resigning from Northern Ireland Water and that you bent over backwards to ensure that Mr McKenzie remained in post.

Mr Priestly:

That is simply not the case.

Ms Purvis:

Many of the issues that we have drawn out today point in that direction. I do not see, and neither has it been explained clearly, where four non-executive directors are culpable for those alleged failures in governance; I see breaches in administrative procedures, which are the responsibility of a management team. I cannot find where there have been failures in governance, particularly

as the independent review team reported that the frameworks and the appropriate approvals were in place and that the board had received assurances from the executive team that it had been informed properly and fully. I will leave it there.

Mr Dallat:

There are a couple of issues that I want to mop up. Dawn Purvis has given us some very valuable food for thought; she mentioned the cost of the independent review team that set up the whole thing. There seems to be some doubt about whether it cost £40,000 or nearer £50,000.

Ms Patterson:

It cost £42,300, excluding VAT; if VAT is added, the amount is closer to £50,000. However, the Department can claim back VAT, so the cost to the Department is —

Mr Dallat:

As least that was before VAT went up. Is it true that you paid one person £1,100 a day, another £800 a day and that £350 was thrown in for secretarial expenses?

Ms Patterson:

Those rates are correct. The rate of £1,100 a day was £400 cheaper than the government procurement framework rate.

Mr Dallat:

It was a real bargain.

Ms Patterson:

The framework rate was £1,500 a day.

Mr Dallat:

Many of us picked the wrong career, but then you have to pay when you need a show trial.

Mr MacKenzie, I am sorry for going back to the dinner that you had with the regulator, but you told us that your relationship with Peter Dixon was just that of one chief executive to another. This is important for our report. You e-mailed the board of directors the following day about that nosh-up. It seemed to be very friendly stuff, and you say that you received useful inputs from Gerry. I take it that that is Gerry Loughran of Phoenix Gas, or is it a different Gerry?

You also sent a special e-mail to Mr Dixon, which puzzles me.

Mr MacKenzie:

Mr Dixon was to have been at the dinner but had to pull out.

Mr Dallat:

And you missed him, obviously.

Mr MacKenzie:

I merely told him what had happened at the dinner.

Mr Dallat:

It was just one chief executive to another, but you missed him and you thought of sending him an e-mail the next day.

Mr MacKenzie:

To tell him what had happened at the dinner.

Mr Dallat:

Of course, that was not the end of the e-mails between you and him. On the 27th, you sent him another one, saying that you needed help from friends. Could you explain that?

Mr MacKenzie:

Yes. I was going through a very difficult process. We had just received the draft determination for the price control, and we were being asked to deliver some £56 million of opex savings across a three-year period. Peter deals with the same regulator as I, and I was keen to understand how he had handled such issues.

Mr Dallat:

That sounds plausible enough, but, according to the e-mails, he was a friend.

Mr MacKenzie:

He is a business acquaintance.

Mr Dallat:

That is changing by the second. Amazingly, Mr Dixon was appointed to the independent review team to sit in judgement on another regulated utility as an impartial and independent member. Is it not starting to sound like an old boys' club?

Mr MacKenzie:

He was appointed by the permanent secretary not by me.

Mr Dallat:

One of the terrible things about this country in the past was the social circle of friends who

controlled everything. I was sure that that was in the past. I hope that my interpretation of the e-mails that you sent do not lead me to the wrong conclusion. I will go home wondering how much clarity we have really achieved. You said that you were in favour of openness and clarity, but you are not very good when it comes to the Freedom of Information Act 2000 (FOI). You like to keep things back.

Mr MacKenzie:

I do not know what you mean.

Mr Dallat:

Well, let me see. You have received freedom of information requests, but you have held information back. You know that.

Mr MacKenzie:

Any information that we have been asked for under FOI has been given, including anything that I have been asked for.

Mr Dallat:

I will want to check that, Chairperson, because that is not my information. Requests for information under FOI were extremely hard to extract, and, in some cases, not extracted at all. I may be wrong in blaming Mr MacKenzie rather than the Department, but —

Mr MacKenzie:

I have provided everything that I have been asked for under FOI, Mr Dallat.

Mr Dallat:

I will clarify that, Chairperson, because it is important. Has the Department withheld any FOI

requests?

Mr Priestly:

FOI requests on this issue?

Mr Dallat:

Yes. That is all that we are discussing.

Mr Priestly:

We have responded to the FOI requests that we have received in connection with this issue. As far as I am aware, we have made full disclosure, except in relation to information about the appointment of interim board members. I cannot remember under which section of the Freedom of Information Act 2000 that information was withheld, but it is work in progress; it is to be published, and it is legitimate to withhold it.

Mr Dallat:

I do apologise, Mr MacKenzie; the Department is the culprit. On at least three occasions, you did not release information that was asked for in FOI requests. That kind of information would have been freely released by any other Department. Perhaps the Committee could get that information.

Mr Priestly:

I am happy to release to you the FOI requests that we received and the information that we divulged. I am not aware that we have withheld information.

Ms Hamill:

Freedom of information requests are made under statutory authority. Therefore, if an individual

has a concern that information has not been released, he or she can appeal to the Information Commissioner.

Mr McGlone:

Just before I get into this wee bit here, I am concerned by what Ms Patterson said. The problems around procurement predate the establishment of NI Water as a Go-co, and you have accepted that. Indeed, many of the personnel who, as Mr MacKenzie knows, were in the Water Service, moved over to Northern Ireland Water. I am deeply concerned to hear that. The focus is, correctly, on NI Water, but some of those bad habits, it has been accepted, existed prior to NI Water, in the Water Service under DRD, as it was then. There does not seem to be any deep will on the part of the Department to go back and look at those bad practices.

There have been issues about procurement. In some ways, it bugs me that those practices could have been going on and loads more money could have been blown, yet the Department does not take that on board, nor does it want to investigate those practices forensically in case there are attendant problems that, if there are personnel with shoddy habits, may pop up in some other guise within the Department's remit. That concerns me deeply.

I will move on to a few other issues. Colleagues have referred to an e-mail. What role does Mr Price have in NI Water at present?

Mr MacKenzie:

He is a non-executive director and chairman of the audit committee.

Mr McGlone:

When a chairman of the audit committee says that:

“non-adherence to procedures was not picked up by Internal Audit (despite 3 Audits on Procurement in 2009) nor were

they picked up by Halcrow and at no time were they reflected in reports or in assurance statements to the Board.”

That is a pretty legitimate statement coming from a person of his standing, whom Mr Priestly obviously holds in great respect in the Department. Over this period of problems in procurement, how many audits were conducted, whether internal or external, departmental, with an external auditor or with an internal auditor in NI Water or Water Service, as it was at that time?

Ms Brennan:

There were two internal audits before the issues that arose with contractor A approval.

Mr McGlone:

Therefore in total there were just three internal audits and they were all carried out in 2009.

Ms Brennan:

Yes. Originally, under the three-year audit plan, internal audit was due to carry out a review of procurement in 2008-09. That was deferred to 2009-2010 at the request of management because new processes were being put in place at the time and the audit committee approved that.

Internal audit carried out its review in the summer of 2009, and several recommendations were made on weaknesses in the process from a compliance perspective. Recommendations were made to put controls in place to enhance compliance and to detect where procedures were not followed. Sample testing was carried out in the audits; unfortunately, that sample testing did not detect any issues with how particular contracts had been awarded: we did not find any exceptions, but we did identify issues in the process.

Mr McGlone:

Therefore two internal audits were carried out; and then there was a third one. Did you head up those audits?

Ms Brennan:

Yes.

Mr McGlone:

Therefore three internal audits were carried out, two of which found nothing, and the third — was it the contract compliance one?

Ms Brennan:

The first two did not find “nothing”; they made some —

Mr McGlone:

They did not find significant issues around procurement that have now hit the fan.

Ms Brennan:

They found issues with the process, but the methodology —

Mr McGlone:

Answer my question, please. Did they find significant procurement issues, the issues that we are discussing here today?

Ms Brennan:

They did not find issues of the nature that were found subsequently.

Mr McGlone:

That answers my question.

What issues were raised by your contract compliance audit report that issued to Mr MacKenzie and others in September?

Ms Brennan:

It raised issues around the process. The procurement function was just establishing monitoring procedures, for example, to flag up far enough in advance to business users when contracts were reaching their expiry dates. That was one of the issues that we raised.

Mr McGlone:

Mr Chairperson, I think that it would be useful for the Committee to obtain that report so that the Auditor General and the Committee could compare and contrast it with what ultimately emerged. We will consider it when it comes.

Let us move on to other issues. I want to touch upon comments made by colleagues. We have already heard about the relationship, whatever it might be, the dinners and stuff, that John referred to. We heard about another person who was on the independent review team who was a partner in a significant Belfast firm that had earned upwards of £6 million from the Department. In many ways one of the things that we question is at this stage if people who are in the network who either have a past financial benefit derived from the Department or, potentially, a future one clearly where something nice could be added to their CV. I would certainly question the merits of the independent outcomes of a report written in circumstances like that, where there may be an interest there, either past or future. That is another aspect that we need to explore in relation to the independence of the outcomes of the report.

I will move on to other issues. We were touching there on the number of times that the matter was audited internally. Can you provide me with details as to how many times it was audited externally, if it was externally audited, or if the Department, either in a cursory manner or a formal manner, actually said, "let's have a look at the books"? I presume that that is readily available.

Ms Brennan:

The external audit?

Mr McGlone:

Yes: how many times that was done over the period that the problems that we are discussing today were not noticed.

Ms Brennan:

The external audit management letters over the first two years in which the organisation was a Go-co did not identify any issues with procurement.

Mr McGlone:

Therefore the external audit — that is four audits so far — did not identify any procurement issues, and another audit identified process issues.

Ms Brennan:

I will just clarify one point, if you will allow me. The audit approach that is accepted in line with professional standards is that sample tests be carried out. Only if one became aware that there was a particular issue would one go into deeply substantive work, which we did as soon as Laurence became aware of the issue with contractor A. That is when we covered a high number of the transactions, and through that we found a percentage of non-compliance issues.

Mr McGlone:

The only thing that I can conclude from that is that the audits were not extensive enough and were clearly inadequate, because the whole purpose of auditing, as we know sitting here, is to determine if there are issues or problems in there and to discern those and act on them promptly. So far we have established that there were five audits.

Ms Brennan:

The statutory audit takes place every year and covers all key financial areas.

Mr McGlone:

Just to clarify, how many audits took place in the period under discussion, either carried out by the Department, NI Water or externally?

Ms Brennan:

NI Water carried out two internal audits, and there were external audits carried out each year.

Ms Hamill:

When we talk about external audits we are talking about the audit of the financial statements and the information below that; we are not talking about the audit of the processes and detailed behaviour.

Mr McGlone:

That is fine. Therefore you are talking about two, and then there was a third one.

Ms Brennan:

The third one — the contracts —

Mr McGlone:

Unless Mr Price here is —

Ms Brennan:

There was the audit into contract A as soon as Laurence became aware that there might have been

an issue with the contract.

Mr McGlone:

All I want to know is how many audits took place. Was it three, two, four, or what?

Ms Brennan:

There were three internal audits, including the audit of contractor A.

Mr McGlone:

And none was carried out in 2008?

Ms Brennan:

No internal audit was carried out in 2008.

Mr McGlone:

OK. That is all I wanted to establish.

Mr Dallat:

Who were the external auditors?

Mr MacKenzie:

KPMG.

Mr McGlone:

Thanks for that. Mr Priestly, is it a fact that your Department and Northern Ireland Water's internal auditors, Ernst and Young, agreed not to release internal audit reports to the Comptroller and Auditor General?

Ms Patterson:

Yes.

Mr McGlone:

It should be a simple yes or no answer.

Ms Patterson:

The simple answer is that, yes, for a time the Department did agree.

Mr McGlone:

Why?

Ms Patterson:

When the company was set up as a Go-co, Ernst and Young were the external providers, and NIW's board had signed a contract with Ernst and Young for that service.

The conditions of the contract prevented the Department providing those reports to anyone outside the Department and the company. However, I want to put on record that, when that was brought to my attention, I did not, and do not, agree with that condition, particularly where an NDPB is concerned. Indeed, when the Audit Office completed its accounts last year, it raised

that in its management letter. At that stage, I opened a dialogue with NIW and the chair of the audit committee to explain that that condition was not appropriate, because the Audit Office has the right to get in on any public money. I also said that the decision needed to be overturned. With Paul's help, we negotiated the removal of that condition with Ernst and Young, so that for this year's audit, the Audit Office had full and open access to everything that was done in NIW.

Mr McGlone:

Who negotiated such a condition? More importantly, who signed up to the contract?

Ms Patterson:

At the time that the contract was put in place, such a condition would not have been an unreasonable request. Northern Ireland Water had been established as a Go-co, and the privy of relationship under company law was between the external contractor and the board of directors. However, with the turning of the governance arrangements and the reclassification of NDPBs, it becomes nonsensical, because —

Mr McGlone:

It is nonsensical, but that is not what I asked you. I did not ask you whether it was reasonable or unreasonable; I asked you who was responsible for signing up to the contract.

Ms Patterson:

I am sorry, but I do not have that information.

Mr McGlone:

Perhaps you could find that out for us.

Ms Hamill, are you aware of any other public bodies in which the access rights of the Comptroller and Auditor General have been limited and denied in such a way?

Ms Hamill:

No. Apart from the specific issue relating to the Go-co, I am not aware of any other such situations. If the Comptroller and Auditor General found any difficulty in accessing such information, I would expect him to come directly to me so that I could resolve the problem.

Mr McLaughlin:

Utilities have been privatised elsewhere. Were such confidentiality clauses and commercial sensitivities standard operating practices in that context?

Mr MacKenzie:

Yes, they were.

Mr Priestly:

Chairperson, I wonder whether it would be possible to have a comfort break for a few minutes.

The Chairperson:

It has been a long session, so we can have a break for five minutes.

Committee suspended.

On resuming —

The Chairperson:

We have a quorum again, so we will go back into open session. Mitchel McLaughlin just said to me while the meeting was suspended that Mr Priestley had to go out for a leak. That is quite ironic, given that we are talking about NI Water. *[Laughter.]* It was Mitchel McLaughlin who said it, not me.

Mr McGlone:

Before we begin again, I will formally hand over for the record the e-mail that was referred to earlier.

I refer you to paragraph 24 of the internal audit section of the independent review team's report. Mr Priestly, why did the Department not engage with the chairperson of Northern Ireland Water's audit committee until fairly recently, despite having received such critical assurance statements?

Mr Priestly:

Perhaps I am taking you up wrongly, and I apologise in advance if I am. The assurance statements that we received from Northern Ireland Water were misleading. Northern Ireland Water assured us that nothing was going wrong. It took a very long time for us to get access to the internal audit reports. It was not part of the Go-co's governance arrangements for us to be represented on the company's audit committee. That issue became relevant when the company was changed to an NDPB. It is regrettable that it took so long, but we got there eventually.

Mr McGlone:

The PAC's April 2008 'Report on Good Governance — Effective Relationships between Departments and their Arm's Length Bodies' recommended that:

"a department should be represented at the audit committees of each of its arm's length bodies."

As you sit here today, you are probably hoping that the company is very much an arm's-length body. The Department of Finance and Personnel accepted that recommendation in the corresponding memorandum of reply of 11 July 2008, but here we are, two years later. Did that recommendation not transfer to relevant Departments? Why was there a slow take-up by DRD?

Ms Patterson:

The Department has an arm's-length body subcommittee of the board, which considered the PAC's recommendations shortly after the memorandum of reply issued. Given that, at that time, Go-co/NDPB status referred to public expenditure purposes only and said that governance should not be changed, the committee took the decision not to place someone on to the NIW audit committee but to place someone on to the Translink audit committee. I do not want you to think that a thought process was not gone through. It was, and that was the decision that was taken. The fullness of time has now shown that the NDPB means much more than just PE. I accept that the process was slower than it should have been.

Mr McGlone:

Perhaps I am having a bit of a senior moment, but, to be honest with you, I do not understand how a Department can do that. If there had been someone there with competency, possibly even yourself, the issue would have been picked up on much earlier. I just do not understand it. Rather than go through the convoluted thought process that I have heard so much about today, perhaps the Department could give us some clarity in writing about why it did not happen pronto.

Finally, on page 8 of the update that Mr Priestly provided to the Committee on 9 June 2010, it is set out that the appointment of the new post of procurement compliance officer was limited to an internal trawl. Mr MacKenzie, how did you come to that decision, given the performance of the staff? As we heard today, nothing was picked up on in regular audits, yet you opted for an internal trawl. Why was an external trawl not used? We have heard so much about how wonderful external people are and how beneficial they are to the Department and to NI Water. A lot of them have had an interest, albeit a vested interest, you could argue, and input into quasi-independent reviews and so on. Why did you do that?

Mr MacKenzie:

We are faced with very challenging efficiency targets this year. Many people who work in Northern Ireland Water are very competent. It seemed to me that someone in our organisation who had the appropriate skill set and who had not been involved in this area previously would have been a suitable candidate. We have been through an interview process, and we have found someone who has never been part of procurement before but who has all the skills necessary to be a procurement compliance officer.

Mr McLaughlin:

Does employment guidance and good practice say that are you required to look for candidates internally before advertising externally?

Mr MacKenzie:

As part of our process, we always look to see whether there is a suitable internal candidate before we advertise externally.

Mr McGlone:

I think that perhaps the tenet of Mitchel's point is that, irrespective of what you always do, and I mean no disrespect to Mr MacKenzie, some things have been done regularly. That does not necessarily make it the right thing. Have you sought advice on the matter from, for example, the Equality Commission, the Department or other external bodies?

Mr MacKenzie:

We discussed it with the Department, and I believe that the candidate who we have found for the role has all the necessary competencies.

Mr McGlone:

That was not my question. The person that you have found may have all the competencies. I

want to know about the process by which you got to that point. We heard today about concerns over public appointments. Did you seek clarity or advice from the Equality Commission or your human resources (HR) unit about the appointment of that person, who may be aptly qualified for the role, to ensure that you went through the proper employment practices and procedures?

Mr MacKenzie:

Yes. We went through a proper process internally, whereby the job was advertised internally and anyone in the organisation could have applied. People applied for the job. We held a fair interview process, the entire process was managed by the HR function and a suitable candidate was found.

Mr McGlone:

Who sought the appropriate advice?

Mr MacKenzie:

I sought the appropriate internal advice from HR, which ran the process for us in line with fair procedure.

Mr McGlone:

That is all I wanted to know, after all that.

The Chairperson:

Some other members want to ask questions, but I ask them to be as brief as possible, as it has been a long session.

Mr Hilditch:

I will deviate slightly. I am concerned that another major issue is perhaps hiding around the

corner. The jungle drums are out. The independent audit was not a fundamental review; it concentrated only on the report. The One programme, which is nothing to do with Christine Bleakley, I hope, looked at amalgamating systems, such as IT systems. I understand that it cost between £60 million and £80 million. How has the value for money for the One programme been demonstrated independently?

Mr MacKenzie:

We are going through an internal validation process. That is almost complete. It will seek to validate the benefits derived from the One programme, and our internal audit team will work to ensure that that validation process is appropriate.

Mr Hilditch:

It has been flagged up to me recently that the jungle drums are out. I hope that nothing is hiding round the corner.

Mr McGlone:

Ms Brennan, did you work with Ernst and Young previously?

Ms Brennan:

That is correct.

Mr McGlone:

By what method did you come to NI Water?

Ms Brennan:

I came in through an external recruitment exercise that was carried out in July 2008. I joined NI

Water with the objective of establishing the internal in-house audit function.

Mr Priestly:

It was an open competition that was publicly advertised.

Ms Brennan:

Yes.

The Chairperson:

I have a couple of other questions to ask. You will be glad that the session is nearing its conclusion. A number of reports were before the Committee today, and, having read them, I imagine that NI Water's latest accounts will have been qualified. I will ask the Comptroller and Auditor General to comment on that.

Mr Kieran Donnelly (Comptroller and Auditor General):

I understand that the accounts for Northern Ireland Water for 2009-2010 were signed off a couple of days ago. They have not been qualified, which might be a surprise. I audit the accounts of the parent Department, which is DRD, and I will sign those off today before the summer recess. I have qualified the parent Department's accounts and will report on those. Therefore, it seems a bit incongruous that Northern Ireland Water's accounts are not qualified, given the gravity of the issues. The heart of the matter is that, whenever I sign off any accounts throughout the public sector, I give an opinion on two things: first, whether the accounts are true and fair at the commercial end; and secondly, I give a regularity opinion that the accounts conform to the Assembly's intentions. An auditor is not required to give a regularity opinion on the accounts of a Go-co. That is a weakness that we should think about.

The Chairperson:

I am sure that, now that members have heard that, we will consider it when we conclude our

inquiry. Given the concerns about procurement and governance in NI Water, not only the Committee but the public will be looking for assurance that there are no similar activities in, for example, Translink, which is another limited company that receives significant public funding from your Department. Can you give us any assurance on that?

Mr Priestly:

The assurance that I can give the Committee is that, in the light of what happened in one of our arm's-length bodies, Lian, the relevant director and I are having another look at our governance of Translink and at areas where we may want to change and tighten things up or seek different and better assurances about their practice.

The Chairperson:

Have you started to look at that, or is that just coming up in the light of our inquiry?

Mr Priestly:

We have started to look at that. I have a draft letter about changes that I want to make that I am about to clear with the Minister and that I intend to send to the chairman of Translink.

The Chairperson:

Is that recent?

Mr Priestly:

I am ready to send the draft to the Minister. We have been thinking about that for the past few months, since these matters emerged.

The Chairperson:

Therefore, you have been thinking about it for the past number of months, but you have the letter

at only the draft stage. It is good that there is a draft letter, and, hopefully, it will be signed off as soon as possible. We certainly do not want another evidence session about any other of the arm's-length bodies of the Department for which you are the accounting officer. We appreciate all the work that has been done.

This is one of the worst cases that I, as Chairperson of this Committee, have come across concerning the total breakdown of procurement controls. I am sure that Committee members, some of whom have been on the Committee longer than I, think the same. It is incredible that a body that gets two thirds of its funding from public funds should have ignored the most basic rules and shown a complete disregard for public sector principles.

The Committee will consider today's evidence and will probably need an articulated lorry to deliver all the other information that we asked you to provide. I dare say that the Committee will undertake a lot of deliberation on the matter, and you will hear the outcome of those deliberations in due course. If the Committee seeks more information, it will put that request in writing to you.

Thank you. It has been a very long session. I appreciate your time and effort.