

**REPORT OF THE INDEPENDENT REVIEW
TEAM TO THE ACCOUNTING OFFICERS OF
THE DEPARTMENT FOR REGIONAL
DEVELOPMENT AND NORTHERN IRELAND
WATER**

STRICTLY PRIVATE AND CONFIDENTIAL

25 February 2010

Final Report

Contents

1	Introduction and Terms of Reference	1
1.1	Introduction	1
1.2	Background and Terms of Reference (ToR).....	1
1.3	Limitations of this Report	2
1.4	IRT Approach to the Review	3
1.5	Format of this Report	4
2	Context	5
2.1	Introduction	5
2.2	Northern Ireland Water (NIW).....	5
2.3	DRD as Shareholder.....	7
2.4	Events since Establishment of NIW.....	8
2.5	Recent Development	10
2.6	Summary	10
3	Analysis of the Governance Failures	11
3.1	Background to the Contracts Approval Internal Audit Report	11
3.2	Summary and Categorisation of Exceptions	12
3.3	Analysis of Governance Failures	14
3.4	Findings.....	18
4	Analysis of Failures by DRD as Shareholder	20
4.1	Background	20
4.2	Analysis.....	22
4.3	Findings.....	24
5	Recommendations	26
5.1	Overview	26
5.2	Further Action to Address the Governance Issues Surrounding Procurement	26
5.3	Additional Governance to be introduced by NIW	27
5.4	Position of the NIW Board Members and other Senior Managers Involved in these Issues	27
5.5	Recommendations to DRD as Shareholder.....	28

Appendices

Appendix I: Contracts Approval Internal Audit report of 27th January 2010 plus addendum

Appendix II: The current organisation chart for NIW's Executive Committee

Appendix III: Key Elements of the Risk Management Control and Governance Arrangements

GLOSSARY OF TERMS

BIP	Business Improvement Plan
CEO	Chief Executive Officer
DFP	Department of Finance and Personnel
DRD	Department for Regional Development
E&Y	Ernst & Young
IRT	Independent Review Team
IWRP	Independent Water Review Panel
MOU	Memorandum of Understanding
NDPB	Non Departmental Public Body
NED	Non-Executive Director
NI	Northern Ireland
NIAUR or the Utility Regulator	The Northern Ireland Authority for Utility Regulation
NIW	Northern Ireland Water Ltd
PAC	Public Accounts Committee
QSM	Quarterly Shareholder Meetings
SE	Shareholder Executive
SU	Shareholder Unit
STA	Single Tender Action

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1 Introduction and Terms of Reference

1.1 Introduction

An independent review team (IRT) has been jointly commissioned by the Accounting Officers of the Department for Regional Development (DRD) and Northern Ireland Water (NIW) to undertake a review of procurement governance issues within NIW. This report sets out the findings and recommendations of the IRT.

1.2 Background and Terms of Reference (ToR)

In light of a breach of NIW's governance arrangements and its Licence, the Chief Executive Officer (CEO) of NIW commissioned a wider Internal Audit review of NIW contracts. This breach related to a single tender action (STA) with an organisation referred to within this report as Contractor A.

Following discovery of the above breach, the CEO tasked the NIW Internal Audit team to investigate whether any other pre-existing contracts did not comply with the Company's governance arrangements. The remit of the review considered payments on a sample of contracts between 1 April 2007 and 8 December 2009 (all let prior to the arrival of the current CEO in July 2009).

The ToR indicated that the draft Contracts Approval Internal Audit report was made available on 15 January 2010 and was considered by the NIW Executive Committee on that day. The draft report detailed a number of departures from the Company's financial delegations, including:

- several instances in which STAs had been executed without appropriate internal approval;
- several instances where advance Shareholder (DRD) approval should have been but was not sought; and
- one clear instance of a potential breach of NIW's Licence involving the extension of a contract beyond the time period for which it was publicly procured.

In light of the significance of the issues identified in the draft Contracts Approval Internal Audit report the DRD and NIW Accounting Officers jointly commissioned an independent review to report, with recommendations, on actions to be taken by NIW and DRD to address the governance failures. The approach was agreed with the Minister.

The membership of the review team is:

- **Peter Dixon**, Group Chief Executive, Phoenix Energy Holdings Ltd;
- **Jackie Henry**, Public Sector Partner, Deloitte; and
- **Glenn Thompson**, Business Consultant and former Senior Civil Servant and Accounting Officer.

The terms of reference for the independent review are defined as follows, to:

- analyse how the governance failures detailed within the Contracts Approval Internal Audit report occurred;
- recommend any further action necessary to address the governance issues surrounding procurement;
- recommend any additional governance arrangements to be introduced by NIW;
- make recommendations in relation to the position of NIW Board members (executive and non-executive) and other senior managers involved in these issues;
- provide an analysis of any failures by DRD as Shareholder and any necessary recommendations; and
- make any other recommendations the review team believe to be relevant and necessary under the circumstances.

1.3 Limitations of this Report

The independent review was undertaken during the three weeks commencing 25 January 2010. The review involved analysis of a considerable volume of information and an extensive consultation programme and every effort has been made to validate findings and to evidence the basis for conclusions. Given the volume of information provided and the breadth of consultation undertaken, it has not been possible to include details of every source in this report.

In accordance with the terms of reference the review team have relied upon the Contracts Approval Internal Audit report (final version dated 27th January 2010 plus addendum dated 10th February) undertaken by the NIW Internal Audit team and have not sought to re-perform or audit its findings. We also became aware of ongoing work on 'Deep Dive' audits. In summary, the scope of the deep dive audit work is to:

- assess whether any other contracts not detected as part of the Contracts Approvals review have been approved inappropriately or failed to be procured in accordance with the Contracts Utilities Regulations 2006, including contracts within Engineering Procurement (EP) under £500k;
- assess whether any other financial delegation requirements have been breached by the application of detailed substantive testing; and
- consider the potential for breaches of key financial controls in other areas outside of contracts and confirm whether any non compliance has taken place by the application of substantive testing (primarily in expense areas).

1.4 IRT Approach to the Review

In undertaking this Review, the IRT has completed the following activities.

Table 1.1

IRT Approach

Desk Research	Extensive review of a wide range of materials including Board Minutes, Internal Audit reports, Internal Audit assurance statements, Financial Delegation Framework; correspondence between NIW and the Shareholder; Minutes of quarterly Shareholder meetings (QSM); Audit Committee minutes etc.
Consultation (1)	<p>NIW Board</p> <ul style="list-style-type: none"> • Chairman • Non-Executive Directors (n=4) • Executive Directors (n=3) <ul style="list-style-type: none"> ➤ CEO ➤ Director of Finance & regulation & Commercial ➤ Director of Asset Management
	<p>NIW Management and Staff</p> <ul style="list-style-type: none"> • General Counsel and Company Secretary • Director of Corporate Affairs • Director of Human Resources • Director of Customer Services • Director of Engineering Procurement • Head of Internal Audit Designate • Head of Operational Procurement • Acting Chief Information Officer • Head of One Programme <p>Former Employees</p> <ul style="list-style-type: none"> • Former acting Director of Operations • Former Commercial Director • Former Director of Customer Services
	<p>Department for Regional Development</p> <ul style="list-style-type: none"> • Permanent Secretary • Deputy Secretary • Director of Shareholder Unit • Director of Water Policy
	<p>Other</p> <ul style="list-style-type: none"> • NIAUR • Shareholder Executive • Head of NIW Internal Audit - Ernst and Young

The IRT also invited the first CEO and a former Director of Operations of NIW to interview however they declined to attend.

The purpose of the fact finding interviews was to discuss:

- the exceptions noted within the Contracts Approval Internal Audit report;
- the circumstances underpinning these exceptions;
- the background to the issue of the Contracts Approval Internal Audit report to the DRD Accounting Officer by the NIW CEO;
- the understanding of the NIW control framework;
- the organisational culture and context during the time when the exceptions occurred including; the business transformation programme, use of third party consultants and staff substitution; the basis of single tender action and value for money issues surrounding business case preparation;
- the prominence given to Internal Audit in NIW;
- the relationship with the Shareholder and the effectiveness of the governance model; and
- lessons to be learnt.

1.5 Format of this Report

The remainder of this report is structured as follows:

Section 2 – Context

Section 3 – Analysis of Governance Failures within the Contracts Approval Internal Audit report;

Section 4 – Analysis of Failures by DRD as Shareholder; and

Section 5 – Recommendations.

2 Context

2.1 Introduction

The purpose of this section is to give a brief overview of the roles of the NIW and DRD and the sequence of events since NIW was established in April 2007.

2.2 Northern Ireland Water (NIW)

On 1 April 2007 the Water Service, an agency of the DRD, became Northern Ireland Water Ltd, a Government owned company GoCo subject to companies legislation, appointed under the Water and Sewerage Services (NI) Order 2006 as the provider of water and sewerage services in Northern Ireland (NI).

The 2006 Order also provided for a regulatory framework covering the dimensions of economic, consumer, environmental and drinking water quality. The Northern Ireland Authority for Utility Regulation (the NIAUR or Utility Regulator) in particular has a duty to protect consumer interests, ensure that NIW carries out its function properly and ensure that NIW is able to finance its functions. The Utility Regulator may impose financial penalties for potential breaches of NIW's Licence conditions and other infractions.

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

- deliver substantially better quality services more efficiently and at lower cost;
- manage the business within the financial parameters agreed in NIW's Strategic Business Plan;
- achieve the maximum affordable improvements in environmental compliance in both wastewater treatment and drinking water quality;
- enhance shareholder value and provide returns that match or exceed the industry/regulatory cost of capital; and
- strive to outperform the efficiency and other targets set within the Strategic Business Plan framework.

Under the Governance arrangements for NIW, DRD as shareholder appoints the Chairman and all other Non-Executive Directors (NEDs) and participates in and approves the appointment of Executive Directors. A shadow Board was established in April 2006. Changes in the composition of the NIW Board since vesting are set out in Table 2.1.

Table 2.1
NIW Board Movements

Date	Board Movements
3 April 06	Shadow Water Service Board appointed – NEDs Chris Mellor (chair). Ruth Thompson. John Ballard & Rose Hynes Executives Katharine Bryan (CEO), Ronan Larkin (Finance & Reg) & Phil Barker (Operations)
20 Mar 07	All Shadow Board members appointed to Board of NIW
1 Apr 07	Vesting of NIW as GoCo
19 Jul 07	Rose Hynes (NED) resigns
Feb 08	Minister launches Public Appointments process for new NEDs
28 May 08	Katharine Bryan (CE) resigns
1 Jun 08	Chris Mellor doubles up as Chair and Interim CE (to July 2009)
7 Jul 08	2 NEDs appointed – Don Price and Declan Gormley
25 Nov 08	George Butler (Asset Management) appointed as Exec Director
Dec 08	Phil Barker (Operations Director) resigns
1 Apr 09	Chris Mellor, Ruth Thompson & John Ballard re-appointed
28 Jul 09	Laurence MacKenzie (CE) appointed
15 Sept 09	Laurence MacKenzie designated as NIW Accounting Officer by DRD Permanent Secretary

The organisation chart for NIW's current Executive Committee is at Appendix II.

2.3 DRD as Shareholder

2.3.1 The Governance Structure

In the planning for vesting the new GoCo, under direct rule Ministers DRD adopted the Shareholder Executive (SE) model for the discharge of its shareholder function. The model aims to implement a systematic approach to the application of corporate governance best practice addressing the SE's four shareholding principles of clarity, value, transparency and professionalism. A Report published by the National Audit Office¹, found that the SE has improved the way in which Government acts as shareholder and that it has generally acted as an effective and intelligent shareholder by making good use of the shareholder levers.

The Department is responsible for the appointment of the Board of NIW. The relationship with the company is managed by the Shareholder Unit (SU) within DRD. The current purpose of the SU is to ensure that the company acts as far as possible commercially, within the public expenditure constraints imposed by the NDPB classification status, to provide better performance, better services and better use of funds. To assist in the management of its shareholder interest DRD has entered into a Memorandum of Understanding (MOU) with the SE. This provides the DRD with access to a suitably qualified and experienced team of specialist advisors. The SE also works with the Scottish Executive advising on matters relating to Scottish Water.

The SU is headed by a qualified Accountant and two Deputy Principal Accountants are included in the staffing complement. The key elements of the risk management, control and governance arrangements are outlined in Appendix III.

2.3.2 Reclassification of NIW as a Non-Departmental Public Body for Public Expenditure Purposes

The governance arrangements originally put in place for NIW were established on the basis that income would be generated from industrial, commercial and domestic water charges and that eventually NIW would become self-financing. However this has not transpired to date. Following the NI Executive's decision to defer domestic water charges NIW continues to be substantially funded from public subsidy. As a result, for 2008/09, NIW was reclassified from public corporation to Non Departmental Public Body (NDPB) for public expenditure purposes. This had an immediate and direct impact on the DRD resource and capital budgets and has required the SU to monitor NIW much more closely to avoid any potential over or under spend that could have a detrimental effect on the DRD budget. Also, in response to these developments, DRD has introduced strengthened governance arrangements, including the designation of the NIW CEO as an Accounting Officer in support of the DRD Accounting Officer.

¹ The Shareholder Executive and Public Sector Businesses (HC 255 Session 2006-2007, 28 February 2007).

2.4 Events since Establishment of NIW

The fact finding interviews have highlighted the range of external events that affected NIW since it came into operation on 1 April 2007. We set out in the table below some of the key events by way of illustration of the external environment.

Table 2.2
Sequence of Events since Establishment of NI Water

DATE	EVENT	COMMENT
1 April 2007	Transfer of Water and Sewerage functions to NI Water Ltd NI Secretary of State postpones introduction of domestic water charging pending restoration of devolution	Company came into existence appointed as water and sewerage undertaker under terms of Licence Assets and liabilities transferred under Transfer Scheme Governance Arrangements apply
May 2007	Devolution restored - NI Executive defers domestic water charges and agrees TOR for Independent Water Review	
June 2007	Independent Water Review Panel established (IWRP)	
October 2007	IWRP Phase 1 Report published	Series of recommendations to be considered by NI Executive on charging
January 2008	IWRP Phase 2 Report	Deals with management, governance and delivery. Recommendations included: Greater oversight role for Minister for Regional Development, increased local knowledge and experience at board level both within NI Water and the Utility Regulator, and enhanced powers and duties for the Consumer Council. The IWRP also advised that NI Water should remain as a GoCo until 2013 subject to review.
February 2008	Cost Re-apportionment Issue emerges	Planning assumptions used for domestic/and non-domestic customer numbers inaccurate. Utility Regulator to investigate

March 2008	Approval of Business Improvement Plan (BIP)	This is a key transformation programme (also known as One Programme)
April 2008	Investigation of Cost Re-apportionment Issue	Utility Regulator Team supervised by NIAUR Audit Committee assisted by Grant Thornton
May 2008	DRD issue Supplementary Governance Arrangements	DRD Accounting Officer sought to enhance NIW's Governance and Accountability
November 2008	Utility Regulator outlined potential enforcement action against NIW in respect of cost re-apportionment Issue	
January 2009	Company formally notified of re-classification of NIW as NDPB for public expenditure purposes.	Reclassification took effect from 1 April 2008. This resulted in change in monitoring arrangements to reflect impact on DRD Budget
February 2009	Utility Regulator accepts Legally Binding Undertakings from NIW to improve its Systems of Planning and Internal Control	
June 2009	Submission of PC10 Business Plan to the Utility Regulator	Major piece of work to secure funding for 2010-2013 period
July 2009	Termination of Customer Billing/Contact Centre Contract	Complex contractual termination and safeguarding of service delivery
September 2009	Designation of NIW CEO as Accounting Officer Publication of Utility Regulator's Draft PC 10 Determination for consultation	Reflecting NDPB classification
October 2009	Termination of Contractor A following IA Report	Linked to work on Termination of Customer Billing/Contact Centre Contract
January 2010	Issue of draft Contracts Approval Internal Audit report Independent Review Team commenced work	DRD and NIW Accounting Officers commissioned an independent review of the governance failures raised in the Contracts Approval IA Report

2.5 Recent Development

The IRT became aware of a serious breakdown in relationships between the NIW Board and its CEO over the way the Contracts Approval report had been notified to the Shareholder without consideration by the NIW Board. We have been informed that the Board accepted that the CEO had a duty to inform the Shareholder of these issues. The Board was concerned however that the CEO in respect of his duties as a Director of NIW had insufficient regard to his duty to the company. The Board was advised that the CEO had tendered his resignation but later the CEO had asked that it be withdrawn. The IRT has been advised by the Chair of NIW that, in his opinion, the CEO does not have the trust and confidence of the Board and that this position is now irreconcilable. The CEO advised the IRT of a breakdown in trust between himself and the NIW Board. Whilst this matter is outside our scope we are concerned about the severe difficulty this situation causes in enabling the Shareholder and NIW to put in place the necessary remedial action plan to implement our recommendations.

2.6 Summary

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

3 Analysis of the Governance Failures

3.1 Background to the Contracts Approval Internal Audit Report

The Contract Approval Internal Audit was commissioned by the CEO of NIW, with the full endorsement of the NIW Board, in October 2009 (Board minute 27th October 2009) in response to the findings of a previous internal audit investigation into the procurement of Contractor A which breached the Company's Financial Authority Framework.

The investigation into Contractor A, a consultancy specialising in procurement, had concluded that that organisation had been engaged through a STA with a spend to date of £660,000, a further £50,000 in the pipeline and a settlement on the six per cent incentive bonus relating to 'identified savings' yet to be reached (detailed in Schedule 7 to the contract master agreement and relating to the termination of the Customer Billing/Contact contract). We understand that in December 2009 NIW received a further invoice for £888,000 based on Contractor A's calculation of the savings and interest to date on the claims identified, which remain outstanding. We were told by NIW that the position is under consideration.

The review of Contractor A concluded that the appropriate internal and external Shareholder approvals, as required by the delegated authorities set out in the NIW Financial Delegations Framework and the NIW Guidance on the Use of External Consultants and Staff Substitution Framework, had not been obtained. The CEO had notified the Shareholder of the issues found and gave an undertaking that internal actions would be pursued to ensure that such procurement authority breaches do not recur in the future. In support of this the CEO commissioned the Contracts Approval Internal Audit review.

In addition, the NIW Board and CEO received assurances from each member of the Executive Team stating they were unaware of any material issues which have not been brought to the Board's attention or that required Shareholder approval (NIW Board minute 29 September 2009).

The objectives of the Contracts Approval Internal Audit review were to:

- confirm whether existing contracts were approved appropriately in line with the relevant existing internal financial delegations and external delegated authorities established with the Shareholder;
- confirm whether procurement methods were in accordance with EU procurement legislation, Regulatory Licence requirements, the Water and Sewage Services Order and defined internal procurement procedures; and
- identify process improvements required to assist in preventing contracts being entered into without the required authorisations.

The Contracts Approval Internal Audit review was primarily based on contracts recorded by the Commercial Directorate within the current Contracts Database and may not cover some existing contracts that have not yet been captured within the Contracts Database. Although, efforts were made to capture any other potential relevant contracts by reviewing all suppliers where expenditure exceeded £100k in the preceding 12 months (01 December 2008 – 08 December 2009). Where the expenditure was found to be over

£100k and the item was not included within the Contracts Database, the expenditure was then assessed back to April 2007.

A further two audits have been commissioned in recent weeks which relate to a 'Deep Dive' into the opex contracts below £100,000 and capex contracts below £500,000. In addition, the CEO has also recently commissioned an investigation into instances of 'invoice slicing' arising from one particular contract which fell within the scope of the Internal Audit report into Contracts Approval. These are referred to later in this report.

A working draft of the Contracts Approval Internal Audit report was made available to the CEO on 12 January 2010. Draft version 1 of the Contracts Approval Internal Audit report was submitted to the CEO on the 15th January and was circulated and considered by the Executive Committee on that day. On Monday 18 January the CEO emailed a two page summary of the Contracts Approval Internal Audit to the Chairman and the NEDs. In performing his role as NIW Accounting Officer the CEO then advised the DRD Accounting Officer of the detail of the draft Contracts Approval Internal Audit report findings.

The communication of the draft Contracts Approval Internal Audit report by the CEO to the DRD Accounting Officer in advance of the Board having sight of the full report and having had an opportunity to consider it in detail has been raised by the NIW Chairman and NEDs as a matter of concern and a clear example of the CEO's conflict of interest in discharging his role as Sub-Accounting Officer and his responsibilities as a Director of NIW. The communication of the draft report to the Board in this way, the establishment of the Independent Review, together with the tendering and withdrawal of the CEO's resignation, has led to a position where the Chairman advises that, in his opinion, the CEO no longer has the trust and confidence of the Board and that this position is now irreconcilable. The CEO advised the IRT of a breakdown in trust between himself and the NIW Board.

3.2 Summary and Categorisation of Exceptions

When the IRT commenced work on 25 January 2010 the Contracts Approval Internal Audit was in draft form and the IRT initially worked from version 3 of the report (22nd January 2010). A final version of the Internal Audit report was issued on 27th January and this was followed with a report amendments summary. The full 27th January Contracts Approval report and reports amendments summary as at 10 February 2010 is at Appendix 1.

The Contracts Approval Internal Audit report details a number of breaches of the NIW's Financial Delegation Framework, including:

- Six STAs over £250k without Shareholder or NI Water's Board approval;
- One consultancy item over £750k without Shareholder, DFP or NI Water's approval;
- 15 exceptions where no evidence of appropriate internal approval was sought prior to expenditure being incurred, 12 of these are STA's which in many cases were inappropriate and should have been competitively tendered to ensure value for money;
- Two potential OJEU / Licence breaches in terms of contract extensions; and

- Two potential technical OJEU / Licence breaches in relation to notice of award not being posted to OJEU.

Throughout the IRT fieldwork and the fact finding interviews with NIW personnel, the draft status of the Contracts Approval Internal Audit report was consistently raised as an issue. In particular, interviewees challenged a number of aspects of the report including for example the incompleteness of evidence of authorisation and approval in certain exceptions, the definition and interpretation of STA and the interpretation of what constitutes a Licence breach. In our view the net effect of this was to seek to minimise the significance of the findings and to rationalise why exceptions may have occurred. As noted in Section 1 of this report, the terms of reference for the independent review define its scope as an analysis of the governance failures noted within the Contracts Approval Internal Audit report. The IRT has relied upon the Contracts Approval Internal Audit Report 27 January plus Addendum. That said an important issue for the IRT has been the extent to which amendments to the early draft of the Contracts Approval Internal Audit report have impacted the substance and significance of the initial findings that serious governance failures have occurred.

The IRT recognises that given the seriousness of the findings within the Contracts Approval Internal Audit report and the events following its release senior management involved in the original presentation of records to Internal Audit have revisited the documentation and completeness of the evidence base originally made available and that formed the basis of the report considered in, what was described by the Head of Internal Audit designate as, a closing meeting with the Finance Director and Head of Operational Procurement in December 2009.

The NIW Chairman and NEDs have also stressed that the organisation has not been allowed adequate time to explore the exceptions noted within the Contracts Approval Internal Audit report and to test the completeness of the evidence base or rationale for the audit exceptions noted therein.

The IRT has reviewed the substance of the final Contracts Approval Internal Audit report and Report Amendments document of the 10th of February and considers the findings significant and represent a serious failure in procurement governance surrounding public funds.

Responsibility for the exceptions noted within the report was discussed throughout the course of the fieldwork with NIW interviewees. On the basis of the evidence collated through interviews and the documentation available from the audit report it has not been possible to establish who is responsible for the exceptions across the senior management team. The evidence analysed indicates that the majority of these exceptions relate back the period pre vesting through NIW's first year. Approximately 28 per cent of exceptions related to the period when the NIW Chairman was also interim CEO.

As referenced above, IRT is also aware of the Deep Dive audits commissioned by the CEO including: the investigation into invoice slicing; the review of opex and the audit of capex below £500k. The IRT requested an interim report on these audits before the close down of the review fieldwork. We have been updated on the interim progress of the investigation into invoicing slicing by NIW's Head of Internal Audit, with the approval of NIW's Audit Committee. The report states that to date the investigation has not confirmed any positive indicators of fraudulent activity. The work continues.

In relation to the deep dive audits we were initially told by NIW that emerging findings could not be released to IRT as the Chairman had decided that this is a matter for the Board and the Audit Committee in the first instance in order to validate the emerging findings before reaching conclusions and deciding on further action. However, following an intervention by the DRD Accounting Officer we did receive a report from the Head of NIW's Internal Audit. She informed us that the first phase of this work is nearing completion regarding the review of mainly opex contracts not previously covered in the Contracts Approval review. The next phase covers capex contracts under £500k, this work is also now underway. She added the caveat that work was still ongoing and validation with management regarding exceptions is ongoing. However, her professional view of exceptions as at 22nd February is as follows:

- **Consultancy** - two STAs over £250k without shareholder approval, four STAs without appropriate internal approval, one potential OJEU breach in relation to notice of award not being posted on OJEU, one consultancy contract without approved business case and one instance where total expenditure of £249k raised by quotations rather than competitive local tender as required;
- **Goods and Services** - sixteen instances of STAs without appropriate internal approval (nine appear to have valid reason for STA procurement approach but others should have been competitively tendered), one of these STAs is over £250k without shareholder approval, a further five instances where total expenditure is over £30k and quotations only received rather than competitive local tendering as required and three contracts with spend over £30k outside of contract period. Also, another possible five exceptions which are still being investigated;
- **Contract extensions live contracts database** - total of 21 contracts found to be running on extensions outside the permitted contract terms, eight of these with expenditure outside of the permitted contract period in excess of the OJEU threshold and potential Licence breaches;
- **Contract extensions archive contracts database** – out of a sample of 45 contracts (15%) selected from the archive contract database (i.e. contracts no longer in use), eleven contracts with expenditure outside of the permitted contract period in excess of the OJEU threshold (potential Licence breaches), six of these did not have new tender notification until after the original contract expiry date (four with delays between 6 and 27 months). A further 25 contracts have expenditure between £30k and the OJEU threshold outside of the permitted contract period, 13 of these did not have new tender notification until after the original contract expiry date;
- **Approval of consultancy over £750k by Shareholder** – work is ongoing; and
- **Contract expenditure outside of approved contract value** – work is ongoing.

3.3 Analysis of Governance Failures

Application of the Financial Delegation and Control Framework

The IRT has explored the following key aspects of the control framework:

- the extent to which there was a clear Board approved financial delegation and control framework within the organisation;

- the extent to which the Executive Team are aware and understand the financial delegation and control framework and the basis upon which it should be applied to the procurement approval process; and
- the audit and compliance environment that provides assurance that the financial delegation and control framework is applied as defined.

The evidence presented to the IRT confirms the existence of a Financial Delegation Framework and the existence of the Guidance on the Use of External Consultants and Staff Substitution (as recommended by the Public Accounts Committee (PAC)) which are approved by the Board. These control documents clearly set out the authority levels and approval basis for initiation of procurement activity within NIW together with the definition and defined approach to STA and specific procedures relating to External Consultancy and Staff Substitution. The fact finding interviews undertaken as part of the IRT fieldwork have confirmed the Executive Team is aware of the Company's financial delegation framework and the basis upon which it should be applied. Nevertheless the Contracts Approval Internal Audit report identifies a number of exceptions to the application of this agreed control framework.

The fact finding interviews highlighted a range of contributory factors that were claimed as having led to the rules set out within the Financial Delegation Framework and other key control policies not being applied. These are summarised as follows:

- **The complexity of the business operating context:** Section 2 sets out the complex and dynamic business context within which NIW has been operating since vesting;
- **The impact of confusion in identity and strategic purpose of the organisation** given the impact of political decisions to defer the introduction of domestic water charging. The aims and objectives of the organisation had been set in the expectation of funding through water charges and a degree of commercial freedom with DRD as the shareholder and with NIAUR applying economic regulation. The consequent continuation of public subsidy from DRD and the resulting re-classification for 2008/09 of NIW as an NDPB for public expenditure purposes have resulted in increased public accountability. The governance model has changed to reflect these and is a complex half-way house (between GoCo and NDPB) and has resulted in the designation of the NIW CEO as Accounting Officer for NIW in support of the DRD Accounting Officer;
- **The scale of business transformation:** The evidence considered as part of this review has highlighted the scale of business transformation and investment required to move Northern Ireland Water Service forward into the commercial self financing and governing organisation that it was originally intended to be. NIW interviewees advised that commencement of the business transformation programme (predominantly an IT system based change programme) was delayed to March 2008 due to the time required to define the overall structure and content of the programme and to build a robust business case and governance arrangements necessary to secure Departmental budget approval.

The delay in commencement of the programme has been cited by a significant number of interviewees as a contributory factor in a number of ways;

- in the delay it has caused in the implementation of a procurement system that is now, reportedly, providing end to end support and control of contracts, incorporating built in checks that highlight circumstances where financial delegations are about to be breached. There is some evidence of NIW having made positive developments in procurement, for example the accreditation of NIW as a Centre of Procurement Expertise, its receipt of an Achieving Excellence in Procurement award and the findings of the Halcrow report, an independent review of procurement undertaken on behalf of the Utility Regulator in line with the requirements of the NIW Licence; and
- in the scale of change management and transformation within the business that was then being managed over a shorter than planned period of time. This led to the engagement of a large volume of independent contractors and consultants within NIW in varying staff substitution roles some of whom were in key procurement and change positions within the organisation.

The Department advised the IRT that it had required the company to submit the business transformation programme for approval by the end of June 2007/2008. The Department advises however that significant elements of the programme, that had been approved by Direct Rule Ministers, were underway during the 2007 financial year. The expenditure for that year totalled £21 million, £8.1 million operational expenditure and £13.2 million capital expenditure. In effect this represents a third of the overall programme costs.

- **Organisation culture:** the fact finding interview programme undertaken as part of this review provided a valuable insight into the culture of the organisation and its progression over time. Many of the interviewees referred to the legacy culture of the Water Service Agency. Some referred to the difficulty and frustration of trying to operate in a commercial manner in a restrictive public sector culture. In particular cited as a contributory factor was the lack of enforcement of compliance in resolving audit recommendations and the absence of systems of performance management and the lack of routine follow-up processes to ensure that adequate controls and check mechanisms were in place; and
- **The capacity of the Board and Senior Management Team:** During some 15 months of NIW's operation the complement of NEDs was not compliant with The Combined Code on Corporate Governance. Turnover at CEO and senior executive levels in the organisation was cited as not being helpful in terms of ensuring stability. The situation was compounded by the scale of business as usual and business transformation activity which was significant and was cited as the reason that some areas of the business were heavily reliant on third parties.

Audit and Compliance Environment

As part of the transitioning of Northern Ireland Water Service to GoCo, Ernst & Young (E&Y) were appointed internal auditors in April 2007 under a three year contract. The strategy from the outset was to build assurance and risk management capacity and capability in-house. The intention is from 1 April 2010 the NIW Internal Audit function will be fully operational.

Evidence from the fact finding interviews suggests that the establishment of Internal Audit as a strategic assurance function within NIW was difficult in the first year, primarily due to the reported legacy view of Internal Audit as a transactional compliance

function that sat outside the core operation of the business. Many Internal Audit reports in Year 1 of the contract were rated red, which is the most severe level of control weakness. The Independent Assurance Statement as at 31 March 2008 was a Category 4² rating “requires immediate improvement” however it did refer to underlying factors such as the delay in business transformation and Board and senior Executive capacity (background to which is summarised above).

The Independent Assurance statement as at 31 March 2009 concluded on the same basis as March 2008, as a Category 4 rating wherein the system of internal control and risk management was again considered to require immediate improvement. In forming the 2009 opinion the Internal Auditors noted the progress that had been made in the year with the number of Category 1 recommendations for the year ended March 09 being six compared to 22 for the year ended March 2008. With regard to financial year 2009 / 2010 we noted that in his report to the October Board meeting (Board minute of 27 October 2009) the Chair of the Audit Committee advised that ‘the company’s internal audit rating as at 30 September (2009) was the same as the previous year, however there was room for improvement’. The Audit Committee minutes of 26th October 2009 noted that the key for improvement was for management to deliver on the action plans.

Against this assurance background there was turnover in the Chair of the Audit Committee with the first chair resigning on 19 July 2007. At that time, pending the outcome of the NI Executive commissioned Independent Water Review which commenced in June 2007, DRD decided to hold off replacing the NED pending the review’s outcome. This is further explored in Section 4 below however it resulted in a doubling up of NEDs across the governance Committees.

The strengthening of the NED position occurred in July 2008 when two new NEDs were appointed to the Board with one taking on the role of Audit Committee Chair from 28 November 2008 (Board minute of 25 November 2008).

We note that in providing its bi-annual representations on Internal Control to the Shareholder, NIW has indicated since July 2008 only partial compliance on timely follow up action on internal and external audit reports.

Evidence from the examination of the audit programme and detailed audit reports, the assurance statements, Audit Committee minutes, Board minutes and Executive Team

² Internal Audit opinions are classified into five types, which detail the level of assurance that applies:

1. Fit for purpose	No major actions required, although there may be control weaknesses;
2. Requires further improvement	Limited number of planned actions to address material risks/issues, low likelihood of occurring;
3. Requires wide ranging improvement	Large number of planned actions to address material risks/issues, low likelihood of losses occurring;
4. Requires immediate improvement	Actions need to take place in short time frames to address material risks/issues, high likelihood of losses occurring/losses being incurred; and
5. Disclaimer	There may be rare occasions when we are unable to give an opinion, e.g where there is an issue with such impact, complexity and/or uncertainty that we are unable to reach a reliable opinion. In such circumstances we will explain our position fully.

minutes suggests that whilst there was some concern at the position it took too long for progress to be made by the Executive team under the scrutiny and oversight of the Audit Committee in addressing and reducing the significant number of 'red' category audit actions. The position improved to a degree in 2008/09 especially since the appointment of a new Chair of the Audit Committee in November 2008. However we have concluded that the prioritisation and pace of actioning of recommendations was slow

Evidence from the fact finding interviews confirms that a substantive change in performance, ownership and organisational focus on internal control and compliance has now been established as a direct result of the appointment of the current CEO appointed in July 2009. The NIW Chair advised the IRT that the CEO was given this in writing on appointment as one of his priorities.

In July 2008 NIW appointed a Governance and Internal Audit Manager with the intention being to develop the in-house Internal Audit function within NIW. In January 2010 the Governance and Internal Audit Manager became the designate Head of Audit and is due to take up the substantive post on 1 April 2010.

In terms of prominence, the in-house Internal Audit function reporting lines were changed in January 2010 to have it report to the Director of Finance, Regulation and Commercial. Prior to this, Internal Audit reported to the Head of Corporate Governance.

3.4 Findings

Whilst the absolute number of failures to adhere to controls within the Contracts Approval Internal Audit report has changed from the first draft to the final 27th January report, it is important to emphasise that the substance and significance of the report findings remain unchanged. We do not accept that the contributory factors outlined earlier in this report excuse failure to adhere to established controls. The IRT's overarching finding is that the failures noted within the report are of a significant nature and represent a serious breakdown (in terms of the quantum of cases and monetary value) in the governance and control framework of NIW. In addition we have noted the findings of the review into Contractor A and the further examples of serious control weaknesses from the emerging findings of the deep dive audits and conclude that the overall position is of the utmost concern and that urgent remedial action is needed within NIW.

As noted above, the evidence presented to the IRT confirms the existence of a governance and control framework that is approved by Board and is understood by the Executive Team. The breakdown in the application of the governance and control framework is a serious matter for those responsible and accountable, primarily the Board of NIW and the Executives responsible for ensuring compliance.

The IRT considered whether the governance failures identified in the Contacts Approval Internal Audit report are systemic. Our initial analysis was that whilst there had been non compliance with the control framework, it was not clear that there was a systemic failure. However, in light of the emerging findings from the deep dive audits, provided these are validated by due process, a finding of systemic failure in operational procurement would be justified.

The annual internal audit opinion is the main form of advice to the NIW Board and Executives on the control assurance environment. This has remained at Category 4 (requires immediate improvement) since NIW's inception. Whilst there is evidence that progress is being made in addressing and reducing the large number of 'red' category

audit actions, the prioritisation and pace of actioning of recommendations by the Executive Team, under the Board's guidance, has not been adequate. This pace and prioritisation has increased significantly and appropriately under the current CEO.

4 Analysis of Failures by DRD as Shareholder

4.1 Background

The Shareholder Unit (SU) in DRD was originally established as one element of the overall governance model appropriate to NIW as a government owned company.

As noted previously, from 2008-09 NIW was categorised as an NDPB for public expenditure purposes. This was an indirect result of the deferral of domestic water charging which necessitated the continuation of funding by DRD. This change in status coupled with the overall desire of the DRD Accounting Officer to improve public accountability led to the governance architecture for NIW being strengthened in May 2008. The current governance structure is summarised in Table 4.1 below.

Table 4.1
DRD Governance Oversight Arrangements

<i>MONTHLY</i>	<i>QUARTERLY</i>	<i>BIANNUALLY</i>	<i>ANNUALLY</i>
Meeting with NI Water Finance and Regulation Team to monitor financial and non-financial performance of the company in the period	Quarterly Shareholder Meeting (QSM) – main forum for holding NI Water to account	Meeting with the Chair of the NI Water Audit Committee and DRD Senior Finance Director and Director of Shareholder Unit to provide assurance that the Audit Committee is operating effectively and to identify and escalate issues as necessary	Meeting between DRD Minister and NI Water Chair to discuss NI Water’s performance
Post Board Meeting involving NI Water Company Secretary and Director of Shareholder Unit	Pre-QSM ‘Ground Clearing’ Meeting involving NI Water finance and performance team and Shareholder Unit to examine detail of QSM pack and to report issues/concerns by exception to QSM		Meeting with NI Water Senior Independent Director and DRD Permanent Secretary/DRD Minister to discuss Chair appraisal/performance
NI Water Business Improvement Team Meeting to	Meeting between Shareholder and NI Water NEDs in advance of QSM to focus on strategies		

monitor progress on the Programme and expenditure against the Budget	and overall financial health and performance of the company and to allow NEDs to raise any governance or senior staffing issues		
Meeting involving DRD Senior Finance Director, Director of Shareholder Unit and NI Water CEO	Post NI Water Audit Committee Meeting involves Shareholder Unit and NI Water Internal Audit & Governance Team and allows the Shareholder Unit to raise questions on internal audit reports and to receive progress reports on implementation of recommendations		
	Post NI Water Asset Investment Committee Meeting to monitor progress on the Capital Works Programme		
	DRD/NI Water bilateral Meeting to discuss operational issues between the two organisations, including governance of NI Water operational performance		
	Output Review Group Meeting attended by DRD, NI Water and key stakeholders to provide a forum for stakeholders to define key outputs from the water and sewerage industry, inform and be informed on these outputs, and monitor output performance		

4.2 Analysis

The issue for the IRT in fulfilling its terms of reference is the extent to which the DRD governance architecture, described above, and its application contributed to the governance failures detailed in Section 3.

Non-Executive Director Capacity

Under the Governance arrangements for NIW DRD, as Shareholder, appoints the Chairman and all other NEDs and participates in the recruitment of the CEO and consents to the appointment of Executive Directors (at Board level). In accordance with good governance practice the shared view between the DRD and the NIW Chairman on Board composition was that the optimal number of Directors on the NIW Board should be 5 Non-Executives and 3 Executives.

On 19 July 2007 one of the NEDs and Chair of the Audit Committee resigned from the Board. As the Independent Water Review was then underway the decision was taken to hold off replacing the NED pending the Review's outcome. We understand that, in response to the NED capacity position, the Department prepared a submission to the DRD Minister advising on the appointment of interim NEDs to the NIW Board for a period of 6 to 12 months, pending the outcome of the Independent Panel Review. However, Departmental Officials were advised that the Minister was concerned that this would present as a statement of intent and as a result no new NEDs were appointed while the review was ongoing. This meant that from July 2007 to May 2008 the number of independent NEDs was below the originally planned levels and, this position was further exacerbated when in June 2008 the Shareholder appointed the Chair into the dual role of Chair and CEO following the departure of the first NIW CEO.

The reduced capacity amongst the NEDs led to a doubling up of roles. In addition, following the resignation of the first Chair of the NIW Audit Committee the Chair of the Board became a proxy member of the Audit Committee to fulfil the quorum requirement. This did not comply with Point 2, 4 of the Combined Code 2003 which states that:

“the Chairman of the Company should not be an Audit Committee member”.

The position improved from end July 2008 when two additional NEDs were appointed. A new CEO took up post at end July 2009 and this brought the Board complement up to the agreed level for the first time since vesting.

NIW highlighted its non compliance in the Corporate Governance section of its Annual Report & Accounts for 2007-08 and 2008-09. The NIW Chair also raised the matter with the Shareholder on a number of occasions.

The Panel Report was published in late January 2008 and DRD launched a public appointments process in early February with appointments made in July 2008.

Appointment of Chair as interim CEO

As noted above, following the departure of first CEO of NIW at end May 2008 we understand that the Board, in full consultation with the Shareholder, considered a number of options for a replacement CEO. These included:

- immediate commencement of recruitment process for a successor;

- appointment of another member of the executive team on a temporary basis and then commencement of a recruitment exercise;
- appointment of an interim CEO from outside the company and then commencement of a recruitment exercise; and
- combining of the Chairman and CEO role for a limited period and then recruit into the role.

We understand it was not thought an external recruitment was practical at that point given the uncertainty that then surrounded the future of the company and the difficulty this would have created in attracting the right candidate. It was concluded that there was no clear candidate from within the Executive Team. We understand continuity was a major factor in arriving at the decision with the Shareholder to appoint the Chairman as acting CEO in May 08. We understand the Shareholder was consulted at each stage and endorsed the decision to combine the Chairman and CEO role for a limited period before advertising.

The fact finding interviews confirmed the expectation of both the Board and the Shareholder was that this combined role would be for a period of approximately three to six months. In effect the dual role continued for 14 months.

We understand that whilst the responsibility to appoint the CEO is that of NIW, DRD is required to secure DFP approval to NIW Board Remuneration and that proposals were initially submitted to DFP by DRD in August 2008 with approval being given in November 2008 at which point the competition for the position was then launched by DRD.

This decision by the Shareholder was contrary to the guidance set out within the Combined Code that clearly stated that the roles of Chairman and CEO should not be exercised by the same individual. (Combined Code A.2.1).

The evidence considered by the IRT confirms that the Chairman in his role as interim CEO made a significant contribution to the steadying of NIW and in particular to the focusing of the organisation on its core business; in developing the capability of the management team and in developing much stronger set of stakeholder relationships.

Designation of NIW CEO as Accounting Officer

The issue of supplementary governance arrangements by the DRD Accounting Officer in May 2008 focussed on assurance statements, access to internal audit reports, risk management with NIW and business cases and post project evaluations. Following an exchange of correspondence the DRD Accounting Officer and the Comptroller and Audit General addressed the NIW Board in June 2008 and underlined the Audit Office's expectations of DRD's accountability for NIW and the implications of NDPB status in that regard. DRD advised it was in June 2009, linked to finalisation of DRD Accounts, that the full implications of the re-classification were understood.

In September 2009 the DRD Accounting Officer designated the recently appointed NIW CEO as Accounting Officer for NIW. The NIW Board's acceptance of this is minuted at its Board meeting of 28th August 2009. In a letter dated 4th December to DRD NIW Board made it clear that it accepted the Accounting Officer arrangements on the basis that they were not intended to undermine the role of the CEO and NIW Board and compliance

with duties of a director of the Company would take precedence in legal terms over obligations as Accounting Officer.

The Board's concerns about the potential for conflict of interest between the CEO's Accounting Officer role and this role as Director of the company was acknowledged by the DRD Permanent Secretary (18th December 2009) where he commented that to avoid potential conflict there would be a need for ongoing co-operation between the NIW Board and the two Accounting Officers.

In the Board's opinion this constituted an agreed protocol that was not followed in the handling of the Contracts Approval Internal Audit Report by the Accounting Officers.

NIW Internal Audit

We comment in Section 3 on NIW's audit and compliance environment. We also examined how DRD had responded to the emerging issues on the Category 4 annual assurance rating (requires immediate improvement) for NIW's system of internal control and risk management.

We note that in May 2008 the DRD Permanent Secretary issued revised governance arrangements which dealt inter-alia with timely delivery of NIW's Assurance Statements and audit matters and including a request to provide minutes of Audit Committee meeting which we understand is not being complied with to date. It was August 2008 before DRD received copies of NIW's internal audit reports. Also the NIW's bi-annual representations on internal control have consistently from July 2008 to date reported only 'partial compliance' with the requirement to actively follow up internal and external audit recommendations.

DRD was therefore aware that there was an inherent weakness in NIW's internal control framework and the matter was raised from time to time at QSM meetings and in correspondence. However, it was only recently agreed that the Chair of NIW's Audit Committee would have a bi-annual meeting with DRD's Senior Finance Director and Head of the Shareholder Unit which would review assurance on the work of NIW's Audit Committee and identify and escalate any issues as necessary. DRD told us that at the February 2010 QSM meeting with NIW an internal audit report tracking all 'red' recommendations and the improvements which have been made was tabled for the first time. We were informed by DRD that the issue of NIW's internal audit reports to the Northern Ireland Audit Office was the subject of correspondence with NIW's Chair of the Audit Committee.

4.3 Findings

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

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

- strengthening NED capacity and ensuring this was in line with good governance;
- appointing a new CEO following the Chair's appointment into dual role; and
- appointing the CEO of NIW as Accounting Officer immediately following reclassification of the organisation as an NDPB.

The IRT recognises that the delays outlined above were in part due to the complex political environment surrounding the Water Reform programme and in part due to the timeline required to secure inter-Departmental approvals and clarification with DFP.

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

In terms of DRD's role in the Internal Audit environment of NIW we consider that prior to May 2008 DRD was slow to act to ensure that NIW was taking internal audit matters seriously. Recent events have demonstrated that the DRD has given enhanced attention to NIW's performance in following up audit recommendations. The Department has been encouraged by the increased attention this matter has received under the direction of the current CEO to whom it has given strong support and encouragement.

5 Recommendations

5.1 Overview

The IRT has concluded that the failings noted in the Contracts Approval Internal Audit report represent a serious breakdown in the governance and control framework of NIW. The breakdown in the application of the governance and control framework is a serious matter for those responsible and accountable, primarily the Board of NIW and the executives responsible for ensuring compliance.

The control assurance environment of NIW, the independent objective process designed to assess the financial health of the company's operations and governance processes, has remained at Category 4 (requires immediate improvement - high likelihood of losses being incurred) since inception. The IRT has concluded that the prioritisation and pace of actioning of Internal Audit recommendations by the Executive Team and the scrutiny and challenge provided by the Audit Committee and the Board was inadequate. It has noted that following the appointment of the current CEO the focus and priority given to these issues has improved.

As detailed in Section 2 of this report, the IRT is aware of a serious breakdown between the NIW Board and its CEO over the way the Contracts Approval Internal Audit report had been notified to the Shareholder without consideration by the NIW Board. The IRT has been advised by the Chair of NIW that, in his opinion, the CEO does not have the trust and confidence of the Board and that this position is now irreconcilable. The CEO advised the IRT of a breakdown in trust between himself and the NIW Board.

The IRT is concerned about the severe difficulty this situation causes in enabling the Shareholder and NIW to put in place the necessary remedial action plan to implement the recommendations of this review and to deal with the emerging findings of, amongst other things, the deep dive audits. It is our view that this situation cannot be allowed to continue and appropriate and action must be initiated by the DRD Accounting Officer to ensure that a proper governance and control environment is secured within the NIW as a matter of urgency. In our view this would be best secured by tasking the current CEO and NIW Sub-Accounting Officer to deliver the agreed action plan, supported as necessary by DRD.

Given the circumstances described in our report, we consider that a firm action plan is required to establish the appropriate governance and control framework for NIW going forward. We have set out a number of detailed recommendations below.

5.2 Further Action to Address the Governance Issues Surrounding Procurement

We recommend that:

- The NIW CEO should ensure that there is a transparent 'end to end' governance system in relation to procurement processes, which will provide a robust control framework in relation to business cases, tendering activity, financial delegations, payments and the collation of management information;

- the deep dive opex audit and analysis; the below £500k capex audit and analysis and findings; and the invoice slicing audit investigation and findings must all be pursued with vigour and reports made available as soon as possible. The findings must be considered in detail and any necessary further work commissioned;
- the NIW CEO should undertake a detailed mapping of Executive accountabilities for failures noted within the Contracts Approval IA report, the deep dive audit and the below £500k capex audit;
- the NIW Board should determine responsibility for procurement governance and compliance in support of the NIW CEO. In our view the possibilities are the Director of Finance or a dedicated Compliance Officer;
- the NIW CEO should ensure that Procurement compliance is included as a standing item on the NIW Executive Committee and Board agenda; and
- the NIW CEO should establish and implement a training programme for the senior management team of NIW on the creation of business cases, tendering activity, financial delegations, payments and the collation of management information.

5.3 Additional Governance to be introduced by NIW

We have three recommendations relating to Internal Audit in NIW which are designed to ensure that Internal Audit is an independent, objective assurance activity designed to add value and improve operations. By bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. The Audit Committee of the Board of NIW and the NIW CEO should:

- change IA reporting lines within NIW so that the unit is accountable direct to the NIW CEO and Accounting Officer and to the Chair of the Audit Committee;
- ensure that it provides proper oversight and validation of the work of IA; and
- review the adequacy of IA resources and conduct a benchmarking exercise of the IA unit.

5.4 Position of the NIW Board Members and other Senior Managers Involved in these Issues

- we have identified at 5.1 the urgent action that should be taken to resolve the disconnect that presently exists between the NIW Board and its CEO;
- we have found it impossible, within our timeframe, to establish which executives within NIW should be held responsible for the failures noted to date. We therefore recommend that the NIW CEO, should initiate a detailed mapping of responsibility for failures noted within the Contracts Approval report. This should lead, where necessary, to disciplinary action;
- the NIW CEO should review the structure of the Executive Team including lines of accountability and responsibility and ensure clarity and alignment of executive's objectives and KPIs; and

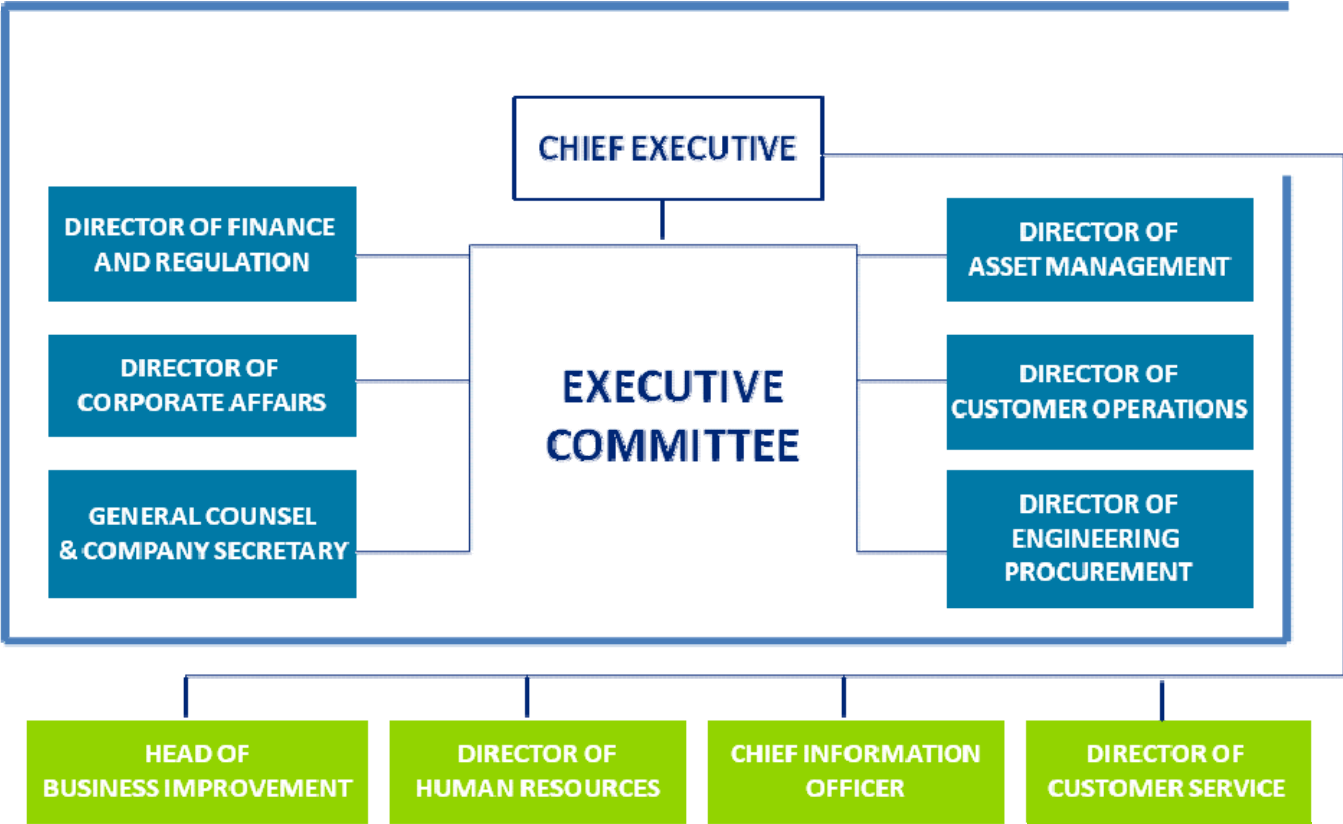
- the NIW CEO should give clear leadership to the executive team in relation to the importance of internal controls and the implementation of IA recommendations. Specifically, the CEO should establish clear performance targets on internal audit compliance for individual members of the executive team and Level 3 managers.

5.5 Recommendations to DRD as Shareholder

- we recommend that the DRD Minister and the Department, working with NIW, should take urgent action to create an appropriate governance and control environment within NIW;
- as an interim step and in order to strengthen the current governance arrangements, DRD should be represented on the NIW Audit Committee;
- DRD should satisfy itself as to the robustness of the ongoing work by NIW IA on procurement governance and control issues. In particular, DRD should ensure that this work is subject to ongoing independent validation; and
- DRD should review the appropriateness of present authority levels in respect of, amongst other issues: staff substitution, consultancy and STA's.

Appendix I: Contracts
Approval Internal Audit
report of 27th January 2010
plus addendum of 10th
February 2010

Appendix II: Organisation Chart for NIW's current Executive Committee



Appendix III: Key elements of the risk management control and governance arrangements

- The Governance Letter sets out the principles underpinning the relationship between NIW and DRD as its only Shareholder. The governance arrangements are based on the SE approach for public sector shareholders;
- DRD has established a framework of Key Performance Targets which sets out the specific measures of performance which it expects NIW to achieve in each business planning period;
- The SU monitors and evaluates both business and performance and progress against the plan at monthly meetings with the NIW Finance Directorate. In advance of the monthly meeting copies of the NIW Board Pack, KPI's and management accounts (including Profit and Loss, Balance Sheet, Cashflow budget, actual and quarterly reforecast, capital works programme, quality of service reports) are reviewed. SU will raise issues identified from the review process at the monthly meetings with NIW;
- Quarterly Shareholder Meetings ("QSM") are held with the NIW Chair and Board members. The SU requests explanations and seeks corrective action from NIW to address any areas of poor performance. The SU prepare a report following each QSM for the Minister and DRD Board which summarises the issues arising and includes the agenda, minutes from the meeting and resultant actions;
- The DRD Minister meets with the NIW Chairman on an annual basis to discuss NI W's performance;
- The DRD SU entered into a Memorandum of Understanding with the SE which provides DRD with access to qualified and experienced staff to assist it on an ongoing basis. In particular, the SU monitors NIW's financial and non-financial performance, reviews NIW's annual business plan and advises on bonus proposals. A representative from the SE is in attendance at the QSM;
- In accordance with the Governance Letter the SU is provided with a copy of the Regulatory Accounts;
- DRD as Shareholder approves the NIW business plan and budget. The approval of the plan is in the form of a letter from the DRD Minister to the NIW Chairman detailing the approval and any conditionality, if necessary;
- The SU is provided with a quarterly report from NIW's Risk and Reputation Committee and Corporate Risk Register which is reviewed and discussed as part of the QSM;
- The NIW CEO's and the Executive Team bonuses are submitted to the DRD Minister and then DFP for approval; and
- On receipt of each loan note request a checklist is completed by the SU that covers all areas of compliance with the Loan Notes Subscription Agreement. The loan note is recorded on the Loan Note monitoring spreadsheet which also calculates the interest due.