MARTIN JENKINS

# THREE WATERS REVIEW

## Report

**The Interface between Asset Management and Council Governance Practices**

6 December 2017

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# PREFACE

This report has been prepared for the Department of Internal Affairs by Doug Martin, Paul Clarke, Philippa Bowron and Morgan Hanks from MartinJenkins (Martin, Jenkins & Associates Limited).

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# INTRODUCTION

The three waters review aims to develop key longer-term improvements to the whole system. It has three focus areas: financial incentives; asset management practices; and compliance and monitoring. As part of the asset management focus area, we were asked to consider local government sector practices at the asset management-governance/decision-making interface for three waters.

This report is intended to provide an evidence-based assessment of current practices, and identify good practices and potential opportunities for systemic improvements.

The scope of the report includes observations on arrangements for governance decisions about strategic direction, investments, levels of services, responses to risk, and current and future demand for three waters services. The report considers the quality of information given to decision-makers, and whether it provides a robust basis for their decisions.

## Our approach

The approach we used to assess existing governance arrangements included the following:

- a review of past reports relating to three waters asset management in New Zealand
- a desk review of available information on governance arrangements
- developing a governance framework to establish a baseline understanding of what good governance should look like in the area of water asset management, and also to inform our interview questions
- face-to-face interviews with elected members and senior officials from a representative sample of councils and relevant council-controlled organisations
- a workshop with Zone 2 Local Government New Zealand members
- analysis and reporting.

Although the purpose of the review was to inform the development of a problem definition, where appropriate (and as agreed with DIA) we have also identified some opportunities for improvement.

The most significant part of this work was the face-to-face interviews. This had the advantage of allowing us to engage with a variety of council sizes and types and cover a range of dimensions of the governance/asset management interface. This approach largely depends on the self-assessment of the interviewees; however, we were able to test this to a degree, through follow-up questions. This allowed us to make observations on practices and issues.

## The governance framework we developed

Although there is extensive literature on asset management good practice, there is little on asset management governance specifically. We therefore developed an asset management governance framework, setting out the key features we would expect to be in place for robust governance. We did this using our experience of governance in a range of contexts and drawing on a number of sources on good governance and good asset management practice.

- The framework is summarised in Figure 1, and is explained in more detail in Appendix 2 on page 32. Appendix 2 also identifies the sources used.

We used this framework as a basis for assessing the adequacy of governance arrangements in place across the country, and as the basis for our interview questions.

The framework identifies:

- **governance functions** that should be the primary focus of those responsible for governance
- detail on the **scope** of those functions
- **characteristics of good governance** that sit across the functions and that should be taken into account in discharging those functions.

The scope of the framework is broad. This is consistent with the OECD's definition of 'infrastructure governance':

- By the governance of infrastructure is meant the processes, tools and norms of interaction, decision-making and monitoring used by governmental organisations and their counterparts with respect to making infrastructure services available to the public and the public sector. It thus relates to the interaction between government institutions internally, as well as their interaction with the private sector, users and citizens. It covers the entire life cycle of the asset, but the most resource intensive activities will typically be the planning and decision-making phase for most assets.[1]

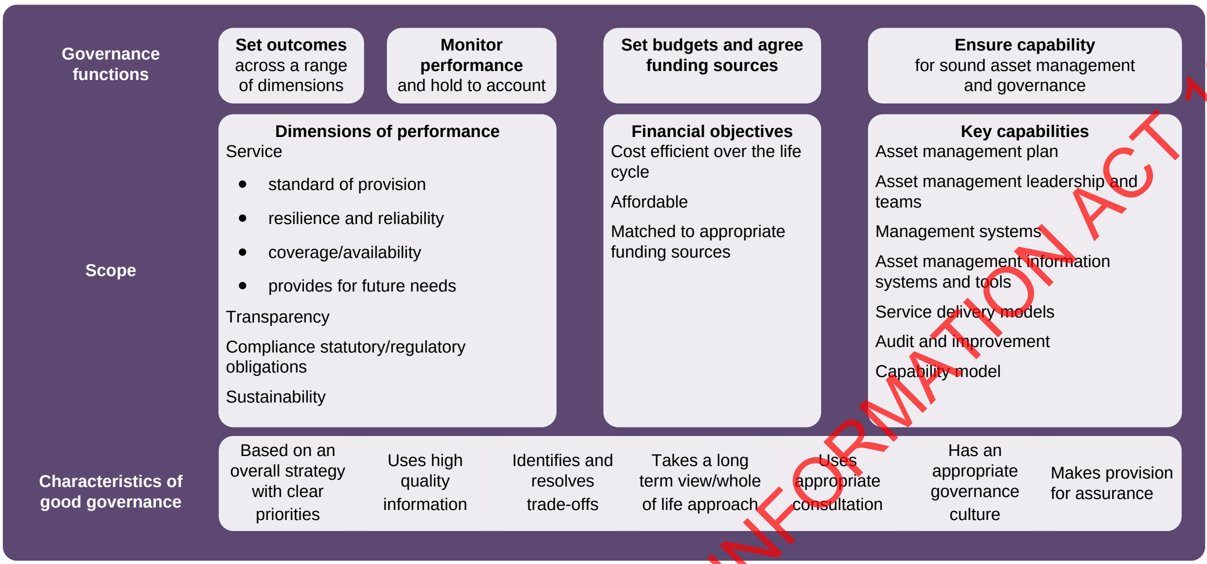
The multi-dimensional character of robust governance has two implications.

- Part of the art of good governance will be applying appropriate attention to the different dimensions, recognising that these might vary over time.
- Governance is likely to be a shared responsibility. This is reflected in practice.
  - In the case of a council-controlled organisation, the board and the supervising council committee both have roles.
  - Where there is no council-controlled organisation, the council and senior management have roles.

However, this sharing of roles raises the possibility of blurring of accountabilities, as we discuss in the section 'Separation of governance and management' on page 17.

[1] http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=GOV/PGC/SBO(2015)6&docLanguage=En

**Figure 1: Governance framework**




# Interviews

In order to ensure a representative and appropriate sample of councils, we selected a cross-section taking into account type (regional, district, city), population size, demographic profile, geographic profile, rating base/economic profile, asset composition, and whether councils are using shared services. Table 1 below lists the councils that were selected for interviews.

**Table 1: Councils interviewed for water asset governance**

| | Council |
|---|---|
| 1 | Auckland Council |
| 2 | Hamilton City Council |
| 3 | Matamata-Piako District Council |
| 4 | Wellington City Council |
| 5 | Tauranga City Council |
| 6 | Western Bay of Plenty District Council |
| 7 | Whakatāne District Council |
| 8 | Kawerau District Council |
| 9 | Christchurch City Council |
| 10 | Selwyn District Council |
| 11 | Hurunui District Council |
| 12 | Waimakariri District Council |

In each case we interviewed:

- the Mayor and/or Deputy Mayor, and where possible another elected member
- the CEO, and where possible senior council officers.

In most cases the councillors and officers were interviewed separately.

Auckland Council and some of the Wellington region's councils differ from the other councils in that they manage water assets through council-controlled organisations: Watercare in Auckland, and Wellington Water. (An exception is Auckland's stormwater, which is managed internally.)

In Auckland, we interviewed the Auckland Council's Mayor, Deputy Mayor, and CEO and Watercare's senior management. In Wellington we interviewed the Deputy Chair of the Water Committee (Mayor of Upper Hutt Council), the Chair of Wellington Water, the CEO of Wellington Water, the Mayor and the Water portfolio holder at Wellington City Council and the CEO and two Senior Managers at Wellington City Council.

The basis for the questions in the interviews was the governance framework (Figure 1 above). Interviews typically lasted an hour. While some of the questions were consistent across interviews, we followed leads, local issues and factors that came up in conversation to ensure we got the best insights. Because of that more varied approach, we are not able to report on the interviews as if they were surveys and to provide a full comparative analysis across councils; however, the interviews were valuable in informing our views and observations.

# FINDINGS AND OBSERVATIONS

This section sets out the key findings from our review of the interface between governance and asset management for three waters within local government in New Zealand. It includes a summary of our advice in response.

Our findings are based on our assessment of the status quo, on our experience in the governance area, and on our interviews with elected representatives and officers of the selected councils (listed in Table 1 on page 3).

## Governance structures

### Summary of current arrangements: Three broad models

There are three broad structural models used across councils for providing public water services in New Zealand; the governance implications for these types vary in nature but not in significance.

- **Council elected member governance**: In most of the country, councils manage water services directly, using the elected member governance model.
- **Asset-owning council-controlled organisation**: In Auckland a council-controlled organisation, Watercare, wholly owns Auckland's potable and wastewater assets for a single (Auckland) council.
- **Asset-managing council-controlled organisation**: In the Wellington region a council-controlled organisation, Wellington Water, manages but does not own the three waters assets of multiple councils.

There are some variations within the first, elected member governance model. Manawatu and Rangitikei have a shared arrangement for water, while many other areas, such as Waikato, Taranaki and Christchurch, have local authority shared services (LASS). In the three waters context, LASS mostly involve agreements to collaborate around training and expertise, but sometimes include specific shared services with respect to individual water sources or treatment plants.

Further details of the models are set out in Appendix 3.

### Council elected member governance: the predominant model

The majority of the councils we interviewed were operating the elected member governance model. Here, three waters services and assets are governed in the same way as any other council operation, typically with council committees focusing on specific aspects of governance and reporting to council by way of council meetings.

Typically, up to three committees may be involved, including:

- an audit and risk committee considering risk management
- a committee monitoring outcome performance and the implementation of new investments

- a planning committee, which plans any major new investments (often within the context of councils' long-term planning).

Overall feedback from the councils on the elected member governance model was that the elected members are happy with it (with a couple of exceptions). However, many council officers see opportunities for improvement and a number of elected members perceived a need for improvement in other councils. As discussed further below, both elected members and officers have taken steps in recent times to improve three waters governance, particularly in risk management.

It should be noted that councils vary significantly in the challenges they face in respect of three waters asset management including: status of the assets; the extent to which future upgrades are funded; the scale of services; their ability to attract and retain suitably qualified staff; and the physical operating environment. All of these have an impact on what is required for robust governance.

## Setting outcomes

Our interviews led us to believe that there is variation across councils in the setting of outcomes. Elected members in their governance role seemed confident talking about community outcomes, including risk management. By contrast, operational outcomes and attention to less immediate risk tended to be proposed and managed within the organisation and communicated to the governance group.

This in itself is not an issue as long as the governors have a view on the trade-offs and compromises involved in this. In our interviews, some councillors provided us with examples of options, trade-offs and consequences being clearly presented to them by officers; others were comfortable with being presented with a yes or no decision.

In some instances council officers have brought in external expertise to assist with some of the kinds of outcome setting that would normally sit with a board. This also helps provide some of the different perspectives that a professional board would have. While this is the best proxy officers can implement, it is not a complete substitute for an independent board as it can create concerns around inadequate separation of governance and management, as we discuss on page 17.

## Monitoring performance

Again there was variation in the levels of monitoring across the different councils. All councils focused on legislated monitoring (for example, drinking water quality) and on financial inputs like asset performance modelling and associated investment requirements (sweating the asset). Some provided us with evidence of monitoring community satisfaction.

Larger councils reported more comprehensive monitoring, including complete reports on state of assets that feed into associated risk assessments, performance predictions, and options for addressing issues and their implications.

None of the councils we interviewed had performance measures in respect of the three waters through to governance on strategic areas like capability development, strategic procurement, and systems improvements. As a result, there is limited assurance that these are optimised.

We noticed significant differences in the amount of public information available on council websites in relation to water services and the outcomes set and achieved for them.

We observed a number of issues with water monitoring at the technical level.

1 While non-treated water sources were generally well monitored, the results of monitoring tests take some time, and a water-borne disease could by then already have taken hold and spread.

2 Nearly all councils observed that their focus on risk had increased significantly since the contamination incident in Havelock North. Our concern is that the current emphasis on monitoring is not systemic and might continue only while the memory of the Havelock North incident is fresh, and therefore that the levels of diligence we observed may not be long term.

3 The expectations around levels of monitoring and reporting are typically driven by the CEO and council officers, rather than the governance group, and so accountability is blurred. As with outcome setting, a few CEOs told us they have strengthened internal governance to mitigate risk around this.

## Setting budgets

We found in our interviews that budget setting is reasonably consistent and tied to asset performance. There was an acknowledgement that recent water issues had focused councillors on the importance of getting this right, and both councillors and officers stated that water was given priority over other investment needs. Councils have to navigate the consequences of past asset funding decisions, and some have residual issues (lack of asset depreciation) from previous years that affect their current budget considerations. Most, but not all, seemed well aware of these and had plans in place to address them.

There is a severe affordability issue with some of the councils we interviewed, and several expressed their fear that increased water regulation would place a greater financial burden on them.

There is little accessible information about strategic budget setting for three waters available in any of the documentation we were given or on council websites. We have therefore only been able to refer to our interviews as the basis for our comments on this aspect of governance.

## Ensuring capability

Capability at governance level in councils is different from that in many typical governance arrangements, as the governance role is played by elected members, rather than appointed professional directors. This has the advantage of ensuring better community representation, but it also means there is not deliberate representation of a broad range of perspectives and skill sets.

With the councils we interviewed the governance is often supplemented by external representation – usually an independent chair – on the Audit and Risk committee. This goes some way to providing committees with more typical governance expertise, but it usually involves only one person and covers only one part of the governance function. Some councils do not believe external representation is necessary and in those cases the council officers had made arrangements for incorporating external expertise in the council's internal governance arrangements.

Only one council mentioned governance training, but that was not in relation to water asset management specifically. We understand that most councils do provide governance training, but we did not get a sense of whether any training opportunities had been taken up with respect to three waters governance.

There is a large variation in the extent to which those in the governance role consider the council's capability requirements. There was no real discernible pattern as to which councils took more interest or less interest in this aspect of governance. Size and financial constraints did not seem to be factors here to the extent that they were in the other areas we looked at.

Most councils reported making recent efforts to improve asset management and/or asset management capability. In a number of cases, asset management was reported to have been relatively weak in the previous three years.

## Characteristics of good governance

The following table sets out our findings on the extent to which councils using the elected member governance model met the characteristics of good governance in discharging the functions discussed above.

**Table 2: Quality of governance under council elected member governance model**

| Aspect of governance | Comment |
|---|---|
| Based on an overall strategy with clear priorities | Strategy appears to be mostly developed in the context of formal Long Term Plans and Infrastructure Strategies. Some councils were taking a strategic approach to asset replacement and some were not. This is most evident in the varying approaches to treatment of depreciation and asset renewal budgeting. |
| Uses high-quality information | Councils appear confident in the information received, but the information we were shown by councils varied in quality and depth. Only some were able to support the articulated levels of confidence with examples. |
| Identifies and resolves trade-offs | Key trade-offs are mostly made in the context of councils' formal long-term planning. Options and issues are presented by council staff. The process of taking elected members through this appears to work well. There may be opportunities for greater consideration of the trade-offs. |
| Takes a long-term view / whole-of-life approach | Generally a long-term view is taken of asset management through the asset management plans, and budgets are dictated by the formal requirements for Long Term Plans. These are 10 year plans, significantly shorter than the life of relevant assets. |
| Uses appropriate consultation | No issues of consultation arose in our interviews. However, there is a lot of variance between councils on what information is shared with the public. Some councils have quite detailed information available on their websites and some have no information outside their planning documents. |
| Has an appropriate governance culture | The primary concern of the elected officials we spoke to was on substantive asset management matters, rather than governance issues per se. While there have been improvements in governance in recent years, it is not clear that there is an embedded focus on how to do governance better. As a result there is a risk that any recent gains may not be sustained. |
| Makes provision for assurance | We encountered a number of examples where an independent review of asset management arrangements was undertaken. |

| Aspect of governance | Comment |
| --- | --- |
| | However, these were usually on specific details only, rather than end to end, and were often instigated by officers not governance. |

### General observations

The elected member governance model relies on elected community representatives having the skills required for governing a complex set of assets and engineering systems, and there is no way to provide assurance of that if no external expertise is sought to complement elected member governance.

Most councils noted that that they had made a number of improvements to governance arrangements in recent times. Further details are provided on page 16 below.

However, we are concerned that, without systemic change, this attention could wane as recent water issues become more historical.

We also noted instances where arrangements are clearly not working well.

- In one instance the elected members were not giving adequate consideration to risk, had only a limited understanding of the network, and almost no visibility of issues, commenting that they 'don't get involved in details'.
- In another instance, there was a complete divergence of views between elected members and officers on the extent to which drinking water assets were fit for purpose in providing safe drinking water.

In general, we found that elected members did not have a consistently clear and comprehensive view of what is involved in 'good' water asset management and 'good' governance of water assets. That conclusion is supported by the Zone 2 Local Government New Zealand meeting where the feedback on what could assist with better governance included requests for clearer standards, better guidelines, professional development and requirements around best practice.

There was one example that in our view had aspects of best practice governance. Here, elected members were able to show us information on the status of the network, and also to talk to us about how it compared to previous years and detail the plans to improve it in upcoming years. In this specific case they were also able to talk confidently in more detail and about different aspects of the asset and risk, including risk mitigation plans. This was at a larger council that had better economies of scale than most of the others we interviewed.

## Council-controlled organisation models

As noted on page 5, there are two exceptions to the use of the council elected member governance model, both of which involve council-controlled organisations (CCOs). Those two alternative arrangements are described, in turn, in the following two sections.

This section provides a brief overview of council-controlled organisations and the mechanisms for that control.

Council-controlled organisations are regulated under the Local Government Act 2002. Ultimate control rests with council(s). This is normally discharged by a council committee. Where multiple councils have a controlling interest, there is typically a committee with elected member representatives from each of the participating councils.

The parent council exercises control through a number of mechanisms, notably:

- the organisation's constitution
- the appointment of directors
- annual Statements of Intent that include statements of service performance and associated measures
- monitoring and reporting arrangements.

This is effectively a two-tier system. It allows elected members to focus on service performance and community requirements, with the council-controlled organisation's board covering capability, holding the its executive to account, and providing the more general characteristics of good governance.

## Asset-owning council-controlled organisation: Auckland Watercare

Management of Auckland's three waters services is split between direct council management for Auckland's stormwater services and a council-controlled organisation, Watercare, which provides Auckland's drinking water[2] and wastewater services and owns the associated assets.

We interviewed the Mayor and Deputy Mayor of Auckland Council, the CEO of Auckland Council, and a number of senior leaders in Watercare.

Our overall observation of this model is that it works well. We observed in particular a high level of awareness and expertise across the dimensions of the governance framework.

### Setting outcomes

Watercare's outcome-setting is well aligned with Auckland Council's Long Term Plan. Through our interviews and the documentation provided to us, we observed, across a range of dimensions, particular competence in future planning, a high level of understanding, and strong capability also in communicating expectations to management.

### Monitoring performance

Watercare's board has a good level of governance oversight over the performance of the organisation, and relays that to the council. Watercare makes its Statements of Intent and Annual Reports[3] publically available on its website, along with a quarterly public newsletter, water quality compliance reports, and management plans.

[2] With the exception of reticulation in the Papakura area, which is managed by Veolia.

[3] The most recent is available at https://www.watercare.co.nz/SiteCollectionDocuments/AllPDFs/Annual-report-2017.pdf

Greater comfort about performance is one factor that has improved the relationship between Auckland Council and Watercare in recent years. This seems to be related to an improvement in managing the reporting and budgeting information flow.

### Setting budgets

Watercare's financial operations are largely dictated by Part 5 of the Local Government (Auckland Council) Act 2009. The Act requires Watercare to 'manage its operations efficiently with a view to keeping the overall costs of water supply and waste-water services to its customers (collectively) at the minimum levels consistent with the effective conduct of its undertakings and the maintenance of the long-term integrity of its assets'. The Act states that Watercare 'must not pay any dividend or distribute any surplus in any way, directly or indirectly, to any owner or shareholder'.

Our observations from the interviews was that the appointed board of professional directors applied a high level of scrutiny to the budgets in an effort to ensure efficiency.

### Ensuring capability

Our observation from our interviews and the documentation we sighted was that Watercare is an efficient provider with high levels of capability in governance and management, and high levels of professional and technical expertise. Watercare's governing board is aware of the levels of expertise within the organisation and is comfortable that these are appropriate. The board, which is appointed by the council, appears to have a high level of collective experience as professional directors and a broad range of skills, including commercial, financial, tax, regulatory, sustainability, research, public policy, engineering, project management, infrastructure, Iwi interests and resource development.

### Characteristics of good governance

While we did touch on stormwater management in our interview with Auckland Council, there was insufficient detail to enable analysis, so the following table focuses on the drinking and wastewater systems owned and managed by Watercare.

**Table 3: Quality of governance under asset-owning CCO model**

| Aspect of good governance | Comment |
|---|---|
| Based on an overall strategy with clear priorities | Drinking water asset strategy[4] and wastewater asset strategy[5] are publically available. |
| Uses high-quality information | Auckland Council has confidence in the information received, and it commented on the increase in Watercare's reporting to the council in recent times. |

[4] https://www.watercare.co.nz/CMSPages/GetAzureFile.aspx?path=~%5Cwatercarepublicweb%5Cmedia%5Cwatercare-media-library%5Creports-and-publications%5Cwater_asset_strategy.pdf&hash=549e8c60f98b6b074719d48883523b3016312d8c1c6912bb68bb35558c55dc7a

[5] https://www.watercare.co.nz/CMSPages/GetAzureFile.aspx?path=~%5Cwatercarepublicweb%5Cmedia%5Cwatercare-media-library%5Creports-and-publications%5Cwastewater_asset_strategy.pdf&hash=7cd5b77add4695aa96bb9c4853177417d47f5eb5ca4057b170c9ebb8a33369cc

| Aspect of good governance | Comment |
|---|---|
| Identifies and resolves trade-offs | Key trade-offs are mostly made in the context of council's formal long-term planning. Watercare seems to work well with council officers through the planning process. |
| Takes a long-term view / whole-of-life approach | Asset management plans are for a 20-year period. |
| Uses appropriate consultation | Council acknowledged a preference for better public-facing information and our observation is that there could be improvements in this area. However, the levels of consultation and public-facing information were better than for most other interviewed councils' water services. |
| Has an appropriate governance culture | The council elected member governance and appointed director governance appear to work well together and provide complementary aspects. There appeared to be mutual respect between the two governance layers. |
| Makes provision for assurance | The size of the water assets and the resulting size of the entity needed to manage it, alongside the expectations of the governance, mean that there is, in our view, reasonable provision for assurance. |

### General observations

The board of Watercare and the elected members had a good understanding of risk, including forward projection of risk associated with things like climate change and city growth.

This asset-owning council-controlled organisation model is both scalable and replicable. However, in many cases, we encountered no support from elected members for its adoption. The primary concern was a public perception that asset transfers potentially lead to privatisation. While there is a recognition from elected members and officials that this is unlikely to happen under the current government, they reiterate that it is a strong public perception based on previous asset privatisation experiences in New Zealand.

We did not explore the existing governance arrangements for stormwater (currently under the elected member governance model). However, following a recent value for money review, Auckland Council has announced it is considering transferring management of stormwater to Watercare under a contractual arrangement. 9(2)(g)(i) [redacted]

## Asset-managing council-controlled organisation: Wellington Water

All of Wellington's three waters services are managed by a council-controlled organisation, Wellington Water, which is a shared service organisation owned by Wellington City Council, Hutt City Council, Upper Hutt Council, Porirua Council and Greater Wellington Regional Council. Wellington Water is therefore both a model for governance and management arrangements and a model for shared services.

The governance consists of an appointed board of directors and the 'Water Committee', which consists of elected representatives of each of the shareholding councils (usually the Mayor or the Water portfolio holder). The Water Committee appoints and monitors Wellington Water's board.

We interviewed the Deputy Chair of the Water Committee, Wellington Water's Chair and CEO, the Wellington City Council Mayor and WCC's three waters portfolio owner, and Wellington City Council's CEO and senior officers.

The overall feedback from those interviewed was that this model has brought about a step change in all areas of performance, and that they are now working on improvements that are about 'degrees of excellence'. As with the asset-owning council-controlled organisation model, there are high levels of governance, management, and professional and technical expertise across the governance framework.

### Setting outcomes

The council-controlled organisation's board sets the requirements for the performance of the organisation as an entity by recommending and agreeing outcomes with shareholders through the Water Committee (elected members of councils). The board also works closely with the Water Committee to ensure that outcomes reflect each council's requirements and are integrated with the councils' Long Term Plans.

### Monitoring performance

The monitoring of each council's network is tailored to the particular council's requirements and reported back through the Water Committee and through Wellington Water's attendance at council meetings from time to time. Annual, half-yearly and three-monthly reports are made publically available on the Wellington Water website.[6] It is useful to note here the clarity of reporting against community outcomes and the separation of community and organisational outcomes.

### Setting budgets

Each council sets its own budget for water services. The budgets are set through the Long Term Plan process, with each council purchasing levels of service in consultation with its community, with advice from Wellington Water on what realistic options are available and the consequences associated with each option. Wellington Water and the councils attested to a close working relationship around budgeting.

### Ensuring capability

As with Watercare in Auckland, we observed a high standard of expertise at governance level, with that governance expertise also ensuring good capability at management level.

[6] For example see: https://wellingtonwater.co.nz/dmsdocument/179

The directors appointed by the Wellington Water Committee had significant experience in governance, as well as skills in law, finance, corporate governance, people and performance management, government and corporate relations, communication, community programmes, corporate affairs, infrastructure, risk management, business consultancy, local and central government, and economic growth.

The governors, both appointed and elected, attested to the high levels of competence and capability within the organisation and communicated high levels of trust. There is a good level of self-evaluation of capability, and this is also reported on publically in the half-yearly report referred to above (see footnote 6).

## Characteristics of good governance

**Table 4: Quality of governance under asset-managing council-controlled organisation model**

| Aspect of good governance | Comment |
|---|---|
| Based on an overall strategy with clear priorities | Wellington Water strategy is in its formal accountability documents. Water asset strategy, at least in financial terms, is with the individual council, with Wellington Water advising and implementing on their behalf. |
| Uses high-quality information | The councils we interviewed expressed a view that they had better-quality information now than they did prior to Wellington Water being established. |
| Identifies and resolves trade-offs | Wellington Water seems to work closely with councils to identify risks and rewards associated with trade-offs, with high involvement in council's long-term planning. |
| Takes a long-term view / whole-of-life approach | Asset management plans are undertaken by the councils, who own the assets, with advice from Wellington Water. Wellington City do a 10-year asset plan. |
| Uses appropriate consultation | Consultation appears to be high although Wellington Water expressed a desire to do more with engaging the public. It publishes clear, concise and frequently updated public information on its website. |
| Has an appropriate governance culture | The council elected member governance and appointed director governance appear to work well together and provide complementary aspects. There is mutual respect between the two governance layers and a recognition that the structure has led to significant improvements in water supply and management. |
| Makes provision for assurance | Wellington's multiple-council approach provides, in our view, reasonable assurance, as in Auckland. This is due to the size of the water assets and the resulting size of the entity needed to manage it, and the high expectations for governance. |

## General observations

Risk in relation to existing assets, future challenges, and resilience in crisis events is well understood, with mechanisms in place to identify and manage risk. Mitigation options are well defined and were cited at all levels of people interviewed.

Wellington Water observed that it has taken time for its relationship with councils to mature: levels of trust have increased over time as the competence of the organisation and the value of the model have been proven. They also observed that the benefits of shared service have increased with the maturity of the relationship. In their view, while there could be more benefits realised with asset ownership, those would not be as substantial as the benefits realised to date through shared service and increasing levels of trust. In addition, Wellington councils noted that the advice given by Wellington Water has a level of independence, as the organisation has no vested interest (unlike an asset-owning council-controlled organisation model).

We did have specific feedback from a council in the Wellington area that they had realised significant cost savings from the shared council-controlled organisation, as well as gains in effectiveness from aggregating and applying consistent service delivery models.

We also observed that Wellington Water's reporting was more transparent and more frequent compared to both Watercare and the council elected member governance examples. While that cannot be attributed entirely to this governance model, our observation is that the level and clarity of reporting by Wellington Water is close to best practice.

Our view is that this model is replicable and scalable. It was also more palatable than the Watercare model for other councils, who see the continued direct council ownership of assets as allowing continued connection with communities. However, the asset-managing model would not easily allow for cross-subsidisation across regions. Cross-subsidisation can be desirable in some circumstances, but concerns about it are a factor behind the delays in progressing proposals to move the three waters functions of Hamilton City, Waikato District and Waipa District Councils into a jointly owned council-controlled organisation.

## Overall assessment of current governance arrangements

Our overall assessment is that:

- there is an opportunity for significant improvement in water asset management through aggregating and applying more consistent models of service delivery
- there is a lack of assurance that governance will be robust, and
- there are a number of indications that governance is not consistently at the appropriate level.

There are a range of options that would deliver varying levels of improvement, depending on the level of appetite for intervention. These include:

- providing stronger governance guidelines and more peer support for asset governance
- incentivising shared service arrangements and the development of external governance groups, and

establishing council-controlled organisations (either along the lines of Watercare, where the council-controlled organisation owns the assets, or Wellington Water, where the council-controlled organisation manages council-owned assets).

The above arrangements could be regulated or incentivised, or a mix of both. Given the advantages we have witnessed through the approach in Wellington, our view is that 'coalition of the willing' arrangements are most likely to be effective. The councils we interviewed stated a preference for financial incentives.

## Recent improvements

Councils have been improving governance of three waters, especially for drinking water. Driven in part by the Havelock North water supply contamination incident in August 2016, the councils we interviewed had made significant steps to improve governance and asset management. The improvements were also occasioned by the election of new councils in late 2016. These steps include:

- **Appointing external chairs to council Audit and Risk committees** (where these were not in place already). In a couple of cases, councils did not believe this was necessary, and the council officers had made arrangements to incorporate external expertise in the council's internal governance arrangements.
- **A greater focus on water management in council business.** Typically this falls into three streams:
  - a focus on risk through the Audit and Risk committee (this has been wider than just water, but water appears to have been a focus)
  - monitoring of drinking water quality and the implementation of investment decisions, typically through routine or periodic monitoring
  - a focus on major investment decisions and their timing – typically done in the context of the Long Term Plan and Infrastructure Strategy. CEOs confirmed that significant effort was put into engaging with councillors on asset management and that councillors responded well, although there were mixed reports on the extent to which councillors appreciated the importance of the decisions being made.
- **Strengthening internal governance/management arrangements at the staff level.** In many cases these are coordination mechanisms of the kind you would expect to find in any large organisation. At best these can be effective enhancements to governance. Two features help this: external representation (typically the chair), and the council being large enough to create a separation between the internal governance group and those responsible for delivering services and advice. This separation ensures accountability and helps the governance group stay out of operational issues.
- **External review of asset management to provide assurance and identify opportunities for improvement.** In the best cases this introduced a structured framework for thinking about at least some of the dimensions of capability and the appropriate standard to aim for. However, more typically there remain opportunities for further assurance and a more comprehensive view of capability requirements.

The larger councils had greater opportunity to invest in the last two areas.

While we note this raft of recent improvements, we should also note their genesis at least in part in the Havelock North events. This raises concern about what happens to governance levels when memories of specific incidents fade.

# Separation of governance and management

Ideally, robust governance of the three waters would see the governors leading across the broad range of aspects covered in the governance framework that we developed for this report (see Figure 1 on page 3).

This requires the right mix and extent of skills, experience and focus. While it is possible that some elected members on a council will have some of the skills and experience required, it is unlikely in practice that a council will have them to the full range and extent appropriate. They may also not have the right focus given the varied interests and priorities among members.

That assessment is supported by our observation that while the elected members we spoke to were well informed about water service issues, upcoming key decisions, and water quality monitoring arrangements, they tended to focus on these specific issues at the expense of the more general concepts of governance. As a result, some aspects of governance were not given the full attention appropriate.

As a result, the governance agenda is driven by the CEOs. In general we noted that CEOs and senior staff had a clearer view of what it takes to deliver good governance. The differences were of degree and we note that what is appropriate for governance is in part dependent on the underlying issues. We also note that the understanding of specific issues shown by elected members supports effective governance.

The burden placed on leadership teams of driving comprehensive governance compromises the separation of policy setting and service delivery, because CEOs and their leadership teams assume overarching responsibility for both. This matters, because it weakens accountability. It weakens accountability because of the conflict of interest that arises when the same body is responsible for setting standards and delivering them. While CEOs are not setting, for example, water quality standards, they are having a much stronger influence on capability and technical performance standards.

In addition, the inquiry by the Auditor-General into the Mangawhai community wastewater scheme noted a 'need for members of a governing body to have the courage to keep asking questions until they understand what they are deciding, and the benefits of formal processes and records to support decision making'. The questioning is not coming from members of governing bodies as strongly as it might be.

While we have noted some arrangements that enhance internal governance and management and provide additional assurance to the CEO and his or her senior management team, these fall short of compensating for that lack of separation. This is not to suggest that those internal arrangements are inappropriate, or that they are unreasonable responses in the circumstances. Rather, they are not a complete or optimal solution.

# Observed variance in governance

Using the governance framework as a basis for assessment, we found varying standards of governance across the interviewed councils, especially with respect to understanding and accountability around strategic outcomes, and understanding of technical issues beyond drinking water. Governance was strongest for the councils with water council-controlled organisations (Auckland and the Wellington region), and we did not identify significant opportunities for improvement in these cases. We believe this is at least partially because having an appointed board as a result of the council-controlled organisation arrangement provides a range of skills and a depth of experience, and ensures that robust governance practice is implemented.

However, scale plays a role too: both directly, as attracting suitably experienced and skilled directors is easier with greater scale, and indirectly, as scale makes it easier to justify the establishment of a council-controlled organisation given transition and overhead costs.

The other metro councils have reasonably robust governance arrangements, but with opportunities for improvement. This is borne out by the experience with Wellington Water in improving governance – it has shown that the shift to a council-controlled organisation arrangement can further strengthen governance, management and technical capability. Wellington City Council commented that Wellington Water has produced a step change and shown that Wellington City previously did not have the clearest possible view of good three waters governance.

The remaining councils were below the standard of the council-controlled organisations and metro councils. In our view, size aids better governance because economics of scale mean that:

- it is more tenable to establish robust internal governance arrangements
- it is easier to establish the robust information systems needed to support asset management
- it is more feasible to get independent assurance and advice
- there is greater opportunity to provide elected members with clear advice on key governance decisions.

While it is possible to achieve these attributes with small groupings or single small councils, it is much more difficult, and once achieved those attributes are less likely to endure.

# Ongoing assurance of robust governance

While the strength of governance varies across the councils as discussed above, and some councils without council-controlled organisations currently do have reasonably strong governance, the current arrangements for councils without a water council-controlled organisation does not provide assurance of enduring, strong, healthy governance. A number of factors, alongside the assessment against the governance framework above, support this finding:

- our observation that there are common areas for improvement in governance, as noted above
- the problems with the Mangawhai community wastewater scheme between 1996 and 2012 were found by the Auditor-General to be, in part, governance failures, and little has changed systemically to ensure that such failures do not occur again

- the present system does not provide for a deliberate approach to getting the right mix, level and focus of governance skills and experience. Councillors are not primarily elected on their governance skills but rather to represent the community's interests. This means that while elected governance provides good community representation, and may provide some of the appropriate skills, it does not provide assurance that the governing body is set up to deliver best practice governance of these complex, critical assets.
- our observation that the governance agenda is often driven by council officers, and their concerns that councillors are often not well placed to challenge their recommendations, despite robust efforts to engage by all parties
- the operation of a variety of bespoke models of service delivery across councils, often historical, which suggests that there are unrealised opportunities for efficiency gains. That level of variation also makes it difficult for councils to work together and share experience and knowledge.
- the professionalisation of three waters governance is below that for other infrastructure assets (such as electricity and gas), despite equal or greater challenges.

Without ongoing assurance of robust governance, the standard of governance will vary over time and across councils. This may not matter much in a stable context with limited upcoming new investment or other critical decisions. However, as explained below, that is not usually the case.

## Risk

The most apparent risk of poor governance of the three waters is the occurrence of another event with immediate adverse impacts on the community. This could be like Havelock North – though the current risk of this is probably low given recent focus on the management of drinking water quality. It could also be damage to property by a flood event, environmental damage from wastewater contamination, or one of a range of other service failure and resilience issues, which may or may not have happened before.

More generally, there is risk of sub-optimal decisions on the timing and nature of major investments, and the risk of failure to extract maximum value from the present assets. This could result in unnecessary cost, or poor value for money.

There is no way to assess how extensive or likely the risks are. This would require more extensive work, involving more councils and the assessment of areas beyond governance.

## Challenges

A particular area of concern for three waters governance is that many councils face a range of challenges in this area, including:

- financial challenges, particularly where depreciation has been underfunded or unfunded in the past or where new investments are required
- demands from communities for better environmental care

- the likelihood that drinking water quality standards will become more stringent over time and require new investment
- increased sophistication in the technical capability that underpins asset management planning
- climate change and the accompanying increased risks of flooding.

In addition, smaller councils can have trouble attracting and retaining suitable water engineering expertise, and they also acknowledge difficulties with succession planning. This restricts the availability of robust advice and information to support governance decisions.

## Scale

The two council-controlled organisation models we looked at enable better governance practices, more stability at governance level, and more transparency around decision-making, reporting and investment. Transparency is increased by the need to communicate and report between two distinct organisations.

An **asset-owning council-controlled organisation** that is jointly owned by several councils would have the advantage of enabling cross-subsidisation, which would allow for investment in the most needed areas. This is an issue given the disparate state of water assets across the various council areas – though the ‘wealthier’ councils will likely have some obvious concerns. (Note: this is hypothetical given that the only current New Zealand example of an asset-owning water council-controlled organisation is Watercare in Auckland, which is single-council owned.)

An important benefit of the **asset-managing council-controlled organisation model** of Wellington Water is that it allows for more free and frank advice to council and the public, as the company has no vested interest in taking a particular position. It allows for most of the benefits of the asset-owning model and, subject to good communication between the company and the councils, can increase the level of trust in the advice received, which has a degree of independence. The downside of this model is that there is no ability to cross-subsidise; so while there were reports of significant cost savings with this model, it does not address the issue of affordability.

Both models combine a mixture of institutional arrangements (the council-controlled organisation structure) and large scale, which in Wellington is achieved by ownership by multiple councils. A council-controlled organisation for a smaller council acting alone is unlikely to provide substantial benefits.

While the model of council-controlled organisations of scale has clear benefits and is supported by some elected members, we encountered more members who do not support it. However, there are grounds to believe that political support may be possible.

- Those councils that have them have found the arrangement to be beneficial, and Hamilton City, Waikato District and Waipa District Councils are working to establish a joint council-controlled organisation.
- When the question was posed to them, councillors of a large council were open to the idea of a council-controlled organisation if asset ownership were retained by the individual councils (that is, the Wellington Water model).

- A common objection to council-controlled organisations is that they dilute the influence of elected members. This is a particular concern for such council services as parks or infrastructure such as roading, which have place-shaping implications, with wide-ranging community interest. However, water is a utility service comparable to electricity supply with less community interest in its delivery. (There is interest in water standards, fluoridation, and stormwater protection, but councillors would still be making the key decisions.)
- Much of the concerns expressed by councils relate to the establishment of an asset-**owning** council-controlled organisation, which elected members believe their constituents would see as preparation for asset divestment – however, many of the benefits can be achieved from an asset-**managing** council-controlled organisation.

Council-controlled organisations could conceivably be mandated (by legislation), but softer approaches are also possible. Our view is that the willing coalition provides a better path forward. Government may also wish to provide financial incentives – this could be tied to service performance objectives and also help redress the variation in water asset conditions across New Zealand.

The council-controlled organisation model is also not the only way to achieve scale. We have focused on that model because of the benefits we observed of the combination of independent governance at scale, but a shared service model could also achieve some of the benefits of scale.

# Central levers that help drive good governance

A number of central levers and expectations were noted as helping drive good governance:

- **Infrastructure strategy and Long Term Plan** – The 10-year long-term planning requirements and the requirement to prepare a 30-year infrastructure strategy were frequently noted as driving engagement by councils in asset management strategy, in the major investment trade-offs, and in the overall service standards expected.

  It was noted that councils are going into their second iteration of their infrastructure strategy and there are opportunities to improve it.

  We were not able to discuss the extent to which these instruments are best aligned with the needs of asset management governance (though it was observed that their timeframe falls well short of the up to 100-year asset life of many water assets) and this presents an opportunity for further consideration.
- **Good practice on audit and risk** – Guidance from the Office of the Auditor-General on good practice for councils emphasises the importance of an effective Audit and Risk committee, ideally with a suitably experienced external chair. Where this had been newly instituted, councils felt it did provide additional assurance around the management of risk and resilience. Conversely, where this arrangement was not established, some felt there were opportunities to strengthen oversight in these areas, while others defended the choice not to have this arrangement.
- **Monitoring requirements** – Formal monitoring by Regional Councils and District Health Boards places an obligation on councils to establish a monitoring regime.

- **Audit NZ review** – Subject to limitations, Audit New Zealand reviews can provide insight into the effectiveness of asset management and asset management governance.

# Other observations

## Recognition of importance of water by councils

Few, if any, elected members campaign on water asset management. Yet it was clear that councils do proactively engage around key issues relating to water management and that it was given attention commensurate with its importance on councils' agendas. Water asset management is a key focus in the development of Long Term Plans. As we commented above, CEOs confirmed that significant effort was put into engaging with councillors on asset management and that councillors responded well, though not always appreciating the importance of the relevant decisions.

## Variable willingness to spend on water assets

Councils vary in their willingness to spend on water assets. We encountered examples where significant rates rises had been put through to fund future investment requirements, which affirmed the importance those councils attached to this area. In other cases, however, councils clearly feel financial constraints; those constraints are shaping decisions, with a risk of compromising longer-run value for money.

# CONCLUSIONS

## Water asset management in perspective

**Three waters has specific features that inform appropriate governance arrangements**

Three waters are among many services for which councils are responsible. However, there are a number of features of three waters that mean it should receive particular attention.

- It is an essential utility and critical infrastructure and is distinctive as such in the council portfolio. Roads come closest, but have a central agency (NZTA) driving some aspects of council actions.
- It is particularly long term in nature – with assets having a working life of up to a century.
- Most of the infrastructure is underground, and therefore often not front of mind and not subject to public comment and feedback in the way that, for example, roads or other council assets are.
- Failure can be catastrophic and in extreme cases has the potential to cause loss of life.

We believe that these factors mean that a particularly high standard of governance is required.

## Current governance levels: Improvements and limitations

**Robust governance is difficult to achieve**

Governance of three waters asset management has many facets, and driving the governance agenda effectively requires professional input with the right mix of skills and experience.

Where there is no council-controlled organisation that drive comes from council CEOs and senior staff. However, this compromises the separation of policy setting from service delivery, and so reduces accountability. Although CEOs and senior officers have instituted a variety of arrangements to enhance governance, those measures fall short of compensating for this lack of separation.

**Councils have been improving governance, especially for drinking water risk…**

We found that, overall, understanding of risks associated with the water assets was high. From our observation the political risk associated with service failure on something as fundamental as water is a strong motivator for increasing governance oversight.

Driven in particular by the Havelock North incident, councils have been improving governance. The steps taken have typically included: more reporting; more effort by elected members to understand the issues and trade-offs; and in some cases the inclusion of external expertise on Audit and Risk committees. Most of the improvements focus on drinking water and are specifically in the area of monitoring.

**…but where there is no appointed board and a lack of scale, there is inadequate assurance of ongoing robust governance**

The level of governance apparent across the councils we interviewed varied. There are limited mechanisms for assurance of ongoing robust governance, and where there is no appointed board and only small scale, there are clear opportunities to improve the standard of governance.

Though some improvements have been made, they are not systemic (with the exception of introducing external expertise in Audit and Risk in some cases).

Most of the elected members we interviewed recognised that improvements have been in response to the events in Havelock North, and this raises concerns about how durable the current, relatively high, level of awareness may prove to be. The risk is that levels of oversight may wane when memories fade and a different issue demands attention, or if enough time passes without further incident.

**A risk of long-term consequences**

There is therefore a risk that incidents of similar moment to Havelock North may recur (but possibly quite different in nature), or that councils will obtain inadequate value from the investment in water infrastructure.

## Opportunity for a step change through council-controlled organisation models

**Strengthening governance through bringing in professional expertise…**

Water services are a critical infrastructure, and the public has high expectations for safe drinking water and responsible treatment of the environment. We believe that moving to council-controlled organisation models with scale (which would mean ownership by multiple councils) would provide an opportunity for a step change in performance in governance in this key area.

This overall finding is based on:

- the fact that the delivery of three waters services has much in common with other utilities such as electricity and gas
- the experience of Auckland's Watercare and Wellington Water and the assessment of the three models against the governance framework
- our observations on possibilities for improvement in governance and at the governance-management interface.

The improvement would arise from instituting professional board members and management, and from pooling analytical (eg, modelling) and technical (engineering) capability. A CCO model will also provide efficiencies through the application of consistent models of service delivery. Council-controlled organisations can provide these gains whether set up as asset-owning or asset-managing.

**…but council-controlled organisations can defer appropriate decisions to elected members**

While appointed boards can strengthen governance, certain critical decisions are appropriately made by elected members. With the two CCO models, there appears to be a reasonable consensus across the stakeholders that the allocation of decision-making between councils and appointed boards appears to be right.

Of those decisions that should be made by elected members, some are more appropriately made locally while some are more appropriate for the national level. The allocation between local and national will inevitably be controversial, but there is a clear split in practice. For example minimum water standards are set nationally, while decisions on appropriate water treatment (effectively a decision regarding the trade-off between levels of risk and taste) are made locally.

**Council-controlled organisations can be either asset-owning or asset-managing**

Both CCO models enable better governance practices and more stability at governance level. Because there is the need to report across organisations, they can also provide more transparency around decision-making, reporting and investment (although we noted a significant difference between Watercare and Wellington Water in levels of public reporting and transparency).

Although the Auckland example of an asset-owned council-controlled organisation involves only a single council, that model would, if applied to multiple council ownership, have the advantage of enabling cross-subsidisation across discrete water asset systems, and this would allow for investment in the most needed areas. This is an issue given the disparate state of water assets across the various council areas.

The asset-managing model presented by Wellington Water allows for more free and frank advice to council and the public, as the company has no vested interest in taking any particular position. This allows a more natural migration along the maturity curve. So long as there is good communication between the company and the councils, this can increase the level of trust in the advice received, as it has a degree of independence.

The downside of the asset-managing CCO model is that there is no ability to cross-subsidise beyond what is available now to individual council areas. So while there were reports of significant cost savings with this model, beyond that this model does not address the issues of affordability stemming from previous governance decisions around asset sweating, low rates take, and more complex, expensive legacy systems.

**A soft approach to supporting the adoption of council-controlled organisations would be appropriate**

While council-controlled organisations have significant benefits, many elected members do not support them on the basis that asset-owning CCOs may be seen by their constituents as a step towards asset divestment and privatisation. One council also thought their internal model would always be cheaper. However, the cost burden is reduced where a CCO is owned by multiple councils.

But while council-controlled organisations could conceivably be mandated, softer approaches are also possible. Our view is that the willing coalition provides a better path forward. Government may wish to provide financial incentives: this could be tied to service performance objectives and would also help redress the variance of asset conditions across New Zealand.

## And there are other options

The two main factors behind our recommendation for multi-council council-controlled organisations are that they would involve both a large scale and also a deliberate approach to appointing the right mix of skills and experience. These two key attributes could also be achieved outside a CCO arrangement through a formal shared service arrangement, with additional expertise brought in at governance level. Such expertise could be provided by having externals either on a council committee, or on an advisory board that reports to the CEO. This could also be supplemented with clear, strong guidance from central government on three waters governance.

**There is a range of other opportunities to improve governance**

We looked at a number of top-down causes of effectiveness, considered their current status, and on this basis detailed a range of determinants and related opportunities to improve governance. This analysis is set out in Table 5 below.

The determinants are not the same as the characteristics of good governance set out in Figure 1. This is best explained by way of example. One of the governance functions is ensuring capability for sound asset management. This requires having some governors or directors who have a clear understanding of the capability required. A determinant of whether this happens is whether the mechanism in place to appoint governors/directors takes this requirement into consideration.

We recognise that some of those opportunities may be relatively difficult to exploit; we have included them here as suggestions for possible consideration rather than as recommendations to be implemented.

**Table 5: Governance: Determinants and opportunities to drive improvement**

Note: In thinking about future interventions, it is important to take into account the fact that councils vary significantly in their circumstances in relation to water management. Interventions therefore need to be designed with sufficient flexibility to allow for this.

| Determinants | Explanation | Current status | Opportunities |
|---|---|---|---|
| Appointment of governors | Good governance depends on having the right mix of people (expertise and experience) with the right incentives and accountabilities in place. This is largely driven by the appointment process, including the opportunity for appointment associated with scale. | In most cases, the governors are councillors. The selection process is based on accountability to the community, rather than specific experience and expertise, and does not have regard to mix. The exceptions (council-controlled organisations) still include this but involve an additional layer of governance. | Make or require greater use of independents in council committees.<br>Delegate some governance decision-making, particularly with regard to more technical aspects (as happens with a council-controlled organisation). |
| Institutional arrangements (eg, whether there is a council-controlled organisation, committee structures and internal arrangements) | Institutional arrangements affect the appointment of governors, but they can also affect how decision making is allocated to those best placed to make the relevant decisions. | For most councils, councillors are responsible for all aspects of governance decision making.<br>Where there is a council-controlled organisation, a more stratified approach is taken. | Establish a management or asset-owning council-controlled organisation.<br>Establish a national body that removes responsibility for some aspects of decision-making from councils.<br>Establish robust internal governance arrangements, possibly using suitably experienced independents. |

| Determinants | Explanation | Current status | Opportunities |
|---|---|---|---|
| Budgeting | Good governance is not cost-free, and the benefits can be intangible. In financially constrained settings there can be temptation to under-invest in governance or to under-invest in the underlying assets for short-term gains. | In many cases, councils are working to improve governance, which suggests there has been under-investment in the past.<br>Councils vary considerably in their ability and inclination to invest in robust asset management – extending to dimensions that support good governance.<br>Most councils appear to be taking a long-term view in their investment decisions, but a number are clearly facing shorter-term pressures. | Amalgamation or shared services that share costs<br>Central government contribution to water asset management<br>Enhanced regulatory frameworks (including enforcement) that drive governance. |
| Regulatory frameworks and guidance | Regulatory frameworks can relate to process (eg, requirement to develop an LTP) or to standards (eg, water service quality).<br>Guidance (eg, expectations of good practice) can be considered a softer approach to achieving the same ends. | Some regulatory levers were frequently noted as helpful, particularly regarding longer-term planning, though there may be opportunities for improvement.<br>The regulation of potable water quality is complex and there may be opportunities to rationalise. | Review current levers to consider alignment and fitness for purpose.<br>Extend scope of regulation. There are trade-offs between national consistency and local flexibility.<br>Enhance capability to monitor and enforce regulation.<br>Extend scope and mechanisms of guidance. |
| Scale | Small scale makes it difficult to afford and attract the necessary governors. This includes, eg, independent members/chairs of Audit and Risk committees.<br>It also makes it difficult to establish and secure assurance of robust information systems that inform governance decisions. | It is clear that scale is a barrier to effective governance for many councils, though the size of the water asset is a factor as well – eg, a small council with a compact and simple water system will face less of a challenge. | Introduce or extend shared service arrangements. Council-controlled organisations are one vehicle for this but there are others. Shared service arrangements may be restricted to back office functions (eg, asset information systems) or extend to service delivery. |

| Determinants | Explanation | Current status | Opportunities |
|---|---|---|---|
| Stakeholders and accountabilities | Some stakeholders will drive some decisions that may be seen by others as questionable governance. | A particular example will be the issue of chlorination, which is effectively a decision around the trade-off between water quality risk and taste.<br>Some councillors see this as a reasonable exercise of community preference, others see it as unnecessary risk. | Improve public information that informs decision making.<br>Remove certain decisions from the responsibility of councils (this is equivalent to greater regulation in those areas). |
| Quality of information and advice | Critical governance decisions depend on having good information about the state and performance of the assets, and having good advice on options and related trade-offs. | In many cases the information is good, but this is not universal. Staff consistently reported working closely with councils to secure their engagement in decision making.<br>Ultimately this is a matter of the underlying capability (in the board sense). Some councils had taken a view on capability requirements, though generally this was not as broad as it might be. Some, but by no means all, had obtained independent assurance. | Through guidance or regulation create expectations about the capabilities needed for asset management. (This would be less important where independent professional directors are suitably involved.) |

# APPENDIX 1: BACKGROUND AND CONTEXT

## The New Zealand context

The three waters are an essential part of New Zealand's critical national infrastructure. Water services differ from most other critical infrastructure systems in that the responsibility for asset management and service provision mostly lies with local councils (water provision to public can sometimes sit with private organisations, eg, motor camp owners, ski fields and marae) with little oversight or funding support, at asset level, from central government. While responsibility for roads, for example, also sits with local authorities, there is more involvement from central government through the NZ Transport Agency.

A large number of New Zealand drinking water supplies are from sources and reticulation systems that were initially intended to provide stock water. These are often small supplies that were initially installed and governed by local committees. The feasibility of upgrading these systems to comply with drinking water standards can be expensive, and smaller councils are struggling to afford this.

Equally, areas with large population growth are struggling to keep up with the infrastructure investment needed to serve the rapid increase in population. Some are close to their debt limit and are looking to central government for funding assistance.

According to the Three Waters Review Cabinet Paper, the value of water assets across New Zealand at June 2016 was $54.7 billion. Water New Zealand, in its 2016 snapshot report, notes that 'the highest proportion of income spent on three water services occurs amongst regions with the lowest incomes'. Water New Zealand also reported that capex spend by its 2016 survey participants as a proportion of budget had a median of 69%.

## Regulation and oversight

There are a number of statutory and regulatory obligations as well as standards regarding water services with which councils are required to comply, as well as oversight reports and databases.

### Drinking water

The Health (Drinking Water) Amendment Act 2007 amended the Health Act 1956 to specify that all drinking water suppliers must ensure their water is safe to drink. It introduced a statutory requirement that drinking water suppliers must develop and implement a water safety plan to guide the safe management of supply.

A water safety plan requires a review of the water supply from water source through the treatment processes to the pipe network that carries the water out to the consumer. It includes risk assessment for contamination, mitigation options, and a documented response commitment to water standard breaches.

New Zealand drinking water standards specify the maximum acceptable concentrations of pathogenic micro-organisms and toxic chemicals in drinking water. District Health Boards monitor the water suppliers (usually councils) in each area to ensure they meet water quality standards. In the case of a serious health risk, the district's Medical Officer of Health can order a water supply to close.

## Wastewater and stormwater

There are a range of regulatory requirements applying to waste and storm water:

- Building Act 2004 (managed by local authorities)
- Resource Management Act 1991 (managed by regional councils)
- Health Act 1956
- Standard NZ wastewater standards set out by AS/NZS 1547:2012 On-site domestic wastewater management
- Consenting processes, as required by the Resource Management Act 1991
- Reporting that identifies the assets and outlines council plans for how it will assess and deal with any future changes to service provision, for example through council Long Term Plans, Strategic Asset Management Plans and Infrastructure Plans, as required by the Local Government Act 2002.
- Annual auditor's report in accordance with the Local Government Act 2002
- For council controlled organisations, parts of the Companies Act 1993.

# APPENDIX 2: GOVERNANCE FRAMEWORK

The framework below draws on our experience of governance in a variety of contexts and on a range of sources, notably:

- IIMM International Infrastructure Management Manual, Institute of Public Works Engineering, Australasia, International Edition, 2015
- Towards a Framework for the Governance of Infrastructure, OECD, September 2015
- Realising a World Class Infrastructure, ICE's Guiding Principles of Asset Management, Institution of Civil Engineers (UK), 2013
- The Four Pillars of Governance Best Practice for New Zealand Directors, Institute of Directors, 2017
- The Inquiry into the Mangawhai Wastewater Scheme, Controller and Auditor-General, 2013
- Asset management and long-term planning: Learning from audit findings 2015 to 2017. Audit New Zealand, 2017.

| | | | | |
|---|---|---|---|---|
| **Governance functions** | **Set outcomes** across a range of dimensions | **Monitor performance** and hold to account | **Set budgets and agree funding sources** | **Ensure capability** for sound asset management and governance |
| **Scope** | **Dimensions of performance**<br>Service<br>• standard of provision<br>• resilience and reliability<br>• coverage/availability<br>• provides for future needs<br>Transparency<br>Compliance statutory/regulatory obligations<br>Sustainability | | **Financial objectives**<br>Cost efficient over the life cycle<br>Affordable<br>Matched to appropriate funding sources | **Key capabilities**<br>Asset management plan<br>Asset management leadership and teams<br>Management systems<br>Asset management information systems and tools<br>Service delivery models<br>Audit and improvement<br>Capability model |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Characteristics of good governance** | Based on an overall strategy with clear priorities | Uses high quality information | Identifies and resolves trade-offs | Takes a long term view/whole of life approach | Uses appropriate consultation | Has an appropriate governance culture | Makes provision for assurance |

## Functions and scope

We have identified four high-level governance functions:

1. Setting outcomes across a range of dimensions including strategic direction.
2. Monitoring performance against those dimensions and holding those responsible for asset management delivery to account.

3 Setting budgets and agreeing funding sources. This is not independent of outcome setting as there are clear financial trade-offs.

4 Ensuring that capability for sound asset management and good governance is in place. This is primarily an assurance role, but it does also have an impact on resource requirements.

## Outcome dimensions

These relate to functions 1 and 2 above.

- Service

  Governance should ensure that the levels of service delivered by the assets are specified. Desirable features include:

  - A focus on the end user experience
  - Additional technical performance measures (management may also introduce operational measures)
  - Performance measures are SMART
  - Review of appropriateness from time to time
  - Consideration of different customer and user groups
  - Linking to costs
  - Integration with decision-making and planning
  - An overall integrated performance-management framework
  - Consideration of quality, reliability, responsiveness, sustainability, timeliness, accessibility/coverage, and cost.

  In considering accessibility and coverage, attention should be given to future demand (both rising and falling).

  Resilience is important, though it does not fit well into conventional performance frameworks. Resilience may appropriately be linked to other systems (eg, roads and stormwater).

- Transparency

  Transparency requires being clear to the public about service standards and achievement.

- Compliance with statutory/regulatory obligations and other standards

  Regulatory requirements should be identified and mechanisms in place to ensure compliance.

  Consideration should be given to compliance with other standards such as ISO 55000.

- Sustainability

  Consideration should be given to sustainability, which may apply across different dimensions of the water networks, eg:

  - Water sources
  - Discharge of waste and stormwater.

  In some circumstances, consideration should be given to whether demand management measures are needed (eg, hosepipe bans).

### Financial objectives

Budgets need to support cost efficiency over the lifecycle of the assets. This is part of taking a long-term view.

Service levels need to be affordable. This can include consideration of financing mechanisms that match to the long-term nature of the assets.

### Key capabilities

Key capabilities needed for good governance include:

- A strategic asset management plan that is fit for purpose, has a clear future focus, has an end-to-end view of the asset and service, and informs capability planning. Governors should be informed on the extent to which the plan is implemented in practice.
- Appropriate arrangements for the leadership of asset management, including appropriate accountabilities. This includes ensuring appropriate separation of governance and management roles and having senior staff with the right skills and experience.
- Management systems should be formalised with well-defined business processes. Good management systems should have:
  - a strong integration with asset management practices
  - a focus on continuous process improvement.
- Asset management information systems that support effective asset management through awareness, management and reduction of risk, and support infrastructure investment. It should identify critical assets.
- Consideration should be given to appropriate service delivery models. Services include professional services, maintenance, construction, and general operations. Models include internal, partnerships/alliances, or external under different contractual arrangements.
- Consideration should be given to the overall asset management system, the appropriate level of maturity, and an integrated approach to improvement.
- Asset creation involves some of the most critical decision-making. It is important that there is appropriate focus and strategic context for decision-making.
- An appropriate mix of skills, experience and expertise across governors.

At the governance level consideration should be given to the appropriate mechanism for delivering the required capabilities. This might include appropriate institutional arrangements and eg shared services.

## Characteristics of good governance

Effective decision-making required for good governance has the following features:

- **Based on an overall strategy, with clear priorities**, for achieving the required standard of asset management. The strategy should have clear scope, policy and objectives and should provide a basis for prioritising investment decisions.

- **Uses high-quality information** to support evidence-based decision-making. This includes information on:
  - asset condition and any maintenance backlog
  - performance
  - future demand.
- Identifies and resolves trade-offs, including in:
  - setting performance standards
  - formulating strategies and policies
  - specific investment decisions
  - budgeting.
- Takes a long-term view / whole-of-life approach, including:
  - understanding the true costs of ownership and the implications of deferred interventions
  - addressing asset life extension.
- **Uses appropriate consultation** with the public, consumers and other stakeholders in setting standards and around major investment decisions (there are minimum statutory requirements in Part 6 of the Local Government Act 2002).

In addition, good governance:

- Has an appropriate governance culture that includes:
  - clear governance roles and responsibilities
  - periodic review of the effectiveness of governance arrangements – this can be self-review
  - planning the governance workload
  - ensuring effective meetings of governance committees or boards.
- **Provides for assurance,** including drawing on third-party advice from time to time, and ensuring adequate audit arrangements.

## Risk management

Risk management is not explicit in the framework, but it underpins a number of elements listed:

- risk trade-offs are at the heart of resilience and reliability service specification
- risk information would be part of the high-quality information and should be taken into account in resolving trade-offs
- risk management and mitigation would be one of the management systems required.

# APPENDIX 3: CURRENT GOVERNANCE ARRANGEMENTS

## New Zealand water governance models

Table 6 summarises the different governance models in place across New Zealand

**Table 6: Councils by governance model type**

| | Council | Potable water | Waste water | Storm water |
|---|---|---|---|---|
| 1 | All except as below | Elected members | Elected members | Elected members |
| 2 | WaterCare (Auckland Council) | Asset-owning council-controlled organisation | | Elected members |
| 3 | Wellington Water (Hutt, Porirua, Upper Hutt, Wellington city councils) | Asset-managing council-controlled organisation | | |

Councils in the Waikato areas are investigating options for establishing a council-controlled organisation to manage three waters services. They have not reached agreement as to whether it should be an asset-owning or asset-managing model.

Further details of the current three waters governance arrangements are set out below.

## Governance arrangement details

### Model 1: Council owned and operated

Outside of Auckland and Wellington, other councils directly manage their three waters services. Council members are responsible for decision-making and council staff are responsible for delivering on policy set by the council.

There are a variety of arrangements for how councils oversee their water services. Governance is typically provided by one or more council committee with responsibility for providing advice and recommendations to councils or as delegated. These can be a ‘council of the whole’, although in some cases they may be smaller committees with a selection of council representatives that provide advice and recommendations to council for decision-making.

There are typically three points of interaction with councils:

- infrastructure planning – typically done under the ambit of the LTP and Infrastructure Strategy
- implementation of infrastructure projects and monitoring of service delivery
- risk management.

These may be done through separate committees. Most councils have appointed an independent Chair to their Audit and Risk Committees.

Support for the council comes from the CEO and his or her senior leadership team.

In addition, most CEOs from the councils we interviewed have put in place internal arrangements to provide assurance over their advice to councils. These range from strong internal governance with external representation that can be used to hold council staff to account, through to lower-level management coordination arrangements.

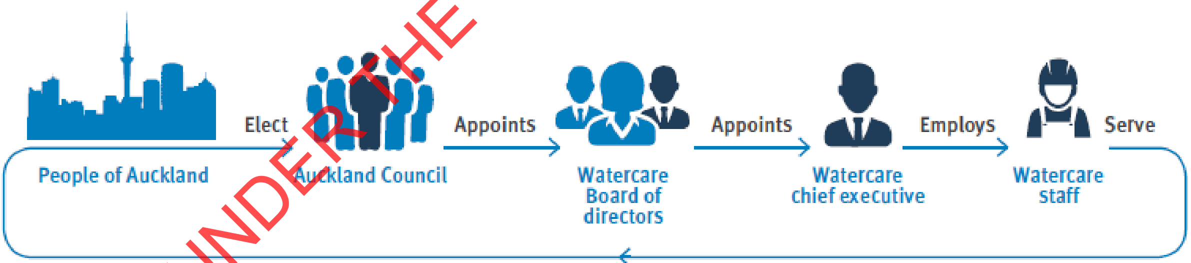
## Model 2: Asset owning council-controlled organisation – Auckland's Watercare

Management for Auckland's three waters services is split between direct council management for Auckland's stormwater services and a council controlled organisation, Watercare, which oversees Auckland's drinking water and wastewater services.[7]

Established in 2010 by legislation, Watercare has full asset ownership. The company is wholly owned by Auckland Council and is responsible for over $8.8 billion in total water assets. The company is self-funding and receives no funding from local or central government. Operational responsibility sits with Watercare's Chief Executive, and the Board of Directors has ultimate responsibility for all company decision making.

Auckland Council appoints Watercare's seven independent non-executive directors who are responsible for governance policies and procedures. The Board has three subcommittees that support its work: Audit and Risk; Capital Projects Working Group; Remuneration and Appointments.

**Figure 2: Interface between Auckland Council and Watercare**




Source: Watercare.co.nz

Watercare works with Auckland Council to ensure plans are aligned with Auckland Council's development and growth plans, its Long Term Plan and Annual Plans, including infrastructure and financial plans.

There are a series of processes in place for ensuring accountability. Auckland Council expresses its requirements through a letter of expectations and Watercare sets out its objectives through its Statement of Intent. The Board reports to the Council quarterly, through its Council-Controlled Organisation Governance and Monitoring Committee, on the performance of the company against

7 Veolia manage reticulation in the Papakura area with Watercare providing the bulk supply services

both financial and non-financial performance measures. The Council reviews the Board's performance annually.

While Watercare's current scope is only two waters, we understand consideration is being given to contracting it to manage stormwater on a fee-for-service basis.

Accountability to key stakeholders is managed through a dedicated Watercare executive whose role it is to maintain regular and timely communication and access to information throughout the year. Advisory groups also provide specific advice – the Environmental Advisory Group advises the company on how its activities affect the environment and the Mana Whenua Kaitiaki Forum, the Māori advisory group, provides guidance on how Watercare's plans and operations affect Māori and their relationship with the natural environment.

The Board is required to hold at least two meetings a year in public. Currently the Board meets monthly and each meeting includes a session that is open to the public.

There are statutory limitations in that Watercare is obliged to provide service at the lowest reasonable cost and cannot return a dividend, as legislated in Part 5 of the Local Government (Auckland Council) Act 2009.

## Model 3: Asset-managing council-controlled organisation – Wellington Water

All of Wellington's three waters services are managed by a council controlled organisation, Wellington Water. Wellington Water is a shared service organisation owned by Wellington City Council, Hutt City Council, Upper Hutt Council, Porirua Council and Greater Wellington Regional Council. It provides three waters network management services. Established in 2014, it manages annual expenditure of approximately $154 million to maintain and develop water assets with a replacement value of approximately $5.3 billion.

Unlike Auckland, Wellington Water's shareholders (the councils) have retained ownership of their respective assets. Also, this is a 'coalition of the willing' rather than the legislated approach taken in Auckland. In this model, Wellington Water acts as a 'trusted advisor', providing investment advice about the operation and future development of three waters assets and services as well as managing them on behalf of the councils.

Each council decides the level of service it will purchase from Wellington Water, the policies it will adopt, and the investments it will make in consultation with their respective communities and after considering advice from Wellington Water.

**Wellington Water Committee**

The Wellington Water Committee provides shareholder governance and regional oversight for Wellington Water and its management of the network infrastructure. The Committee is made up of elected representatives from each of the five shareholder councils, appointed by the Mayor of each council. As a shareholder, each Council holds 20% of the voting shares of Wellington Water.

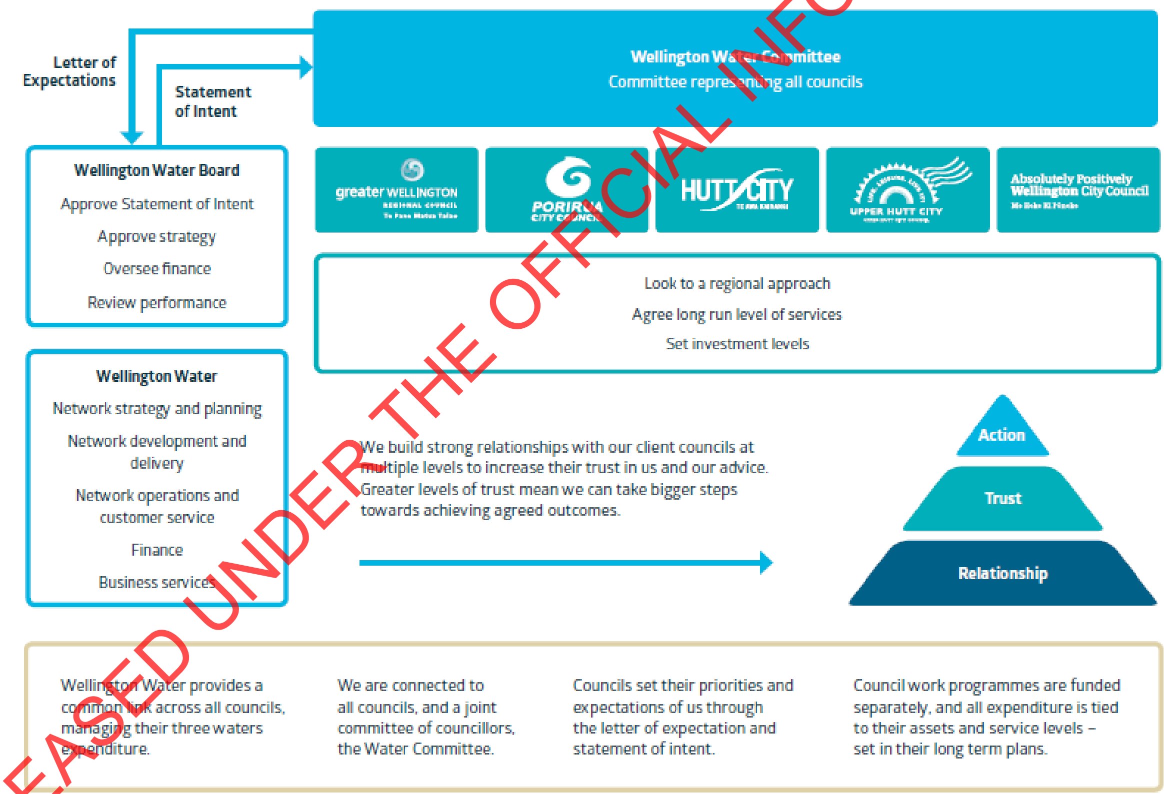
The Wellington Water company reports on corporate goals and performance to the Wellington Water Board and the Wellington Water Committee on a quarterly and annual basis. The Committee meets quarterly and is responsible for considering Wellington Water's half-yearly and annual reports, monitoring performance of the company, appointing directors to the Board, and providing recommendations to shareholders on proposals for the company.

The Committee also issues the letter of expectations and approves the company's Statement of Intent.

### Board of directors

Wellington Water is currently governed by a board of five (maximum of eight) independent directors appointed by the Wellington Water Committee. Directors can serve a maximum of two terms, or six years, unless a longer period is agreed by the Wellington Water Committee. The Board approves the company's strategy, ensures legal compliance, ensures the company has necessary capability, and monitors the company's performance, risk and viability. Directors carry out an annual review and evaluation of the Board's process, efficiency and effectiveness. The results are presented to the Board and the Wellington Water Committee. Figure 3 outlines the governance structure for Wellington Water.

**Figure 3: Wellington Water governance structure**




Source: Wellington Water

# APPENDIX 4: SUGGESTIONS ARISING FROM INTERVIEWS

In our interviews, we asked whether there were suggestions as to what actions might be taken to improve the governance of water management, including those that might be driven by central government.

The range of suggestions received is recorded here with some comment on the implications and issues that they would raise.

### 1 Keep delegation to local councils

Most of the councils we interviewed suggested that central government should not intervene further. The basis for this is that councils have the best understanding of the desires of their communities and are accountable to them. This view was softened if central government intervention included increased central government financial contribution.

### 2 Council-controlled organisation establishment

Many councils discussed council-controlled organisation establishment. From a political perspective there was a strong aversion to moving assets into a council-controlled organisation as this could be perceived by communities as preparation for sale. The asset-managing council-controlled organisation model was much more palatable, although smaller councils still had mixed views. Some see benefits and other would prefer to keep three waters in-house.

### 3 Amalgamation

We received a couple of suggestions for amalgamating councils – ideally on a large scale leading to significantly fewer councils than at present. This is to ensure greater capability, and potentially greater economies of scale, than exist at present. This is obviously a matter with ramifications that extend well beyond water asset management.

Most of the councils we interviewed did not suggest amalgamation and we would observe that, in considering three waters, there are options for providing economies of scale and enhance capability for water asset management across groups of councils that do not require such significant structural change: for example shared service arrangements and/or a jointly owned council-controlled organisation.

### 4 Centralised model

One council proposed that responsibility for the three waters be removed from councils and placed in a central government agency that would have responsibility in the same way that NZTA has responsibility for the highways network. The analogy was also made to electricity as another commodity infrastructure that is not the responsibility of councils.

As with amalgamation, it would provide greater capability, professional governance arrangements, and economies of scale in service delivery.

It would have significant implications for funding arrangements, transferring responsibility from ratepayers to central government – although there are a number of options as to how this would work in practice, including: funding from general taxation; and the establishment of user charges (at least for drinking water).

While the model does not preclude local consultation mechanisms, it is inherently associated with a greater degree of standardisation of service specification than allowed for under current arrangements.

### 5 NZTA funding model

This was suggested by one council and involves central government contributing to the funding of the three waters in a manner similar to NZTA's funding of local roads through the national land transport fund (FARs). The case for this was largely financial, from a council facing significant costs associated with having to renew wastewater consents in 2026, but it was also noted that a planning process analogous to that of the regional land transport plans would help drive asset management discipline.

As with the previous suggestion, this would transfer some responsibility for funding to central government – abated by the extent to which there would be co-funding by councils. As with any models that have central-government funding, there would be equity issues in transition associated with underinvestment by some councils in previous years.

Compared with the previous suggestion, there would be greater latitude for councils to specify local service standards.

### 6 Centrally provided standards analogous to the Building Code

Another suggestion is that there be central standards for asset performance somewhat analogous to the Building Code (the discussion didn't get into the extent to which the cost would be based on performance rather than alternative approaches such as under earlier Building Act frameworks).

This would take responsibility for such standard-setting away from councils and give it to a central body. Arguably for some technical standards, there is little rationale for regional variation and this would avoid duplication of standard setting. The suggestion was made alongside the suggestion for independent monitoring (see below), but is separable in principle.

### 7 Independent monitoring

Another council suggested strengthening monitoring by regional council and ensure independence. The scope could extend to the monitoring of technical standards. We are not clear how this would enhance the present regime. Drinking water is regulated by the Health Act 1956 and monitored by the District Health Boards on behalf of the Ministry of Health as detailed on page 30.

# APPENDIX 5: PREVIOUS REPORTS AND INDUSTRY FINDINGS

## Inquiry findings

### Havelock North Stage 1 Report

Havelock North experienced one of the worst cases of water contamination in New Zealand's recent history. In August 2016 more than 5000 people, or 40% of the population, fell ill following the confirmation of the presence of E.coli in the local water supply. It was later revealed that the likely source of contamination was sheep faeces, which had entered the reticulated drinking water system following heavy rain.

Ministry of Health officials reported that the outbreak cost approximately $21 million, most of which was borne by residents.

A stage 1 formal inquiry conducted in 2017 found that several parties with responsibility for the water supply regime for Havelock North failed to adhere to the high levels of care and diligence necessary to protect public health and avoid outbreaks of serious illness.

The resulting report specifically states (on page 79) that the 'District Council's management and governance fell well short of the standards required for a public drinking water supplier'. In particular it states that 'The District Council's Audit and Risk Committee did not include drinking water safety on its agenda and the councillors did not have any adequate visibility of drinking water risks. Nor did they address those risks with the community'.

While none of the faults, omissions or breaches of standards directly caused the outbreak, it is generally accepted that greater diligence and cooperation is needed to ensure a higher standard of care. Relevant observations from the report includes:

- **Significant gaps of readiness –** The Hastings District Council' lacked a ready Emergency Response Plan, draft water boil notices, and up-to-date contact lists for vulnerable individuals, schools and childcare centres.
- **Falling standards** – The Hawke's Bay Regional Council's knowledge and awareness of aquifer and catchment contamination risks near the contamination location had fallen below required standards. The Regional Council failed to take the necessary steps to assess risks, through resource consent processes, in the management of uncapped and disused bores nearby, in its State of the Environment and resource consent monitoring work, and in its liaison with the District Council.
- **Lack of ongoing monitoring** – The District Council did not properly manage maintenance of plant equipment or keep records of that work, and carried out little or no supervision of necessary follow up work; it was slow to obtain a report on bore head security, and did not promptly carry out recommended improvements.
- **Poor working relationships** – there was a critical lack of collaboration and liaison between the Regional and District Councils which resulted in number of missed opportunities that may have

prevented the outbreak. The Ministry of Health Guidelines for Drinking Water Quality Management for New Zealand requires 'maximum interaction and mutual support between the various stakeholders'. The inquiry found the relationship between the District Council and the Regional Council before August 2016 to be 'dysfunctional'.

- **Unenforced standards** – Drinking Water Assessors who work with District Council to monitor compliance with drinking water safety standards were too hands off and should have been stricter (eg ensuring District Council had an Emergency Response Plan and meeting responsibilities of its Water Safety Plans).
- **Lack of accountability** – Drinking Water Assessors failed to press District Council on the lack of risk assessment, analysis of key aquifer catchment risks, and the working relationship between it and Regional Council, and failed to require deeper investigation into the unusually high rate of transgressions (positive E.coli tests) in the reticulation system.
- **High transgression history** – Lessons were not learned from the 1998 outbreak, despite an independent report (1998 Clark Report) that found the same location for the contamination source. District Council did not take the outbreak seriously enough and failed to implement enduring systemic changes.

While a number of these issues are operational, it does appear that the risks could have been mitigated with more diligent and capable oversight. Some of our interviewees noted that they believed Hastings District Council to be generally good, capable governors and expressed concern about the risk levels and capability to respond in less resourced areas.

## Kaipara

Mangawhai is a small, remote community on the east cost of Kaipara district with a small permanently resident population (1086 in 2013), that grows significantly during summer (to around 4000). The Kaipara District Council recognised as early as 1996 the need for a community wastewater scheme. Following a review of existing water quality issues, likely causes and how to deal with them, the council decided it needed a centralised reticulated wastewater scheme.

### What happened?

Initially the council negotiated a public private partnership arrangement in order to avoid having to borrow to fund the capital costs of construction up front. The agreement would see the private partner build the asset at its own cost, and then own and operate it for 25 years. The council would pay toll payments to the partner once the scheme was operating. At the end of the 25 years, ownership would transfer to the council.

The enactment of Local Government Act 2002 shortly after a preferred provider was selected, however, had significant impacts on the planned arrangements. The Act stipulated that councils could only enter into wastewater service contracts with private-sector entities for up to 15 years and that councils had to own the infrastructure. Ultimately this meant the PPP approach was no long possible. A quick decision was made to change the contract delivery method but maintain the same parties. This change also had implications for the financing arrangements and subsequently the overall capital cost of the project.

Additional issues included:

- last minute change to the contractor
- problems associated with the identified disposal site
- increased scope of the wastewater project
- piecemeal approach to extending the project manager's role
- changes to asset ownership transfer to the Council
- additional financing costs incurred due to Council approved project start delays
- overly complex financing agreements
- changes made to what was to be built, but no evidence of Council knowledge of change
- inadequate communication and consultation with the community.

## Auditor-General's Inquiry

A 2012 inquiry into the Mangawhai community wastewater scheme conducted by the Auditor-General found that over the 16 year period from 1996, the council made a number of decisions that resulted in a failed council, councillors being replaced with commissioners, the departure of a chief executive, a severely damaged relationship between the council and community and an organisation that has needed to be rebuilt.

The inquiry ultimately concluded that the decision to develop a reticulated sewerage system was sound and the system in place is functioning well and has appropriate capacity. However, it found overall issues of poor governance, poor decision making and inadequate management of both the organisation and project, in particular:

- **Poor record keeping** – Throughout the life of the project the Council failed to maintain adequate records for many important decisions that would enable it to explain what it had done, and why. This lack of information also affected the ability of the auditors to effectively do their work.
- **Lack of role clarity** – The project governance roles were never clearly defined. With no single person or group given responsibility for maintaining full oversight of project, this responsibility defaulted to the Chief Executive. As a result, risks were not identified early in the project which led to significant issues later on. There was no governing body in place to challenge information or to provide strategic advice to the council. Overall, the inquiry found the council was too focused on solving problems of the day rather than taking a long term view.
- **Informal decision making –** All project decisions were made through a process of informal workshops and council meetings. While elected members did receive regular briefings, it was largely based on advice directly from project managers and commercial advisers and as such was not independent.
- **Lack of governance capability over time –** Over the 16-year period, the community saw a number of mayors and councillors come and go as part of the electoral cycle. Additionally, the inquiry highlighted that elected councils in small areas often run the risk of not including the skills needed for effective governance of an entity with such significant legal and financial responsibilities.

# Past sector findings

In its call for a review of three waters services, Government has recognised that there are a number of indicators of system-wide performance challenges and vulnerabilities. The *National Infrastructure Plan* identified that water sector infrastructure will require the most attention of all infrastructure sectors.

Sector wide issues include minimal central oversight to provide transparency, address challenges and actively encourage service improvements, in contrast to other infrastructure sectors. Additionally, current compliance and monitoring settings make it difficult for both communities and government to know whether the services are delivering the expected outcomes until there is a service failure.

Reports from the Productivity Commission and the Office of the Auditor-General highlighted a need for system-wide improvements including regulatory and institutional frameworks, and performance monitoring, as well as local authority level improvements such as better use of data to support decision making, investment in asset renewal and planning for future demand.

At the local level, councils face issues of a lack of consistent and reliable information on the state of performance of water assets and service delivery, political imperatives to keep rates low while being seen to fund higher profile amenities, and the potential lack of capacity or capability required to deliver modern water services and address issues as they emerge.

In some cases this has seen multi-million dollar blow outs on the costs for planned infrastructure, while in other cases it has seen particular councils fail to adhere to the high levels of care and diligence necessary to protect public health. Some of these failures are outlined below.

Although there are no specific studies of governance practices used in water infrastructure, a number of past sector reports have identified key issues that have significant governance implications. These are summarised as follows:

## NZ Institute of Economic Research

The NZ Institute of Economic Research analysed the results of a survey of councils conducted by LGNZ on specific characteristics of council three waters services. The results provided an overview of the governance models in place across councils. They also revealed some indicators, both good and bad, that have implications for governance, and some of which may also indicate financial constraints.

Note this report is dated 2014 and many Councils have reported that they have made significant improvements since then.

- Most councils have different rates of depreciation for potable and wastewater assets. Variation in choice of revenue model across and within councils to fund water services indicates a need for further review of how councils make these decisions.
- Variable rates of council compliance with standards. Metro councils reported higher level of compliance with potable and waste water standards than other council types.
- Most councils have KPIs set for service quality and reliability and generally meet these KPIs
  - Service KPIs agreed by 60%-80% of councils in most groups

- Reliability KPIs set with community agreement and achieved for 60-100% of councils in most groups.

- Most (76%) of rural council don't have up to date hydraulic models of whole potable water scheme. Two metro and 16% of rural councils have asset renewal plans but don't match fund them.
- All metro councils have a water management plan and consider future consent needs in planning. Less so for provincial (59-81%) and much lower for rural (48-76%).
- Most (88%) of rural council and 70% of provincial councils don't have up to date models of whole waste water scheme.
- The proportion of councils that have a wastewater management plan is 70% of metro groups, and about 40% of provincial and rural groups.
- Metro councils had higher level of compliance with storm water management standards.

## Office of the Auditor-General

In 2014 the Office of the Auditor-General published a report on the funding and management challenges local government faces regarding their networked assets, including three waters. The report identified a number of issues with governance implications.

The report highlighted the critical role that information plays in making high-quality, well-informed decisions. It found that while local authorities tend to have access to a lot of data, it is not always used well or is not always the best information to support decision making. The report noted that operational staff (eg engineers, operations managers, asset managers) generally receive information on the condition of assets, it is not always reported to managers or governing bodies. It is critical that decision makers not only have access to this information, but that they have a clear understanding of how assets perform throughout the life cycle, or are willing to ask the right questions, in order to ensure the decision making is evidence based.

Decisions must also factor in planning and risk management. The report found that for a number of reasons local authorities adopted 'just in time' financial strategies regarding their capital expenditure. This meant in some cases reducing forecast levels of renewals and a 'run to failure' approach, essentially delaying renewal until unavoidable.

## Local Government NZ

A 2015 report by Local Government NZ surveyed 70 councils and found overall there is no consistent and transparent reporting on performance across the sector. Improved information on water asset management is critical to ensuring better overall management and decision making.

In particular the report found that approaches to managing water assets varies from council to council. It found that provincial rural councils tended to have higher levels of non-compliance, and tended to have more issues with accessing expertise.

The report recommended a ‘sector-led approach’, including a sector agency that would manage an overarching and common data and information framework, include representatives that would reflect the broad range of interests across rural, provincial and metropolitan areas and, importantly, act as a sector thought leader by conducting reviews and develop recommendations on key industry issues.

# APPENDIX 6: FEEDBACK FROM ZONE 2 LGNZ MEETING

We attended the Zone 2 LGNZ meeting in Kawerau on 3 November. Some of the mayors attending had contributed to the initial interview process so our questions in this workshop were at the next level.

The main insights were as follows:

- Central government could contribute more by having clear expectations around governance best practice standards and by requiring local government to meet those standards, while assisting with training and procurement and a focus on outcomes.
- The barriers to providing best practice service are varied, but there are a number of issues related to affordability. Different councils cited different facets where affordability was the barrier. Understanding best practice is also an issue.
- An equitable funding subsidy should be provided, with some clear prioritisation and standards. The Scotland model's central-local mix should be looked to.

The raw feedback is as follows:

### Aside from money, what is the best thing central government could do to help you with governance of three waters?

- Be more directive and explicit about structures and standards. Provide guidance but also require councils to adopt best practice methods – ie, council-controlled organisations if they are most efficient
- Make planning systems easier – agility is important
- Work to provide more funding models
- Require economies of scale that deliver best outcomes
- Be consistent nationally – ie, fluoridation is a national issue that costs each council a lot
- Assist with clarity over governance vs management
- Provide guidelines on options for governance and best practice – one size doesn't fit all
- Clear standards for delivery of water supply and discharge
- Technology knowledge
- Sharing ideas around best practice
- Professional development
- Structures required
- Transparency

- Big picture is often a barrier
- Consultants' fees
- Staff resourcing and training
- Strategic approach to think regionally but act locally
- Implement strategic risk management standards
- Financial discipline
- The department should speak through one person
- Engage with the sector in any new regulations or change to three waters
- Mandate chlorination
- Benchmarking – setting standards
- Consideration of risk, especially from a governance perspective
- Be practical, one size doesn't fit all – ie, small councils and small towns
- Understand that the costs of meeting the standard could be better managed by trading off in another way – eg, riparian planting and the considerable cost of hitting 100% from being 95% compliant
- Best bang for buck vs outcomes
- Technological advances and opportunities
- Centre of excellence for engineering advice
- Procurement efficiencies
- National standards enshrined in legislation
- Explain the brief DIA has given MartinJenkins regarding DIA's intentions for this project
- Best quality and information on local assets, requirements and standards
- National guidelines that can also be modified for local needs
- Set the standards – consistency
- Put in compliance measures that are arm's length
- Take account of individual risk and where each council is at in its asset replacement programme
- Focus on the purpose and outcome, not the structure – form follows function
- Focus regional councils on the problem rather than economic development.

### What are the barriers to providing best-practice three waters services?

- Local politics
- Lack of clear community understanding
- Competing drivers – economic, environmental, community

- Affordability, funding, cost x 4
- Uncertainty around growth projections
- Aging infrastructure
- Changing government policy settings
- Ability of local ratepayers to fund
- Relationship with owners – ie, iwi
- Technology barriers
- Resources
- Sharing best practice
- Planning and financial (critical mass)
- Affordability – replacement of aged infrastructure
- New standards/compliance
- Community expectations/tolerance
- Lack of broad expertise in smaller rural TLAs and lack of collaboration across the sector
- Cost of compliance
- Encouraging a greater degree of collaboration
- Sharing the costs of consultants
- Consistent training framework
- Split/lack of coordination between agencies
- No national standard for training
- Cost vs compliance – there are high, unrealistic compliance requirements in some aspects – eg, loss of quality data for 3 mins makes us non-compliant
- Engineering capability
- Lack of clarity around best practice and standards
- Communities that are resolute in their opposition to chlorination
- Offsets across catchments
- Lack of standards that must be complied with
- Shifting the level of service, quality levels, quantity allocation too frequently
- Set in place an EPA
- Regional Council approach to rules, regulation, enforcement approach
- Let local government sort out on a catchment-wide natural capital basis.

**What arrangements do you think would be appropriate if government were able/willing to assist financially with three waters?**

- Infrastructure loans
- Mixed shareholding/joint ownership of assets or government ownership and local governance boards – ie, Scotland model
- Driving economies of scale – NZ is small
- Allow flexible LOS
- Allow communities some control but set firm baselines – ie, Scotland model
- Clear policies and prioritisation criteria for funding assistance
- Indemnification against infrastructure overinvestment if growth projections aren't realised
- Range of funding options – grants, interest-free loans, infrastructure bank
- Consultation
- Accountability
- One size doesn't fit all
- Best practice for local government
- Reinstate the government subsidies previously available
- Look at Scotland Water example
- Bring back financial assistance rates
- Bigger models of collaboration where appropriate
- Facilitate and improve governance and management
- Investment in training
- Incentives to meet the prescribed standards
- Cost sharing
- Centralised water services
- Consultants' fees
- Set up an NZTA for water
- Need a structure that takes in criteria such as depreciation, affordability. An equitable system for NZ
- An equitable approach to **all** providers in the provision of funding
- Reintroduce subsidies for drinking and wastewater system capital development – ie, Swiss scheme

- Funding should be available for any regulatory impost
- Any funding policy should include consideration of the national significance of a water body (eg, for tourism).