

**Northern Ireland Water Limited
Northern Ireland Authority for Utility Regulation**



**Reporter's Report
on
Northern Ireland Water's
Annual Information Return 2007-08**

Reporter's Commentary on the Board Overview

December 2008

**REPORTER'S REPORT
ON
NORTHERN IRELAND WATER'S
ANNUAL INFORMATION RETURN 2008**

REPORTER'S COMMENTARY ON THE BOARD OVERVIEW

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REPORTER'S REPORT ON**NORTHERN IRELAND WATER'S ANNUAL INFORMATION RETURN 2008****REPORTER'S COMMENTARY ON THE BOARD OVERVIEW****1 INTRODUCTION**

Mr J Mills, a Technical Director of Black & Veatch, is the appointed Independent Reporter for Northern Ireland Water (NIW). This report on the company's Board Overview has been prepared by the Reporter from information gained during the audit of the Annual Information Return 2008.

The Annual Information Return Reporting Requirements require the reporter to provide a report on the NI Water Board Overview which should:

- Review, give his opinion on, and identify any shortfalls in the process established by the company to ensure that the Board Overview is well founded and consistently supported by the textual and numerical information in the Annual Information Return and the reports by the quality regulators relating to the quality enhancements programme.
- Give an opinion on the effectiveness of the company's Annual Information Return process and whether it has been followed.
- Comment upon the consistency of the Board Overview commentaries with the numerical information drawn from the annual return tables and their associated commentaries, and from the quality regulators' reports.
- Comment on the degree of co-operation he has had from the company, particularly with regard to timely access to the finalised Annual Information Return, to enable him to complete his work and report in accordance with the NIAUR timetable.
- For chapters 1, 2, 3 and 4 of the Board Overview the reporter should briefly summarise the key trends in company performance and confirm or otherwise the accuracy of the Board Overview statements and supporting numerical data (including costs but excluding financial performance measures). In addition, for chapter 1 the reporter should give his opinion on the accuracy and completeness of the company's information on their health and safety initiatives and performance trends; and for chapter 3, the reporter should give his opinion on the company's progress towards sustainable procurement.

2 COMPANY PROCEDURES FOR THE BOARD OVERVIEW

The Board Overview includes a statement on the processes and systems of internal control adopted by the NI Water Board for the completion of the Annual Information Return.

The Board meets regularly through the year and receives regular briefing. These reports include key performance indicators which, in part, align with key information reported in the Annual Information Return.

As well as the regular Board papers and reports, the Board is able to challenge and monitor the business through its committees. In particular:

- The Audit Committee which commissions and receives reports from the internal audit function and from the external financial auditors and the reporter.
- The Risk & Reputation Committee, responsible for the company's internal risk management process.

The Director of Finance and Regulation reports to the Board and provides briefing on regulation issues. The Director of Finance and Regulation is the Senior Responsible Officer for the production of the Annual Information Return.

The Board Overview is administered by the Regulation Department drawing on inputs from staff responsible for the production of information in the main return. The Annual Information Return and the Board Overview were considered by the Executive Team, the Audit Committee and the NI Water Board at their respective meetings in June. Internal briefing papers were submitted in advance of the meetings. The Director of Finance and Regulation and Regulation Manager attended the meetings allowing the respective bodies to raise any questions they considered necessary. The AIR08 was subsequently endorsed by the Executive Team and the Board in July.

The reporter had the opportunity to address the Executive Team, the Audit Committee and the NIW Board in June to highlight key issues arising from our audits and to understand the engagement of the Board in the production of the return.

In the Board Overview, the company notes that it is developing its systems to provide financial and non-financial information in the Annual Information Return. It recognises that the lack of fully developed systems and controls is bound to impact on the accuracy, reliability and completeness in the company's first Annual Information Return. The Board highlights particular concerns associated with customer numbers, leakage and DG2/DG3/DG5.

In our opinion, the company's approach and corporate governance means that the Board Overview is well founded and based on the information in the main Annual Information Return.

3 COMPANY'S ANNUAL INFORMATION RETURN PROCESS

The company has a formal process for preparing the Annual Information Return (AIR08).

The preparation of the Annual Information Return is managed as a project under the PRINCE2 methodology.

A Senior Responsible Officer (SRO) was appointed to oversee project delivery, progress and cost. For AIR08, the SRO was the Director of Finance and Regulation providing responsibility at Board level and a direct route for communication with the Board.

The NIW Regulation Manager was nominated as the project manager responsible for managing the production of AIR08.

A Project Initiation Document (PID) was prepared. The PID is comprehensive and specifies the background, stages of delivery, contacts, communications, risk assessment, governance structures and roles.

A Project Board was established with consisted of senior representatives from contributing departments and was chaired by the SRO or the Project Manager. The Project Board met monthly to receive reports from the Project Manager and contributors. Project Board minutes were taken and circulated along with an action tracker.

Responsibility for line entries or groups of line entries were allocated to individuals. A methodology statement was prepared for each set of line entries. The methodology statements include data definitions, the sources of information used, the analysis undertaken and the required sign-off for the submission. The methodologies provide a sound control point for the production of AIR08 and a useful reference for the preparation of future submissions.

The production of the AIR08 was subject to scrutiny by the Executive Team, the Audit Committee and the NIW Board which is outlined in Section 2 above.

The company recognises limitations in the level of assurance in respect of NI Water's internal systems of control and its ability to provide robust reports on some information required in the Annual Information Return. The company highlights areas of work which will drive improvement including econometric comparison, systems and data improvement projects, implementation of audit recommendations and on-going review by the Executive Team, the Board and the Shareholder.

In our opinion, the company had an effective process for completing its Annual Information Return. The company makes reasonable use of confidence grades to reflect its current level of confidence in the reported data. Based on our audit work and documentary evidence we believe that the company's procedures for completing the Annual Information Return have been followed.

Our opinion is limited to areas of the Annual Information Return covered in our main report.

4 CONSISTENCY OF THE BOARD OVERVIEW WITH THE MAIN RETURN

We have reviewed the entries in Tables A to E and the accompanying commentary in respect of the areas of the main return covered by our audits. We confirm that the numerical information in Tables A to E is consistent with the equivalent data in the main return. We consider that the commentary in the Board Overview is consistent with the detailed company's commentary in the main report.

The reports on water quality and wastewater quality in the AIR08 is taken from NI Water's records based on sampling and testing work carried out by NI Water. This work is scrutinised by the quality regulators. We understand that the Utility Regulator does not receive a separate report on performance from the Quality Regulators. We recommend that this is considered for the future. We have confirmed water quality information in the Table A against the NI Water's published Drinking Water Quality Report for 2007. We have confirmed the wastewater quality reports against our sample audits of NI Water's wastewater quality performance figures.

5 CO-OPERATION BETWEEN THE COMPANY AND THE REPORTER

The company has actively engaged with the reporter and his team to allow him to complete his work and report in accordance with the NIAUR timetable.

The company met with the reporter in April 08 to provide an initial briefing on the AIR08. This covered the general processes being adopted for production of the return and an introduction to the methodologies for individual data entries.

The company arranged a schedule of audit meetings in response to the reporter's audit plan. The reporter's team generally met table and line owners with representatives of the NIW Regulation Department sometimes in attendance. Follow up meetings were arranged through the Regulation Department as requested.

The company issued early drafts of tables and commentaries so that points of issue could be identified at an early stage and addressed in the audit process. We found that company staff were well prepared for the audits and were generally able to access supporting information during the initial audits. In some cases follow up meetings were required to allow selected background reports and data to be sourced to provide detailed audit trails for the return.

Regular meetings between the reporter and regulation staff provided early feedback on issues arising and, where necessary, the need for future audit to resolve uncertainty. We found the company willing to consider issues raised by the reporter and address these in its return.

The reporter had the opportunity to address the Executive Team, the Audit Committee and the NIW Board to highlight key issues arising from the audits and to understand the engagement of the Board in the production of the return.

Overall we have been impressed by the co-operation and openness of NIW staff throughout our work. We confirm that the company has provided timely access to interim drafts and the finalised Annual Information Return, to enable us to complete our work and report in accordance with the NIAUR timetable

6 REVIEW OF BOARD OVERVIEW CHAPTERS 1, 2, 3 & 4

6.1 Chapter 1 – Key Outputs and Service Delivery

Table A – Water Service

The company has reported figures for the percentage of properties receiving low pressure for the first time following a comprehensive assessment based on hydraulic modelling and pressure monitoring in the network. We believe that the reported figures provide a substantive baseline position. The company recognises that further work will be required in the areas identified as at risk to confirm the status of individual properties.

The company has reported an overall performance score for interruptions to supply. We believe that the company has reasonably well developed systems for reporting this information, although the company recognises that further work is required to ensure that these systems are embedded and reporting is consistent across the company.

The company has generally improved its performance in dealing with customer contact in a timely fashion. The Crystal Alliance contract was operational throughout the year and is delivering service improvements. The low performance against DG8 (bills for metered customers) is partly explained by the company's policy of not charging (and not issuing bills to) customers whose consumption did not exceed a domestic allowance of 200 m³ in the report year.

We have been able to reconcile reported water quality data to the 2007 Water Quality Report published by the company. Percentage mean zonal compliance with drinking water regulations declined marginally in the report year.

Table A does not include water quality information in respect of trihalomethanes which is a key focus of NI Water's water quality investment programme. In the report year water quality compliance for trihalomethanes (THMs) remained poor with 32.3% of samples taken in 2007 exceeding the permitted concentration value (PCV). The position has been recognised and Authorised Departures are in place for many water supply zones where the THM PCV is exceeded. The completion of treatment works improvements in 2008 under the Alpha PPP concession and other work undertaken directly by NI Water should reduce the quantity of THMs in supply.

The company reports a number of mains bursts which is similar to most water and sewerage companies in England & Wales.

Table B – Sewerage Service

The company reports figures in relation to the risk of flooding for the first time in the report year. The company is undertaking an assessment of historic records of sewer flooding and setting up systems to improve recording for future incidents. Only limited progress has been made to date and the reported data is incomplete. We would expect an increase in the reported number of properties at risk as the company makes progress on its assessment of flooding risk.

The company has reported WwTW compliance data in the BOV based on the following:

- We understand that the WOC figures are based on 251 works with numeric WOCs at the start of 2007, 31 of which failed in the year.

- We understand that UWWTD compliance figures are based on the final pass/fail assessment by NIEA for 79 works with numeric UWWTD standard in 2007. 11 works failed the UWWTD standards. This includes one works failing the total nitrogen standard and one works which failed because insufficient samples were taken. Eight of the works failing UWWTD standards also failed against the WOC standards. The UWWTD results includes the new North Coast works (a pass) which operated for part of the year and also three works at Portrush, Portstewart and Coleraine which were transferred to the North Cost works in the year.
- The percentage failing sewage treatment works in Line 22 does not appear to include the works which met the WOC standard but failed the UWWTD consent standard.

The number of intermittent discharges which are satisfactory are calculated from Lines 16a and 17a of Table 16. These lines refer to intermittent discharges excluding CSOs. The reported number of intermittent discharges is based on progress to date by EHS in categorising intermittent discharges as satisfactory and unsatisfactory which has covered 15% of CSOs. NI Water has also had to make assumptions in allocating intermittent discharges between CSOs and other discharges. As further work is done to complete these assessments there might be material movements in the proportion of discharges reported as satisfactory which relate to data improvement as opposed to any underlying change in the infrastructure.

The number of sewer collapses per 1000 km is materially higher than similar performance data reported for England & Wales. This suggests that NI Water's sewerage infrastructure is in a significantly worse condition than other water and sewerage companies. We understand that NI Water is responsible for sewer laterals and drains which are not the responsibility of water and sewerage companies in England & Wales. It is possible that these public laterals and drains have a disproportionately high collapse rate. We recommend that further work is done to separate out collapse (and other defects) on public laterals and drains before drawing conclusions on the condition of the sewerage infrastructure.

Health & Safety

The company reports on Health & Safety performance and activities under Table 41 of the main return. The company has not commented further on Health & Safety in the Board Overview.

Numbers of days lost due to sickness, accident and occupational ill health have fallen. The number of RIDDOR incidents have fallen from 17 to 16. The number of incidents of occupational ill health have risen from 152 to 172.

The company has noted the reducing number of incidents of days lost due to sickness, accident and occupational ill health and note that the current rate is lower than for the NI Civil Service. The rate of days lost remains higher than for water and sewerage companies in England & Wales.

From our audit of Table 41 and the Procurement Plan we can confirm that the company is working actively with its service providers to promote good health and safety practices throughout its business. The company actively monitors performance of its supply chain and has developed initiatives to share information and reinforce good practice.

6.2 Chapter 2 – Financial Performance Measures

Reported expenditure in Block A of Table 3 reconciles to expenditure reported in tables 21, 22, 35 and 36 of the main return, subject to minor rounding errors. The total operating expenditure in Line 3 includes the PPP fees reported in Line 3a.

The reported OPEX expenditure excludes £2.368 million of expenditure on non-regulated elements of the business covering private septic tank emptying and the maintenance of Roads Service vehicles.

Total OPEX expenditure including non-regulated business is £186.121 million, 3.1% less than that envisaged in the Strategic Business Plan.

Total CAPEX expenditure reported in Table C is £252.743 million. This includes capital income associated with connection charges and infrastructure charge receipts totalling £3.703 million, giving a total CAPEX less capital income of £249.040 million. This is 9.8% less than that envisaged for the year in the Strategic Business Plan. The company has advised us that this reflects reduced investment in development, delayed management and general investment pending approval of the BIP programme and delays to some works to optimise solutions.

We have not commented on other expenditure figures in Blocks B, C and D which are not covered by our audits.

6.3 Chapter 3 – Key Supporting Information

We note that the calculation rules for Table D Line 31 (Average connected properties – water (excluding void properties) take data from Table 7 which includes void properties. This has results in the reported figures of expenditure per property being understated in Table D. We recommend that the calculation rules are revised and a figure excluding void properties reported. The calculation rules for Table E line 25 take data for properties billed from Table 13 and exclude void properties.

In our main report we have expressed concern regarding the allocation of expenditure between quality, base, enhanced service level and growth. We believe that there is further work to do to ensure that a robust allocation methodology is applied consistently.

We note that the company does not reline water mains which contribute to water quality failures as a matter of policy. Water companies in England & Wales have used a mixture of relining and replacement to renovate water distribution systems depending on the burst frequency of the exiting pipe. We recommend that NI Water reviews its current policy against the experience of other companies.

The company reports estimate leakage of 156.52 Mld against a target level of leakage of 157 Mld. The company has reported an imbalance between bottom up and top down leakage which is greater than 5%. Notwithstanding this, the company has applied a maximum likelihood (MLE) adjustment and reported leakage within its target level. The company has concluded, and we agree, that this is a prudent approach pending the outcome of work either underway or proposed to improve confidence in both the top down and bottom up leakage estimates.

The company has reported a security of supply index of -26, indicating that its security of supply is materially worse than almost all water and sewerage companies in England &

Wales. Commissioning the Alpha PPP project in 2008-09 will result in a stepped improvement in security of supply. We understand that further improvements are dependent on the construction of new transfer pipelines to address security of supply in small isolated water supply zones.

The company has not been able to report on numbers of properties at risk of flooding where the problem has been solved or mitigated.

Sustainable procurement

We have reported separately on the company's Procurement Plan in February 2008 and the company's Procurement Activity Report in 2008.

Over the past year the company has reviewed its procurement needs and policies with a view to improving effectiveness and efficiency.

The company seeks to develop a sustainable procurement policy through a balance of:

- Engaging actively with its supply chain to disseminate information on its intentions and to receive feedback from potential suppliers on the capability and desire to provide services in particular combinations and scale of contracts.
- Bundling services of a similar nature based on the company's experience, broader experience and feedback from the marketplace. At the same time encouraging existing suppliers to form consortia capable of delivering broader ranges of services to reduce interfaces and administration costs.
- Entering into longer term relationships allowing suppliers to invest in and develop organisations and systems which will reduce administrative costs and improve overall levels of service and reporting.
- Developing contract conditions, payment mechanisms and incentives which more closely align the interest of the contractor with the requirements of the company and its customers. This includes sharing savings, rewarding quality and performance and ensuring that information and reports are provided in a timely manner.

Much of the company's capital programme is delivered through frameworks which include long term relationships between the company and its supply chain. In its Procurement Activity Report the company has provided detailed information on the development of its long term capital delivery strategy. The company has initiated development of its procurement strategy for PC10 and PC12 periods

Overall, we believe that the company adopts a sustainable approach to procurement based on engagement with the market and the management of sustainable long term relationships.

6.4 Chapter 4 – Efficiencies

In its Procurement Activity Report, the company has highlighted pressures on its operational budgets which increase the challenge of delivering the planned efficiency targets. These include:

- General inflationary pressures, in particular those relating to commodity prices, which are increasing the cost of electricity, fuel and chemicals.

- A review of potential savings arising from activities in the Procurement Transformation Programme. This concluded that benefits of some activities are likely to be less than previously expected. The company has advised us that following this a review it has outlined a plan to bring benefits back on target. The plan has been supported by the One Programme Board and Executive Team and is at the early stages of implementation.
- Delays to implementation of the Business Improvement Programme which has delayed the installation of some of the systems and technologies the company expects to deliver efficiencies.

However, the company has delivered its services in 2007-08 with OPEX of 3.1% less than that envisaged in the Strategic Business Plan. The company has identified further OPEX efficiency targets to be delivered in 2008/09 and 2009/10 over that envisaged in the Strategic Business Plan which it is committed to achieving.

The company's capital expenditure was less than that envisaged for 2007-08 in the Strategic Business Plan. The company has not yet reported on specific efficiencies within the capital programme. In our audits we reviewed the populated Capital Investment Monitoring template which provides a comparison of the current investment programme against the baseline Strategic Business Plan (SBP) programme. We were concerned that the Strategic Business Plan does not appear to include a clear statement of outputs and delivery dates. We believe that this exposes both the company and other stakeholders to risks in respect of planning and control. It will also make it more difficult to judge whether the programme has been delivered and the planned capital efficiencies achieved.