External Review

Wellington Water Limited: capital programme estimating and budget systems

Final Report by Roy Baker and

Kevin Jenkins

22 July 2024

This Review has not been independently verified or audited. We have made reasonable efforts to ensure the information contained in this report reflects the range of views expressed by the people we spoke with. The Reviewers do not accept any liability if this report is used for some other purpose for which it was not intended, nor any liability to any third party in respect of this report, nor any liability arising from or otherwise in connection with this report (or any omissions from it), whether in contract, tort (including for negligence, breach of statutory duty, or otherwise), or any other form of legal liability (except for any liability that by law may not be excluded). This note supplements the Terms of Reference for our engagement.

Acknowledgment

Most of the interviews undertaken by the Reviewers were with employees of Wellington Water Limited. We would like to acknowledge and thank each of them for the quality of discussion, and for their generosity in openly sharing their experiences and views to help us identify lessons.

We also spoke to representatives of the shareholding councils and extend our sincere thanks for their participation and feedback to help ensure such a situation does not arise again.

The Reviewers were assisted by Suzanne Carter.

Administrational support was provided by Garry Butler and Sheree Matheson of Wellington Water. Thank you.

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Key findings

The reviewers were asked to investigate an error that Wellington Water Limited (Wellington Water) had made in the information it gave to its shareholder councils on or around 1 May 2024 for their longterm planning, which incorrectly excluded Wellington Water's corporate cost.

The error and how Wellington Water responded to it

We established a timeline of what happened, and we drew on several frameworks to put what happened in context. This shed light on the causes of the error and the changes that Wellington Water needs to make to prevent similar problems in the future.

We found that the error had multiple inter-related causes. The error arose because of deficiencies in structures, systems, and processes, including a lack of strategic leadership at the highest levels of the organisation, and in wider problems of organisational culture. The problems went wider, and higher, in the organisation than any single function.

Importantly, the consequences of the error, including for the trust and confidence of the shareholder councils, were magnified by how Wellington Water responded to it. When they became aware of the error, the organisation did not react quickly enough or take it seriously enough and downplayed the problem in their communications with councils. Had the information given to councils been corrected when Wellington Water first became aware of the error, the impact for the councils could have been minimised. Wellington Water had numerous opportunities over the next three to four months to address the problem but did not take them.

An organisation that has not kept pace with increased demand

In our review we discovered an organisation that was not as mature as we would expect it should be. Wellington Water is now 10 years old, but it has not evolved in step with the evolution of its functions and as an organisation has not kept pace with increased demand.

We found unclear structures and accountabilities, with like functions not being grouped with like; a control environment that is loose and not fit for purpose; inadequate systems and processes; some missing competencies (including strategic leadership); under-resourcing in the Finance and the Risk functions; and a mismatch between Wellington Water's values and, as described to us, its culture. Our recommendations address those issues.

We also found a culture of not wanting to hear or present bad news. There is a tendency to want to manage bad news before informing stakeholders, and to try to shape their perceptions and reaction to the problem in order to minimise it. Although staff and middle management had formed good relationships with the shareholders, we were told that Wellington Water comes across as defensive to shareholders.

Our recommendations for how Wellington Water can prevent further errors and recover lost trust and confidence

We were struck by how much our recommendations align with those of the 2022 Inquiry into the Cessation of Water Fluoridation by Wellington Water. We observe that some problems identified in that Inquiry have not yet been fixed. Our review found a tendency to see problems with the organisation's structure, systems, and processes as issues to be put off and addressed by the new entity to which Wellington Water will transition.

However, the problems this review has identified need to be addressed urgently, otherwise errors of the type investigated by the 2022 Inquiry and this review will happen again. The work to be done includes, critically, recovering the lost trust and confidence of Wellington Water's shareholder councils. For the senior leadership, it also includes recovering some lost trust and confidence among their own people.

Introduction

1. On 24 May 2024, Wellington Water apologised to shareholding councils for an error made in their advice to council shareholders for capital programme water assets. They explained the exclusion of a 6% corporate cost for major projects in the first three-year delivery of a 10-year plan, accumulated to a shortfall of $51 million. Wellington Water proposed to mitigate the impact of the deficit by re-programming activities to reduce the impact on Council's and rate payers. Wellington Water apologises for error in budget advice

2. At the same time, the Board of Wellington Water announced an independent review to understand the circumstances and cause of the error, and to provide recommendations for improvement.

3. On 13 June 2024, we – Roy Baker and Kevin Jenkins – were appointed as Reviewers. We were asked to present our findings to the Wellington Water Committee on 26 July 2024.

4. The purpose of the review is to inquire into and report on how the estimation error occurred and identify lessons appropriate for an entity with a limited life to learn from, to minimise future occurrences.

5. To reach their findings we undertook a process of inquiry and discovery, interviewing 42 people involved in Wellington Water, including Board Members, leaders, managers, team member employees, contractors, and representatives of the six shareholding Councils.

6. We also reviewed approximately 450 documents including Board, management, corporate and operational papers, internal and external emails and attachments, and public documents relevant to Wellington Water to write our Report.

7. Once we had documented our findings, we returned to the documents and compared our findings with those already on the public record.

8. While in draft, our Report was shared with those Wellington Water employees who had met with us and discussed their views so they could offer any corrections or comment on other material matters. We have incorporated some of that feedback into this Final Report. Some feedback we received was in our view either outside of the Terms of Reference or expanded on points in detail that are already made this Report, this feedback has not been included.

9. Given the tight timeframe for preparing this report, we have not been able to address comprehensively every matter that was raised in this review. The review did not involve a forensic assessment of finance functions, and it has not sought to prove or disprove numbers. People capability has not been factored into observations. We have focussed on what we believe to be the critical factors given the purpose of the review as stated in the Terms of Reference (see Appendix 1).

Recommendations

Our recommended actions are intended to help Wellington Water learn from these events and improve its response to any future occurrences. Given Wellington Water's impending transition into a new entity, we understand the remaining short-term life of the organisation in its current form and the need for pragmatism. However, we believe that if there is not investment in the areas covered in our recommendations, there is a high risk that further problems, similar to the estimation error or the cessation of fluoridation, could occur.

Rebuild the trust and confidence of shareholding councils in Wellington Water

- Review the capital projects across the tri-ennium to ensure that the appropriate corporate cost is accurately recorded, enabling fact-based discussions to occur with councils as their capex programmes are actioned.
- Establish controls to ensure accuracy and transparency of the allocation of corporate costs in a timely manner.
- Wellington Water needs to be front and centre in the budgeting process, overseeing all the financial processes (including capital/investments) for Wellington Water and ensuring strategic focus, providing high-quality advice, and appropriate controls.
- Wellington Water needs to work with Council CFOs to:
  - Improve the quality, reliability, and timeliness of monthly reporting data to Councils, especially forecast capex and opex spend.
  - Ensure that Councils are aware of the cost estimates levels that are applied to projects and programmes and how they are determined, thereby improving the accuracy and confidence in the projected forecast investments.
  - Create comprehensive and streamlined annual planning processes.
  - Determine a more transparent process for how the corporate cost for the capital programme is managed, including showing the corporate cost as a separate line item for councils and eliminating the need for each individual capital project to estimate and account for those costs.
  - Review the 2022 Service Level Agreement with Councils – section 11 of the three-Year Plan – to ensure that it is still current, especially the delivery date for the three-Year plan to councils.
- The Board of Wellington Water works with the shareholders to determine if one standard set of monthly financial reports for all councils (both opex and capex) could be agreed, in order to minimise complexity within Wellington Water reporting.
- Strengthen the sign-off process and include common checklists for projects across Wellington Water, to ensure the corporate cost element is correctly included.

Rebuild the trust and confidence of middle management and staff in Wellington Water's senior management

- Ensure Wellington Water's budget planning cycle to start at the same time as, or before, any Annual Plan/LTP planning for Councils.
- Ensure that the Senior Leadership Team and Tier 3 managers have a better understanding of the process and the importance of all aspects of planning.
- Inculcate the values of the organisation into all work areas and behaviours and acknowledge employees' values-based actions.

- Return to a “no blame” culture by changing behaviour to better align with Wellington Water’s values.
- Consider working with staff (beginning with senior leadership) to fully define expectations around individual behaviours and actions that support Wellington Water’s values and include the outcome of this work in the Code of Conduct.
- Reverse the tendency in the business to manage first rather than share first (with external stakeholders) – that is, make the default to signal issues early.
- Build a mutually supportive culture based on listening and responding.
- Increase the organisation’s focus on outcomes.

Restructure the organisation so that accountabilities are clear, and capabilities can be substantially enhanced in the lead-up to the new entity

- Introduce an orthodox structure that has clear role accountabilities and responsibilities for role holders – for example, group like functions with like.
- Strengthen the strategic finance function.
- Introduce more finance/business partner capacity to help run the whole business.
- Consider establishing a Chief Operating Officer-type role dedicated to achieving rapid business as usual (BAU) business and process improvements both for short-term quality control and in readiness for the transition to a new water entity.
- Consider where IT and HR functions are best located given the organisation’s size.

Treat Wellington Water’s readiness for reform as separate from the BAU work programme

- Consider establishing a separate team that focusses solely on the move to a new entity to keep BAU separate, and to ensure focus remains on delivery with no slippage in delivering the opex and capex programmes for councils.

Review Wellington Water Annual Plan processes to deliver capital programmes for councils

- Streamline and clarify integrated planning and finance processes and ensure they are universally understood across the business; prioritise key risk areas and use best-practice guidance to create clear standards, ensuring guidance or policies around their use are in place.
- Map key processes immediately, particularly around the use of spreadsheets and data transfer.
- Create and update standard procedures for quality control, including Wellington Water-wide templates, checklists, gateways, audit requirements, authorisation, and communication.
- Ensure that ownership and accountability of key processes are understood and reflected in position descriptions.
- Reduce reliance on financial and other stand-alone spreadsheets and explore new cost-effective collaboration and productivity tools (this need not wait for the new entity and the new processes and systems it may adopt).
- Require transparency in external and internal reporting as a default, unless there is a good reason not to.
- Consider how to further optimise the relationship with Watercare and its new model, for future synergy.

- Once the review of major projects confirms corporate cost is accurately recorded, ensure that collectively the overall Wellington Water corporate cost will be recovered (see above).

Strengthen governance oversight

- Increase the focus on oversight of any recommendations implemented from this Report, using an internal audit function to report to the Board on progress and issues.
- Ensure that shareholding councils have high-quality information and that there is improvement in the relationship between each council and Wellington Water.
- Ensure that internal governance groups (more aptly described as "management committees") are established to oversee the Long Term Plan (LTP) and that annual planning continues to be accountable until the project has been completed and formally signed off.
- Review the risk management system so that it is:
    - Fit for purpose (best practice is unlikely to be achievable in the period leading to the establishment of the new entity but, in order for this function to have any impact, it needs to be refocused on key risks).
    - Integrated into strategic and operational management.
    - Accorded the mana necessary for it to identify and call out risks as they emerge.
- Ensure that the capacity of the assurance functions is the right size for the risk profile of the organisation.
- Review the quality and content of information provided to the Risk and Audit function and determine if there are any gaps to be addressed.

Wellington Water's operating context

Wellington Water Limited was established in 2014 following the merger of Capacity Infrastructure Services and Greater Wellington Regional Councils water supply group. Six councils own and fund Wellington Water: Greater Wellington Regional Council (GWRC), Hutt City Council (HCC), Porirua City Council (PCC), South Wairarapa District Council (SWDC), Wellington City Council (WCC) and Upper Hutt City Council (UHCC).

Wellington Water sets out its role on its website: "We give our councils advice on their assets, and they make decisions on what to fund through their Long-Term Planning (LTP) process. Councils also set the levels of water services and set policy. We work to the budgets they set and prioritise our work to make the best use of the funding and resources provided to us".

Wellington Water has been waiting on planned water reforms for several years. The Three Waters reform, evolving into Local Water Done Well, has delayed investment in assets and infrastructure and, as it continues to await decisions about its future, Wellington Water is operating continuously in a "change is coming" context.

The Government is progressively rolling out its Local Water Done Well policy. The Local Government (Water Services Preliminary Arrangements) Bill, which is expected to be enacted in August, will require councils to prepare Water Services Delivery Plans setting out how they plan to deliver water services on a financially sustainable basis. It is anticipated that many councils in the region will opt to submit a Joint Plan and continue work to establish a new regional Council-controlled organisation (CCO). Future legislation that will provide for new forms of council owned water services organisations is expected to be introduced in late 2024 and enacted in mid-2025. This is the earliest a new form of regional CCO would be able to be established.

Under Local Water Done Well, councils will be responsible for deciding whether and when to establish a new regional CCO. The ten councils comprising the Wellington region and Horowhenua District signed a Memorandum of Understanding on 10 May 2024 to work together on a joint water services delivery plan and to develop a joint delivery model that can address the challenging long-term funding and delivery requirements for water in the region. We understand this process is subject to several "off ramps" for individual councils to decide whether to commit to the joint delivery model, and no decisions have been taken around the timing for establishment of a regional water services organisation.

Planning to prepare for the transition of Wellington Water into a new entity has slowed significantly with the need for councils to drive reform locally rather than relying on central government resourcing. Planning and preparing budget information relating to investments required for the 2024-2027 investment cycle and for the 2024-2034 planning period has been undertaken. However, major investment in new systems has been deferred until transition has occurred; improvements to asset information and management, processes and systems need to be oriented to the short term, in readiness for a transition.

Wellington Water has also been under the public spotlight. It has had to deal with a confidence issue around the non-fluoridation of drinking water at Te Mārua and Gear Island water treatment plants, repair several thousand leaks due to aging water infrastructure, and manage a potentially significant water shortage through the recent summer. It has also had to manage ongoing non-compliance and poor performance at wastewater treatment plants across the region for many years. Issues such as these intensify scrutiny and corrode reputational capital. Failing infrastructure is regarded poorly by the public and Wellington Water are viewed as responsible for failing to respond, as well as their shareholders.

Since 2021, Wellington Water has grown from an organisation of 265 to 395 people to meet demands arising because of these issues, the increased size of its capital programme, and its core role; operating and maintaining existing infrastructure, renewing it when necessary, delivering projects of significant investment and providing recommendations and budget advice about future capital projects for each Council's LTP.

Answers to Questions - from the Review's Terms of Reference

Section a. How the estimation error occurred

What is the process Wellington Water follow in compiling the capital programme estimates for the LTPs and is it fit for purpose, including comparisons, benchmarks and assurance steps?

The process that Wellington Water followed in developing the LTP is set out in Appendix 3.

Factors that made the development of 2024/25 LTP particularly complex

The LTP is a complex process, a number of factors made the development of the 2024/25 LTP unique:

- The regulatory environment became more complicated as the 2023 year progressed due to changing government directions.
- By September 2023, it was clear not only that councils would need to prepare the capital programmes for the first two years of the LTP, but that if there was a change of government, they would need to prepare a detailed 10-year plan. (If Councils needed to move from preparing a twoyear plan to prepare a 10-year plan, then Wellington Water also needed to prepare advice and information to inform these plans for each of the Councils).
- In mid-2023, to ensure they could meet councils' deadlines if a 10-year plan was required, Wellington Water decided to build opex and capex programmes for the full 10 years of the 202434 LTP period.
- Wellington Water used information compiled for the now disbanded National Transition Unit, to provide a fiscally unconstrained view of a budget, as the starting point of the capital programme. Wellington Water assumed the numbers prepared included the corporate costs.
- The fiscally unconstrained view was not sustainable for councils because they could not undertake Wellington Water programmes within their financially prudent regimes.
- 10-year planning was more complex than a normal annual plan, and so there was significant twoway communication between Wellington Water and each council to agree on the projects that could be delivered by the contracting market, to deliver the capital programme.
- Within Wellington Water there was also complexity. Similar communication happened between departments to determine what projects and programmes could be delivered and at what price.
- In late 2023, councils asked Wellington Water to review and reduce their opex costs.
- Wellington Water responded by reducing opex costs by 5%. This was communicated internally at the same time that Finance was looking to increase the capex charge between 6% and 10%. This caused confusion in areas outside Finance and contributed to general confusion about the allocation of costs.
- The Network Strategy and Planning Group brought together programmes from Network Development and Delivery, Customer Operations Group and the Network Management Group. Network Strategy and Planning's focus was on presenting Wellington Water's entire programme of work and its costs to councils.
- The Project/Programme costs were the responsibility of the budget holders submitting their work to Network Strategy and Planning, and different approaches were taken. The Business unit budget accuracy was not checked.

- A key focus in the capex development process was to provide councils with an agreed minimal viable product in order to meet each council auditor's assurance requirements. This work was peer reviewed by an independent supplier for additional assurance.

Analysis of the process

The process was mostly good. It could be improved to align timeframes better with councils' timeframes. It is worth noting that the current Service Level Agreement with Council (dated April 2022) required Wellington Water to deliver draft 3-year plans by 1 September (section 11.1). This date seems unrealistic, and we do not believe it has previously been met.

A governance structure was established for assurance and was in place to oversee the LTP process. There was regular reporting to SLT and the Board.

Wellington Water provided programmes and appropriate risk statements to the councils given they faced fiscal challenges, which included pressure on debt ceilings and rate affordability.

In providing the programmes, particularly projects beyond the first year of the LTP it was unclear to us how well the Councils understood the basis of the estimates and at what level of price risk etc the estimates were based upon. Without a good understanding of this process Councils are likely to have difficulty managing any subsequent cost uplifts or overruns.

At a strategic level the process met its milestones and delivered outputs to councils for their LTP. Feedback from Councils about the process up until May was generally complimentary.

The flaws were the unsystematic allocation of corporate costs, the lack of financial oversight at a macro level, the poor communication around the corporate cost percentage to be allocated, and the lack of response on several occasions when clarification was sought.

Indications that an increase from 6% to 10% may occur for the 24/25 year (Year 1 of the LTP) was informally notified by Finance in late October/November. While the Service Planning team were aware of the change, and of the risk to the LTP programme, the issue did not gain real momentum until 25 February 2024.

From late November, internally there was confusion across Wellington Water about whether or not there was an increase from 6% to 10% corporate cost charge. Questions were asked about the level of the charge and were not answered. A number of people we spoke to told us that the 10% corporate cost was included in project budgets; others said it wasn't included and that it would be added on later, they couldn't tell us by whom.

In February it was known that the corporate cost charge of 10% had not been fully applied. Despite the issue being raised again, the issue was not addressed. From our interviews with various Wellington Water staff, we have concluded that many of those involved did not appreciate the significance of the impact of the change and how to address it given that the councils were already working to finalise their draft consultation documents. Some leaders also did not understand the repercussions.

The ambiguity and delay meant some data that was exchanged or used at different stages of the process included the corporate costs and other data used excluded the costs.

What is the process for establishing and apportioning the corporate cost for estimating purposes for the LTP, and is it appropriate for the Wellington Water model?

Wellington Water has three basic funding mechanisms for the total cost of running the organisation, all three of which are controlled by Finance:

- **Management & Advisory Services:** the sum of money invoiced to councils that fund Wellington Water, in predetermined proportions, solely related to running the organisation
- **Corporate costs charged to the council operational expenditure (opex) programmes:** the portion of the organisation's costs that relate to supporting the delivery of the opex programme

- **Corporate costs charged to the council's capital expenditure (capex) programmes:** the portion of the organisation's costs that relate to the planning and delivery of the capital programme.

There is little understanding outside of the Finance function of how any of these mechanisms operate, and in fact different managers and staff told us quite different versions.

This question focuses on the *corporate costs allocated to the capital expenditure (capex) programme.*

Overview of the three-stage process to allocate corporate costs

The starting point for the development of the corporate cost charge process is the development of the Wellington Water corporate budget as a whole.

Stage 1

The first part of the process is to determine the amount of the corporate costs to be charged to capex projects:

To do this Finance:

- Annually seeks inputs from business units (that develop capital projects – from initial concept through to delivery of the project) to determine the estimated percentage of each staff member's time that they spend on specific capital projects. This percentage is then applied against their salary cost to determine the amount that needs to be recovered against the capital projects.
- Totals these costs from the business units that support the capital programme.
- Calculates the amount of corporate overhead – using a detailed spreadsheet.
- Divides the total of 2 and 3 (above) by the total capex programme for the year, to calculate the percentage that each capital project needs to apply to the projects estimated costs. This determines a project cost that includes the corporate cost 'overhead'.

For the first year of the LTP, Finance have estimated the cost to be recovered to be $30m, and a capital programme (before corporate costs) of $300m, thereby requiring a corporate cost of 10% to be added to all capex projects.

Stage 2

The second part of the process requires the various business units involved in developing budgets for capital projects to add the 10% corporate cost "overhead" component to each capital project. The corporate cost needs to be added last to ensure the percentage is applied to all costs.

Stage 3

The final stage of the process sits again with Finance. Monthly, Finance allocates a portion of the annual total budget against projects. Finance manages this at a corporate level including any differences between actual charges and what was budgeted.

- Each month, Finance allocates corporate overhead cost. Monthly financial reports are generated in Excel using data extracted from the Tech1 finance system.
- They then push an extract into a data warehouse which provides a view of total costs including a corporate cost to individual project managers. This view is what is used to report to Councils.

The outcome Finance is trying to achieve is relatively simple, i.e. where costs within business units are incurred that are in direct support of a capital project, then those costs should be capitalised against the built asset. Similarly, a portion of corporate overhead should be included, for example, a portion of a manager's time spent supporting a capital programme or a portion of the IT costs that relate to asset management would be treated the same way.

Capitalising such costs gives a more accurate cost of the built asset. It also reduces the opex costs of Wellington Water, which in turn reduces the opex funding required from councils. This in turn flows into a lower rate requirement for ratepayers.

The system is dependent upon individual projects having the corporate cost percentage applied in all areas of the business where capital projects eventuate.

In previous years the percentage used to allocate corporate costs was 6%. Over the last few years Wellington Water has grown significantly and this growth, driven by higher capital investment from Councils, has meant the percentage needed to increase to cover costs.

Key observations about the process to allocate corporate costs

We noted variations in the application of corporate costs:

- Wellington Water has a manual that provides guidance on cost estimation of capital projects. The manual states "The cost estimate needs to include all costs associated with the project, excluding Wellington Water's management fee to the Council. The value of the management fee varies annually and will be added to the cost estimate by Wellington Water" (Page 20).
- There seemed to be inconsistency as to when the percentage was applied in the lifecycle of the development of the budget. Although, by the time a project has reached Level 3 in the estimation phase, the corporate charge is generally incorporated.
- The Delivery Team do not include corporate costs which are added on later.
- Some major projects have a bespoke corporate cost added (neither 6% nor 10%).
- Spreadsheets used by the Network Development and Delivery Group incorporated fields for each of the internal and external views (and the inclusion or exclusion of corporate costs), complicating the view for anyone outside of finance.
- There is "a lack of understanding and ownership" of the application of the corporate cost, an unclear sign-off process relating to the inclusion of corporate costs or not, and the view of many budget holders that there is an element of fait accompli around budget responsibility (including the allocation of corporate costs) that is outside the budget-holders control.
- Wellington Water's budget planning process starts independently of the development of their annual plan process and of the LTP process for Councils. It generally commences later than the other two processes. This creates risk for accurate budget preparation and a disconnection with the business planning which guides Wellington Water's organisational activities for the period
- The LTP looks at future projects so is more complex, and therefore estimates are less certain. The Annual Plan process is simpler; projects are to be delivered in the year; therefore, project costs are locked in and include the corporate cost.
- For programmes of work such as Renewals, budgets tend to be based upon how much Councils are prepared to invest each year. As such they do not generally have specific corporate costs identified. These programmes receive a monthly charge as part of the monthly allocation process and physical works are undertaken up to the balance of the programme.
- It is worth noting that while the corporate budget process is nearing completion it won't be until July that both the council's capital programme and Wellington Water's corporate budget will be locked in, and the true corporate cost percentage known. Any difference will need to be managed by Wellington Water's finance team.

Is it appropriate for the Wellington Water model?

The concept of ensuring costs associated with delivering a capital programme is sensible, and at a high level will provide recovery of the costs. The current model lacks transparency, particularly to shareholding councils and is complex to operate. Its application as a whole has challenges for Wellington Water:

- It is not well understood outside of the Finance team (and what understanding there is seems variable). This includes Senior Managers.

- It is not transparent to shareholder councils and needs to be.
- It is not transparent to asset managers within Wellington Water.
- The allocation model requires each project to budget 10% for corporate costs, However, the corporate costs charged monthly against each project are not simply 10% of the monthly project cost. Instead, the costs charged are based upon the monthly costs percentage each unit advised when the budget was developed (reviewed quarterly to allow for changes in the programme), which is a rather complicated bespoke assignment of costs (determined by the detailed information collected as part of the annual inputs process outlined above).
- The Finance function manages the overall allocation at the corporate level against actual costs. This is regardless of whether the capital programme is over or under budget for the year.
- While collectively the corporate costs are recovered, within each project the charge will be either over or under the budgeted 10%. Where the project costs are over 10%, (for example, major projects) this would result in a "price change request" and ultimately discussions with Council regarding increasing the budget.

As discussed throughout this paper, improvements can be made.

What is the state of Wellington Water's systems and processes that support the LTP process and are they fit for purpose? What are the main factors in terms of preventing or detecting an abnormality in the estimates?

About the Systems

The most up-to-date information systems integration model has been provided to us from Wellington Water[1].

The main systems used to support an annual plan or LTP process are:

- **Project Server.** A tool used by Network Development and Delivery to record individual capital projects costs (both actual and forecast)
- **Investment Register**. An application recently built and used by Network Strategy and Planning. This register had a number of challenges, including data quality, and it was therefore determined to prepare workings, and present the capital programmes, in spreadsheets.
- **Spreadsheets.** Stand-alone spreadsheets are common in the organisation.

Many people told us the systems were "outdated", "clunky" or "poor". There is a common view that the systems constrain staff from doing their best work and impact their effectiveness.

"We clunk along with spreadsheets"

When the previous government's water reforms surfaced, investment was logically paused, awaiting transition arrangements. Any significant investment in core systems would best be undertaken by the new entity to ensure they are fit for purpose.

While it has not yet been decided on how a new water entity for the Wellington region would operate, we note that systems are well established and in use in Watercare, Auckland (if not the same systems that would be needed). There would be value in engaging regularly with Watercare, to gain a deeper understanding of their systems and processes, if only to get a head start around proven ways of working with data and reporting solutions that will assist with a transition to a new entity.

[1] Microsoft PowerPoint - Board Asset Management Plan workshop-Attachment A-Our asset management approach presentation.pptx (wellingtonwater.co.nz)

About the processes

Processes need attention.

Common themes of our conversation were “processes are old and antiquated” and “there are too many processes”.

“The processes for Wellington Water are very weak”

We heard of processes not being written down, cost changes not being documented when they should be, the ongoing need to remake work because a process was not captured, and lack of controls around process and delegations not being followed. We were told there were few examples of standard operating procedures and process change formality when we asked to see these. We note that a Project Change Request (PCR) is used for major projects.

There is a tendency to use emails to communicate changes to a process which would be more appropriately communicated through formal channels.

We were told that email distribution is not effectively engaging those who need to know about process changes. The quantity of emails circulated generally is high. Often emails are addressed and cc-ed to a very broad group which creates an opposite effect to that intended, i.e. diminishing the importance of the information and relying on the group to take responsibility. As one interviewee put it “if everybody knows, nobody knows”. The perceived reliability of email information is dependent on a sender providing explicit information to the right group of people, and being responsive to questions or feedback when clarity is required.

The lack of formality from a responsible owner creates uncertainty and reduces transparency around who has authority to authorize, obfuscating responsibility and accountability when it is most needed. Instilling formal change process requirements will ensure clarity and reliability and improve business performance.

On the Finance side, we note the resource constraints within the Finance team. Notwithstanding, they have worked to continuously improve budgeting, forecasting and reporting. Finance tries to have a standard set of reports for all Councils, however this has proven to be difficult to maintain as Councils have different requirements and seek tailoring of information that adds extra work and complexity.

Investing to improve processes such as creating a standard approach for financial reporting to help ensure accuracy and timeliness for both Wellington Water and the Councils, and undertaking some process mapping, would reduce risks, improve workflows, and provide clear ownership. The most obvious process to start with is the Allocation of Overheads.

Factors impacting the detection of a reporting abnormality

In our view the critical over-riding factors impacting the detection of a reporting abnormality is the organisation’s loose control environment (see Section c.), the absence of clear and publicised responsibilities (canvassed throughout this Report), and inaction, quite probably due to the organisational climate and a culture that is not aligned with its core values. This does suggest Wellington Water continues to profile symptoms of “learned helplessness” (see Section c.).

What is the capacity of the staff involved in this process (out of scope of this review is the capability of staff)?

The most significant area where capacity was an issue was in the Finance team. While acknowledging that a future standardisation of processes would achieve efficiencies, until that time there is a clear need to increase the numbers of suitably qualified Finance people that can work across the business and support managers.

While the governance group regularly had resourcing on its agenda, the pinch points associated with an LTP compared to an Annual Plan are more severe, and in our view under-estimated.

The current capacity of the Service Planning team should be enough to manage an annual plan process, however, if there is a need to undertake another LTP process, more capacity needs to be considered.

During the LTP process key staff departed. The loss of experience, and the arrival of employees new to the organisation, put pressure on quality and delivery of the LTP outputs, however this was not seen as a capacity issue at the time. We were told Workstream Leads had little relevant experience in LTP, Local Government, water infrastructure or asset management and being new, had little relevant experience in how to navigate the organisation.

What are the roles of other parts of Wellington Water such as the Finance team and Internal Audit in providing advice and assurance?

While the LTP process is led from the Network Strategy and Planning Group, we would expect the Finance function would be responsible for ensuring integrity of the data inputs and final numbers, especially given the complexity of the LTP process and known system challenges. This was not the case.

- Finance as owner of the opex and capex cost allocations to councils as part of the LTP, were stronger in the opex component (especially as there was a general request from Council's to reduce the opex overhead burden in the forthcoming period), than with the capex, particularly around formal advice and implications of the change in corporate cost percentage from 6 to 10%.
- The CFO was on the LTP Steering Group established to run the process. However, the disbanding of the assurance function well before the end of the process meant risks did not have regular oversight.
- Feedback from staff was that they expected finance to have a more visible role than occurred.

It is clear that at a senior level within Wellington Water there was misunderstanding about the impact the change to the corporate cost percentage had on the programmes already given to Councils.

Typically, assurance functions are well positioned to advise the leadership about the potential or development of significant risks or compliance gaps. The exclusion of the risk and audit functions in large and expensive operational work programmes, in itself increases the organisation's risks.

- Internal Audit was not involved in the LTP process.
- Risk Assurance was involved to a minor extent in Q4 of 2023/24, but too late in the LTP process. Risk work was focussed only on risk dashboards for Councils in support of National Strategy and Planning.

These functions have a key role to play in advising leadership and assuring governance and need to be taken seriously as business partners in an organisation with a high-risk profile.

What is Wellington Water's approval process, and did it provide the appropriate checks and balances? What process was followed between management to governance to councils?

It is unclear to many of the people we spoke to what approval process should occur. We had a variety of views as to which roles have the authority to approve processes or final documentation.

Other than, the Major Projects Team's PCR process (in which the head of the Network Development and Delivery authorises individual projects), we were not made aware of documented end to end signoff processes, although we note that Senior Leadership Team ratified the draft LTP programme.

Our observations about the process followed between management to governance and Councils are discussed in Section c. of this paper.

Section b. What happened in response

When did people know in the organisation there was an Estimation Error?

Refer Section a. above.

Why did it take so long to detect the Estimation Error?

We heard many different views about why the error was missed. The most common reason reported to us was that everyone simply assumed someone else was looking after it or it wasn't their area. These themes were common in nearly all of our conversations.

Why was there a delay in understanding the scale of the issue and advising the shareholders?

Although the issue had been raised in late 2023, it wasn't until February 2024 that it received any significant attention. This was probably driven by the fact that the Service Planning team were beginning to focus on the need to advise councils before each council's deliberation on their LTP. This involved scrutiny of the impacts of likely end of year over-and-under-spends, scope changes, and the need for updates since the capex programmes were given to councils in late 2023.

The lack of ownership of the corporate cost allocation approach meant it wasn't widely understood.

Once the quantum of the error became known, the first reaction was to contain the situation. There seems to have been an evolving mantra that the impacts could be managed internally simply by delaying projects and trying to absorb the fiscal impact within budgets.

Rather than immediately bringing the matter to the attention of shareholders so they could consider the impacts on their projects and the budgets they were about to finalise, management instead focussed on quantifying the impact for individual councils, to include in the paper being prepared for councils about the end of financial year changes. This in fact created more confusion and only reinforced the "mistrust of shareholders" (this matter is discussed further in Section c.).

Is there a culture problem in the organisation (e.g. the "learned helplessness" referred to in the MartinJenkins Inquiry into the Cessation of Water Fluoridation by Wellington Water dated 21 June 2022) that sees a reluctance to deliver bad news?

See Section c.

Provide a timeline summarising the actions of Wellington Water from the beginning of the process for developing financial elements for capital projects for the LTPs up until Wellington Water communicating the Estimation Error to all of its shareholding councils, and provide commentary on the quality of those actions

A timeline summarising Wellington Water's LTP Process is attached in Appendix 2.

Why the Estimation Error happened

Our conclusion is that this error occurred due to systemic issues, namely a lack of understanding and ownership of problems when they arose, and poor information flows. It was not a spreadsheet error as reported in the media; information was omitted with widespread consequences, and there were no controls in place to pick this up. We discuss this further in Section c.

Section c. The contribution of culture to the error

This section addresses the third key issue in the Terms of Reference, "Determine the root cause of why the Estimation Error happened", and responds to the following specific questions:

- How did the following factors contribute to the error – organisational structure, oversight, capacity, culture, systems, processes, and resources?
- What changes to culture, systems and processes are required to ensure there is not a repetition of this incident and generally that Wellington Water is able to produce reliable cost forecasts for inclusion in its shareholder councils' budgets?
- Is there a culture problem in the organisation (e.g. the "learned helplessness" referred to in the MartinJenkins Inquiry into the Cessation of Water Fluoridation by Wellington Water dated 21 June 2022) that sees a reluctance to deliver bad news.

In this section we also comment on the management response, governance response and the shareholder response.

The culture of an organisation is influenced by all aspects of the organisation. The effectiveness of Wellington Water's systems and processes is discussed in Section a. above. However, there are also other ways of looking at this, such as a value for money framework (effectiveness, efficiency, and economy), organisational design, organisational maturity assessment, risk management, and the control environment. Our frame was the Terms of Reference, but we also drew on aspects of those other frameworks.

Wellington Water's Control Environment

The COSO[2] framework offers a system to establish internal controls into an organisation's business processes. Together, the effectiveness of five controls (environment, risk assessment, control activities, information and communication, and monitoring activities) can provide assurance that an organisation operates ethically, transparently, and to expected industry standards. Internal control is a process that manages risks to acceptable levels and supports good operational decision-making and governance. It is effected by an organisation's Board, management, and employees to provide reasonable assurance that objectives for operations, reporting, and compliance are being achieved. A control environment sets the organisation's standards and the structure on which the internal controls are based.

Structure

Wellington Water operates broadly along the same structural lines as it did when it was established in 2014. Although we noted a change to the structure when the Network Management Group and Customer Operations Group functions where separated (when the alliance with Fulton Hogan was established around 2019), the Network Development and Delivery Group reorganised, including in 2021, and the Director of Regulatory Services role was introduced two years ago; overall, the organisational structure has not evolved as the functions and responsibilities have. There are now tensions and impediments in workflow because of the way the organisation is structured. Work goes through many hands across teams and may be duplicated (with or without knowledge of those involved) or is siloed.

"We are structured to generate confusion about accountabilities and responsibilities"

One of the strongest themes of the feedback for this review is that the structure is a problem. It obstructs clear oversight of activities, especially in areas where we would expect to see assurance. This is particularly striking in relation to financial assurance. There have also been questions raised about where some functions reside.

"We have to go to so many people in the business to get just one little piece of the puzzle"

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[2] Committee of Sponsoring Organisations (COSO) was established in 1985 and is an independent private-sector initiative that provides thought leadership into enterprise risk management, internal controls, fraud deterrence and governance. In 1992, COSO published 'Internal Control Integrated Framework'. The Framework was revised in 2013. The Framework is included in Appendix 5

Collaboration is highly rated by most of the people we spoke to. And we often heard that the people "are great" and "willing to help". However, the effort made to work collaboratively across teams depends on individual effort. Feedback to us was the lower levels of the organisation work well together but "higher up it becomes siloed" and "we are not communicating as well as we should be". Several people argued that Wellington Water has outgrown its structure and it has been a mistake to leave fixing this problem to the new entity.

The two biggest challenges of the structure are:

- It creates confusion about who is accountable for what which results in:
    - Duplication of effort, with some roles appearing to be doing work that should be done by other roles, and other roles (either because of this or for other reasons) not owning their accountabilities.
    - Others trying to fill the gaps, when accountabilities lay elsewhere, which unintentionally reinforces a "blame culture", not the culture the organisation aspires to.
    - People working more deeply in the organisation being frustrated and demoralised when issues raised are not heard, acknowledged, or taken seriously.
- It obstructs and slows information flows, which:
    - Impacts timely decision-making (lots of emails to lots of people meaning uncertainty about who makes decisions).
    - Stymies the sharing of well-timed advice, information, and insights. o Affects quality processes and controls (as demonstrated by the estimation error).
    - Reduces productivity.

All of which makes it harder for people to do a good job.

We understand the constraints of an organisation preparing for a major transition. However, the current structure frustrates clarity and does not facilitate accountability and empower responsibility. The perceived lack of both accountability and responsibility is a major barrier for the organisation.

Control standards, systems, and processes

Wellington Water's Statement of Intent and the Shareholders Letter of Expectations set out performance expectations, and regular reporting is set out clearly.

Rightly, the Board and management exercise different oversight controls. However, Board controls rely on the quality of management information; the Board needs to be comfortable that it is receiving information appropriate to its governance role.

There is evidence that, on the regulatory and compliance front, standard practices are in force and working well. Risk and audit also use common processes and tools.

Delegations are clear in the position descriptions of the Senior Leadership Team. However, we conclude from our analysis that the organisation does not always hold senior managers accountable for their responsibilities.

We did not review HR policies and processes.

Within Wellington Water's control environment we looked for evidence that business processes use standard practices.

- While the policies we reviewed were adequate, and we found some evidence of standard operating procedures, overall business processes were not to the standard we expected in the documentation that was provided to us. We heard examples of innovation to address gaps, but it would be better to standardise good processes.

- Operationally, some people were clear about the processes they needed to perform, and others were not.
- Improvements to current systems have a short-term focus. Collaboration on documents is difficult, spreadsheets are plentiful, and version control is a constant challenge. For example, the change to the corporate overhead cost from 6% to 10% was not documented. There was also no guidance on how to apply the overhead for those who would need to do this, and no controlled communication.
- Checklists do not appear to be a mechanism used well to help ensure quality control.
- Most people told us that they did not know who was responsible for checking and authorising information to be shared outside of Wellington Water.

"...we are just doing what we can with what we've got."

Risk Assessment

Wellington Water operates in several contexts (it manages council assets, provides advice to councils, and delivers programmes for councils), and its risk posture is naturally different for each context.

We have reviewed corporate risk papers and find them to be as expected for an organisation managing significant public assets. Risk dashboards, assessments, mitigations, regular auditing, and reporting all exist and are aligned with the organisation's objectives. The Risk and Assurance function is watchful for changes affecting Wellington Water's operating environment.

Operational risks are considered and discussed regularly within business units. The word "risk" is part of the Wellington Water's lexicon, and it was mentioned often in our conversations.

However:

- Roles and responsibilities in relation to risk ownership and management are unclear. In particular, we found that the assignment of operational risk is always at a General Manager level, while the role accountable for all operational risks is recorded as the Director of Regulatory Services.
- Risks are not always owned and managed in the right area of the organisation.
- There is one FTE providing the corporate risk function, and they have no control over the management or monitoring of risk.
- Information about risks is available within the organisation, but risks are not regularly interrogated and actively managed across the organisation. Information is of little value if it is not acted on.
- The impact of reform and constrained resourcing, as identified in audit reports, has been to suppress improvements to make controls and processes more effective.

"Something like this was always coming."

Control activities

In its paper "Asset Management Approach" (August 2022, see footnote 2) Wellington Water's information system is referred to as "not just one system", and as "a combination of policies, processes and systems and the people that implement it".

Procedures put policies into action. We have not reviewed whether procedures have been implemented. We note however there are a range of operational procedures. What is important is that the procedures are fit for purpose, that people in the business know about them, that the procedures are followed, and that the organisation understands how well they are used.

How people engage with control activities also tells us a lot about the organisation.

We have learned through this event that when some people within the organisation have sought to effect some internal controls they have not succeeded. This appears to be for several reasons:

- First, accountabilities and responsibilities are not clear within the organisation.

- Second, the estimation error wasn't prioritised or given attention when it was raised, stranding those who tried to escalate it.
- Third, when it was taken seriously the error was seen as an issue to manage rather than solve.

Because the organisation mainly works in the long term, and budgets move around, it is relatively easy if controls are not in place to liberate budget assumptions because they are capex. This means delivery timeframes can be extended to defer spending, with little real scrutiny. Although this is relatively common practice for long-term capex projects, it risks creating a culture that does not prioritise financial discipline, and instead encourages loose controls and diminishes individual responsibility.

Information and communication

In this section we focus on the communication that occurred in relation to the estimation error, as a practical way of setting out our answers to the questions posed by the Board and of gaining insights into communication and engagement practices specifically.

As discussed in Section a., through the period there were many emails, addressed to and copied to many people, asking for or providing information or views about the error and what the next steps should be. The emails we viewed showed general confusion, especially about where responsibility for the problem lay, which there were different views on. People assumed others were responsible or were addressing the issue.

"I think genuinely everybody in that process thought someone else was dealing with it"

Communication with shareholders

Five out of the six shareholding councils gave similar feedback: that the error in allocating Wellington Water's corporate costs caused additional work at a critical time in the LTP process and put extra pressure on everyone involved. Those councils also said that if they had been informed earlier, they could have minimised the impact on their council's plans.

All councils were consulting or deliberating in May to finalise their budgets in Council.

The approach to communicating the issue to the shareholders was inadequate. The implications of the error for shareholding Councils, and consequently the wider public interest, was not understood at the highest level of the organisation until at least 1 May 2024. The CEO requested a "full plan" before they raised the issue with Councils.

There is an important lesson here. Councils are both shareholders and clients. The shareholders, as owners, needed to be informed as a priority that there was a likely problem. The potential impact on councils was something the councils should have been accorded to manage for themselves, given the stage they were at in the LTP process, and the councils could have managed or worked around the problem if they had been told earlier. Because they did not get early notice of the error, the councils lost the ability to make changes within their three waters budgets or other capex areas.

While no doubt councils would have been exasperated by the error, informing Council CEs, and providing an estimate of the ramifications while Wellington Water found out more, would have enabled Wellington Water to work through the issues collaboratively *with* the councils as it was in the interests for all to do so quickly.

There was still time to prepare and put together more detailed information for councils, including exact calculations and details of Wellington Water's options for alleviating the new cost pressure.

Escalating to shareholders earlier also would have likely sped up resolution of the issue, as it would have been a higher priority by necessity.

"It is also about trust with our Councillors, they already have an issue with trusting Wellington Water to deliver on time and on budget, we had been working hard to improve that"

When Wellington Water realised it needed to communicate rapidly, it wasn't ready. It couldn't provide a good level of information to properly inform shareholders or other stakeholders at least temporarily and alleviate the concerns.

When Wellington Water did communicate, instead of providing information in a managed way to its shareholders, the information about the error was released asymmetrically, with one shareholding council receiving the information first, at a planned meeting on 17 May, well ahead of the others. The Officer of that council, recognising the impact on other councils, informed CFO colleagues in the councils that an error had been made. This put the remaining shareholders in a reactive position, knowing about an error but not what it meant for them. All six councils then passed and received information between themselves and sought to obtain more information from Wellington Water. Wellington Water's release of the information in this way breached the shareholders' trust in Wellington Water management from the outset.

On 21 May, Wellington Water's Chief Executive phoned council Chief Executives to tell them there was an issue. An email followed on 22 May formally notifying them. Overall, this email communication created confusion, with one council officer called it "ambiguous". Another said that "it raised the heart levels significantly". Council officers sought clarity. A memo was issued.

The memo mostly related to the standard end-of-year process but noted that of three items to be addressed to close out the LTP planning, one of them was the new matter of unallocated corporate cost overhead. The memo included an estimated cost for each council. The memo suggested that Wellington Water would accommodate the overall costs by delaying the delivery of some programmes. The feedback to us was that this looked more like trying to hide the error than openly addressing it.

"When we get a memo from Wellington Water our first thought is can somebody check this"

The full extent of the error became known to everyone at the meeting of the Wellington Water Committee (WWC) on 24 May. A Wellington Water media release included the impacts on each council.

Following the WWC meeting, individual councils had to immediately deal with inquiries from their own ratepayers and media, who wanted to know what the error meant for the council and ratepayers.

However, councils were not provided with the methodology behind the calculations that would have allowed them to check how their portion of the $51 million gap was calculated.

"As you can imagine we had media asking us questions. We had councillors asking us questions. We had the CE asking questions."

This lack of transparency around the calculations has been contentious and frustrating for councils, as it hindered them in presenting the issue clearly and transparently to their communities.

The councils and their communities needed – and still need – to know how the numbers were put together so they can trust they are accurate.

Councils had all received formal communication about the individualised impacts for them by 29 May.

Slow pace of response

The delay in communicating with the shareholder councils was unfortunate and unnecessary: the error came as a surprise to councils, and should not have. Communication to the councils, as the owners of Wellington Water, needed to be prioritised and progressed with urgency.

In its Media Policy and draft Stakeholder Engagement plan, Wellington Water had committed to being accountable, transparent, and a trusted advisor, promising to inform shareholders and other stakeholders of "relevant or likely" matters of risk as soon as possible. In this case, Wellington Water did not do so.

There was also an opportunity to engage early (after informing the Board chair) with the Coordinating Chief Executive of Council Chief Executives. The Coordinating Chief Executive could have helped coordinate information flows and would probably also have proven a good sounding board at the time.

We conclude that the extent of the estimation error and its impacts was not understood at the highest level of Wellington Water and that there was not sufficient appreciation of the wider interest and the impact of the issue on shareholders. It was treated as inconsequential. Wellington Water's hesitancy to mobilise resources, set up a dedicated team of experts, and communicate transparently and rapidly about the error has probably caused more damage to the trust of shareholders in Wellington Water than the error itself. It's management of this issue has undermined its role as a trusted adviser to shareholder councils, and it will take time to rebuild that trust.

Other feedback from shareholders

We received further feedback from councils about information and engagement. One council officer had worked with Wellington Water to address an overspend in the 2023 capex budget round and had been assured that forecasting would improve for the coming year. All councils told us there is still ongoing frustration with:

- The lack of transparency around budgeting and forecasting.
- Accuracy in budgeting and forecasting (they seek better version control and timeliness).
- The time taken to respond to information requests
- The lack of a single financial lead at Wellington Water.

However, it would be remiss not to mention the positive feedback about many of the Wellington Water people that council officers engaged with. There are people they enjoy working with and trust to give good advice.

We heard from council officers that Wellington Water people "are working hard and trying hard", that they are possibly "under-resourced and under supported", and that "some people are really excellent and know their stuff."

"We are in their corner, we are a shareholder, we want this to work."

Communication with the Board

The Wellington Water Chief Executive, when informed of the estimation error, escalated the issue to the Board Chair on 1 May. The Board Chair followed up with the Chief Executive on 3 May seeking an update and was advised that Wellington Water could potentially manage the situation within current budgets as 6% difference was not hugely significant, and that level of contingency was commonly managed within projects.

Downplaying the error, gave the Chair the impression that there was no urgency and the issue would be visited with the full Board at a scheduled meeting on 9 May.

However, the papers for both the Audit Committee and the Board on 9 May did not raise the issue. Those papers addressed the LTP and budget and conveyed a strong message that they had been well received by the shareholder councils. During the discussion on major projects, the Audit Committee raised questions about the error when considering the Major Projects report. The minutes record management advising "that it will be managed within budgets by adjusting timeframes and estimating corrections outside of LTP decision making. Overall, it totals $19m however this is being assessed by staff currently".

Treating the error as something to fix as BAU also postponed a more thorough investigation into the issue. It prevented the management of resulting risks that could have occurred prior to the Wellington Water Board meeting on 9 May or the Wellington Water Committee meeting on 23 May.

Papers prepared for the 9 May Board meeting included one on the 2024/25 Corporate Budget, this did not include information about the increase to the capex management fee from 6% to 10% or any risk assessment related to the increase. We note that information had been available, and that a senior leader, by email, had referred to the importance of the issue and asked whether it had been included in the Board paper.

We believe that not raising the matter with the Board at that time was a serious misjudgement by management.

The unfolding of events resulted in the Board being involved in fronting the issue publicly. While Board involvement is not uncommon for a public issue, it may not have been necessary if the Board had had complete and up-to-date information as events developed.

Monitoring activities

A key role of the Board is to monitor the activities of the organisation to deliver its strategy. The Board needs accurate and timely information so that it can meet its fiduciary responsibilities. The Board therefore needs to ensure that it regularly reviews the quality and appropriateness of the information it receives.

We found a high level of attentiveness to external monitoring regimes.

Risk and Assurance also have regular monitoring processes.

It is expected that deficiencies are communicated to management or the Board as appropriate. The main mechanisms are through audits and incident investigations undertaken and reported by the Risk and Assurance function and supported by the Q Pulse system, or through risks or issues reported through management.

The new “Incidents of Significance” policy establishes a process for directly escalating an issue to the Director of Regulatory Service. This policy was updated after the Inquiry into the Cessation of Fluoridation Report (2022) was released, to strengthen mechanisms to report issues found deficient from that process. It is not clear that this mechanism worked in the case.

Evaluations are important monitoring tools and can strengthen business processes. We did not review internal evaluations. We did review external evaluations from the past three years.

There is no compliance requirement with standard setting bodies, however there are opportunities to use international standards as benchmarks to strengthen the overall effectiveness of prioritised activities. The value of using best practice benchmarking includes independent verification.

Culture and its influence at Wellington Water

Organisational culture has many dimensions and is a dynamic concept guiding organisational activities both through the visible (artifacts and behaviours) and the undisclosed (assumptions). As one of our interviewees stated it mostly refers to “how we do things are around here”.

At the core of culture are an organisation’s values.

Wellington Water’s values are well understood, and people referred to them often. The three values are *Tangata Tiaki* – together we protect our most precious taonga; *Whānau* – united we support, connect and respect each other; and *Mana* – we recognise, respect, and value the mana of others and seek to build mana-enhancing relationships.

The friendly behaviour, positivity, and collaborative approach of peers was consistently acknowledged to us and appreciated. We heard that there are plenty of opportunities for employees to learn about workmates, acknowledge mahi, and interact socially and stay connected with each other, in person and on social channels. In the internal communications we reviewed there was a strong theme of working well together and celebration.

The 2023/24 annual engagement survey tells us that commitment to the organisation is high. There is also a strong theme of pride. Four out of five people agree that Wellington Water treats them well, with only a slightly smaller proportion agreeing that they enjoy their work.

Setting the tone

Within the organisation, the Senior Leadership Team set the tone and shape its culture, both for BAU and for managing issues. A number of people we interviewed expressed a lack of trust and confidence in senior management.

The error made was complicated to unpick. Internal skill, time, and resource was needed to understand what happened, determine solutions, and manage the impacts. There was a lack of information sharing among senior leadership, between senior leadership and operations teams, and between corporate functions and operations teams. For example, the General Managers of Network Strategy and Planning and Network Development and Delivery gave contradictory directions to their teams about the treatment of the corporate costs (one to incorporate the costs into the councils' capital programmes, the other requesting differences to be managed through a reconciliation after quarter one). This caused additional confusion and tension amongst staff about the way forward.

Individuals and self-appointed small groups were trying to understand the issues so that they could help, because no leader owned the issue.

None of this went unnoticed by employees in the teams involved.

"There is a lack of clear ownership and accountability."

Along with structure, lack of accountability and lack of direction from senior leaders were the two most common themes of the feedback we received when we asked, *"What's not working?"*. We were told these themes had been raised previously and nothing had changed.

The people we spoke with want to know who is accountable. They want to know that their leaders will make decisions even when they are tough decisions. There is a lot of ambiguity in BAU and, in the absence of leadership, people are trying to resolve the ambiguities themselves or are just living with them.

"Sometimes there is a misunderstanding where we are waiting to get a directive from SLT and they are kind of waiting for you to give them a recommendation. There's a bit of cat and mouse."

There was also a lack of transparency at senior levels about what was happening to respond to the estimation error. There was little communication, including to people who would, according to their role, have good reason to be involved. We were informed of a tendency to try to contain or manage problems quietly. The planning of the response to this situation was "tightly held", with small "closed sessions" preferred over a project or team response. People want more transparency.

"It's symptomatic of our model and how things are set up. It's systemic."

The engagement survey found that two out of three employees trust the organisation, which means one out of three either are not sure or do not. Around half of those surveyed have confidence in the decisions made by senior leadership, which means about half are not sure or do not.

Incongruence between beliefs about how someone will or should act and how they do act leads to distrust.

Some of the employees we spoke to provided examples of behaviour that was contrary to the values of *Mana* and *Whānau.* The examples raised with us occurred in both horizontal and vertical relationships and included behaviour at the highest level of the organisation.

Central to this Review has been the importance of a no-blame approach, which is also at the heart of Wellington Water's values. Yet several employees we spoke to said that blaming was in fact a common occurrence in parts of the organisation. We were told that there is "a bit of a blame culture – people jump to conclusions". Some said they felt that the heat was unfairly directed onto them when the Chief Executive communicated the background to the estimation error. The communication about the error "said no finger pointing but the actions are not that".

We were also told about instances of people being removed from participating in the process of understanding the error, as well as being excluded from conversations on other matters in which they had responsibility and being ignored when trying to escalate other matters of importance.

We understand that when things go wrong in an organisation that serves shareholders controlled by elected councillors, pressure can drive irritability and frustration (which is an emotional response to stress) and create tension between people. Tempers can fray and frustration can grow into defensiveness and even aggression. This of course is not healthy either for the people involved nor for the organisation.

Behaviours that do not align with Wellington Water's definitions of the values of Mana and Whanau need better monitoring, no matter how senior the people involved. If necessary, there needs to be a process for escalating the issue directly to an independent party or the Board.

We believe there would be value in working with staff (beginning with senior leadership) to fully define expectations around individual behaviours and actions that support Wellington Water's values and including the outcome of this work in the Code of Conduct.

Learned Helplessness and a reluctance to deliver bad news

In our review we heard Wellington Water described as a "reactive" entity with "a culture embedded over time" and, to an extent, a "she'll be right" attitude. Over time, people have got used to waiting ... and waiting ... for change. We were told that in some areas of the organisation this comes with a lack of pro-activeness to get on top of things, as well as some complacency and an aversion to being too structured or too process oriented. We were told that inaction and defeatism exist, that some good people are disengaged, and that:

"One person can't make a decision, there is a reliance on Senior Leadership Team achieving a consensus."

We understand that people in the organisation feel they have little control over their work life because reform has been taking so long, and we acknowledge that Wellington Water people are tolerating a relatively unusual work environment. However, Wellington Water has to fulfil its purpose and meet the expectations of its shareholders. It must ensure it is fit for purpose in this unusual period.

"Learned helplessness – there is a culture that isn't changing much from a leadership point of view"

Employees know the model is not working. They know they will be waiting until at least 2026 to see a difference, and those that have been with Wellington Water a long time have been holding out for the change. But they also want to be proud of the work Wellington Water does, and they want to be supported by leaders to make practical changes and to have tools and processes that help them do the best job they can while they are in transition. In some areas they want to help create these tools and better ways of working. They shared plenty of ideas for this.

"There is a defensiveness in that we tend to come up with a rationale about why things are the way they are rather than being open to criticism and going 'Okay, how do we do things better?'."

There is optimism too. Some we heard from, including some people newer to the Wellington Water, see opportunities to get on top of things, to bring an objective view, to challenge the status quo, and to focus on achieving great outcomes for their stakeholders.

There is opportunity for Wellington Water's values to be more consistently reflected in actions – for leaders to listen more to their people, to provide more proactive leadership (rather than reactive and unempowered) and to strengthen lines of accountability so that initiatives can be supported.

So, is there a reluctance to deliver bad news?

We would say that it depends, and potentially it depends on who you are.

We saw a lack of ownership of the estimation error, or a lack of interest in sharing or resolving it, by those we would expect would have a vested interest. That indicates to us both complacency and a poor understanding or assessment of organisational risk and its impacts.

The issue required attention from the beginning, and required the Mana that features in the organisation's values ("Individually, we bring our best to every situation").

The Chief Executive's downplaying of the matter to the Board because they thought the matter could be managed down, was a misjudgement, and may suggest a reluctance to work with the Board on issues as they arise. However, ensuring the Board of the organisation has the information it needs to meet its responsibilities is a priority for any Chief Executive and builds trust.

The first response in this case appears to have been to analyse, fix and possibly minimise, and then talk to the shareholders and other stakeholders. This may be a good strategy for some scenarios, such as quickly moving, quality-controlled environments, but it wasn't for this one. The Board could have provided wise counsel and helped management.

The Senior Leadership Team's inability to resolve the issue was, we heard from feedback, founded on misplaced assumptions and we agree the complicated structure makes lines of accountability opaque. Within the organisation, many people raised the issue: they wanted to be heard and they wanted the issue addressed so they could do a good job.

Appendix 1: External Review Terms of Reference

Wellington Water Limited: Capital programme estimating and budgeting systems.

The Board of Directors (**Board**) of Wellington Water Limited (**WWL**) have appointed Roy Baker and Kevin Jenkins (assisted by Suzanne Carter) to undertake a review of the circumstances surrounding the error that occurred on or about 1 May 2024 that meant that WWL's corporate cost had not been included in the LTP advice provided to councils relating to major projects carried out within the capital programme (**Estimation Error**). Accordingly, the review will report to the Board of WWL.

Introduction

1. WWL is owned by Wellington City, Hutt City, Upper Hutt City, Porirua City and South Wairarapa District Councils and Greater Wellington Regional Council. On behalf of the shareholding councils, the company manages $7 billion of assets which provide safe drinking water, treat wastewater and manage stormwater. WWL is amongst the largest organisation involved in water infrastructure management in New Zealand.
2. WWL and the Board receive overall leadership and direction from the Wellington Water Committee (**WWC**). The WWC is made up of representatives from the shareholding Councils and mana whenua and is Chaired by the Mayor of Hutt City, Campbell Barry.
3. WWL funding is provided by its shareholding councils and (with the exception of the Regional Council) the water rates and charges are the single largest, and fastest growing cost the Councils are obliged to pass on to their ratepayers.

Background

4. As part of the development of the Councils' Long-Term Plans (**LTPs**), WWL provides recommendations on capital projects that should be included in the LTPs together with the associated budgets. Councils rely on the accuracy of this advice to develop a draft document, consult with their communities, and eventually adopt their LTP before 1 July 2024. This whole process can take more than 12 months.
5. There can be several iterations of information provided, but the first round of this advice was provided by WWL in September 2023.
6. The capital budgets should represent the total estimated capital cost to deliver the capital programme and should include the WWL corporate costs required to manage and support the capital programme.
7. On or about 1 May 2024, WWL staff realised that an error meant that WWL's corporate cost had not been included in the LTP advice provided to councils relating to the capital programme (**Estimation Error**). It took nearly three weeks to determine the scale of the Estimation Error and advise councils (estimated $51 million or around 6%) in the first three-years alone.
8. While there is nothing to suggest that the wider asset advice is questionable, the Board is concerned that the Estimation Error has undermined WWL's role as a trusted advisor. The Board has decided to commission an independent review to identify what went wrong, look at the company's systems and processes and provide recommendations for improvement.

Purpose of the review

9. The purpose of the review is to inquire into and report upon the following:

How the Estimation Error occurred and identify lessons appropriate for an entity with a limited life to learn from in order to minimise future occurrences.

Scope of the review

10. In considering this question, the reviewers shall consider WWL systems and processes for developing financial elements for capital projects for the LTPs and the way they are provided to the shareholding Councils, and in doing so they will ask a number of questions to determine how systems and processes can be improved, including:
    a. *How the Estimation Error occurred:*
        i. What is the process WWL follow in compiling the capital programme estimates for the LTPs and is it fit for purpose, including comparisons, benchmarks and assurance steps.
        ii. What is the process for establishing and apportioning the corporate cost for estimating purposes for the LTP, and is it appropriate for the WWL model?
        iii. What is the state of WWL's systems and processes that support the LTP process and are they fit for purpose? What are the main factors in terms of preventing or detecting an abnormality in the estimates?
        iv. What is the capacity of the staff involved in this process (out of scope of this review is the capability of staff)?
        v. What are the roles of other parts of WWL such as the Finance team and Internal Audit in providing advice and assurance?
        vi. What is WWL's approval process, and did it provide the appropriate checks and balances? What process was followed between management to governance to councils?
    b. *What happened in response:*
        i. When did people know in the organisation there was an Estimation Error?
        ii. Why did it take so long to detect the Estimation Error?
        iii. Why was there a delay in understanding the scale of the issue and advising the shareholders?
        iv. Is there a culture problem in the organisation (e.g. the "learned helplessness" referred to in the Martin Jenkins Inquiry into the Cessation of Water Fluoridation by Wellington Water dated 21 June 2022) that sees a reluctance to deliver bad news?
        v. Provide a timeline summarising the actions of WWL from the beginning of the process for developing financial elements for capital projects for the LTPs up until WWL communicating the Estimation Error to all of its shareholding councils and providing commentary on the quality of those actions.
        vi. Provide specific comment on:
            - The management response,
            - The governance response, and • The shareholder response.
    c. *Determine the root cause of why the Estimation Error happened:*
        i. How did the following factors contribute to the error – organisational structure, oversight, capacity, culture, systems, processes, and resources?
    d. *Recommendations on actions to address issues found in this review which will support management learning from these events - within the context of the water reform:*
        i. What changes to culture, systems and processes are required to ensure there is not a repetition of this incident and generally that WWL is able to produce reliable cost forecasts for inclusion in its shareholder councils' budgets?
        ii. Provide an action list to ensure this and similar issues do not arise again before WWL ceases to exist in its current form.
11. This review may consider any past incidents and behaviours from a systemic perspective to establish whether there are any parallels between past events and this Estimation Error (e.g. the findings and recommendations contained in the previous reviews or inquiries referred to below).
12. Any recommendations made as a result of the review needs to be appropriate in recognition that the lifetime of WWL is limited due to water reform. While WWL is still delivering critical water services, there will unlikely be an appetite from its shareholders for heavy investment in improvements in systems and capabilities prior to water reform, unless there is a clear rationale and evidence that such investment would be critical in the life of WWL or may be carried over into any new water entity.
13. The Board has the authority to amend these terms of reference.

Out of scope of the review

14. The review will not ascribe blame or liability to any party or individuals and cannot be used in any disciplinary processes with any individuals involved and will not pre-empt or duplicate any other inquiry into any incidents that come within scope of this review. The review is not to inquire into, determine or report in an interim or final way or otherwise prejudice the following matters:
    - Whether the capability of staff may have contributed to the error,
    - Whether any employment laws have been breached,
    - Whether any disciplinary processes ought to be progressed,
    - Whether any questions of liability arise,
    - Any third-party inquiries or investigations into the Estimation Error, and
    - Any other reviews, inquiries or investigations into similar matters, except to assist the reviewers in establishing if there are any parallels between the events considered in these reviews and the Estimation Error.
15. For the avoidance of doubt and consistency with inquiries under the Inquiries Act 2013, this review has no power to determine civil, criminal or disciplinary liability of any person.

Process for Review

16. Any documents and information the reviewers require to conduct the review will be made available to the reviewers, including the following:
    a. A copy of the preliminary investigation carried out by staff to identify how the Estimation Error occurred. Any documents used to draw the preliminary conclusions will be attached to this report,
    b. A copy of the Martin Jenkins Inquiry into the Cessation of Water Fluoridation by Wellington Water dated 21 June 2022; the Field Force Contract Optimisation Review Report (and its Executive Summary) 2023/2024 and WWL's response to it dated 20 December 2023; the Wellington City Council's Mayoral Taskforce on Three Waters Report 2020; and the Independent Report into the relationship between Wellington City Council and WWL dated April 2020; and any associated materials relating to any these reviews. These reports are being provided solely for information to assist the reviewers in establishing if there are any parallels between the events considered in these reviews and the Estimation Error,
    c. Internal policies, and processes and procedures relating to/involving relevant third parties, and
    d. A copy of the WWL organisation structure chart.
17. The reviewers can invite any of the following staff or stakeholders to voluntarily provide information or take part voluntarily in an interview for this review whose insights will be reflected as general themes in the report:
    a. Any current WWL staff member, including the Chief Executive,
    b. Any current Fulton Hogan employee who is working on secondment at WWL including the Alliance Director (Fulton Hogan Secondees),
    c. Any current Board member including the Chair,
    d. WWL's shareholding Councils represented by one representative from each Council and one person in PMO positions,
    e. Suppliers of interest (e.g., HR culture advisers if they are being used), and
    f. Any further documents or resources the independent reviewers require to carry out the review.
18. If it would assist the reviewers to speak to any former WWL staff, Fulton Hogan Secondees or Board members, reasonable endeavours will be used to seek their agreement to participate.
19. Participation from people in the review process is voluntarily and optional only. All information disclosed by a participant will be kept in strict confidence Any pressure placed on a person to participate in the review, or any reprisal, retaliation, disciplinary action or other adverse action taken against a person for declining the offer to participate in the review is strictly prohibited.
20. The report will be respectful of WWL and its people by not identifying individuals by name or job title except where that is necessary to fulfil the terms of reference. The names of the people who participated in the review as well as any documents, notes, recordings or any other information (verbal or otherwise) made by either the participants or the reviewers during the course of this

review are owned by and held by the reviewers in strict confidence and will not be disclosed to anyone outside of the reviewers.

21. The review will be conducted in accordance with natural justice.

Overview and Reporting

22. The Board Chair will oversee the review process and will be available to meet with the reviewers as required to discuss progress and to consider any changes to terms of reference and advise the reviewers of the names of people who may be appropriate for the reviewers to consider interviewing. He will nominate a contact person within WWL to act as day-to-day liaison and arrange meetings and provision of any additional information required.
23. The review will report findings and opinions on, and make any recommendations it considers fit within the scope of these terms of reference, and will include the following:
    - Factual background, including a chronology of events,
    - Make findings that report the themes at a high-level in a way that will help WWL to learn from the Estimation Error, and
    - Make recommendations that will help WWL to improve its performance in the event of a similar incident and to minimise future occurrences.
24. The report will be provided to the Board in draft for legal advice and legal review, and for comment from the Board. The Chair will provide a copy of the draft report to the Chief Executive for her to share with any affected parties for comment prior to finalisation and to check the factual accuracy of the report and to socialise it with individuals who have had input into the review. The Board may provide commentary/additional questions that will need to be addressed in the final report.
25. The final report shall be presented at a Board meeting and then to a meeting of the WWC. That WWC meeting will only be closed to the public where there are good reasons to exclude the public under section 48 of the Local Government Official Information and Meetings Act 1987 for the WWC to consider the report in in whole or in part.
26. The reviewers will be required to attend the Board meeting during its Board Only Time without WWL Management, and to attend the WWC meeting alongside WWL Management and the Board Chair.
27. The Board Chair will respond to any media queries and handle any public communications about this review, and the reviewers may be required to assist with responding to any media queries as required.

Timeframe

28. The Board requires the draft report by Thursday 4 July 2024.
29. The reviewers will meet with the Board on Thursday 11 July to discuss the draft report.
30. The Board requires the final report by Monday 22 July.
31. The final report will be presented to the WWC on 26 July 2024.

Appendix 2: Timeline of key events

July 2023

- CE report to WWC – advised Wellington Water and the Regional Establishment Group will be engaging with councils in August and September 2023 to set out the unconstrained investment needs and funding scenarios, and seek feedback on investment priorities.
- Internal 24-34 Investment Advice Programme Governance Group chaired by CFO established and project plan developed.

Aug 2023

- Discussion around Relationship between opex and capex programme and size of management fee.
- Start Development of capital programmes - key inputs:
  - National Transition Unit numbers. ○ Committed projects.
  - Renewal programmes.

Sept 2023

- Continue development of programmes, establishing maximum deliverable levels.

Oct 2023

- Indications from Finance that the current year's corporate costs were averaging 10%, up from 6% in previous years. We note the suggestion: "may need to check capex management fee labour allocations look reasonable".
- Wellington Water's Corporate budget process commenced.

Nov 2023

- 9 November Board paper – Investment Advice 2024-2034 Update.
  - At stage 4 of process.
- Board Endorsed the principles and the proposed approach for providing the final (stage three) investment advice to Councils.
- 9 November Audit and Risk Committee consider paper 'Activities underway to support auditing of councils LTP documents.
- Planning team raise that the: impact of corporate cost increase to 10% was not reflected in Major Projects numbers.
- Discussion around rational for size of increase in corporate cost from 6% to 10%.
- Capex programmes provided to Councils for them to engage with their Councilor's e.g. HCC information was provided mid-November for their 27 November council meeting.
- NSP requested Finance and NDD to establish a way forward, noting that advice given to Councils at that date was net of capital allocations.

Dec 2023

- Investment Advice Programme Governance Group winds up.

Jan 2024

- Continue to collect updates to capex programme (internal).

Feb 2024

- 15 Feb board meeting - Investment Advise 2024-2034 Update.

- Board noted (Wellington Water) is at the third and fourth stages of a four-stage process for providing investment advice.

- 15 Feb Audit Committee Emerging risk around audit and council expectations to provide 30-year investment plans and appropriately updated infrastructure strategies in addition to the agreed MVP-AMP identified.
- Mid Feb Freeze placed on internal changes/updates to programme. Start to pull together impact to discuss with Councils prior to their deliberations.

Mar 2024

- Work into materiality of fee impact is undertaken and this continued into April. Prime issue seemed to be nil fee on Major Projects.
- 27 March Senior Leadership Team presentation about how corporate charges are developed and work.

Apr 2024

- The question of what % corporate costs should be applied to Council capex was raised again.
- Planning team start work with Finance, NDD and others on the impact of closing out the 2023/24 capex programme to accommodate timing, scope and other agreed project changes and programme costs. ○ Close Out work signalled to each Council. ○ A Paper needs to go to Councils before their deliberations are complete.
  - GM NSP advised, and raised, that corporate cost is not fully accounted for within the capex programme.
- 18 April SWDC advised of corporate cost issue, SWDC were only doing an Annual Plan for 2024/25.
- Question was asked if the issue was to be included in the 2024/25 budget paper to Board.
- 30 April estimated cost impact of around $19m pa escalated to GM NSP.

May 2024

- 1 May CE was advised as a risk with impact around $19m pā.
- 1 May Board Chair was verbally advised of 6% issue.
- 1- 2 May while discussing other matters with some board members, the Chair verbally informs them of the issue.
- 3 May Chair follows up with CE for an update on the issue.
- 9 May Board was advised impact of issue $19m as part of discussion on major project paper.
- 14 May assumptions agreed around approach and calculation of missing corporate cost allocation: $51m outcome over triennium.
- Draft papers prepared to Councils covering end of year changes, are then updated to include corporate cost omission.
- Instructions made not to apply 10% to years 4 - 10 of LTP as assuming it’s in the contingency and for a pragmatic approach at this late stage.
- 17 May $52m impact over the triennium by Council finalised.
- 17 May HCC Strategic Advisor verbally advised of Corporate Cost impact to them ($20m) during their deliberations meeting.
- 17 May Wellington Water Head of Service Planning sends email with final LTP advice that includes reference to “$20M .. to correctly allocate corporate costs”

- 20 May HCC CFO contacts other CFO's and informs of the problem
- 20 May Ripples from HCC flow back into Wellington Water. Issue verbally discussed and plan agreed for CE to phone all CEs on 21 May, before formal advice is sent.
- 24 May WWC meeting. Acting Board chair apologies to committee on behalf of Board for the Wellington Water error.

Commentary on the Quality of the Actions taken, as outlined in the Timeline

Improvements could be made in several areas:

- The process itself would have benefitted from the Project Steering Group remaining in place until 30 May (rather than finishing in December 2023). This would have enabled the corporate cost issue to have been raised and resolved.
- While the issue started to surface in October/November its significance did not start to be realized until later.
- The interdependency of the corporate budget process and its timing was not understood.

A number of actions had a significant impact:

- The process of developing the capital programme.
- The Planning team were relatively new.
- Advice on the need to increase the corporate cost requirement to 10% should have been stronger, more timely and engagement with the business units responsible for capital project development and delivery undertaken.
- The impact of the change from 6% to 10% was not understood by those that needed to know. The allocation level had been 6% for a number of years and any issues regarding under provision would have been absorbed by capital delivery being under budget.
- More transparency with Councils was needed once the size of the funding gap was known.
- The initial belief "it's only 6% within a large capital programme, we can manage it internally" was ill founded.
    - The actions taken probably slowed down the need to drill into the issue and get a better understanding of the impact on Councils programme.
    - It was the Council's choice, not Wellington Water's, to decide resolutions for issue, so early engagement and full transparency with them should have occurred earlier (also see Section C).
- Late engagement with councils resulted in anger and mistrust from Councils.

Appendix 3: How the estimation error occurred

The process that was followed (2024-34 Long Term -Development of Three Waters Capital Programmes) by the Service Planning team is set out in the attachment in Appendix 3. The previous LTP process attachment would have also helped inform this year's approach. The 4-stage model was communicated to the Board and progress updates were provided regularly.

The approach was reasonable given the unique and complex environment in which Wellington Water operates (see also Operating Context). It was designed to provide good quality information to Councils and to ensure Councils were aware of the risks associated with their lower level of capital investment.

The key flows of information were:

- Data already provided to the NTU was the starting point for developing a 10-year view for councils.
- The NTU data was an unconstrained view.
- It was necessary to turn this into a programme that was achievable to deliver.
- It was necessary to run a prioritization lens across the programme to ensure the WWC and Councils factored in strategic priorities for Three Waters.
- Councils were presented with a prioritised deliverable programme.
- Council fiscal constraints required the programmes to be recast.

Through all the above steps, information was flowing between the Service Planning team within NSP (who were the "aggregator" for production of the LTP numbers to Councils) and NDD, (primarily the Major Project area who are responsible for the individual projects costings and delivery). The Customer Operations Group and the Network Management Group were also involved where capital projects originated from them.

There were many iterations of the numbers, and spread sheets were heavily used.

We found the following key actions/beliefs collectively resulted in the full corporate cost ($30m) not being included in what went to Councils for their draft LTPs:

- The NTU data was initially thought to include overheads, however it did not.
- The significance of the error was not appreciated/fully understood from the time it was first raised.
- As the programmes/projects were being assessed for deliverability and reworked, differences between the detailed individual project cost and the NTU number did not appear to trigger a concern. This may be because the Major Projects estimates in their Project Server application do not include corporate costs, they are added later.
- Committed projects needed to be in the programme, these should have included the corporate charge (albeit would have been only 6%).
- Within Major Projects 6% is not always applied, and a $2m cap exists on some projects.
- Confusion about whether updated data given to the service planning team included or excluded the corporate cost became greater as people were trying to understand the magnitude of the gap
- The confirmation of the requirement to increase corporate costs from 6% to 10% came too late in the process, coupled with the fact that its implication was not well understood outside the Finance function and there were other competing pressures in Finance at the time, the timeline was too short for effective implementation.
- Ownership/accountability and responsibility was not clear in a number of areas.
- There were ineffective or no sign-off process as updated numbers passed to the planning team.

Appendix 4: Wellington Water's Process to Develop the LTP

2024-34 Long Term Plan - Development of three waters capital programmes

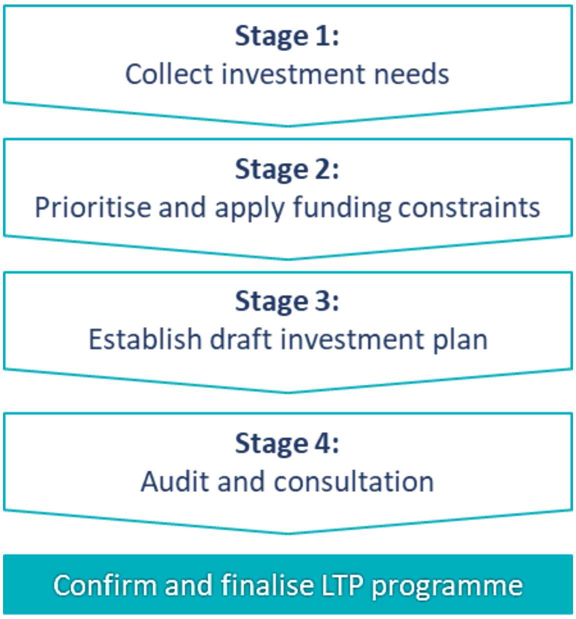
Purpose

The purpose of this paper is to provide an overview of the approach taken to deliver the 2024-34 Long Term Plan (LTP) water programmes for the six Wellington Water Limited (Wellington Water) owner Councils.

The previous 2021-31 LTP water programme was developed in 2020 based on our understanding of the councils' three waters assets and investment needs, at that time. Since then, Wellington Water has gained better knowledge on the condition of Council's water assets and the compliance, health and safety, and environmental risks those assets present in their current state. Greater understanding of the infrastructure required to support Council's growth aspirations and respond to increasing level of service requirements has also been gained. This information has informed the councils investment needs for the 2024-34 LTP period.

Approach

The councils' 2024-34 LTP capital expenditure (CAPEX) programmes were developed iteratively through a 4-stage process. This process looked to provide a regionally consistent approach to water services for the Wellington region – one which aligns with agreed strategic priorities and balances the needs of the region and individual councils with council affordability. Due to the iterative process, the capital programmes at each stage were point-in-time programmes which continued to be refined as new information and feedback was applied.



In stage 1, Wellington Water confirmed the investment priorities for the region and established the dataset of activity that was to inform the councils programmes.

During stage 2, a view of what Wellington Water could deliver for the councils if there were no financial constraints (a maximum deliverable programme for the region) was established. Council and internal experts were consulted on the programme and feedback was incorporated to develop recommended programmes.

More consultation occurred during stage 3 where a final draft programme was developed based on a budget level each Council advised was affordable.

Stage 4 will see final changes to the capital programmes following LTP consultation and audit feedback.

The approach in each of the stages is further detailed in the following sections.

Stage 1: Collect investment needs

Purpose

The purpose of stage 1 was to:

- Bring a strategic lens to the programme and be top-down in approach
- Provide information to begin conversations about three water investments for the 202434 LTP
- Outline the immediate and long-term challenges facing Council's water assets and services
- Highlight the extent and nature of investment needed over the next 10 years and a level of investment that is deliverable across the region
- Seek direction on the desired outcomes Council seeks to achieve for its community Stage 1 ran from March 2023 to mid-September 2023.

Initiating the programme

Wellington Water started by collating and cleaning a dataset of projects from Wellington Water's Investment Register[3] and Project Server[4] system. The resulting dataset included every project and activity on Wellington Water's system, producing an unconstrained view of proposed investment for the region.

The unconstrained investment highlighted there is more work to do than Wellington Water has the capacity in the market to deliver. Investment would therefore need to be prioritised to ensure it is targeted to activity that delivers the highest benefit against agreed strategic priorities.

Investment Direction

The Wellington Water Committee provided direction at its 17 March 2023 meeting for Wellington Water to develop 2024-34 LTP programmes which continue to deliver on the five strategic priorities which guided water investment in the councils' 2021-31 LTPs. Those strategic priorities are:

- Looking after existing infrastructure
- Supporting a growing population
- Sustainable water supply and demand
- Improving environmental water quality
- Achieving net carbon zero emissions

Wellington Water then ran individual workshops with five out of six Councils to understand how Councillors viewed the regional strategic priorities to be addressed in their 2024-34 LTP and understand where their priorities lay.

Pre-circulation material was provided prior to workshops to give Councillors time to review material and form views. The content of the presentation provided an overview of the previous LTP process; current context and operating environment; and the current challenges overlayed with the strategic priorities. A group activity helped Councillors let Wellington Water know where to focus investment.

Outputs

Council workshops and presentations which provided Councils awareness of how the recommended programmes were being developed and an opportunity for them to ratify the approach to date. The workshops help Councils set the direction for Wellington Water to develop the recommended programme.

[3] The Investment Register is a database that houses all investment needs up to the point that they are in the delivery phase.

[4] Project Server is the project management tool used at Wellington Water.

Stage 1 key documents

- 17 March 2023 Wellington Water Committee paper
- 17 March 2023 Wellington Water Committee presentation
- Council Stage 1 presentation pre-circulation material
- Council Stage 1 presentations

Stage 2: Prioritise and apply funding constraints

Purpose

The purpose of Stage 2 was for Wellington Water to present to councils an investment level that could be delivered – a maximum deliverable programme and to get an idea from the councils on their affordability level and the risks with investing at a level below what Wellington Water recommends. This stage ran between mid-September to mid-October. The following high-level activities were completed:

- Present initial investment options to Councils with indicative budget levels for both baseline and maximum deliverable, high-level activities, and risks for three waters assets and services investment
- Integrate the feedback from Councils around their strategic priorities from stage 1
- Validate the dataset
- Build a more detailed programme
- Document risks and consequence of reduced investment from the recommended programme

Building the programme

A regional maximum deliverable investment level was determined and apportioned to each council based on historic spend.

Starting with the unconstrained dataset, Wellington Water developed more refined CAPEX programmes for the councils. A prioritisation methodology was applied to determine the priority of projects against project's key attributes including criticality, risk and service objectives. The result was a ranked list of projects that formed the starting point of what could be included in the councils' programmes. At this point the ranking was based purely on project specific attributes and did not reflect a logical split of investment across water types or Local Government Act criteria (growth, renewal and level of service), or consider the deliverability of the programmes beyond the total investment level.

Following the prioritisation methodology being applied, a series of workshops were held with Wellington Water subject matter experts and council officers to inform and validate the prioritised approach, and factor in additional criteria to the prioritisation methodology. The workshop sessions facilitated conversations around which projects should be reprioritised, which should be in or out of the recommended programme and what could be deferred. All projects were considered across the region to ensure alignment with regional priorities.

Following the workshops, a desktop process was applied to the programme where projects were deferred or removed until the maximum deliverable value was reached. Again, iterations of the dataset were worked through between Wellington Water and <its supplier> until Wellington Water landed on an initial view of what a maximum deliverable programme could look like.
The maximum deliverable programme was the input for the workshop presentations for each Council. The programme was being developed during this stage, so the presentations represented a point in time view.

Baseline budgets were also set using the 2021-31 LTP figures and rough baseline programmes were developed by drawing a line under the programmes at the point that came close to the baseline budgets.

Stage 2 presentations were given to each council which included:

- a summary of the outcome from the stage 1 workshop activity where the strategic priorities were ranked by each council,
- an overview of each councils' unconstrained investment need, and
- an overview of the capital programmes that could be delivered under a baseline and maximum deliverable spend, including how each could contribute to the regional strategic priorities.

Investment Direction

Internal technical reviews and Council workshops for direction setting. A second round of Council workshops was completed. Precirculation material was provided prior to workshops to give Councillors time to review material and form views and ensure a no-surprises approach.

Outputs

Maximum deliverable programmes and workshop presentations.

Wellington Water received feedback from Councils after the workshop presentations on their priorities and what was considered affordable revealing the gap between the need and what could be progressed. This was the key input into stage 3.

Stage 2 key documents

- Internal workshop instructions
- Senior Leadership Team (Senior Leadership Team) Updates
- Council Stage 2 presentation pre-circulation material
- Council Stage 2 presentations

Stage 3: Establish draft investment plan

Purpose

With an understanding of the budget constraints faced by Councils, Stage 3 was where Wellington Water began to develop more refined programmes that fit the budget directed by the Councils. these programmes will be used to support the councils' 2024-34 LTP consultation. Through the process of developing the capital programmes at this stage, Wellington Water sought to:

- Identify any gaps or omissions in the draft programmes
- Document risk and consequence of reduced investment below the Wellington Water recommended level
- Consider low-cost mitigation measures to reduce risk and/or increase confidence in future investment need
- Apply a bottom-up sense check to the programmes to ensure contractually committed and ongoing programmes of work were not missed

Stage 3 ran between mid-October 2023 to early-January 2023.

Building the programme

Another series of workshops with Wellington Water subject matter experts and council officers were held through November to gather additional feedback and comment on the programmes to fit the councils' budgets. The programmes at this point were prioritised by applying the following inclusion criteria in prioritised order:

1. Contractually committed projects
2. Consenting and compliance related activity (including Global Consent activities)
3. Ongoing programmes of work (Modelling, Control Systems etc.)
4. Reactive renewals
5. Planned renewals
6. Other projects such as growth driven projects and level of service driven improvements

The councils' affordable budgets are all below an investment level recommended by Wellington Water. In some cases, the councils' annual budgets in the 2024-34 LTP period drop below the level of investment they are making in FY2023-24. This means that in the first triennium of the 2024-34 LTP most of the councils' programmes are consumed by activity in categories 1,2 and 3 in the bottom-up prioritisation above.

Approval process

The draft programme was submitted to 3WDCM for endorsement and ratified by Wellington Water Senior Leadership Team. As with previous stages, Councils were provided precirculation materials to consider prior to workshops.

Outputs

Final draft programmes to fit the council directed budgets that can be taken forward into LTP consultation.

Stage 3 workshop presentations summarising the programmes developed to fit the council directed budgets. These presentations were clear on the considerable risk exposed by non-funded projects and programmes.

Stage 3 key documents

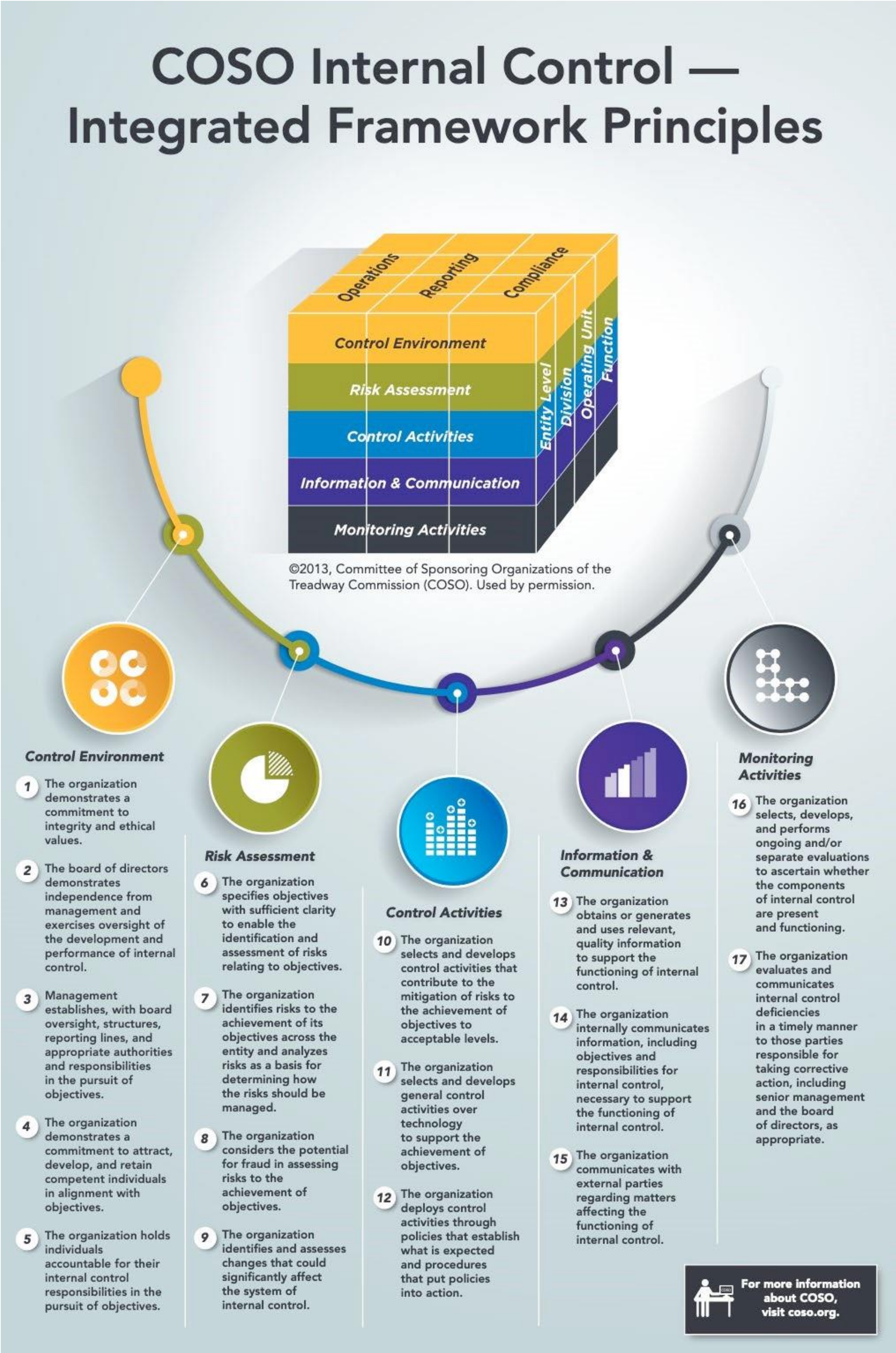
- Approach to network planned renewals
- Council Stage 3 presentation pre-circulation material
- Council Stage 3 presentations
- Stage 3 memo confirming budget and programme for consultation

Stage 4: Audit and consultation

Purpose

In stage 4, Wellington Water will develop supporting material for council's LTP consultations to a level of detail that will satisfy audit requirements. This stage is commencing from early December and will continue through to March 2024.

Appendix 5: COSO Framework



Appendix 6: Lessons from the 2022 Inquiry into the cessation of water fluoridation by Wellington Water that repeat in this Report

In March 2022, Wellington Water announced that fluoride facilities at two water treatment plants had been turned off due to operational health and safety risks. Wellington Water later learnt fluoridation was actually stopped on different dates in 2021. The Board initiated an independent inquiry to obtain key insights and lessons about what went wrong so that Wellington Water management learnt from the events to perform to a higher standard in the future.

The Inquiry into the cessation of fluoridation by Wellington Water (2022) found:

- Both a lack of urgency to resolve ongoing problems (with fluoridation) and to communicate arising problems to the Senior Leadership Team, the Board, the Wellington Water Committee and the public (paragraph 20).
- A lack of visibility and prioritisation at senior management and governance levels, which one interviewee called "corporate invisibility", meant that efforts to meet standards languished (paragraph 44).
- A lack of appreciation internally of the importance that shareholders and the public placed on effectively fluoridated water (paragraphs 46, 110).
- Absence of documented business processes and systems was a contributing factor to the fluoridation issue (paragraph 97).
- The capacity of the risk and audit functions was limited and focused on strategic-level audits so operational risks were not being "picked up" (paragraph 102).
- A reactive culture and learned helplessness (paragraph 103).
- Siloed and disconnected ways of working (paragraph 104).
- Unclear accountability and quality processes for escalating the issue were key contributors to the fluoridation problem (paragraphs 111, 112).
- A lot of people were copied into emails on the issue (senior management and operational staff) without any clear requests or commissioning of work (paragraph 116). People knew something needed to be done and were assuming that someone else was taking responsibility for leading the response. The issue wasn't prioritised in a way that it could be led to resolution (paragraphs 117, 118).
- No escalation criteria to notify the Senior Leadership Team of the issue more quickly (paragraph 119). A process exists to help people report 'Incidents of Significance', an initiative undertaken after the Inquiry (2022) to help employees escalate a perceived risk or issue rapidly to management (through the Director of Regulatory Services), although this process wasn't used for the purpose of drawing leadership attention to the corporate cost error.
- No established process for informing councils of the issue (paragraph 130).
- Internal emails showed it was suggested councils should be informed of the issues well before they actually were. However, there was a reluctance to do so until there was a firm plan in place for turning fluoridation back on (paragraph 131).
- An opportunity to work with councils to take a more joined up approach was identified (paragraph 147).