

Introduction

- 5.001 In July 1997 the Papakura District Council (the Council) entered into a franchise agreement with United Water International Pty Limited (United Water) to operate the water and wastewater services within the Papakura District for a period of up to 50 years.¹
- 5.002 In April 1998 we published a report on our audit of the franchise agreement² in which we highlighted:
- lessons and guidelines for other local authorities that might be considering such an approach;
 - the need for an appropriate, planned monitoring and maintenance regime – including an Asset Management Plan – for protecting the public assets involved throughout the life of the agreement; and
 - concerns about the Council’s arrangements for managing and monitoring the franchise.
- 5.003 In September 2000 we carried out a follow-up audit to look at how the Council has managed and monitored the franchise agreement so far, and whether any of the issues we raised in 1998 remain a matter for concern.

Our 1998 Recommendations

- 5.004 In our 1998 report we drew lessons for local authorities in managing and monitoring a franchise. We recommended that a local authority should:
- *Establish the necessary systems and allocate suitable resources to manage and monitor the franchise from its commencement.*
 - *Implement a programme of auditing the performance of the franchise to provide the level of assurance it requires.*

1 The initial term is 30 years with provision for renewal for a further 20 years.

2 *Papakura District Council: Water and Wastewater Franchise*, ISBN 0 477 02852 7.

- *Develop an Asset Management Plan, which establishes clear benchmarks for existing asset condition and service levels. This will provide a sound basis to develop clear procedures for –*
- *dealing with poor performance or non-performance by the franchisee;*
- *assessing the required condition of the assets before they are returned to the authority's control at the end of the franchise;*
- *dealing with a range of extreme events; and*
- *communicating with the franchisee as a basis for ongoing administration of the franchise.*

Objectives of Our Follow-up Audit

5.005 When we reported in 1998, the Council was still in the process of establishing the regime for managing and monitoring the franchise agreement. We were therefore unable to examine these aspects of the franchise agreement at that time.

5.006 Our follow-up audit addressed how the Council was:

- applying itself to monitoring the operation of the franchise agreement; and
- measuring United Water's performance of its responsibilities under the agreement.



Overall Conclusions, Recommendations and Lessons

Our Conclusions

- 5.007 Changes to local government legislation, other public sector reforms, and public expectations have encouraged local authorities to develop new partnership approaches to the delivery of public services. The franchise agreement entered into by the Council is an internationally recognised partnership approach.
- 5.008 Nothing in this report is intended to suggest any inherent failing in the franchise or asset management model for outsourcing as a way to provide services to the public in a financially prudent and effective manner.

Asset Management and Development

- 5.009 The franchise agreement requires United Water to maintain the water and wastewater infrastructure to an overall standard better than its initial condition and in good operational order. The intention is that, on the expiry or earlier termination of the agreement, the infrastructure be in better condition than at the start of the agreement.
- 5.010 In our 1998 report we emphasised the need for an Asset Management Plan as part of a suitable asset management regime, but noted that the Council included in the body of the franchise agreement no specific requirement for such a plan to be prepared. In our view, this was an oversight that had the potential to adversely affect the Council's ability to manage and monitor the franchise agreement, and to protect the water and wastewater asset in the long term.

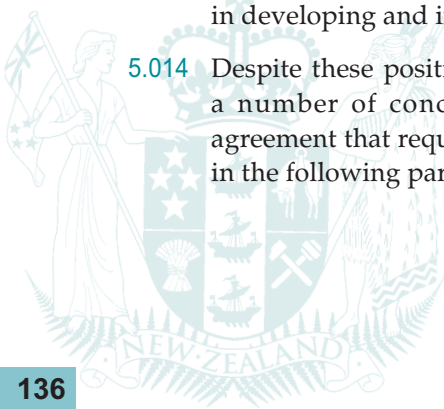
5.011 United Water has produced an Asset Management Plan, and many aspects of the franchise more generally are working well. In particular, we note that United Water, in carrying out its obligations under the agreement, has:

- begun investing in maintenance and upgrading of the infrastructure in a manner that is consistent with a long-term approach;
- kept to the two-year price freeze and subsequent price control limits;
- produced the things required for effective planning – such as drought contingency plans, disaster recovery plans, monthly water quality reports, and reports on water and wastewater charges;
- applied professional working standards and procedures; and
- brought international knowledge and experience to the management of the water and wastewater systems.

5.012 Within the terms of the franchise agreement, the Council has no right of access to the contents of the Asset Management Plan. However, United Water has cooperated and allowed access to specific information in the Plan for particular purposes. In our view, the Council’s lack of access to the Plan could adversely affect its ability to manage the franchise. This has not been a problem to date, but only because of United Water’s cooperation and goodwill.

5.013 The Council’s appointment of a firm of consulting engineers to monitor on its behalf the requirements of the franchise agreement and the activities of United Water is proving to be a successful arrangement because of the firm’s initiatives in developing and implementing a monitoring framework.

5.014 Despite these positive developments, we continue to have a number of concerns about aspects of the franchise agreement that require the Council’s attention, as described in the following paragraphs.



Monitoring Franchisee Performance

- 5.015 The Council still needs to establish, through the consultants, a specific mechanism for identifying and managing poor performance or non-performance by the franchisee. In our view, the Council has taken too long to address this need.

Price Control

- 5.016 The Auckland Average Price mechanism measures prices charged in other local authority districts in the Auckland region. The Council still needs to clarify the definitions within the price control provisions of the franchise agreement (as suggested by the consultants) in order to avoid potential disputes with United Water over calculation of Auckland Average Prices.
- 5.017 In addition, until the consultants have completed (as instructed by the Council) the audit of United Water's own prices as part of the 1999-2000 monitoring programme, the Council has no assurance that charges are being correctly applied.

Customer Service

- 5.018 United Water is operating a Customer Charter that sets performance standards for a variety of customer service issues. However, the Council has not monitored United Water's performance against the Charter. And the current method used by the Council to assess customer satisfaction provides insufficient specific information to provide assurance about United Water's performance on customer service.
- 5.019 The consultants recommended that additional work be done on compliance with the Customer Charter, and that the Council should establish some customer best practice comparisons. The recommendation was taken up by the Council and included in the 1999-2000 monitoring programme, but this component of the programme was incomplete at the time of reporting.

Asset Management

- 5.020 The franchise agreement contains very few specific performance indicators relating to the maintenance and improvement of the water and wastewater infrastructure assets. The Council needs to work with the consultants and United Water to address this omission.
- 5.021 The agreement requires United Water to make an Asset Condition Report in July 2002 and every five years thereafter. We would expect the parties to co-operate to ensure that, by the time this report is prepared, they are in agreement about how the condition of the infrastructure is to be measured over the duration of the franchise. In order to achieve agreement, sufficient indicators and information will be required to support an assessment of United Water's performance.

Council Involvement

- 5.022 We consider that much of what has been achieved to date in managing and monitoring the franchise agreement is largely due to the initiatives taken by the consultants and United Water, with limited direction from the Council. The Council's appointment of the consultants was a positive step in improving the information available that is needed to support the Council in its governance role. However, we understand that some members of the Council's Monitoring Committee have been frustrated by the information available to them to conduct the committee's monitoring activities.
- 5.023 Concerns about the availability of information need to be addressed to enable the Council to play its part as a full partner in the franchise agreement. The Council should also actively conduct an ongoing dialogue with both the consultants and United Water in order to properly manage the franchise and protect the long-term interests of the public of Papakura.
- 5.024 The Council should take the lead in ensuring that the issues highlighted in this report are resolved.

Our Recommendations

5.025 We recommend that the Council articulates and enforces its interests as owner and principal by:

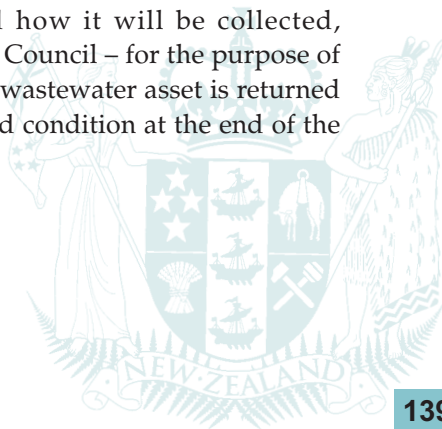
- reviewing its role in monitoring in order to test whether the role adequately reflects the Council’s responsibility to protect the public interest; and
- adopting measures to strengthen its engagement as a full partner in the franchise – in particular by increasing direct dialogue between itself, the consultants, and United Water.

5.026 Our follow-up audit has identified specific issues that the Council needs to address. The most important issue relates to monitoring the condition of the water and wastewater infrastructure asset and ensuring that the asset is returned to the Council in the required condition at the end of the franchise agreement. To that end, we recommend that the Council:

- ensures that it and the consultants have ongoing access to sufficient information to provide assurance about the long-term condition of the asset, the future service levels to be provided, and United Water’s performance; and
- ensures that the Asset Condition Report due in 2002 contains sufficient information for that purpose.

5.027 The Council should in any event agree with United Water the detail of what information:

- is required to be in the Asset Condition Report; and
- should be collected – and how it will be collected, verified, and reported to the Council – for the purpose of ensuring that the water and wastewater asset is returned to the Council in the required condition at the end of the franchise agreement.



5.028 The Council should also:

- discuss and agree with United Water a precise definition of the Auckland Average Price;
- commission an annual audit of United Water's prices; and
- make progress on the recommendations of the consultants for improved monitoring of customer service and reporting of the results.

General Lessons for All Councils

5.029 As a result of our follow-up audit, we reiterate four key requirements of any franchise agreement that should be put in place from the start of the agreement:

- an Infrastructure Condition Assessment, so that everyone is clear about the state of the infrastructure at the start;
- an Asset Management Plan;
- access to appropriate information contained within the Asset Management Plan for management and governance purposes; and
- clear standards that will provide an objective basis for managing the franchise agreement, including standards for the maintenance and enhancement of infrastructure.³

5.030 Monitoring responsibilities and processes also need to be determined, agreed and established at the outset. These should consider and accommodate what direct role the Council itself wishes to play in monitoring the franchise agreement.

5.031 Price controls should take account of the potential revenue stream, the initial condition of the infrastructure, and the need for future investment. Pricing mechanisms should be clear to avoid potential disagreement during the franchise term.

5.032 Councils should monitor specific measures for quality of service to customers, and the measures should be linked to any Customer Charter required of the franchisee.

³ The Appendix to our 1998 report contained a comprehensive set of model expectations covering all aspects of a franchise agreement.

Monitoring the Operation of the Franchise Agreement

5.033 We examined the Council’s procedures, systems and information used in managing and monitoring the franchise agreement, under three headings:

- systems and resources;
- monitoring information; and
- communicating with United Water.

Systems and Resources

Expectations

5.034 In 1998, we expected that the Council would have:

- *allocated suitable resources and established the necessary systems to manage and monitor United Water’s performance under the franchise agreement;*
- *created procedures for dealing with poor performance or non-performance by United Water; and*
- *put in place procedures and performance specifications to enable the Council to monitor maintenance and renewal of, and additions to, the assets during the franchise.*

Findings

5.035 In February 1998, six months after the start of the franchise agreement, the Council invited consultant engineers Montgomery Watson New Zealand Limited (the consultants) to provide technical assistance in relation to the franchise agreement. This assistance included a review of United Water’s preparation of an Initial Condition Assessment of the infrastructure.

5.036 United Water produced the Initial Condition Assessment in draft form in June 1998. The consultants completed a preliminary review of the draft in July 1998. United Water completed the final version of the Assessment, incorporating the consultants' comments on the draft, in September 1998. The Council formally agreed the final Initial Condition Assessment in October 1998 after a further review by the consultants.

5.037 In July 1998, the consultants were asked to review the Drought Contingency Plan and the Disaster Recovery Plan prepared by United Water.

5.038 In June 1999, nearly two years into the franchise, the Council instructed the consultants to carry out an analysis of the agreement and our 1998 report in order to identify appropriate issues for future monitoring, and to outline a monitoring programme. The consultants delivered their report in the same month setting out:

- United Water's obligations under the franchise agreement;
- key issues from our 1998 report; and
- those issues and activities where the Council needed to "actively audit" and those where it would be sufficient to rely on reports from United Water.

5.039 In mid-September 1999, the Council told the consultants to institute the proposed monitoring and auditing programme, which includes reviews of:

- the accuracy of wholesale charges for water and wastewater that United Water passes on to customers;
- United Water's service charges;
- whether the water distribution system meets Ministry of Health standards; and
- United Water's Asset Valuation Report.

5.040 So far, the consultant's monitoring has included reviews of wholesale water charges and the Asset Valuation Report, as well as a review of the Initial Condition Assessment.

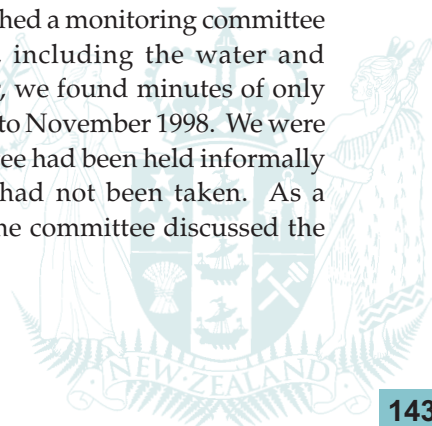
5.041 The Council took over two years from the start of the franchise agreement to formally initiate a monitoring regime. We consider that the Council should have moved more quickly to initiate monitoring of the franchise agreement.

5.042 In its report to Council management on the results of the 1999 annual audit, Audit New Zealand said that:

- the Council *places a lot of reliance on contractors to perform and discharge their obligations under contracts of service;*
- *... Council should enhance its contract monitoring procedures to include more effective risk management in terms of identification, management and reporting; and*
- *in the section on Contract Monitoring Procedures, we identified significant reliance being placed on contractors and United Water ... to perform and discharge their obligations under the contract of service We believe that the development of a more robust contract monitoring system that incorporates the identification of risks to Council and formalises procedures to proactively monitor those risks, will provide greater assurance to Council...*

5.043 In our 1998 report, we pointed out the absence of a mechanism to identify poor performance or non-performance on the part of United Water. The consultants have since highlighted the same issue, but the Council has still taken no action to develop specific mechanisms for identifying and managing instances of poor performance or non-performance. The Council is accountable for monitoring United Water’s performance, and needs to take an active part in monitoring the franchise.

5.044 In April 1997, the Council established a monitoring committee to monitor all of its contracts, including the water and wastewater franchise. However, we found minutes of only one meeting of the committee up to November 1998. We were told that meetings of the committee had been held informally over this period, and minutes had not been taken. As a result, we cannot say whether the committee discussed the franchise agreement.



- 5.045 In November 1998, the newly elected Council reviewed the monitoring committee’s role, purpose and activities. As a result, the Council established a Monitoring Committee with a particular meeting agenda item “Water Franchise Watchdog” so that the Committee’s elected members would take on a more active, systematic role in monitoring the franchise agreement.
- 5.046 Minuted meetings of the Monitoring Committee have taken place regularly since November 1998, and the meetings have considered a range of issues about the franchise agreement. We consider that this committee was in a position to have identified and addressed promptly many of the outstanding issues that we have identified in this report.

Conclusions

- 5.047 The Council took two years to initiate and agree the current monitoring system. It took more than a year to set up effective monitoring of the franchise agreement by the Council.
- 5.048 The Council still needs to establish a specific mechanism for identifying and managing poor performance and non-performance.
- 5.049 In our view, the Council has given insufficient priority to addressing these issues in a timely manner.

Information for Monitoring

Expectation

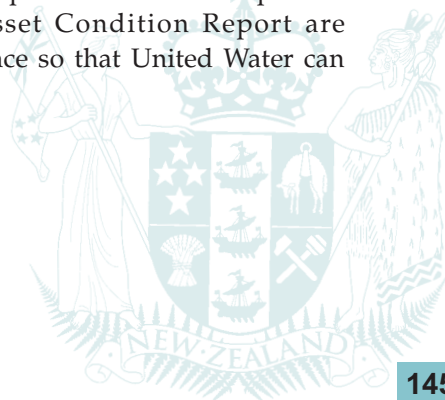
- 5.050 In 1998, we expected that the Council would have:
- *ensured that it had access to sufficient information from United Water to allow it to assess, validate and audit the company’s performance.*

Findings

- 5.051 United Water routinely produces the following information required under the franchise agreement:
- monthly water quality reports;
 - annual report on solvency; and
 - as-built plans of upgrades or modifications to the assets – which the Council is confident would be sufficient in the event that a new contractor needed to take over and manage the assets.
- 5.052 The franchise agreement also requires United Water to provide the Council with any information it may require to establish compliance with the pricing mechanism. United Water has provided such information when requested.
- 5.053 The first five-year report on the condition of the asset (the Asset Condition Report) will be due in 2002. We consider that this report should provide essential information to enable the Council to ensure the satisfactory stewardship of the asset and to review United Water’s performance.

Conclusions

- 5.054 United Water is complying with the information requirements of the franchise agreement by providing information to enable the Council to monitor some aspects of the company’s performance.
- 5.055 The Asset Condition Report due in 2002 (and every five years after that) should provide essential information on the asset and on United Water’s performance. It is important that the contents of the Asset Condition Report are specified and agreed in advance so that United Water can collect the necessary data.



Communicating with United Water

Expectation

5.056 In 1998, we expected that the Council would have:

- *put in place procedures for regular communication with United Water.*

Findings

5.057 When we reported in 1998, the Council had not established formal procedures for regular communication with United Water. Communication arrangements remain much as they were in 1998, involving both formal and informal contacts such as:

- exchanges of letters;
- meetings on key issues; and
- day-to-day contact with staff and senior management on various issues.

5.058 The majority of communications between the Council and United Water have not reflected systematic management of the franchise. Rather, they have been prompted by the need to resolve particular problems.

5.059 There is no regular, direct contact between the Council's Monitoring Committee and United Water.

5.060 The consultants have direct communication with United Water as part of their monitoring role.



Conclusions

- 5.061 The Council’s appointment of the consultants to provide a programme of technical monitoring and information gathering was a positive step in making available to the Council the information that it needed in its governance role. However, we understand that some members of the Council’s Monitoring Committee have been frustrated by the information available to them to conduct the Committee’s monitoring activities.
- 5.062 Concerns about the availability of monitoring information need to be addressed to enable the Council to play its part as a full partner to the franchise agreement.
- 5.063 The Council should also:
- conduct an active, ongoing dialogue with both its own consultants and United Water in order to properly manage the franchise and protect the long-term interests of the public of Papakura; and
 - take the lead in ensuring that the outstanding issues highlighted in this report are resolved.



Measuring United Water's Performance

5.064 The Council needs to be able to measure the following key elements of United Water's performance under the franchise agreement:

- **Price Control** – whether United Water's prices are within the terms and conditions of the agreement;
- **Water Quality** – the quality of water delivered to consumers;
- **Customer Service** – the quality of United Water's customer service; and
- **Asset Management and Development** – whether United Water is adequately maintaining and enhancing the pipes, buildings and machinery that make up the water and wastewater system.

Price Control

Expectations

5.065 Given the monopolistic nature of a public utility franchise, controls are required to prevent unreasonable price increases for customers and unreasonable profit by a monopoly supplier. In 1998, we expected that the Council would have:

- *objectives (for the franchise) that would protect the long-term interests of ratepayers and water users; and*
- *ensured that the franchise agreement included a mechanism for regulating the prices charged to customers.*

Findings

- 5.066 The franchise agreement meant a change to a direct “user pays” system for water use, and for that purpose all properties are metered. The agreement contains two pricing mechanisms, one for water supply and one for wastewater disposal.
- 5.067 United Water is required to pass the costs charged by Watercare for the bulk water supply and wastewater removal directly to consumers, without making additional charges. In May 2000, the consultants reviewed information on the charges for bulk water supply and wastewater removal and found that United Water was complying with the requirements of the franchise agreement.
- 5.068 The franchise agreement fixed United Water’s service charges for both water supply and wastewater removal for the first two years and that obligation was met. From July 1999, United Water could increase the service charges, but the charges are required to remain lower than the Auckland Average Prices (see the Appendix on pages 159-160).
- 5.069 United Water has increased its service charges on two occasions since July 1999 (see Figure 5.1 on page 150):
- In July 1999, the charge for water supply rose from 37.125 to 44 cents a thousand litres (18.5%), and the charge for wastewater removal rose from 22 to 28 cents a thousand litres (27.3%).
 - In July 2000, the water charge increased by 8 cents a thousand litres (18.2%) and the wastewater charge by 5 cents a thousand litres (17.9%).



Figure 5.1
Components of Water and Wastewater Charges to Consumers

	1 July 1997 \$	1 July 1998 \$	1 July 1999 \$	1 July 2000 \$
Water Supply (Watercare charge)	0.46850	0.47875	0.48000	0.49000
Water Service (United Water charge)	0.37125	0.37125	0.44000	0.52000
Water /1000 litres Total	0.83975	0.85000	0.92000	1.01000
Wastewater Treatment (Watercare charge)	1.31630	1.52000	1.64000	1.86000
Wastewater Service (United Water charge)	0.22000	0.22000	0.28000	0.33000
Wastewater /1000 litres Total	1.53630	1.74000	1.92000	2.19000

United Water cannot directly influence the charges set by Watercare, but must do whatever is necessary to ensure that the costs of bulk water are minimised, e.g. by reducing water loss through leaks.

The United Water charge for the wastewater service is based on 80% of metered water supplied.

5.070 The Council compared the increased prices to the Auckland Average Prices by requesting information about water and wastewater charges from other Councils in the Auckland region – deriving the information in Figure 5.2 on the next page that was presented to the Council’s Monitoring Committee in October 1999. Using those charges, and the equivalent figures for the following year, the Council determined that both increases in United Water’s prices to consumers remained below the Auckland Average Prices.

5.071 The Council instructed its consultants to audit United Water’s service charges as part of the 1999-2000 monitoring work programme. Until this has been completed, the Council has no assurance that charges are being correctly applied.

Figure 5.2
Comparative Prices for Water Supply and Wastewater Removal

Council	Water \$/1000 litres (inc GST)	Wastewater \$ average annual charge (inc GST)
Auckland	1.2246	454.31
North Shore	1.18	329.39
Waitakere	1.41	Not used ⁴
Manukau	0.99	481.00
Average	1.2011	421.57
United Water	0.92*	368.64*
Difference	0.2811(30.6%)	52.93(14.4%)

* Based on the 1/7/99 data from previous table. United Water wastewater charge calculated as 0.80 x 240 x \$1.92 = \$368.64 (80% of consumption x average household consumption x the 7/99 price per 1000 litres).

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5.072 In May 1999, the consultants pointed out that the franchise agreement contains no specific, agreed method for calculating Auckland Average Prices. This lack could in future give rise to potential disagreement between the Council and United Water – particularly if the Auckland Average Prices and United Water’s prices were to move closer together. Differences over how the Auckland Average Prices are calculated could put at risk compliance with the requirement of the franchise agreement that United Water’s prices are not to exceed Auckland Average Prices.

Conclusions

- 5.073 United Water has complied with the price requirements of the franchise agreement.
- 5.074 How the Auckland Average Prices are calculated needs to be precisely defined in order to avoid disagreement between the Council and United Water.

⁴ Waitakere City Council supplied its Annual Plan budget of \$13,084,000 for 1999-2000, which could not readily be applied.

- 5.075 The Council needs to ensure that the audit of United Water’s own prices (planned as part of the 1999-2000 monitoring programme) is completed. Until the audit is completed, the Council has no assurance that United Water is correctly applying the charges to its customers.

Water Quality

Expectations

- 5.076 In 1998, we expected that the Council would have:
- *developed objectives (for the franchise) that would protect the long-term interests of ratepayers and water users; and*
 - *ensured that the franchise agreement requires the franchisee to meet all legal or third party water and wastewater quality standards.*

Findings

- 5.077 Water quality is an important aspect of customer service, and can provide an indicator of the condition of the water and wastewater infrastructure. The franchise agreement requires that the infrastructure assets be maintained to achieve a minimum of a grade ‘B’ Ministry of Health standard for water quality.
- 5.078 Water quality results are regularly monitored and reported to the Council. Apart from one occasion (when a technical error in the administration of the tests produced a poor quality reading), water quality has been maintained at the required level or higher. Since 1998, United Water has achieved an ‘A’ grade for the majority of the system, and three ‘A’ grades for the entire district for the year 2000.

Conclusion

- 5.079 United Water has achieved a water quality standard that complies with or is better than the standard required by the franchise agreement.

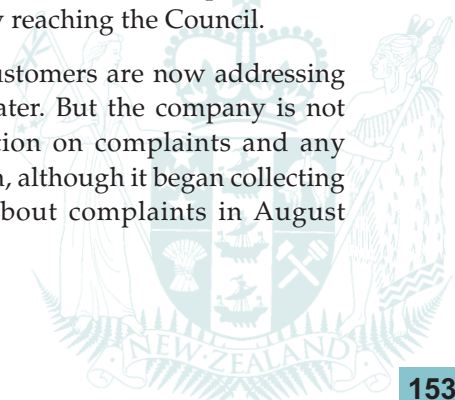
Customer Service

Expectation

- 5.080 In 1998, we expected that the Council would have:
- *put in place procedures to enable it to monitor customer service and quality assurance performance during the franchise.*

Findings

- 5.081 The franchise agreement sets out some performance standards for notifying customers of planned interruptions to the water supply. Other standards in the agreement deal with:
- unplanned interruptions to the water supply and customer complaints and enquiries;
 - wastewater spills, overflows, and unplanned interruptions to the supply of wastewater reticulation services; and
 - planned interruptions to the supply of wastewater reticulation services.
- 5.082 At the time of our 1998 audit, the Council had put no arrangements in place to monitor these performance standards. This remains the case.
- 5.083 The Council told us that during the first year of the franchise agreement it received a number of complaints about the agreement. Many of the complaints were about the new billing system. The number of complaints has fallen, with virtually none now reaching the Council.
- 5.084 The Council suggested that customers are now addressing their complaints to United Water. But the company is not required to provide information on complaints and any response taken to address them, although it began collecting and analysing information about complaints in August 2000.



- 5.085 Under the franchise agreement, United Water has to operate ... so that Customers serviced by the Infrastructural Assets, and paying for such services, may expect a level of service and quality of supply in accordance with accepted industry standards prevailing at the relevant time in the Auckland Area. In line with the agreement, and in consultation with community groups, United Water has developed a Customer Contract and a Customer Service Charter covering a wide range of issues from service difficulties, emergencies, and account enquiries, to environmental matters.
- 5.086 The Council receives no reports of United Water's performance under its Customer Contract or Customer Service Charter.
- 5.087 The Council has its own wider survey of customer satisfaction about Council activities, which it contracted to the National Research Bureau in February 2000. The Council intends to repeat the survey every three years.
- 5.088 The results of the February 2000 survey indicated a general level of satisfaction with the water and wastewater services of about 60%. The Council was consulted on the choice of questions to be asked in the survey.
- 5.089 United Water suggested to us that the survey was of limited use. In its view the survey provided only a very general level of comfort, without any specific information on what aspects of the services customers were unhappy with and wished to see improved.
- 5.090 The Council approved additional work on customer service performance monitoring during 1999-2000. This will make use of United Water's internal management reporting systems to assess performance against the Customer Charter – both at specific dates and over time. The work was not completed at the time of our follow-up audit.

Conclusion

- 5.091 The Council still has no arrangements to monitor customer satisfaction with the operation of the franchise agreement – except through its own survey of all Council services. United Water's Customer Service Charter provides an

opportunity for the company to share with the Council monitoring information – that the company will in any case be producing for its own management purposes – to show how it is performing against the charter.

Asset Management and Development

Expectations

5.092 In 1998, we expected that the Council would have:

- *completed an Asset Management Plan for the water and wastewater networks, or put in place processes to ensure that an Asset Management Plan would be produced; and*
- *ensured that the franchise agreement sets up specific performance measures for maintenance and renewal of, and additions to, the water and wastewater networks.*

Findings

5.093 The development and implementation of an appropriate Asset Management Plan is fundamental to:

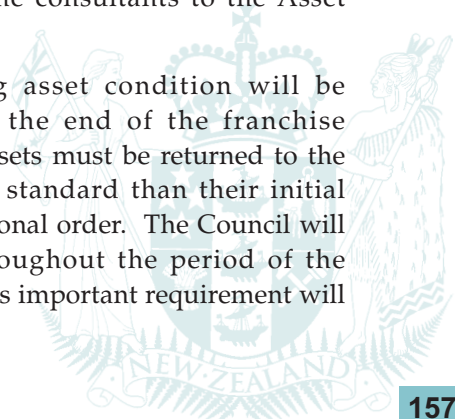
- safeguarding significant public assets;
- the protection of the interests of ratepayers and users; and
- the success of the franchise agreement.

5.094 The Council needs to have confidence that both the assets and the level of service are being maintained and enhanced over time. Key issues of equity, environmental protection, and water conservation are dependent upon United Water maintaining the networks to the required standard.

5.095 The franchise agreement clearly stipulates that an Initial Condition Assessment had to be developed and produced by June 1998. United Water produced a draft Assessment in June 1998 and a final version in September 1998 (see paragraph 5.010).

- 5.096 In its tender for the franchise, United Water provided comprehensive details of its proposed Asset Management Strategy and the methodology that it intended to follow. These details were subsequently bound into the franchise agreement as part of Schedule III, but were not referred to in the body of the franchise agreement. The Council and the consultants are both of the view that this was sufficient to require United Water to produce an Asset Management Plan.
- 5.097 However, United Water takes a different view – believing that it is required to produce only the Initial Condition Assessment, stipulated in the franchise agreement; not an Asset Management Plan, which is not referred to in the body of the agreement.
- 5.098 The difference of view over the requirements of the franchise agreement was not “tested” or clarified, because United Water in any event produced an Asset Management Plan in August 1999 for its own purposes. The company considered that the Plan was essential to properly manage the asset and conduct its business.
- 5.099 United Water considers that it has proprietary rights to the Asset Management Plan, and that the information it contains is commercially sensitive. The company believes that the franchise agreement does not provide for access to the Plan by either the Council or its consultants.
- 5.100 However, United Water has cooperated with Audit New Zealand (on behalf of the Audit Office) as the Council’s external auditor and with the consultants to supply sufficient information from the Plan to allow them to carry out specific tasks. For example, Audit New Zealand reviewed the Asset Management Plan in order to establish a clear linkage between the physical data for the assets in the Plan and disclosures in the Council’s financial statements with respect to funding for depreciation.
- 5.101 The franchise agreement requires United Water to maintain the infrastructure to an overall standard better than its initial condition and in good operational order. On the expiry or earlier termination of the agreement, the infrastructure is intended to be in better condition than it was at the start.

- 5.102 As there was no measure of the condition of the infrastructure at the start of the franchise in July 1997, the earliest benchmarks to measure performance are the Initial Condition Assessment completed in September 1998 and an Infrastructure Asset Valuation of November 1999. However, the franchise agreement contains very few specific performance indicators for the maintenance and improvement of the water and wastewater infrastructural assets that could be used to support a performance assessment.
- 5.103 The franchise agreement requires United Water to produce a report on the condition of the assets within six months after 1 July 2002 and every fifth anniversary thereafter. It will be important, before this report is produced, for United Water, the consultants and the Council to agree on:
- how the condition of the infrastructure will be measured; and
 - the process for periodic monitoring and how the results will be reported to the Council.
- 5.104 United Water believes that the five-yearly Asset Condition Report is the main measure by which its long-term performance should be assessed. Through this report, the company intends to make available to the Council and the consultants information from the Asset Management Plan.
- 5.105 In our view, the Asset Condition Report will be an essential report that must provide assurance to the Council on the condition of the assets, the future service levels that will be provided, and the performance of United Water. This report assumes greater significance given the lack of direct access by the Council and the consultants to the Asset Management Plan.
- 5.106 Measuring and monitoring asset condition will be particularly important for the end of the franchise agreement, after which the assets must be returned to the Council at an overall better standard than their initial condition and in good operational order. The Council will need sound procedures throughout the period of the franchise to assess whether this important requirement will be achieved.



Conclusions

- 5.107 The omission from the franchise agreement of a clearly understood, specific requirement to produce an Asset Management Plan was a significant oversight. In addition, lack of access to the contents and information in the Plan has the potential to adversely affect the Council’s ability to monitor and manage the franchise agreement, and to protect what is a significant public asset over the long term.
- 5.108 The Asset Condition Report, due in 2002, will provide essential information for the Council to assure itself that the water and wastewater infrastructure is being properly maintained and enhanced.
- 5.109 More specific performance measures, standards, and methodologies than are in place at the moment are needed to support this assessment. We expect the Council to continue to work with its consultants and United Water to develop appropriate measures and standards now – so that by the time the Asset Condition Report is due, United Water will be able to provide the information required from its Asset Management Plan. The measures and standards should be used as a basis for developing a method to assess the condition of the assets upon their return to the Council at the end of the franchise.



Appendix

Extracts from the Franchise Agreement on Pricing

Definitions:

Auckland Water Supply Average Price (or AWSAP) means the average price per m³ at which potable water is supplied, during any given period, to retail customers in the Auckland Area, calculated by dividing the aggregate of all amounts charged for such supplies (which amount shall be adjusted for the purposes of this definition so as to remove all subsidies of any type which have been incorporated into the setting of such retail charges) by the total number of m³ of potable water so supplied.

Auckland Wastewater Disposal Average Price (or AWDAP) means the average price per m³ at which Wastewater is received, during any given period, from retail customers for reticulation and treatment in the Auckland Area, calculated by dividing the aggregate of all amounts charged to such retail customers for the reticulation and treatment of Wastewater (which amounts shall be adjusted for the purposes of this definition so as to remove all subsidies of any type which have been incorporated into the setting of such retail charges) by the total number of m³ of Wastewater so received.

Clause 6.2(b):

The Supplier [United Water] warrants that, during the Term, the average potable water charge during any given period shall not be more than AWSAP during that period. The Supplier shall, no less frequently than once every 12 months during the Term, provide to PDC such information as PDC may reasonably require to establish the extent to which the Supplier has complied with this warranty during the proceeding 12 months (or such lesser period, where the Supplier provides such information more frequently than annually). For the purposes of this clause, the “average potable water charge” shall be an amount, stated as the average price per m³ at which potable water is supplied by the Supplier to Customers during that period, being the aggregate of the following charges: ...

Clause 6.5 – General Wastewater Reception and Treatment Charging Provisions:

(a) *The Supplier warrants that during the Term, the average residential Wastewater reception and treatment charge during any given period shall be not more than AWDAP during that period. The Supplier shall, no less frequently than once every 12 months during the Term, provide to PDC such information as PDC may reasonably require to establish the extent to which the Supplier has complied with this warranty during the proceeding 12 months (or such lesser period, where the Supplier provides such information more frequently than annually). For the purposes of this clause, the “average residential Wastewater reception and treatment charge” shall be an amount, stated as the average price per m³ which is charged by the Supplier to Customers pursuant to this Agreement during that period, being the aggregate of the following charges: ...*

