

Review of State Priority Projects – Healthy HeadWaters Water Use Efficiency Project

Department of Agriculture and Water Resources

**Final Report**

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# Executive Summary

This review focuses on the Healthy HeadWaters Water Use Efficiency State Priority Project (HHWUE project) administered by the Queensland Government Department of Natural Resources, Mines and Energy (DNRME). The HHWUE project is part of a series of State Priority Projects under the Sustainable Rural Water Use and Infrastructure Program administered by the Department of Agriculture and Water Resources (DAWR).

This review assessed the governance, risk and control processes in place for the HHWUE State Priority Project to ensure effective use of Commonwealth funds. The review was conducted through a combination of document review, stakeholder consultation and on-farm inspection.

KPMG selected a sample of 20 approved projects (25% of all projects) for desktop review and within this sample nine projects were selected for on-farm verification. The sample covered projects ranging in total cost from $100,000 to over $5 million, across the first 11 funding rounds, different types of infrastructure works and across a variety of catchment areas.

Overall, the review found that DNRME has developed and implemented appropriate controls, processes and structures to assist in the effective administration of the HHWUE project. This included:

* Establishment of relevant governance and reporting mechanisms;
* Defined and documented management processes and procedures;
* Processes and controls to support appropriate use of Commonwealth funds;
* Ongoing management and monitoring of proponent activity; and
* Regular and ongoing stakeholder engagement.

Based on the documentation reviewed, DNRME appear to have progressively improved their control environment to address issues and risks as they were identified through the life of the project. Appropriate control structures were established to effectively manage risk and the use of Commonwealth funds with noinstances of non-compliance with key provisions of the Water Management Partnership Agreement (WMPA) between Queensland and the Commonwealth identified.

A small number of relatively minor opportunities for improvement were identified. None of these were considered significant or demonstrate systemic control weaknesses.

# Introduction

## Background

DAWR has a number of programs that are administered by the States through the Sustainable Rural Water Use and Infrastructure Program (the Program) established under Part Four of the Intergovernmental Agreement (IGA) on the Murray-Darling Basin Reform. The IGA is an initiative which seeks to increase the productivity and efficiency of Australia’s water use.

The aim of the Program is to ‘bridge the gap’ to the sustainable diversion limits by enabling water reforms in the Murray Daring Basin to deliver a sustainable cap on surface water and ground water divisions through a range of water recovery projects. The Program provides funds to State Priority Projects facilitated through Water Management Partnership Agreement’s (WMPA) with each of the Basin States.

**Healthy HeadWaters Water Use Efficiency Project**

The HHWUE project has been designed to assist irrigation farmers in the Queensland Murray-Darling Basin by investing in efficient irrigation systems and technologies that reduce water loss, deliver long-term social and economic benefits, and return a share of water savings to the Basin's rivers, wetlands and floodplains. The project can cover up to 90% of the total cost for eligible irrigators to fund infrastructure projects which increase water use efficiency.

The infrastructure must relate to water storages, water distribution or in-field systems. Approved applicants must contribute at least 10% (in cash, in kind or additional water savings) to the project cost, and transfer at least 50% of the water savings (by permanent transfer of water allocation) to the Australian Government for environmental use. This project is administered by the Queensland Government Department of Natural Resources, Mines and Energy (DNRME).

Phase one of this project (the pilot) commenced in 31 August 2010. Following a review and subsequent business case by DNRME in 2012, phase two of the project commenced on 1 August 2012. The project will conclude on or before 30 June 2020, however the DNRME must ensure that all agreed water savings are transferred to the Commonwealth by no later than 31 March 2019.

The funding for this project amounts to $154.9 million, as per the Commonwealth’s Sustainable Rural Water Use and Infrastructure Program. At the time of the review, the HHWUE project had held 12 funding rounds that resulted in 80 approved projects, representing approximately 41 GL of water savings and more than $105 million in Commonwealth funding.

## Purpose of this report

DAWR engaged KPMG to review the governance, risk and control processes for State Priority Projects administered through the Program to ensure effective use of Commonwealth funds. This engagement is limited to the Queensland HHWUE Project, New South Wales Basin Pipe Project and New South Wales Irrigated Farm Modernisation State Priority Projects. Separate reports will be produced for the New South Wales Basin Pipe and Irrigated Farm Modernisation State Priority Projects.

This report presents findings and observations in relation to KPMG’s assessment of the HHWUE project; the objective of which was to:

*Review the governance, risk and control processes for State Priority Projects administered through Sustainable Rural Water Use and Infrastructure Program to ensure effective use of Commonwealth funds. (Refer* ***Appendix A*** *for further details on the scope).*

## Approach to this review

KPMG assessed the systems, processes and controls established for the governance and administration of the HHWUE project against key program management areas (as outlined in engagement scope) and key requirements of the WMPA. This included governance mechanisms, risk management, financial management processes and monitoring activities. This was undertaken through a combination of stakeholder consultation, document review and on-ground inspection.

As part of the review, KPMG selected a sample of 20 approved projects (25% of all projects) for desktop review, and of this, a sample of nine projects were selected for on-farm verification. The sample covered projects ranging in total cost from $100,000 to over $5 million, across the first 11 funding rounds, different types of infrastructure works and across a variety of catchment areas:

* Border Rivers
* Condamine Balonne
* Moonie
* Lower Balonne
* Lower Warrego
* Upper Condamine

The sample excluded any projects under active investigation or review by other organisations or processes.

On-farm verification undertaken as part of this review did not include a detailed technical assessment of the quality and effectiveness of water infrastructure works. It provides an assessment of progress of works against reported outcomes and non-technical verification of the engineer's reports against on-farm works.

The findings of the report are based on the sample of projects reviewed. Accordingly it is possible there may be instances of fraud, error or non-compliance with laws and regulations within the HHWUE project that have not been identified by this review. Refer to **Appendix B** for further information on the engagement approach.

## Summary of assessment

Overall, KPMG’s assessment of the HHWUE project found:

* No instances of non-compliance with key provisions of the WMPA;
* All proponent projects visually inspected appeared to correspond with scope and progress reported and maintained by DNRME; and
* DNRME had developed and implemented a number of controls, processes and structures to assist in the effective administration of the HHWUE project.

It was apparent from our review that DNRME have been progressively improving their control environment to address issues and risks as they were identified. This is evident through the introduction of new controls and processes over time; for example placing increased scrutiny on fuel expenditure to recognise the fluctuation in fuel estimates as well as improved procedural documentation to support assessment of applications.

While it is not possible to remove all risk, DNRME has established appropriate control structures to effectively manage the use of Commonwealth funds in the administration of the HHWUE project. Notwithstanding this, opportunities for improvement were noted for a small number of issues. In all cases these were relatively minor and not considered systemic control weaknesses. Further detail on these is included in Section 4 of this report.

This report has been structured around the key program management elements. A summary of our overall assessment against these elements is captured in the table below.

| **Area of Focus** | **Key observations** |
| --- | --- |
| Governance and Reporting | Key governance arrangements have been established and were operating for the life of the HHWUE project. The level of planning, oversight and reporting appeared commensurate with the size of the HHWUE project and was seen as fit for purpose by both DNRME and DAWR. |
| Application assessment | DNRME have robust and established processes for the assessment and evaluation of HHWUE applications. There appears to be appropriate controls to support transparent and accountable decision making. Assessment processes have evolved over time to capture lessons learnt to inform process improvements. |
| Risk and issue management | DNRME has a defined and documented approach to identifying, assessing and communicating risks and issues. Risks and issues are regularly reviewed and reported to stakeholders. |
| Financial management | DNRME appears to have implemented appropriate financial management systems, processes and controls at both an individual proponent and overall at the HHWUE project level. These processes and controls are designed to support the appropriate use of Commonwealth funds and appear to be fit for purpose. No significant discrepancies or control deficiencies were identified. |
| Stakeholder engagement | DNRME have planned and implemented various mechanisms for engaging and communicating with stakeholders both internally as well as with the broader Queensland community. |
| Water Transfer | DNRME processes have been designed to support and coordinate the water transfer process between the proponent and Commonwealth. DNRME undertake a review of water eligibility and transferability prior to DAWR approval and contractual transfer. DNRME also assist and update proponents during the water transfer process. |
| Project Management | DNRME appear to have established appropriate processes to manage and monitor proponent projects in accordance with the requirements as set out in proponent works agreements and WMPA. |
| On-ground verification | From visual inspection, installed works appeared to correspond with the documentation provided, specifically, scope and progress of works reported in the approved application, milestone inspection reports and/or final commissioning report. |

Whilst not the purpose of this review, no instances of fraudulent transactions or behaviours were identified during the course of our fieldwork.

# Findings and Observations

## Governance and reporting

*Key governance arrangements have been established and were operating for the life of the HHWUE project. The level of planning, oversight and reporting appeared commensurate to the size of the HHWUE project and was seen as fit for purpose by both DNRME and DAWR.*

KPMG considered the governance mechanisms established to manage and implement the HHWUE project. This included:

* Establishment of a clear governance structure.
* Defined roles and responsibilities.
* Regular, timely and fit for purpose reporting.

The high-level structure and operation of the HHWUE project is described in the WMPA and the accompanying project schedule between DNRME and the Commonwealth represented by DAWR. This includes high-level responsibilities of DAWR and DNRME, project milestones and inter-governmental governance arrangements. The WMPA schedule was regularly updated to reflect annual activity via an annual project plan.

The primary inter-agency governance and oversight forum is the Project Overview Group (POG) meeting. This is a quarterly meeting held between DAWR and DNRME representatives to monitor progress against project milestones as well as to discuss financial matters, and any risks or issues arising. POG meetings also represent a scheduled milestone for the project. KPMG found that meetings were being undertaken in accordance with the WMPA schedule, and minutes and actions for all meetings were maintained and available.

Key interagency reporting requirements are also outlined in the schedule to the WMPA, this included quarterly progress reports, monthly progress project milestone reports, and audited general purpose financial statements. The review found that detailed quarterly progress reports were prepared and presented as part of meeting papers for POG meetings. Outside of this, regular communication and reporting between DNRME and DAWR also occurred either verbally or via email. Discussions with DAWR confirmed that these regular updates were fit for purpose and met the needs of monthly reporting requirements. Audited project financial statements were also sighted in accordance with the WMPA.

Internal DNRME HHWUE project governance and reporting mechanisms are outlined in the *HHWUE Program Management Plan.* The plan describes the process for managing the HHWUE project, the roles of the team members and the expected outcomes of the project. It serves as a common reference point to guide the work of the team members. As outlined in the program management plan, the HHWUE project is managed by the Program Manager who operates within the DNRME South Region management structure. The project reports to the Director Basin Implementation. Key financial and contractual decisions are made by the Executive Director and Deputy Director General in accordance with the operational DNRME structure. KPMG found that all HHWUE project staff involved had a good understanding of their roles and responsibilities and the operation of the HHWUE project.

A monthly internal water services progress report was produced for the project. This highlighted progress at the overarching HHWUE project level and details overall status, as well as key achievements and emerging risks on a monthly basis. Tracking is provided against key program milestones such as 'readiness for funding round', 'audited financials' and 'quarterly reports'. In addition to this, an internal dashboard report was provided to the Executive. This included a traffic light report which provided a high-level status in regards to HHWUE project progress towards quarterly reports to be submitted to DAWR.

KPMG did not identify any non-compliance or significant control weaknesses related governance and reporting processes.

## Assessment of funding applications

*DNRME has robust and established processes for the assessment and evaluation of HHWUE applications. There appears to be appropriate controls to support transparent and accountable decision making. Assessment processes have evolved over time to capture lessons learnt to inform process improvements.*

DNRME are responsible for evaluating and assessing applications for eligibility and compilation of works packages for DAWR review and approval. While DNRME undertake initial assessment activities, DAWR are responsible for final approval of all proponent projects. DNRME have established multiple controls and processes to support the assessment and evaluation process including:

* Appointment of an evaluation panel to conduct the evaluation of all applications.
* Verification procedures for technical certification.
* Third party checks of the technical information.
* Review of applications by the panel’s irrigation advisor.

DNRME work closely with DAWR to develop guidelines for each round. These are discussed and endorsed with DAWR prior to the commencement of a funding round.

Prior to the submission of the works package of eligible projects to DAWR, the DNRME Program Manager and the Director, Basin Implementation, endorse the package confirming that each application meets the requirements of the WMPA and eligibility criteria of the round.

Discussions with the HHWUE project team identified that the assessment process has adapted and improved over time, as was evident through sample testing. Through lessons learnt HHWUE has moved from six monthly to monthly applications to allow prospective applicants more frequent opportunities to submit their applications and adopt lessons learnt from previous applications. In addition, to increase participation and recovery of water, the design of the irrigator contribution was reviewed to allow proponents the opportunity to offer additional water (valued at an agreed market price) above the 50% prescribed savings to fund the 10% proponent financial contribution.

KPMG did not identify any non-compliance or significant control weaknesses related to the proponent application assessment process.

## Risk and issue management

*DNRME has a defined and documented approach to identifying, assessing and communicating risks and issues. Key risks and issues are regularly reviewed and reported to stakeholders.*

KPMG found that DNRME had established key risk management measures for HHWUE and appeared to be actively managing risks. The HHWUE project conformed to the *DNRME Risk Management Framework and Procedure*. This provides a consistent process by which DNRME identifies, assesses, treats and monitors risks - consistent with *AS/NZ ISO 31000*. In accordance with the DNRME Risk Management Framework, the HHWUE Risk Management Plan (RMP) has been developed as a subsidiary document to the HHWUE Program Management Plan. This RMP outlines the HHWUE project’s approach to risk management including key roles, risk appetite, risk tolerance and risk reporting requirements.

A detailed risk register has also been developed covering a broad range of administration and delivery risks, including skills and capacity. Each risk is rated, assigned an owner and provided a mitigation strategy. Those risks that are considered open or under development are supported by more detailed risk treatment plans, providing further detail on the risk and proposed treatments. Identified risks and risk treatments appeared to be regularly reviewed and updated.

DNRME regularly updates DAWR on any risks and issues via quarterly reports and quarterly program overview group meetings. In addition, each work package provided to the DAWR includes a section on risk considerations. This outlines key risks at the works agreement and program level. Each risk is rated and includes a mitigation strategy. This has been provided to DAWR since round one.

An issues register has also been developed for the HWUUE project. The issues identified were assigned a category, author, date, description, priority, action description and status. It was noted that the last issue in the register was dated 2014. Discussion indicated that the issues register document was no longer in use and DNRME had elected to capture both risks and issues in the same document.

KPMG did not identify any non-compliance or significant control weaknesses related to risk and issue management. However, KPMG have suggested further improvements to HHWUE project risk and issue management (refer to Section 4.1 for details).

## Financial management

*DNRME appears to have implemented appropriate financial management systems, processes and controls at both an individual proponent and overall at the HHWUE project level. These processes and controls are designed to support the appropriate use of Commonwealth funds and appear to be fit for purpose. No significant discrepancies or control deficiencies were identified.*

There are two key aspects to financial management which were assessed as part of the review. Firstly, the requirements to manage proponent-level project funds in accordance with their project scope and works agreements and secondly, DNRME’s processes and systems in place to manage the project and ultimately Commonwealth funds in an appropriate manner. KPMG assessed the adequacy of key systems, processes and controls relating to the tracking of budgets, actual expenditure and project schedules as well as project acquittal and milestone requirements.

### Proponent-level Financial Management

KPMG’s review did not identify any discrepancies or significant control deficiencies in regards to DNRME processing of proponent milestone payments. Over the life of the HHWUE project, DNRME’s evidence supporting payment claims and administrative requirements for proponents evolved to address lessons learnt and risks identified. For example, the requirement for proponents to retain fuel logbooks was introduced to help mitigate the risks associated with inappropriate proponent fuel claims. Similarly, DNRME introduced the requirement for proponents to provide bank statements as evidence they had incurred expenditure for the works and the disbursement of funds. Our testing focused on financial management controls and processes and did not test the accuracy or validity of information submitted for proponent claims. The following provides further details on the financial management testing conducted.

* A proponent is entitled to their first milestone payment following notification (from the Australian Government Solicitor) of the water transfer deed to the Commonwealth. Through sample testing KPMG confirmed all proponents received milestone one payments post formal notification of water settlement.
* All proponent claims are required to be reviewed and approved prior to payment. All claims sampled showed evidence of review and agreed to the approved works agreement.
* DNRME, as part of the works agreement, requires a pre-works inspection to be conducted by DNRME or its representative prior to payment of milestone two and generally, before works commence. This is a control designed to ensure no pre-existing works are claimed with HHWUE funding and to confirm the starting point for works. Where applicable, the sample projects reviewed had evidence of pre-works inspections. One instance was identified where the timing of the inspection was shortly after commencement of works, however this was considered an isolated event and did not indicate any systemic control issues.

KPMG has made an observation in relation to the documentation of assets purchased by proponents (refer to Section 4.2).This did not indicate either a breach of WMPA or a systemic control failure.

### HHWUE Project Financial Management

DNRME appears to have appropriate financial management controls in place to manage and monitor HHWUE project expenditure and acquittal of funds to the Commonwealth.

HHWUE project expenditure is classified into two cost categories by DNRME: ‘complementary measures’ which capture staff wages, overheads, supporting projects and studies, and engagement of experts to assist in making informed decisions regarding on-farm water use efficiency options; and ‘infrastructure’ which captures funding payments to proponents. Both expenditure categories are on-charged to DAWR for reimbursement. The DNRME contract database is used to track HHWUE project budget against actuals and detailed spreadsheets per proponent are used to monitor spend and milestone payments. HHWUE also undertake monthly reviews of expenditure and financials.

DNRME claim Commonwealth payments in arrears which mitigates the risk associated with interest incurred on approved Commonwealth funding and acquittal of unspent funds. As HHWUE has been under-subscribed, DNRME utilise a rolling budget and unspent committed Commonwealth funds are carried over to the following financial year. DNRME advised that the WMPA is varied, when required, to account for adjustments in funding forecasts.

DNRME, in accordance with WMPA, provide DAWR with correctly issued audited financial statements by November each year.

## Stakeholder engagement

*DNRME has planned and implemented various mechanisms for engaging and communicating with stakeholders both internally as well as with the broader Queensland community.*

DNRME develops a HHWUE project stakeholder communication strategy for each funding round. The strategy outlines key communication objectives, stakeholder groups, and level of influence, proposed communication channels, activities and budget. The plan is also shared with DAWR.

DNRME provide an update on communication activity to DAWR via quarterly reports, which identify a broad range of communication channels, including industry forums, social media and industry briefings. DNRME update the annual plan (contained within schedule 2 of the WMPA) to reflect HHWUE marketing and industry engagement activity planned for the coming financial year.

DNRME also regularly engage with DAWR. As discussed in Section 3.1, DNRME meet with DAWR quarterly as well as have regular ad hoc communication via phone and email.

KPMG did not identify any non-compliance or significant control weaknesses related to stakeholder engagement.

## Water transfer

*DNRME processes have been designed to support and coordinate the water transfer process between the proponent and the Commonwealth. DNRME undertake a review of water eligibility and transferability prior to DAWR approval and contractual transfer. DNRME also assist and update proponents during the water transfer process.*

The HHWUE project delivers water to the environment through the transfer of at least 50% of proposed water savings achieved through on-farm works to the Commonwealth government. This occurs via the water entitlement transfer deed (WETD). The Review found that appropriate processes and procedures are in place to facilitate the transfer of water savings to the Commonwealth in accordance with WMPA.

DAWR is responsible, through contractual conveyancing specialists, for undertaking the legal due diligence for the transfer of water and managing conveyancing of the water entitlements from entitlement owners to the Commonwealth. DNRME will only make the first milestone payment under a works agreement once the water transfer between the water entitlement owner and the Commonwealth is settled. For this purpose, HHWUE engage with the Australian Government Solicitor to ensure notification of settlement is provided prior to milestone payment.

While the HHWUE project team is not responsible for managing the water transfer process, they work closely with other areas within DNRME (DNRME Water Services and Titles Registry) to help facilitate this process. The HHWUE project team also undertakes checks during the assessment of applications to verify title details on the application form and cross reference information:

* ***Water eligibility***: A water title search is undertaken to verify the water allocation details on the application form and check whether the water allocation offered is located in an eligible zone. HHWUE assessment procedures also require staff to save the water allocation title from the search and place a copy on the relevant applicant's hard and eDOCS files. Additionally, HHWUE project team will purchase an external copy of the water allocation from the DNRME Service Centre.
* ***Water transferability:*** An assessment of the water entitlement to identify any conditions or issues that may impact the transferability of the water product. The outcomes of this test may require further consultation with the applicant to resolve any issues impacting transferability. Applicants may review and resolve issues prior to applying (through a pre-lodgement information request), or may negotiate after application approval.

The HHWUE project also provides support and guidance to proponents wherever possible, working with proponents to ratify any conditions that may impact the transfer as well as tracking progress of title settlement. For this purpose DNRME indicated that a dedicated officer had been assigned to coordinate the water transfer process, including negotiating and managing expectations and monitoring progress. DNRME also provide DAWR copies of the water allocation titles as part of the relevant works packages.

KPMG did not identify any non-compliance or significant control weaknesses related to the water transfer process.

## Project management

### *DNRME appear to have established appropriate processes to manage and monitor proponent projects in accordance with the requirements as set out in proponent works agreements and WMPA.*

### KPMG considered the processes and controls in place to manage and monitor proponent projects. Key areas of focus are discussed in this section.

### Record keeping

DNRME utilises ‘Trello’ as one of their project management tools. Trello is used by case managers for individual projects to visually track their status and record interactions internally and with the proponent. KPMG sighted Trello case notes for projects sampled. From a high level review they appeared to provide a sound overview of a project’s status and interactions between the proponent and DNRME.

DNRME utilise an electronic filing system (eDocs) accompanied by paper files, all key documentation requested for the sample of projects was filed and stored appropriately. We noted a small number of instances where administrative documentation could not be located. All instances appeared to be isolated administrative oversights.

### Staff training and guidance

DNRME assigns case managers to proponents, to monitor the progress of the project and as the proponent’s main point of contact. Discussions with DNRME identified that the majority of the program staff have a background in program management and an understanding of water projects or similar works. Whilst there is no HHWUE specific training or guidance available to staff responsible for the project, broader project management, probity and procurement training is available through the Performance and Development processes or on a business need basis. Where specific technical knowledge was required DNRME engaged specialist providers i.e. technical assessors and probity advisors.

### Project variations

Where required, all variations within the sample of projects had appropriate consultation and approval from DAWR in advance of varying the works agreement (as per WMPA attachment 5).

DNRME adopt a conservative approach to variation approvals and undertake an assessment for each proposed works agreement variations to determine what impact the variation may have and to determine the required approvals processes. Variations are usually endorsed at Program Manager level and Director Basin Implementation, and effected through a deed of variation signed by the Executive Director.

### Progress reporting

As per the works agreement, proponents are required to provide a progress report to DNRME for each quarter that falls fully or partly within the Terms of their Agreement. The majority of projects reviewed within the sample had some progress reports on file and for projects where there was no evidence of progress reporting there was evidence of ongoing communication and interaction with the proponent maintained in Trello (HHWUE case management system). Through sample testing there appeared to be appropriate communication and mechanisms for DNRME to remain informed of and manage projects, as well as to identify any emerging issues or risks with projects. KPMG made a minor observation in relation to proponent progress reporting (refer to Section 4.3 for further detail).

### Conflict of interest declarations and management

DNRME engages a probity advisor to oversee funding round guidelines, procedures and assessments. As part of the assessment of project applications panel members are required to sign confidentiality and conflict of interest declarations. The probity advisor is responsible for overseeing the evaluation process and ensuring the integrity of the activities undertaken as part of the evaluation process.

DNRME’s conflict of interest processes have developed and evolved during the HHWUE project. Inspection reports and technical assessment templates include a standard section to identify and declare conflicts. Noting this, there is opportunity to improve the ongoing management of conflicts and documentation to ensure DNRME has evidence available to support the management or decisions regarding perceived or actual COI (refer to Section 4.4 for further detail).

### Compliance management

#### Compliance with works agreement

DNRME’s processes for assessing and monitoring proponent’s compliance with works agreement obligations appeared appropriate based on the program characteristics and risks. DNRMEs primary form of compliance monitoring occurs via inspection. There are generally three types of inspections:

* *Pre-works inspection*: Aimed at ensuring no prior works have been completed and attributed to this project. This is generally undertaken by DNRME staff and/or an irrigation professional engaged by DNRME.
* *Works inspection*: When a milestone payment claim against a proponent project is due, depending on the materiality of the claim and works involved, DNRME generally requires an inspection report to verify progress.
* *Commissioning Report:* The proponent must have commissioning conducted by an irrigation professional once all project activities have been completed. The report confirms the specification of completed works and that they meet the project outcomes and includes an as-built drawing. Any minor variations from the approved project should also be explained.

KPMG observed that DNRME had consistently been undertaking compliance inspections. During sample testing it was also identified that at least one of the above-mentioned inspections had been undertaken for all projects reviewed (as required). Further, DNRME has established procedures that set the expectations for the competency of persons inspecting project works. This was established to ensure the persons undertaking inspections are suitably competent considering the technical complexity of works.

#### Compliance with relevant legislation and approvals

DNRME considers compliance with relevant legislation and approvals the responsibility of the proponent. For example, if the proposed works include increasing, developing or reconfiguring storages, development approval may be required to undertake this work. Under the Works Agreement proponents are required to ensure compliance with all laws, and to obtain all relevant planning and regulatory approvals. Further to this, DNRME reminds proponents of this responsibility via the proponent handbook and during the contract negotiation period. Any breach of relevant legislation would also be considered a breach of the works agreement.

Depending on the nature of works and approvals required DNRME may require proponents to supply a compliance plan prior to the commencement of works, as indicated in their works agreement. KPMG notes that the compliance plan requirement was not introduced until midway through phase 2 of the HHWUE project. KPMG also noted some inconsistency in the use of the compliance plan (refer to Section 4.5).

#### Insurance certificates of currency

As per the works agreements, proponents must effect and maintain a number of insurances for the term of their agreement, specifically these are:

* Public Liability insurance for $20,000,000;
* Workers compensation insurance; and
* Insurance against loss or damage to an asset for its full reinstatement or replacement cost.

The proponent works agreement states that the proponent must lodge a copy with DNRME at the commencement of their agreement (within 28 days of signing) as well as evidence of policy renewal before its anniversary. During fieldwork DNRME acknowledged the process of requesting evidence of COCs and policy renewal is an additional control designed to assure DNRME that the proponent is meeting associated works agreement obligations however the onus remains on the proponent to have the appropriate insurances in place (refer to section 4.6 for further detail).

## On-ground verification

*From visual inspection, installed works appeared to correspond with the documentation provided, specifically, scope and progress of works reported in the approved application, milestone inspection reports and/or final commissioning report.*

In addition to desktop and compliance testing, KPMG undertook on-farm verification of 9 projects (out of the sample of 20 approved projects). As part of this phase, a KPMG mechanical engineer was engaged as a specialist to assist with assessment. The purpose of the site visits were to:

* Gain an understanding of the processes in place for the proponent to ensure they complied with the funding conditions.
* Undertake an assessment of the progress made in implementing on-farm works and verification of engineering reports and the information gathered during desktop review; and
* Follow up any risks or gaps identified during desktop review.

For all sites inspected, on-ground works appeared to agree to project status and scope of works as agreed and recorded – no significant issues were noted. At the time of site inspection it was noted that one proponent who entered into their works agreement in 2013 still required significant works to complete the project. DNRME were aware of this delay and have communicated the project closure timeframes with the proponent. Progress on this project is also reported to the DAWR in quarterly report and at POG meetings.

# Areas for improvement & lessons learnt

A number of relatively minor improvement observations were identified during the review and are summarised in this section.

## Risk and issue log

KPMG notes that the use of an issues log is important in documenting, assessing and monitoring issues that arise; it also facilitates communication and ensures that there is a common understanding among stakeholders. As discussed in Section 3.3, DNRME no longer utilised the HHWUE issues register. Discussions with the HHWUE project team indicated that initially the issues register was utilised to document risks and issues, this included the identification and treatment of both items. However, upon review of the HHWUE risk management processes undertaken by the HHWUE project team, it was determined that the issues register document was not fit for purpose and did not adequately document the identification, assessment and treatment of risks that had been occurring in practice. DNRME elected to create aRisk Management Plan and subsidiary Risk Register to provide more rigor around the risk management process and better reflect current risk management practice. During this process the issues register was retired and DNRME transitioned to using the risk register for this purpose with both risks and issues captured in the same register. The register however, did not clearly identify which entry was a risk or which was an issue.

Issues can be considered risk events that have occurred, as such are not assessed and prioritised in the same manner as risks. Whilst still deemed appropriate to capture risk and issue information in the same document, it is beneficial to distinguish between the two events to inform better communication and prioritisation. DNRME should ensure risk and issues can be clearly defined and differentiated to allow them be appropriately managed and addressed.

## Asset registers

The WMPA requires DNRME to maintain accurate records of assets purchased with Commonwealth funding, DNRME also requires proponents to supply an asset register. The proponents’ works agreements require proponents to include a list of assets acquired, valued at $5,000 or greater, at the completion of the project. Requirement for asset registers is communicated by DNRME to proponents during pre-contract discussion and proponents are provided with a template.

Through sample testing KPMG could not determine if asset registers had been obtained by DNRME at the completion of any of the sampled projects. DNRME further indicated that the asset register requirement was not universally enforced. The requirement was included in the proponent works agreements at the initiation of the HHWUE project to ensure DNRME could meet its obligation to maintain accurate records of assets purchased. In practice however, it was found that DNRME was better able to meet this requirement through review of documents submitted by the proponent in support of payment claims and other relevant acquittal requirements. The works agreement was not amended to remove the contractual obligation on proponents.

Whilst the works agreement requirements do not appear to have been systematically followed there did not appear to be a breach of the WMPA.

DNRME should ensure that when designing and/or implementing controls, such as the requirement to submit asset registers, they are commensurate to the associated risks and effort involved in undertaking these activities, and where deemed unnecessary remove them as appropriate. DNRME should review whether there is a requirement for asset registers to be included in proponent works agreements.

## Progress reporting

Discussions with DNRME indicated that, in practice, progress reports are only required for projects which have commenced works rather than for all projects with executed works agreements. Additionally, DNRME may waive a progress report if they have sufficient knowledge of the progress: i.e. if a proponent has recently submitted a payment claim DNRME may have sufficient information.

For future rounds or projects DNRME should consider when formal proponent project progress reporting is required. DNRME should define the circumstances where formal reporting may not be required and communicate this to stakeholders involved.

## Conflict of interest management

During sample testing, KPMG identified one instance where the irrigation professional utilised by DNRME to undertake the pre-works inspection was also used by the proponent to certify the application and develop the commissioning report. A conflict of interest declaration was made by the irrigation professional to DNRME stating the assistance provided to the proponent. KPMG, however, was unable to sight evidence of how this declared conflict was resolved or managed.

During discussion DNRME asserted that they were aware of the issue and were comfortable that no actual conflict was present. DNRME indicated that it was not feasible to utilise other irrigation professionals to undertake the inspection activity in this instance without significant associated cost or time delays. DNRME ensured all the proponent and irrigation professional documentation was reviewed by DNRME. Additionally, a separate inspection activity was undertaken by DNRME staff.

KPMG acknowledges that there is a limited supply of suitably qualified irrigation professionals in the region where HHWUE works take place, and professionals from other areas are often unavailable or their engagement is cost prohibitive. However, to ensure declared conflicts are managed and monitored, better practice suggests the steps that were taken to mitigate the risk of a declared conflict of interest should be clearly documented. The level of detail documented should be commensurate with the risk associated with the disclosed conflict(s).

DNRME should ensure there are appropriate processes in place to manage identified or declared conflicts of interest, including the documentation of any associated decisions and follow up. Where this evidence is not available, DNRME may have difficultly justifying or supporting decisions regarding perceived or actual conflicts.

## Compliance plans

During sample testing three instances were identified where compliance plans were required in the proponent’s works agreement, which were not completed. In addition, where compliance plans were developed they contained minimal information and did not clearly outline actions or proposed future activity.

Discussions with DNRME indicated that the inclusion of the compliance plan as a contractual requirement was intended to indicate where proponents require specific approvals for works to continue, and provide the means for DNRME to follow progress on these. It was not intended as evidence of compliance with legislative obligations. DNRME highlighted that in practice most works were not of a nature that required complex approvals, or if so DNRME was able to obtain internal checks, as such compliance plans were rarely utilised for their intended purpose. DNRME indicated that the compliance plan requirements should have been reviewed further once this was identified. It was also communicated that in some instances the requirement for compliance plans were incorrectly included in works agreements as an administrative error and as such the scope of works did not warrant a compliance plan.

When designing and/or implementing controls, such as compliance plans, DNRME should ensure:

* The purpose of compliance plans is clearly articulated to avoid misinterpretation of the requirements;
* The circumstances under which a compliance plan may be required is documented; and
* It is applied consistently across proponents.

## Insurance certificates of currency

As noted in Section 3.7, proponents must lodge a copy with DNRME at the commencement of their agreement (within 28 days of signing) as well as evidence of policy renewal before its anniversary. During sample testing KPMG identified:

* Seven projects missing evidence of public liability insurance for the full/part period of the works agreement; and
* Five projects missing evidence of workers compensation insurance for the full/part period of the works agreement.

DNRME accepted that the above-mentioned missing insurance certificates appear to be administrative oversights and noted they have since improved their COC administration. The revised administration process now includes the systematic recording and checking in the contract database of certificates, and ensuring COCs are obtained on signing of the works agreement. KPMG did not test the design, implementation or operating effectiveness of the revised process.

Noting that the onus to maintain the appropriate insurances remains with the proponent, for future rounds or projects DNRME should consider whether it is necessary to include the contractual obligation for COCs renewals to be provided to DNRME. If deemed necessary, DNRME should ensure supporting review processes are in place and operating as intended.

# Appendices

## Engagement objectives and scope

**Objectives**

Review the governance, risk and control processes for State Priority Projects administered through Sustainable Rural Water Use and Infrastructure Program to ensure effective use of Commonwealth funds.

**Scope**

This engagement was limited to the HHWUE, New South Wales Basin Pipe Project and New South Wales Irrigated Farm Modernisation State Priority Projects. The assessment focuses on the following areas:

* **Program administration processes**, including financial systems, governance arrangements, and risk management processes to ensure they are efficiently and consistently implemented.
* **Program processes** in place to manage risks, and program compliance to ensure delivery of water contracted for recovery (including consideration of State involvement in the water entitlement transfer process), and the adequacy of controls to regularly review procedures and adjust as required.
* **A review of up to 25 per cent of projects** to verify that the requirements stated under the respective Project Schedules and Works Agreements have been met. Sampling methodology for selecting these projects considered funding rounds and catchment areas, as well as individual project size and scale. A random sample from the selected projects was also be verified on-ground.

This review did not include a detailed technical assessment of the quality and effectiveness of water infrastructure works. It provides an assessment of progress of works against reported outcomes and verification of the engineer's reports against on-ground works.

\*Please refer to the *Statement of Works including Terms of Reference,* for further detail on the scope of work.

## Approach

KPMG undertook the following activities in the conduct of this review.

**Initiation**

* Held an initial scoping and meeting with the DAWR stakeholders, to inform the development of a project plan detailing approach, timeframes and governance arrangements for the review.
* Provided the project plan to HHWUE project stakeholders review.

**Fieldwork**

* Held an introductory discussion with DNRME staff and obtained documentation to gain an understanding of administration arrangements, eligibility criteria, funding conditions and requirements, reporting arrangements, performance monitoring and risk management.
* Developed a testing checklists to support assessment of the HHWUE project. The checklist was based on better practice program management principles and key program requirements, including the WMPA, HHWUE project application guidelines and proponent works agreements.
* Selected a judgemental sample of 20 (25%) approved projects for desktop assessment against the testing checklist. Sample selection took into consideration size and complexity of works, catchment area, value of funding and proposed water savings The resultant sample included projects ranging from approximately $100,000 to over $5 million, with a spread from funding rounds 1 -11. The sample covered the following catchment areas:
  + Border Rivers
  + Condamine Balonne
  + Moonie
  + Lower Balonne
  + Lower Warrego Water
  + Upper Condamine

The sample excluded any projects under active investigation or separate review.

* Conducted a site visit at the DNRME Toowoomba state office. Through a combination of stakeholder consultation and document review, KPMG:
  + Understood and reviewed systems, processes and controls for the governance and administration of the relevant program to ensure these have been appropriately designed and implemented, including governance mechanisms, risk management, monitoring activities.
  + Reviewed the selected sample of approved projects for compliance with requirements outlined in the testing checklist.
  + Selected a refined sample of nine projects for on-ground verification – a subset of the original sample.
* Conducted site visits for a further nine approved projects and undertook the following:
  + Gained an understanding of the processes in place at the proponent / funding recipient to ensure they comply with the funding conditions.
  + Obtained feedback from proponents on the HHWUE project.
  + Undertook an assessment of the progress made in implementing on-ground works and verification of engineering reports, namely:
    - Scope of works in approved application;
    - Milestone inspection reports; and/or
    - Final commissioning report.
  + Followed up any risks or gaps identified during desktop assessment.

**Reporting**

* Sought additional information and discussed observations with the DNRME and DAWR to confirm factual accuracy of observations prior to the Draft report.
* Developed a draft a report for circulation to relevant stakeholders.
* Finalised report, based on consolidated feedback from the DAWR and DNRME stakeholders.

## Disclaimer

**Inherent Limitations**

This report has been prepared as outlined in Appendix B of the report. The procedures outlined in the approach do not constitute a statutory audit nor a comprehensive review of operations.

No warranty of completeness, accuracy or reliability is given by KPMG in relation to the statements and representations made by the department and client agencies, nor the information and documentation provided by the department and client agencies, as part of the process used in preparing this report.

We have not sought to independently verify those sources unless otherwise noted within the report. KPMG is under no obligation in any circumstance to update this report, in either oral or written form, for events occurring after the report has been issued in final form. The findings in this report have been formed on the above basis.

Due to the inherent limitations of any internal control structure, it is possible that fraud, error or non-compliance with laws and regulations may occur and not be detected. Further, the organisational control structure, within which the State Priority Project operates, has not been reviewed in its entirety and, therefore, no opinion or view is expressed as to its effectiveness of this greater control structure. The procedures performed were not designed to detect all weaknesses in control procedures as they are not performed continuously throughout the period and the tests performed on the control procedures are on sample basis. Any projection of the evaluation of control procedures to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate. ‘Review’ in this Report is not used in the context as outlined in the Australian Auditing Standards.

**Third Party Reliance**

This report is solely for the purpose set out in Appendix A and for the DAWR’s information, and is not to be used for any other purpose or distributed to any other party without KPMG’s prior written consent.

This report has been prepared at the request of the department in accordance with the terms of KPMG’s work order dated 23 March 2018. Other than our responsibility to the department, neither KPMG nor any member or employee of KPMG undertakes responsibility arising in any way from reliance placed by a third party on this report. Any reliance placed is that party’s sole responsibility.

**Accessibility**

To comply with the Commonwealth Government’s accessibility requirements, two versions of this Report are available: a KPMG-branded PDF version and an unbranded Microsoft Word version. The KPMG-branded PDF version of this Report remains the definitive version of this Report.