Review of State Priority Projects – Irrigated Farm Modernisation Project

Department of Agriculture and Water Resources

**Final Report**

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# Executive summary

This review focuses on the Irrigated Farm Modernisation (IFM) Project administered by the New South Wales Government (NSW) Department of Primary Industries (DPI). The IFM 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 IFM 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 28 approved projects (25% of all projects) for desktop review and within this sample, 12 projects were selected for on-farm verification. The sample covered projects ranging in total cost from $140,000 to over $5 million, across 9 funding rounds and across a variety of catchment areas.

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

* Establishment of relevant governance and reporting mechanisms;
* Appropriate document management processes and evidentiary requirements;
* Defined and documented management processes and procedures;
* Program evaluation and monitoring functions built-in to the project;
* Processes and controls to support the appropriate use of Commonwealth funds;
* Ongoing management and monitoring of proponent activity; and
* Regular and ongoing stakeholder engagement.

Based on the fieldwork conducted for this review, IFM appears to have been managed in a manner to allow for regular evaluation with a focus on continuous improvement and supporting the success of projects. The audit trail and supporting documentation and processes associated with the IFM project demonstrates DPI’s emphasis on transparent and defensible decision making.

It appears that appropriate control structures were established to effectively manage the use of Commonwealth funds based on our review of key program management areas. Additionally, nosignificant non-compliance with key provisions of the Water Management Partnership Agreement (WMPA) between NSW and the Commonwealth was identified.

A small number of 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 Agreements (WMPA) with each of the Basin States.

**New South Wales Irrigated Farm Modernisation Project**

The IFM project aims to improve on-farm water use by identifying inefficiencies in irrigation infrastructure, and subsequently achieve water savings. The project provides a subsidy to eligible irrigators which enables upgrades to on-farm systems, capacity building and recovery of water which is shared between the irrigators and the environment; thus aiming to improving long-term sustainability of regional communities. This project is administered by the New South Wales Government (NSW) Department of Primary Industries (DPI).

The IFM project has three key funding components, these include:

* *Subsidised training and development activities*: Training and development activities including field trips, formal training events, and workshops covering various irrigation and water saving topics. DPI subsidise training events, courses, field days, farm walks and various other activities that increase the capacity of irrigators to effectively plan and implement efficient water management practices.
* *Irrigation Farm Water Use Efficiency Assessments (IFWUEAs):* Irrigators with eligible water entitlements in the NSW may undertake an IFWUEA to identify and quantify irrigation water losses across an irrigator’s Irrigation Management Area. The IFM project will fund a proportion of the cash cost of preparing an IFWUEA.
* *On-farm infrastructure modernisation:* This is the primary funding component of the IFM project. The IFM project may fund up to 80% of the cost of infrastructure modernisation works in exchange for at least 50% of the water savings (by permanent transfer of water allocation) recovered by a proposed project. Proposed projects must offer a minimum of 10ML of entitlement. The primary funding component of the project is on-farm infrastructure modernisation.

The pilot commenced in October 2009. Following a review and subsequent business case by DPI, the next phase of the project commenced on 4 June 2012. The project will conclude on or before 30 June 2019.

The maximum available funding for this project amounts to $111 million, as per the Commonwealth’s Sustainable Rural Water Use and Infrastructure Program. At the time of this review, IFM had 112 approved proponent projects (111 projects proceeding to construction) across nine (9) funding rounds, representing approximately 34 GL of water savings and more than $89 million in Commonwealth funding. No further funding rounds are expected to be conducted under this project.

## 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 was limited to the Queensland Healthy HeadWaters Water Use Efficiency Project, NSW Basin Pipe Project and NSW IFM State Priority Projects. This report presents findings and observations in relation to KPMG’s assessment of the IFM 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 to* ***Appendix A*** *for further details on the scope).*

Separate reports will be produced for the NSW Basin Pipe and Queensland Healthy HeadWaters Water Use Efficiency Projects.

## Approach to this review

KPMG assessed the systems, processes and controls established for the governance and administration of the IFM project against key program management areas (as outlined in engagement scope) and key requirements of the WMPA. This included governance mechanisms, risk management activities, 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 28 approved on-farm infrastructure projects (25% of all schemes) for desktop review, and of this, a sample of 12 projects were selected for on-farm inspection. The sample covered projects ranging in total cost from $140,000 to over $5 million, across the first 9 funding rounds, different types of infrastructure works and across a variety of catchment areas:

* Barwon-Darling;
* Border Rivers;
* Lower Namoi;
* Macquarie; and
* Peel.

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 or realisation of projected water savings. Rather, it provides an assessment of the 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 project that have not been identified during this review. Refer to **Appendix B** for further information on the engagement approach.

## Summary of assessment

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

* Based on sample testing and review of project documentation, DPI appear to have designed and implemented appropriate controls, processes and structures to assist in the effective administration of the IFM project and use of Commonwealth Funds;
* No instances of non-compliance with key provisions of the WMPA; and
* All proponent projects visually inspected appeared to correspond with the scope and progress reported and maintained by DPI.

From the commencement of IFM, DPI appears to have managed the project in a manner to allow for regular evaluation, and have maintained a focus on continually improving and updating both the administration and delivery of the IFM project through the establishment of the Monitoring Evaluation Reporting and Improvement (MERI) strategy. The supporting documentation reviewed and the processes identified throughout this review demonstrated DPI’s awareness of the importance of transparent and defensible decision making.

DPI appear to have established appropriate control structures to effectively manage the use of Commonwealth funds in the administration of the IFM project. Notwithstanding this, opportunities for improvement have been suggested, however, these are 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 | DPI have established relevant governance roles and structures to provide oversight and control over the project. There is documentation that demonstrates these have been operating through the life of the IFM project supported by regular reporting. DPI has also placed a particular focus on continuous improvement and evaluation. |
| Application assessment | DPI has a well-defined and robust application assessment process. Multiple controls and processes exist and are designed to support transparent and accountable decision making. |
| Risk and issue management | Whilst DPI appear to have regular and active discussion on IFM risks and issues, risk and issue management processes have not been formalised. |
| Financial management | DPI appears to have implemented appropriate financial management systems, processes and controls at both an individual proponent and IFM project level. These processes and controls are designed to support the appropriate use of Commonwealth funds and appear to be fit for purpose. No material discrepancies or control deficiencies were identified. |
| Stakeholder engagement | Various mechanisms for engaging and communicating with industry and community stakeholders have been implemented. DPI have demonstrated commitment to engaging with stakeholders through regular and ongoing engagement activities. |
| Water Transfer | DPI have established appropriate processes and procedures to facilitate the transfer of water savings to the Commonwealth in accordance with the WMPA. |
| Project Management | DPI appear to have established appropriate processes to manage and monitor proponent projects in accordance with the requirements as set out in the proponent funding deed and WMPA. The emphasis DPI placed on record keeping and audit trail was evident through testing and ensured an accurate representation of project activities and decisions. |
| 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 and milestone inspection reports. |

Whilst this review was not designed to detect fraudulent activity, any activity warranting further investigation would be brought to the attention of management. Notwithstanding this, no instances of fraudulent transactions or behaviours were identified during the course of our fieldwork.

# Findings and observations

## Governance and reporting

*DPI have established relevant governance roles and structures to provide oversight and control over the project. These appear to have been operating through the life of the IFM project supported by regular reporting. DPI has also placed a particular focus on continuous improvement and evaluation.*

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

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

### Governance and oversight

The WMPA and the accompanying schedules between DPI and the Commonwealth (represented by DAWR) define the high-level contractual responsibilities of each of the entity’s and outline key reporting and governance requirements. Throughout out the IFM project the WMPA project schedule was regularly updated, through contract variations, to reflect actual project delivery activity.

The IFM project’s key governance arrangements, roles, objectives, and implementation strategies are defined in the *Irrigated Farm Modernisation Implementation Plan*. This document was developed in accordance with the WMPA and Intergovernmental Agreement on Murray Darling Basin Reform. It provides a basis for the implementation approach adopted by DPI. During the delivery of IFM, aspects of the implementation plan have been adapted and refined to meet the needs of the project.

The IFM project is led by the DPI Director Water and Irrigation, supported by the Leader, Sustaining the Basin Irrigated Farm Modernisation (STBIFM) and a project team who manage the operational aspects of project delivery. The project reports to the Group Director Plant Systems. Key contractual decisions, such as funding approvals, are made by the Deputy Director General Agriculture (up to $500,000) or escalated to an appropriate delegate with the applicable financial delegation. KPMG found that key roles and responsibilities were clearly defined, and all staff consulted appeared to have a good understanding of their roles and the operation of the IFM project.

The project’s primary governance and oversight bodies are detailed below:

* *Project Governance Group – NSW State Priority Projects (PGG):* This is the primary inter-agency forum for the management and monitoring of NSW State Priority Projects. It is intended to provide high level program and project direction and monitor implementation for the suite of NSW state priority projects funded through the Commonwealth, including the IFM project. This quarterly meeting is chaired by the Director, Programs and Performance at Department of Industry and consists of representatives from, DAWR, DPI Agriculture and Department of Industry-Water (DoI Water).
* *STBIFM Steering Committee*: In accordance with the WMPA project schedule, DPI has established a steering committee to provide project direction to the project and monitor implementation against the project schedule and implementation plan. The committee is chaired by Group Director, Plant Systems and comprises of representatives from the NSW Government as well as independent members. DAWR is invited to attend the biannual meetings of the committee as an observer.
* State Priority Projects (SPP) Management Committee: The SPP Management Committee has been established to manage and monitor the progress of all state priority projects coordinated by the NSW Government. The meeting is attended by all project leaders / managers of respective state priority projects and chaired by the SPP Coordinator (DoI Director, Water Programs and Performance). The SPP Management Committee meets monthly where each project, including the IFM project, provide formal status updates.
* *IFM Project Control Group (PCG):* The PCG is chaired by the Leader, STBIFM, and consists of members of the project team. This group is primarily concerned with operational aspects of the project. The group meets weekly to discuss progress, upcoming milestones, and key risks and issues.

The PGG and STBIFM Steering Committee have defined terms of reference, with all forums having formal agendas and minutes retained.

### Reporting

In accordance with the WMPA project schedule, DPI provides detailed progress reports to DAWR. These are provided in line with milestones outlined in the WMPA project schedule. The reports provide a comprehensive description of project progress and performance in various aspects of project delivery, including financial management, project management, stakeholder engagement and progress against milestones. These reports are reviewed by the *STBIFM Steering Committee prior* to delivery of the report.

DPI produce monthly highlight reports to be presented at monthly SPP Management Committee meetings. These provide a brief description of project progress as well as highlights any key risks and issues to be considered. These reports are reviewed and cleared by the Director, Water and Irrigation. These reports are also presented at quarterly PGG meetings. In addition, monthly project meetings are held with the Leader, STBIFM and Director, Water and Irrigation to discuss progress and emerging risks and issues to be reported to the Executive. DPI also produce a weekly advisory report where emerging issues or urgent notifications can be brought to the DPI executive quickly.

All governance and reporting arrangements appeared to be operating as intended and no instances of non-compliance or significant control weaknesses were identified.

### Evaluation

DPI have established mechanisms to assist with the evaluation and ongoing monitoring of the IFM project outcomes and overall success. In 2012, DPI implemented a Monitoring Evaluation Reporting and Improvement (MERI) Plan, this plan was reviewed and updated in 2015 and replaced with a MERI Strategy to ensure activities were relevant, timely and addressed the information needs of stakeholders. The aim of the MERI Strategy is to provide a consistent approach to measuring, monitoring, evaluating and reporting performance against project outcomes. The MERI Strategy is supported by an IFM program logic and a MERI data schedule. The establishment of the MERI process demonstrates DPI’s commitment to continuous improvement and is linked to the final project reporting requirements, noting KPMG did not test the operating effectiveness or implementation of this process.

## Assessment of applications

*DPI has a well-defined and robust application assessment process. Multiple controls and processes exist and are designed to support transparent and accountable decision making.*

Eligible irrigators may voluntarily submit applications for funding during defined funding rounds. The project funding available for any round is dependent on participation i.e. no guarantee of funding is provided. DPI is responsible for assessing IFWUEAs and infrastructure applications, as well as, approving applications for funding. There is no requirement for DAWR to approve or endorse proponent funding, however they are provided with a description of the assessment processes and controls as part of milestone progress reports.

Key application assessment process and controls implemented by DPI include:

* Verification of IFWUEAs by a panel consisting of a DPI staff member external to the IFM project and an external independent expert. IFWUEAs must also be certified by an appropriately accredited consultant.
* Initial completeness and minimum eligibility checks of infrastructure applications are conducted by an Opening Committee comprising of project staff.
* Technical feasibility and costing assessment is undertaken by the Technical and Costings Committee (TCC), consisting of three independent irrigation industry professionals and chaired by the Leader, STBIFM.
* Value for money assessment of eligible applications conducted by an independent Investment Panel prior to final funding recommendations. The Investment Panel consists of two independent panel members, an external probity advisor and is chaired by a DPI staff member external to the IFM project with relevant skills in the development and implementation of market-based instruments.

In addition to the above, DPI have a defined appeals process should unsuccessful applicants seek to challenge decisions made. This involves a review of all documentation and decisions by an Independent Appeals Panel.

To support the above mentioned processes and provide staff with consistency and guidance, DPI have developed standard operating procedures, tools and templates for all key elements of the assessment process. It appears this material is regularly reviewed and updated to reflect any changes.

DPI also develop and publicly release funding guidelines for each funding round, which detail the funding components, eligibility criteria and application process for prospective applicants. DPI have established a process to ensure these are reviewed and updated prior to the commencement of each funding round, this includes a review by an external probity advisor.

Review of documentation and sample testing did not identify any non-compliance or significant control weaknesses related to the application assessment processes.

## Risk and issue management

*Whilst DPI appear to have regular and active discussion on IFM risks and issues, risk and issue management processes have not been formalised.*

DPI have developed a high-level IFM project risk log which is updated and reported as part of the highlight reports presented to PGG meetings. These project risk logs focus on key risks and issues impacting the project’s progress. DPI also identify and document stakeholder and communication risks per funding round to inform communications activities. Discussion with IFM project staff indicated that regular project risks and issues discussions are held during weekly PCG meetings. All discussions were minuted and actions recorded in an actions and tasks register. The register was reviewed and updated at each PCG meetings. Any significant risks or issues are reported to relevant governance forums as required.

Notwithstanding, KPMG noted that key risk and issue management artefacts were not maintained for the IFM project. This included a risk management plan, risk register or issues register. Refer to Section 4.1 for further details.

## Financial management

*DPI appears to have implemented appropriate financial management systems, processes and controls at both an individual proponent and IFM project level. These processes and controls are designed to support the appropriate use of Commonwealth funds and appear to be fit for purpose. No material 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 funding deeds, and secondly, DPI’s processes and systems in place to manage the IFM project, including 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 testing focused on financial management controls and processes for the processing of proponent milestone payments and did not test the accuracy or validity of information submitted for proponent claims. Key financial controls established are detailed below.

* The proponent is entitled to their first milestone payment following Notification of registration of the water entitlement transfer dealing to the NSW Government. Sample testing identified eight instances where proponents received milestone one payments prior to water transfer. All instances related to funding rounds 1 and 2. Discussion indicated that this was due to delays in water entitlement transfer. Payment was expedited by DPI to ensure construction could commence in a timely manner. DPI indicated that all water transfers did subsequently occur. KPMG also confirmed all subsequent payments were made in accordance with the funding deed (refer to Section 4.2 for further detail).
* All proponent claims are required to be reviewed and approved prior to payment. All claims sampled showed evidence of review in advance of payment and agreed to the approved works agreement. Additionally all payments sampled aligned with the amounts as per the funding agreements.
* All intermediate and final milestone claims must be accompanied by relevant supporting documentation, including invoices, receipts, bank statements and relevant reports. Sample testing found all supporting documentation on file for claims tested.

KPMG noted an increased focus on the provision of accurate supporting documentation through the life of the IFM project. For example, from round five DPI introduced the requirement to provide supporting invoices for intermediate milestone claims as evidence expenditure; in previous rounds all supporting invoices were only required at the final milestone.

### IFM Project Financial Management

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

DPI claim payments from the Commonwealth based on milestones outlined in the WMPA project schedule. Progress milestone claims are determined based on a proportion of the value of water savings expected to be delivered through approved projects and transferred to the Commonwealth. Funds are expected to contribute to proponents’ grants (up to 80%of proponent costs) and project delivery / administration. Any expenditure in excess of the Commonwealth funding provided must be covered by the NSW Government.

Payment claims are made in advance of actual expenditure. Whilst an annual rolling budget is set, funds are drawn down from the NSW Treasury as required to meet expenditure needs. As per the WMPA, any interest incurred from holding funds will be returned to the Commonwealth. An estimate of interest incurred is calculated on a six monthly basis and reported to the DAWR. DPI have established processes to ensure this is subtracted from milestone claims.

In addition to the annual preparation of special purpose audited financial statements, DPI provide a summary of income and expenditure to the Commonwealth, via milestone progress reports and quarterly highlight reports. These reports include an estimate of any interest that may have been incurred.

## Stakeholder engagement

*Various mechanisms for engaging and communicating with industry and community stakeholders have been implemented. DPI have demonstrated commitment to engaging with stakeholders through regular and ongoing engagement activities.*

DPI undertake a range of industry and community communication engagement activities to ensure the provision of regular, timely and accurate project information. Some of these include industry forums, radio announcements, social media and industry briefings. DPI maintain a *Communication and Engagement register* that details all IFM stakeholder activities. It provides a record of stakeholder activity and engagement for the IFM project linked to overarching communication and engagement objectives. A summary of promotional and communication activities is provided to the Commonwealth as part of milestone progress reports, which is informed by the Communication and Engagement register*.*

DPI noted that a *Communication Plan* was developed for each round to highlight key events, as well as communication risks and mitigations (and associated evaluation measures) surrounding potentially contentious project issues. DPI noted that *Stakeholder Engagement plans* were also developed each round to promote consistent messaging about the project and to list the key activities and timeframes.

DPI established an industry reference group to gather input and engage with industry groups for irrigated agriculture in relevant catchment areas. Meetings were held between two to four times per year, generally aligned to coincide with major project activity.

DPI’s primary engagement forum with the Commonwealth is through the quarterly PGG meetings. This is supplemented by ad hoc communications as required.

### Training and capacity building

Throughout the life of the project, DPI in conjunction with services providers, undertook industry stakeholder consultation and interviews to understand information gaps and inform training needs and capacity building activities. In addition, when applying for IFWUEA funding, applicants were asked to nominate training topics of interest. The feedback collected through these mechanisms was used to assist with ensuring that training, information and capacity building was targeted to meet both the needs of the project and the irrigators and was delivered in an appropriate manner i.e. face-to-face, bus tours, and in collaboration with third parties. DPI demonstrated their focus on continuous improvement by requesting course feedback. The capacity building and training opportunities offered throughout the project demonstrates DPI’s commitment to developing the industry and assisting with the success of both the IFM project and individual projects.

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

## Water transfer

*DPI have* established appropriate processes and procedures to facilitate the transfer of water savings to the Commonwealth in accordance with the WMPA.

As per the WMPA, the IFM 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 is facilitated through a Water Transfer Deed between DPI and the proponent. Water Access Licence (WAL) holders, as identified in the Water Transfer Deed, must transfer a share of their WAL equivalent to at least 50% of proposed water savings (associated with their project) to the NSW Government represented by the Water Administration Ministerial Corporation (WAMC). This in turn is consolidated by the NSW Government and transferred to the Commonwealth in Tranches.

As per the WMPA, DPI is responsible for facilitating the transfer process, both to the NSW Government and the Commonwealth Government. The Commonwealth also undertake a due diligence activity over the water transfer through the Australian Government Solicitor (AGS). While the IFM project team is not responsible for enacting the entitlement transfer process, it plays an important role in coordinating all parties involved, this includes managing the completion and lodgement of relevant documentation. DPI have developed detailed procedures to support the transfer process, some key processes elements include:

* Initial title searches conducted at application stage to confirm WAL holder and relevant details.
* Following signing of Water Transfer Deed, coordinate completion, endorsement and lodgement of water transfer applications (under s71Q Water Management Act) for the transfer of the applicable share of WALs to the WAMC.
* Notification to the Commonwealth identifying the relevant entitlement held by WAMC, which will require transfer and initiating the transfer process.
* Coordinating the completion and lodgement of water transfer applications on behalf of NSW government for the transfer of entitlement to the Commonwealth.
* Ongoing monitoring of the water transfer dealing registration process.

DPI have appointed a dedicated member of the project team to monitor and manage the water transfer processes. In addition, DPI provide support and guidance to proponents in the completion of relevant applications where required.

In accordance with the WMPA, DPI only make the first milestone payment to proponents under a works agreement once relevant entitlements have been transferred to the NSW Government. For this purpose, the IFM project team regularly consult with Land Registry Services to ensure notification of registration is provided prior to milestone payment. KPMG noted that for all proponents sampled the first milestone payment occurred following transfer of entitlement to the NSW Government.

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

## Project management

### *DPI appear to have established appropriate processes to manage and monitor proponent projects in accordance with the requirements as set out in proponent funding deed and WMPA. The emphasis DPI placed on record keeping and audit trail was evident through testing and ensured an accurate representation of project activities and decisions.*

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

### Management and monitoring of proponents

DPI assign a dedicated project officer for the day to day management of individual infrastructure projects. Project officers are not involved in the application process and are generally allocated following application approval. The project officers are primarily involved in:

* Monitoring and assessing the progress of the proponent projects,
* Managing interactions with the proponent, including providing support and guidance;
* Reviewing and endorsing interim and final milestone claims; and
* Undertaking project inspections.

The IFM project has not mandated the use of project management systems, however project officers have access to digital tracking sheets to manage interactions with proponents, as required. All official documentation and correspondence is maintained on DPIs records management system, which is discussed further in this section.

To support the management and monitoring of proponents, DPI maintain a comprehensive contract database. This records and tracks all key proponent information including financial data, application details, payment information, water transfer details and progress of works. It is used as the primary source of information for IFM project reporting. The database is maintained and updated by the IFM administration team.

### Record keeping

The IFM project team have established and adhere to strict document management protocols, which includes establishing a defined folder structure and naming convention. DPI utilises an electronic records management system (CM9) to maintain and store all documentation related to the IFM project. While this is supported by hard copy files, CM9 serves as the official record management system. All documentation relevant to the project, including interactions with proponents, are provided to administrative staff who are responsible for storing documentation in the respective project management folder structure. Access to folders is restricted to project staff.

All key documentation appeared to be filed and stored appropriately, additionally all relevant documentation for sample testing was made available upon request.

### Staff training and guidance

Discussions with DPI identified that all project staff have undertaken project management training, provided by an external service provider. The project officers have a background in project management and / or engineering as well as experience in understanding of water infrastructure projects or similar works. Whilst there is no specific IFM training, DPI have developed detailed standard operating procedures, tools and templates to support all key project processes.

DPI have engaged specialist providers to support some aspects of the program to support transparency and accountability, for example, technical assessors for application assessment and probity advisors.

### Project variations

Project variations are raised by proponents in in consultation with project officers. The variations are then reviewed and endorsed by the Leader, STBIFM and effected through a deed of variation signed by the Director, Water and Irrigation.

One variation selected in our sample was provided to the proponent prior to final approval by DPI. This error was identified and documented on the project file at the time of providing the variation to the proponent. Where required, all other variations within the sample of proponent projects were executed in accordance with the established processes.

### Progress reporting

As per the funding deed, proponents are required to provide a progress report to DPI for each quarter that falls fully or partly within the Terms of their Agreement. All projects reviewed within the sample had some formal progress reports on file, as well as evidence of ongoing communication and interaction with the proponent maintained, including records of phone correspondence and face-to-face discussions. Through sample testing there appeared to be appropriate communication and mechanisms for DPI 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 management

DPI have established a number of conflict of interest protocols to ensure integrity is maintained during the assessment and management of proponents. In accordance with the DPI conflicts of interest procedures all staff are required to complete general conflict of interest declarations. Additionally, as part of their role in the assessment of applications, the Opening Committee, Technical and Costing Committee and Investment Panel are required to complete confidentiality and conflict of interest declarations. KPMG sighted relevant declarations for funding rounds selected for testing. An internal review identified improvements to the IFM project management of declared conflicts of interest. Declared conflicts are now managed in accordance with defined processes outlined in the DPI conflicts of interest procedure.

DPI have also engaged an external probity advisor to oversee assessment of applications, ensuring the integrity of the activities undertaken as part of the evaluation process. The probity advisor is also involved in appeals processes, as required.

Sample testing identified one instance where a project officer was initially engaged by a proponent as an irrigation consultant to assist with an IFWUEA application (in 2013) prior to the consultant becoming an employee of DPI. The officer was subsequently assigned to manage that proponent project. A conflict of interest declaration outlining this relationship and its management could not be sighted on file. The officer was not involved in the application assessment or approval process, additionally all milestone payments were reviewed by the Leader, STBIFM prior to payment. This instance was communicated to management. No further instances were identified in our sample.

### Compliance management

#### Compliance with funding deed

DPI monitoring against the agreed scope of works occurs via physical inspection and review of financial records (discussed in Section 3.4). Key physical inspections include:

* *Project initiation meeting*: Project Officers arrange a site visit with proponent prior to commencement of works to ensure they are fully aware of the content and their obligations under the Water Transfer and Funding Deeds. This also provides the opportunity to ensure no prior works have been completed and attributed to this project.
* *Milestones works inspections*: Project officers undertake physical inspections of works where intermediate and final milestone payment claims are made by proponents. These verify that works align with the payment claim, reported progress and terms of the funding deed.

KPMG observed that DPI had consistently been undertaking compliance inspections. During sample testing it was also identified that the above-mentioned inspections had been undertaken for all projects reviewed (as required).

DPI’s processes for assessing and monitoring a proponent’s compliance with their works agreement obligations appeared appropriate based on the IFM project characteristics and risks.

#### Compliance with relevant legislation and approvals

As per the proponent funding deed, the onus of compliance with relevant legislation and approvals lies with the proponent, this includes compliance with relevant laws, and obtaining all relevant planning and regulatory approvals.

To assist proponents, DPI conduct a project initiation meeting to ensure proponents understand their obligations when entering into the funding deed. During this meeting a checklist is completed to ensure all key obligations are discussed. This is reviewed and signed by the proponent.

The project initiation meeting is also used as an opportunity to commence the identification of the necessary planning and regulatory approvals that may be required for the works. The project officer will direct the proponent to the appropriate NSW Government area to confirm the need for approvals. Additionally, at the application stage the IFM team will consult with relevant areas of NSW Government for any potential regulatory risks related to water approvals.

Any identified approvals that apply to a proponent will be included in an approvals report that the proponent will maintain and complete. The approvals report is intended to assist proponents obtaining relevant regulatory approvals in a timely manner. It also allows DPI to monitor compliance and follow up on any delays. The report identifies whether the relevant approval has been received, any action taken to obtain approvals, and details of relevant government contact for approvals. The status of obtaining relevant approvals will be updated as the project progresses. An updated approvals report is provided at intermediate milestones with a final signed report provided with the final milestone claim. KPMG noted that, where required, approvals reports were on file for projects sampled.

#### Insurance certificates of currency

As per the funding deed entered by DPI, 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 as required by law;
* Any other insurance that is compulsory under the law for the time being in force in any jurisdiction; and
* Insurance against loss or damage to an asset for its full reinstatement or replacement cost.

The proponent must lodge copies of applicable insurances with DPI at the commencement of their agreement (within 30 days of signing) as well as evidence of the policy renewal before its anniversary. DPI request evidence of insurance details / evidence as part of a project initiation meetings held with proponents prior to the commencement of works. Further, DPI procedures require updated insurance details or Certificates of Currency (COC’s) to be collected at intermediate milestone payments and site inspections (refer to section 4.4 for further detail).

## On-ground verification

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

In addition to desktop and compliance testing, KPMG undertook on-farm verification of 12 projects (out of the sample of 28 approved projects). As part of this phase, a KPMG mechanical engineer was engaged as a specialist to assist with the 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.

Noting the size and complexity of works, inspections focused on key infrastructure components. The inspections did not test the operating effectiveness of installed works. For the infrastructure inspected, on-ground works appeared to correlate with the reported project status and scope of works as agreed and recorded – no significant issues or variations were noted.

# Areas for improvement & lessons learnt

The following improvement observations were identified during the review and are summarised in this section. These do not appear to have a material impact on the administration of the IFM project.

## Risk and issue management

The IFM implementation plan indicated that a risk management plan will be prepared for the IFM project and reviewed at each Steering committee meeting. In addition, it states that DPI will undertake a risk analysis that remains “live” throughout the entire project.

KPMG found that while DPI have established the mechanisms to report and raise risks and issues, DPI have not developed a formal risk management plan, risk register and issues register in accordance with the IFM implementation plan. Noting the size and complexity of the IFM program, formal risk and issue management artefacts should have been developed and maintained.

DPI were able to demonstrate active risk management practices through the establishment and ongoing review of various project controls and processes. The establishment of formal risk and issues processes and artefacts provides a systematic and transparent basis to evidence these practices. For future projects DPI should ensure risk and issue management processes and procedures are formalised and actively undertaken.

## Proponent payment processing

As per item B.4.2 (ii) of Schedule 5 of the WMPA DPI may only provide funding to a proponent for its on-farm works if:

*“Transfer of the Proponent Water Entitlement required under that contract between the State and the Entitlement Owner has been completed.”*

As discussed in Section 3.4, KPMG identified eight instances where proponents received milestone one payments prior to WAL settlement. All instances related to funding rounds 1 and 2 completed in 2013 and 2014, no further instances were identified in subsequent rounds. Discussion indicated that payment was expedited by DPI to ensure construction could commence in a timely manner. While this did not align with agreed processes, we were advised that this decision was made to mitigate the risk of delays in the delivery of the project. No material impact on program or financial administration could be identified, as:

* DPI indicated that all water transfers did subsequently occur as agreed;
* All subsequent payments were made in accordance with the funding deed; and
* All agreed works were completed in accordance with the funding deed.

This process did not appear to continue in subsequent funding rounds. Additionally, current procedure documentation explicitly states that the relevant dealings must be registered in order to trigger the first milestone payment. For any future project payments, should the need arise to amend the payment protocols outlined in the WMPA, DPI must obtain prior approval from the Commonwealth.

## Progress reporting

During sample testing, KPMG noted that progress reports, in the format outlined in the funding deed, were obtained at intermediate and final payment milestones, however were not consistently provided at quarterly timeframes outlined in the funding deed.

Discussions with DPI indicated that while quarterly progress reports were required, in practice, progress updates were also obtained via regular interactions and communications between proponents and project officers.

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

## Insurance certificates of currency

As noted in Section 3.7, proponents must provide evidence of applicable insurance at the commencement of their agreement (within 30 days of signing) as well as evidence of policy renewal before its anniversary. During sample testing KPMG identified that while evidence of insurance was sighted by DPI during project implementation meetings, ongoing review of COC’s was not regularly conducted / documented in accordance with documented DPI procedures.

Noting that the onus to maintain the appropriate insurances remains with the proponent as well as the substantive risk of project failure, for projects DPI should consider whether it is necessary to include the contractual obligation for COCs renewals to be provided to DPI. If deemed necessary, DPI 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 Queensland Healthy HeadWaters Water Use Efficiency Project, New South Wales Basin Pipe Project and New South Wales IFM Project. The assessment focused 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.

The scope of this report is limited to the New South Wales IFM Project.

\*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 IFM project stakeholders review.

**Fieldwork**

* Held an introductory discussion with DPI 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 IFM project. The checklist was based on better practice program management principles and key program requirements, including the WMPA, project application guidelines and proponent funding agreements.
* Selected a judgemental sample of 28 (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 $140,000 to over $5 million, with a spread from funding rounds 1-9. The sample covered the following catchment areas:
  + Barwon-Darling;
  + Border Rivers;
  + Lower Namoi;
  + Macquarie; and
  + Peel.

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

* Conducted a site visit at the DPI Wagg Wagga 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 IFM 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 DPI 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 DPI 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.