

The Auditor-General
Audit Report No.38 2011–12
Performance Audit

Administration of the Private Irrigation Infrastructure Operators Program in New South Wales

**Department of Sustainability, Environment, Water,
Population and Communities**

Australian National Audit Office

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Canberra ACT
5 June 2012

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Department of Sustainability, Environment, Water, Population and Communities in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Administration of the Private Irrigation Infrastructure Operators Program in New South Wales*.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee', is positioned above the printed name and title.

Ian McPhee
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

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Abbreviations

AGS	Australian Government Solicitor
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
Basin Agreement	Intergovernmental Agreement on Murray–Darling Basin Reform
Basin Plan	Murray–Darling Basin Plan
BCA	benefits-costs analysis
Board	Water Group Outcome Board
CEWH	Commonwealth Environmental Water Holder
CGGs	<i>Commonwealth Grant Guidelines</i>
CGT	capital gains tax
COAG	Council of Australian Governments
DEWHA	(former) Department of the Environment, Water, Heritage and the Arts
DSEWPaC	Department of Sustainability, Environment, Water, Population and Communities
ERC	Expenditure Review Committee of Cabinet
Finance	Department of Finance and Deregulation
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMA Regulations	<i>Financial Management and Accountability Regulations</i>

GST	goods and services tax
ILGP program	Irrigator-Led Group Proposals program
IMPA program	Irrigation Modernisation Planning Assistance program
ITA Act	<i>Income Tax Assessment Act 1997</i>
KPI	key performance indicator
LTAAAY	long-term average annual yield
LTCE	long-term cap equivalent
MDBA	Murray–Darling Basin Authority
Minister	Minister for Sustainability, Environment, Water, Population and Communities
ML	megalitre
NSW	New South Wales
OFIEP	On-Farm Irrigation Efficiency Program
PBS	Portfolio Budget Statement
PIIO	private irrigation infrastructure operator
PIIOP	Private Irrigation Infrastructure Operators Program in New South Wales
RtB program	Restoring the Balance program
SRWUIP	Sustainable Rural Water Use and Infrastructure Program
Treasury	Department of the Treasury
WfR program	Water for Rivers program

Glossary

long-term average annual yield (LTAAY)	Long-term average annual yield is the current method used by DSEWPaC to standardise the calculation of expected water recoveries in the Murray-Darling Basin from the different water access entitlement categories across the catchments of the Basin. The differences between the current LTAAY and former LTCE methods are only minor.
long-term cap equivalent (LTCE)	Long-term cap equivalent was an earlier method used by DSEWPaC to standardise the calculation of expected water recoveries in the Murray-Darling Basin from the different water access entitlement categories across the catchments of the Basin.
Murray-Darling Basin Plan (Basin Plan)	The Murray–Darling Basin Plan, to be adopted by the Minister under section 44 of the <i>Water Act 2007</i> (as amended from time to time).
water access entitlement	A perpetual or ongoing entitlement, by or under law of a state, to exclusive access to a share of the water resources of a water resource plan area

Summary and Recommendations

Summary

Introduction

1. The Murray–Darling Basin (the Basin) is an area of national environmental, economic and social significance. The Basin contains Australia’s three longest rivers—the Darling, the Murray and the Murrumbidgee—as well as nationally and internationally significant environmental assets, such as wetlands, billabongs and floodplains.¹ It covers one-seventh of Australia extending across four states—Queensland, New South Wales, Victoria, South Australia—and the Australian Capital Territory. The Basin is an important resource for rural communities and contributes substantially to Australia’s economy. Irrigated agriculture accounts for over 80 per cent of the Basin’s consumptive water use², contributing to an agricultural industry worth more than \$9 billion per year.³ Water from the Basin also directly supports three million Australians.

2. In response to the predicted water scarcity in the Basin, the Australian Government has increased its focus on improving the Basin’s water management. The Government has invested significantly in long-term initiatives designed to better balance the water needs of communities, farmers and the environment, in particular, through the \$12.9 billion *Water for the Future* initiative. This initiative contains a suite of urban and rural policies and programs, including funding for water purchasing, irrigation modernisation, desalination, recycling and storm water capture.⁴ The \$5.8 billion Sustainable Rural Water Use and Infrastructure Program (SRWUIP) is the largest component of the *Water for the Future* initiative. A key element within SRWUIP

¹ ANAO Audit Report No. 27 2010–11 *Restoring the Balance in the Murray–Darling Basin*, p. 35.

² Australian Bureau of Agricultural and Resource Economics–Bureau of Rural Sciences, *Assessing the regional impact of the Murray–Darling Basin Plan and the Australian Government’s Water for the Future initiative in the Murray–Darling Basin* [Internet], ABARE-BRS, Australia, 2010, available from <http://www.daff.gov.au/_data/assets/pdf_file/0011/1812971/regional-impact-mdba-2010.pdf> [accessed 25 October 2011].

³ Department of Sustainability, Environment, Water, Population and Communities, *Murray–Darling Basin* [Internet], DSEWPac, Australia, 2011, available from <<http://www.environment.gov.au/water/locations/murray-darling-basin/index.html>> [accessed 25 October 2011].

⁴ Department of Sustainability, Environment, Water, Population and Communities, *Water for the Future: Fact Sheet* [Internet], DSEWPac, Australia, 2010, available from <<http://www.environment.gov.au/water/publications/action/pubs/water-for-the-future.pdf>> [accessed 6 October 2011].

is the \$650 million Private Irrigation Infrastructure Operators Program in New South Wales (PIIOP), which is the subject of this audit.

Water reforms in the Basin

3. In recent years there have been a number of reforms aimed at improving the management of water resources and addressing the imbalance between consumptive and environmental water use in the Basin. Major reforms include the:

- passage of the *Water Act 2007* on 3 March 2008, which provided the legislative basis for the Australian Government's intervention in managing the water resources of the Basin;
- establishment (under the *Water Act 2007*) of the Murray–Darling Basin Authority (MDBA) in December 2008, which has responsibility for producing the first Basin-wide water sharing and management plan (the Basin Plan).⁵ This plan is intended to guide the management of the Basin's water resources in an integrated and sustainable way;
- signing of an Intergovernmental Agreement on Murray–Darling Basin Reform (the Basin Agreement) on 3 July 2008, which committed Basin jurisdictions (the Australian Government and the Queensland, New South Wales, Victorian, South Australian and the Australian Capital Territory governments) to new ways of managing water resources in the Basin⁶; and
- establishment of a Commonwealth Environmental Water Holder (CEWH), in April 2008, to manage Australian Government water holdings for the benefit of the environment.

4. To underpin these reforms, the Australian Government is providing \$5.8 billion through SRWUIP to increase water use efficiency in rural Australia. SRWUIP comprises over 40 different projects, programs and initiatives⁷ ranging in size from \$1.2 million to \$1 billion, both within and outside the

⁵ The *Proposed Basin Plan* was released on 28 November 2011. After comments on the Proposed Plan received during the consultation period are taken into account, the Government intends to present the final Basin Plan to the Parliament later in 2012.

⁶ The Basin Agreement also allocated the initial round of Australian Government funds for infrastructure-based water recovery projects under SRWUIP.

⁷ SRWUIP initiatives include compliance and enforcement activities, communication campaigns and meter testing facilities.

Basin. The Department of Sustainability, Environment Water, Population and Communities (DSEWPaC or the department) manages and coordinates SRWUIP activities. SRWUIP includes 15 State Priority Projects where the Australian Government has indicated its intention of making infrastructure investments in the Basin in return for water access entitlements that can be used by the CEWH for environmental watering purposes, and to progress the Government's water reform agenda.⁸ State Priority Project investments are to be principally directed towards projects that:

- deliver substantial and lasting returns of water for the environment;
- secure a long-term future for irrigation communities; and
- deliver value for money in the context of the first two tests.⁹

5. Thirteen of these State Priority Projects are administered by state governments. The other two are Commonwealth-led and administered by DSEWPaC—the Private Irrigation Infrastructure Operators Program in New South Wales (the subject of this audit) and the Private Irrigation Infrastructure Program for South Australia.¹⁰

Private Irrigation Infrastructure Operators Program in New South Wales

6. The Private Irrigation Infrastructure Operators Program in New South Wales (PIIOP) was developed to deliver on a commitment made by the Basin jurisdictions in the Basin Agreement. Under the program, the Australian

⁸ State Priority Project investments were contingent on their assessment against the due diligence criteria established in the Basin Agreement.

⁹ Department of Sustainability, Environment, Water, Population and Communities, *Sustainable Rural Water Use and Infrastructure* [Internet], DSEWPaC, Australia, 2011, available from <<http://www.environment.gov.au/water/policy-programs/srwui/index.html>> [accessed 25 October 2011].

¹⁰ The Department of the Environment, Water, Heritage and the Arts (DEWHA) originally had administrative responsibility for PIIOP (and the Private Irrigation Infrastructure Program for South Australia). DEWHA was re-established as DSEWPaC through machinery of government changes on 14 September 2010. For the purposes of this report, DSEWPaC has been used universally to refer to as the department responsible for PIIOP's administration.

Government is providing up to \$650 million to NSW private irrigation infrastructure operators (PIIOs)¹¹ in the Basin to:

acquire water entitlements resulting from water savings from eligible projects to improve the efficiency and productivity of water use and management, both off- and on-farm¹², ... helping to secure a sustainable future for irrigation communities.¹³

7. Although PIIOP was viewed by the Government as an investment in the Murray–Darling Basin, DSEWPac considered that PIIOP had more in common with a grants program than a procurement activity. The department, therefore, chose to apply a grants-based framework, underpinned by the *Commonwealth Grant Guidelines* (CGGs), to administer PIIOP, in the absence of a more suitable administrative framework. PIIOP is managed within a section in DSEWPac's Water Group, with additional oversight provided by the department's Water Group Outcome Board.¹⁴

Private irrigation infrastructure operators

8. PIIOs across NSW are not homogeneous, varying in structure, size and sophistication. Prior to 1995, much of NSW's irrigation infrastructure—generally either systems of interconnected open channels or piped delivery systems—was owned and operated by the NSW Government. Over the period 1995–2000, NSW Government-owned irrigation schemes were progressively privatised. NSW irrigation infrastructure operators now include: large irrigation corporations; a number of private irrigation districts; private water trusts; and small joint water supply schemes.

9. It is generally acknowledged by governments, industry and conservationists that irrigation water could be used more efficiently. Between

¹¹ A private irrigation infrastructure operator (PIIO) is defined in the *Water Act 2007* as an entity that owns or operates infrastructure to store, deliver and/or drain water for the purpose of providing a service to another person, primarily for irrigation.

¹² Examples of eligible off-farm activities include: upgrading channel lining; replacing channels with piping systems; repairing pipes and pumps; and permanently decommissioning sections of the water delivery system. Examples of eligible on-farm activities include: installing or upgrading on-farm meters; and other infrastructure upgrading activities which complement the proposed off-farm delivery system upgrades while contributing to the total water savings.

¹³ DSEWPac, *Sustainable Rural Water Use and Infrastructure Program: Guidelines for the Private Irrigation Infrastructure Operators Program in New South Wales—Round 2*, February 2011, p. 5.

¹⁴ The Water Group Outcome Board comprises a departmental Deputy Secretary, who is the Chair, and the three First Assistant Secretaries who have responsibility for divisions within the Water Group.

10 and 30 per cent of the water diverted from rivers into irrigation systems is lost before it reaches the farm gate.¹⁵

Selecting and contracting PIIOP projects

10. PIIOP was originally designed to select projects to modernise and upgrade irrigation infrastructure in a single funding round that closed on 27 November 2009. However, as DSEWPaC's recommendations to fund Round 1 PIIOP projects did not exhaust the program's funding allocation, a second funding round that closed on 22 July 2011 was undertaken. PIIOP funding was fully allocated following the conclusion of the second funding round.

11. To guide the preparation of applications in each round, DSEWPaC developed and published program guidelines containing eligibility and merit criteria that reflected the economic/social, environmental/technical and value for money criteria to be applied to the assessment of all State Priority Projects under SRWUIP. PIIOP applications were assessed by an assessment panel that included departmental officers and external advisors. Those projects considered to be the most meritorious were recommended to the Minister for Sustainability, Environment, Water, Population and Communities (Minister) for funding approval.¹⁶ Table S1 outlines the nine successful applicants (five in Round 1 and four in Round 2), the funding approved and the total water to be acquired by the Australian Government following both PIIOP rounds.

12. Funding agreements were executed with all successful Round 1 applicants during the period July 2010 to June 2011. In April 2012, DSEWPaC advised that funding agreements for Round 2 projects are expected to be executed by June 2012.

¹⁵ More specifically, losses in irrigation infrastructure systems can arise from: outfalls, that is, water flowing from the downstream-end of the delivery system; farm irrigation water meter inaccuracy; unrecorded usage of water where water usage is not metered or stolen; leakage of water from channels through channel banks and structures; seepage, that is, the movement of water through the beds of irrigation channels; and evaporation in channels and storages. (Marsden Jacob Associates, *Improving water-use efficiency in irrigation conveyance systems: A study of investment strategies*, Land & Water Australia, May 2003, pp. 7 and 8).

¹⁶ In earlier times, the former Minister for Climate Change and Water and former Minister for Climate Change, Energy Efficiency and Water were responsible for the administration of PIIOP by DSEWPaC.

Table S1**Announced PIIOP projects**

Applicant (Catchment)	Round 1 maximum funding announced (\$ GST exclusive)	Round 2 maximum funding announced (\$ GST exclusive)
Coleambally Irrigation Cooperative Limited (Murrumbidgee)	51 218 330	7 350 000
Murrumbidgee Irrigation Limited (Murrumbidgee)	50 000 000	149 622 911
Marthaguy Irrigation Scheme (Macquarie)	9 528 690	-
Tenandra Scheme (Macquarie)	37 475 140	-
Trangie-Nevertire Irrigation Scheme (Macquarie)	115 000 000	-
Murray Irrigation Limited (NSW Murray)	-	169 226 315 ¹
Narromine Irrigation Board of Management (Macquarie)	-	60 237 244
Total funding	\$263 222 160	\$386 436 470
Australian Government's share of water access entitlements²	69 509 ML (or 39 740 ML LTCE)³	102 549 ML (or 75 100 ML LTAAY)³

Source: ANAO analysis of DSEWPaC information.

Note 1: Includes an increase of \$3 880 000 to correct a departmental assessment error.

Note 2: The announced water access entitlement transfers to the Australian Government per project have not been disclosed for commercial confidentiality reasons.

Note 3: Long-term cap equivalent (or LTCE) and long-term average annual yield (or LTAAY) are methods that have been used by DSEWPaC over time to standardise the calculation of expected water recoveries in the Murray–Darling Basin from the different water access entitlement categories across the catchments of the Basin. The differences between the former LTCE and current LTAAY methods are only minor. One megalitre (ML) equals 1 000 000 litres.

Audit objectives, scope and criteria

13. The objective of the audit was to assess the effectiveness of DSEWPaC's administration of PIIOP, including the acquisition of water access entitlements and progress towards achieving the program's objectives.

14. The audit examined whether DSEWPaC:

- effectively implemented PIIOP and had appropriate governance arrangements to support the program;

- assessed and selected applications in both funding rounds in accordance with the *Commonwealth Grant Guidelines* (CGGs)¹⁷; and
- negotiated appropriate funding agreements for Round 1 projects and established effective arrangements to monitor the implementation of the projects and the achievement of the program's objectives.

Overall conclusion

15. The Private Irrigation Infrastructure Operators Program in New South Wales (PIIOP) is one of a number of programs within the \$5.8 billion Sustainable Rural Water Use and Infrastructure Program. Under PIIOP, the Australian Government has invested in upgrades to irrigation infrastructure in return for a share of the water efficiency gains and to progress the Government's water reform agenda. Water access entitlements are used by the CEWH for environmental watering purposes. Over two funding rounds, DSEWPaC received 12 applications from eight applicants requesting some \$1.79 billion in financial assistance, which was significantly more than the \$650 million funding available under PIIOP.

16. The Minister for Sustainability, Environment, Water, Population and Communities (and the then Minister for Climate Change, Energy Efficiency and Water) approved funding under both PIIOP rounds for nine projects that range in size from \$7.4 million to \$169.2 million in return for 172.1 gigalitres of water access entitlements (which represents over 90 per cent of the projects' estimated water savings).¹⁸ All available funding was allocated and funding agreements for the five Round 1 projects were executed. As at December 2011, DSEWPaC had acquired 35.1 gigalitres (53.5 per cent) of the water access entitlements contracted under Round 1 and expended \$81.5 million (31.9 per cent) of PIIOP funding in Round 1. Although implementation of the Round 1 projects has not progressed as rapidly as DSEWPaC originally expected, the department anticipates that all of these projects will be

¹⁷ The *Commonwealth Grant Guidelines* (CGGs) outline seven principles for grants administration, which are: (1) Robust planning and design; (2) An outcomes orientation; (3) Proportionality; (4) Collaboration and partnership; (5) Governance and accountability; (6) Probity and transparency; and (7) Achieving value with public money. (Department of Finance and Deregulation, *Commonwealth Grant Guidelines—Policies and Principles for Grants Administration*, Finance Management Guidance No. 23, July 2009, p. 14.)

¹⁸ One gigalitre equals 1000 megalitres or 1 000 000 000 litres.

completed within budget by March 2014. As at April 2012, funding agreement negotiations for the four Round 2 projects were underway.

17. As one of the first water infrastructure programs within SRWUIP, PIIOP presented implementation challenges for DSEWPaC. These challenges particularly related to the investment-focused nature of the program—characterised by its intended contribution to water reform in the Basin and the acquisition of water access entitlements in exchange for funding infrastructure improvements—administered within a grant program framework. In this context, the due diligence criteria that were to underpin all SRWUIP investments became PIIOP’s eligibility and merit criteria for funding under the program.

18. While DSEWPaC has implemented PIIOP and allocated available funding, weaknesses in program governance and in the management of a number of implementation issues had an adverse impact on the overall effectiveness of the program’s administration. In this regard, shortcomings were evident in DSEWPaC’s design of the program, the assessment of applications and the development of measures to inform an assessment of whether the program is achieving its objectives. DSEWPaC has established appropriate funding agreements with successful Round 1 applicants and developed effective monitoring arrangements to address the project implementation risks arising from the shortcomings in the assessment of applications.

Program governance

19. Although the department began designing the program in mid-2008, the program area did not develop and submit key program management documentation for endorsement by the departmental committee responsible for PIIOP’s oversight—the Water Group Outcome Board—until mid-2010. As a consequence, DSEWPaC did not have in place an endorsed project plan or associated risk management plan in the first two years of PIIOP, which had an impact on the department’s capacity to implement the program and identify issues early. The Board did not identify these gaps in the program’s management documentation or intervene to resolve the PIIOP taxation treatment issue that put at risk the execution of most Round 1 funding agreements.

Program design

20. In designing PIIOP, early consideration should have been given to the potential taxation treatment of the large-scale grants being offered under the

program. Taxation of government funding will always be a material consideration for potential applicants and a strong influence on the viability of applications for funding. However, it was not until December 2008, over five months into the establishment of PIIOP, that DSEWPac recognised the significance of the taxation treatment of program funding to potential applicants, and subsequently sought taxation advice.¹⁹ The lack of early consideration of PIIOP's taxation implications, coupled with delays in developing PIIOP's funding agreement that outlined the terms and conditions of the funding, delayed the determination of the program's taxation status until late into the Round 1 application process. Advice from the Australian Taxation Office (ATO) in November 2009 that PIIOP's terms and conditions did not support the taxation outcome DSEWPac preferred, and had previously advised to applicants, had the potential to jeopardise the timely and successful implementation of the program. Earlier consideration of PIIOP's taxation implications would have better positioned the department to have factored into PIIOP's design the preferred taxation outcome for the program.

21. DSEWPac decided during PIIOP's design phase that a one-stage application process would be appropriate. This decision was based on the limited number of potential applicants and the prerequisite for applicants to have completed an irrigation modernisation plan that would underpin their applications.²⁰ Notwithstanding this rationale, the detail required in applications and the variability in the quality of modernisation plans necessitated a substantial financial outlay from PIIOs. Some PIIOs considered that they lacked access to the management expertise and finances needed to fund the development of the detailed PIIOP applications. PIIOs had to balance the effort and resources they allocated to their applications with their likelihood of success. Adopting a two-stage application process, which gave greater assurance of the likelihood of success, may have encouraged a greater investment by PIIOs in more comprehensively completing their applications under the program and allowed a more thorough assessment of applications by DSEWPac.

¹⁹ Grants are generally considered as taxable income to recipients, unless legislation specifically provides otherwise. Early taxation advice obtained by DSEWPac indicated that the best outcome for applicants would be for PIIOP funding to be subject to capital gains tax on the disposal of water access entitlements by PIIOs—on the basis that an income tax outcome could have created cash flow problems for PIIOs.

²⁰ DSEWPac administered a separate program, the Irrigation Modernisation Planning Assistance (IMPA) program, that provided funding to assist PIIOs to identify and consider a range of options available to increase the efficiency of their irrigation systems and adapt to a future with less water.

Assessment of applications

22. The department's assessment of PIIOP applications in both rounds proved challenging. This was primarily because the applications did not contain sufficient detail to facilitate a thorough assessment, particularly in relation to addressing the economic/social criteria, environmental/technical criteria and the projects' benefits-costs analyses. A major contributing factor to this situation was the lack of sufficient guidance in the program guidelines on the level of detail and information required from PIIOs to support their applications. DSEWPaC sought to address the lack of sufficiently-detailed information provided in applications through the use of technical advisors, external advisors on the assessment panels and through seeking additional clarification from the applicants. In Round 2, DSEWPaC also intended to provide applicants with expanded guidance materials to improve the quality of applications, but these materials were not finalised and/or released. Residual information gaps in the applications for both rounds posed substantial risks for the assessment panels.

23. Nevertheless, the department considered that most applications met the merit criteria sufficiently to be recommended to the Minister for funding, with the value for money criteria being the primary determinant for the order of merit in each round.²¹ The assessment documentation for both rounds did not, however, demonstrate that any of the approved projects met either the program's economic/social criteria or environmental/technical criteria. The documentation retained by the department for Round 1 was substantially less than that necessary to support a transparent process, as required by the *Commonwealth Grant Guidelines* (CGGs). The documentation supporting Round 2 assessments indicated that applications had very low scores for most merit criteria.

24. The Minister approved DSEWPaC's funding recommendations without variation, after being advised of the challenges the department faced when assessing PIIOP applications and the consequential level of residual risk for the Australian Government in funding the recommended projects. The Minister also approved the conditions imposed on successful Round 1 applicants to address identified project implementation risks and the uncertainties flowing

²¹ In Round 1, value for money was calculated by reference to the ratio of funding sought to the market value of the water access entitlements offered in return. In Round 2, value for money also included reference to a form of benefits-costs analysis and cash/in-kind contributions by applicants.

from the gaps in the applications. The conditions attached to each project's approval were addressed satisfactorily during the negotiations for, or in the content of, the Round 1 funding agreements.

Development of performance measures

25. In terms of whether PIIOP is meeting its objective, DSEWPaC is yet to develop key performance indicators (KPIs) or collect the data necessary to measure and report on PIIOP's performance. The funding agreements require PIIOs to report on the generation of water savings and irrigation system productivity improvements resulting from their PIIOP projects. However, PIIOs are not required to report on how their projects are helping to secure a sustainable future for the irrigation communities. The establishment of an appropriate set of KPIs for PIIOP that align with the objectives of the SRWUIP investments, and the development of an evaluation strategy for PIIOP, would better position DSEWPaC to demonstrate the extent to which the projects are contributing to the achievement of PIIOP's objectives.

26. The ANAO has made three recommendations to improve DSEWPaC's administration of its grant programs. The first reinforces the importance of effective governance arrangements, the second highlights the need to tailor the application approach to the program and implement assessment processes that better reflect the requirements of the CGGs. The third recommendation addresses the need to develop appropriate KPIs to collect and analyse performance data.

Key findings

Program establishment and governance

Establishing the program

27. DSEWPaC consulted appropriately with a range of industry stakeholders during the design and establishment of PIIOP. However, the department's delay in seeking taxation advice and in finalising the draft PIIOP funding agreement meant that advice from the ATO on PIIOP's taxation status was not provided to applicants until late in the Round 1 application process. The ATO's advice was also contrary to the taxation outcome preferred by DSEWPaC. DSEWPaC released the draft funding agreement to the five successful Round 1 PIIOP applicants a week after the announcement of the approved applications. All PIIOs, after consulting with their taxation advisors,

identified the potentially significant taxation liabilities that could arise from entering into a PIIOP funding agreement with the Australian Government.

28. DSEWPaC determined that a one-stage application process would be employed for PIIOP. This decision was based on the limited number of known potential applicants and the expectation that irrigation modernisation plans (the development of which could be funded under another program administered by DSEWPaC) would underpin PIIOP applications. However, DSEWPaC's analyses of the government-funded irrigation modernisation plans identified variance in their quality and comprehensiveness. Despite having completed a modernisation plan or equivalent, all six of the PIIOP Round 1 applicants interviewed by the ANAO stated that the PIIOP one-stage application process had been time-consuming, costly and presented a range of risks. In particular, some PIIOPs commented on the lack of readily available management expertise and finances to fund the development of the detailed PIIOP applications.

29. The PIIOP guidelines for both funding rounds included key information, such as the objectives of the program, the amount of funding available, eligible applicants and projects, the merit-based selection criteria, how to apply and the deadline for applications. However, the guidelines did not contain sufficient guidance on the program's terms and conditions (in the form of the draft PIIOP funding agreement), the relative importance of the merit criteria and the level of detail DSEWPaC required from PIIOPs to support their applications. The limited guidance resulted in Round 1 applications of variable quality that ultimately had an impact on the department's ability to assess the applications.

30. Despite feedback from Round 1 applicants and the variable quality of Round 1 applications, DSEWPaC adopted a similar one-stage application approach for Round 2. Although the department intended to provide Round 2 applicants with expanded guidance materials to improve the quality of applications, these materials were not finalised and/or released prior to the funding round. As a consequence, the variable quality issue encountered in Round 1 was also encountered by the department in respect of Round 2 applications.

Governance arrangements supporting PIIOP

31. PIIOP is managed within a section in the department's Water Group. In addition, the Water Group Outcome Board (the Board) has an oversight role for all programs under SRWUIP, including PIIOP.

32. While the program commenced in mid-2008, administrative arrangements for PIIOP were first documented by DSEWPaC in February 2009 in a draft Annual Plan for the program area managing PIIOP. The Plan was not, however, finalised or endorsed by DSEWPaC senior management, nor was the plan submitted to the Board for approval in accordance with administrative arrangements established for SRWUIP programs. It was not until early June 2010, some two years after the department began designing the program, that DSEWPaC developed, and the Board approved, an Annual Plan. It was a further year before DSEWPaC developed, and the Board approved, a PIIOP-specific Project Plan and associated risk management plan. The development of these project-specific plans better positions the department to manage the ongoing delivery of the program.

33. Since October 2009, the PIIOP section has provided monthly PIIOP status reports to the Board. However, the absence of key program governance documentation has inhibited the Board's ability to use these status reports to effectively monitor program risks and program progress against planned performance. Notwithstanding the absence of key program governance documentation, the Board was informed of the impact of the taxation issue on PIIOP's progress. However, when the resolution of taxation issues became protracted over the period June to November 2010, the Board did not intervene to resolve the issues. There would be merit in DSEWPaC reviewing the systems and processes in place to ensure that all required information is provided to the Board and that the monitoring activities of the Board effectively identify and manage significant risks to program delivery.

34. Although PIIOP is not listed as a discrete program in DSEWPaC's Portfolio Budget Statements (PBS), the PBS and department's annual reports contain performance information (deliverables, KPIs and targets) for the broader 'Water Reform' program related to PIIOP's (and SRWUIP's) performance. However, the department has not established baselines from which to measure water efficiency improvements and the established deliverables do not identify the quantity of water savings that are to be returned to the Australian Government from SRWUIP investments. Improving the relevance of KPIs and deliverables would provide greater insights into the extent to which water programs are contributing to the achievement of program objectives for PIIOP and SRWUIP.

Assessment of applications

Promotion and communication of PIIOP to potential applicants

35. DSEWPaC consulted with peak industry bodies and provided detailed briefings to known potential applicants on PIIOP soon after both funding rounds were launched. Round 1 applicants indicated to the ANAO that they were generally satisfied with the department's responsiveness to important issues raised during the application phase; with the exception being the taxation treatment of the grants.

36. DSEWPaC provided information to potential Round 1 applicants that PIIOP funding would create a capital gains tax (CGT) outcome—in advance of such an outcome being confirmed with the ATO. Subsequent advice from the ATO stated that program documentation did not support a CGT outcome, instead creating an income tax outcome that could cause severe cash flow problems for PIIOs. PIIOs advised the ANAO that their applications assumed either a tax-neutral outcome or CGT outcome.

Assessment framework process

37. The PIIOP guidelines clearly specified the program's eligibility requirements for projects and applicants. The program's merit criteria were based on the due diligence criteria established under the Basin Agreement for SRWUIP investments. However, some of the economic/social, environmental/technical and value for money sub-criteria were not sufficiently clear or specific to guide applicants—particularly in terms of the standard and level of detail expected in the applications.

38. The Rounds 1 and 2 assessment plans prepared by DSEWPaC were designed to deliver an accountable, transparent, fair and competitive process for assessing PIIOP applications. While the plans were generally comprehensive and provided a key point of reference for the assessment of PIIOP projects, there were a number of limitations related to:

- guidance to assessors on benchmarks/weightings within the scoring system, to score applications consistently and establish the relative importance of the criteria to the final scores;
- guidance on how the benefits-costs analyses that applicants were required to submit would be incorporated into assessments;
- assessing the viability of sub-projects independently of the projects as a whole; and

- guidance on including the PIIOs' intended compliance with the funding agreement terms and conditions in the assessments.

Assessment and selection of projects

39. One of the major challenges that faced the PIIOP assessment panels was the variable quality of applications caused by the lack of detail and gaps in the information provided. The variable quality of applications for both funding rounds made it difficult for the department to effectively assess and compare projects—particularly in terms of the extent to which projects met the merit criteria and the relative costs and benefits of each application. DSEWPaC had the option of recommending far fewer or no projects on the ground that the applications were not complete. While this position could be justified, it was unlikely that progressing the assessment of few or no applications would have been compatible with the imperative to progress water reform in the Murray–Darling Basin. DSEWPaC considered that the information provided by applicants was sufficient to progress all applications to a full assessment of the merits in the subsequent assessment phase.

40. The assessment panels in both rounds assessed applications against the merit criteria. However, in Round 1 there were some inconsistencies between the assessment of projects by the panel and those of the independent technical advisors on particular merit criteria. The Round 1 assessment report did not acknowledge the difference of opinions, or provide a justification for the panel's contrary opinion. Additional documentation that may have provided clarity over the Round 1 assessments, such as assessment panel meeting minutes and the assessments of individual panel members, were either not retained or insufficiently documented. The assessment documentation supporting the Round 2 process provided much better alignment between the assessments in technical reports, the individual panel member assessments, minutes of meetings and the final assessment report to the Minister.

41. Assessments against the value for money criteria were the primary determinant of the orders of merit in both PIIOP rounds. In Round 1, the assessment panel determined value for money by calculating a 'market multiple'—the ratio of PIIOP funding sought to the market value of water access entitlements to be transferred to DSEWPaC—for each application. Given the shortcomings in the documentation of Round 1 assessments, it is unclear how the recommended applications met the program's economic/social and environmental/technical criteria. In Round 2, the value for money criteria (including scores based on the market multiple, a form of benefits-costs

analysis, and cash/in-kind contributions by applicants) accounted for 70 per cent of the total potential score for each application. Given the very low scores against the economic/social and environmental/technical criteria (generally less than five out of ten) and for the benefits-costs analyses, the assessment panel's assessment of Round 2 applications does not clearly demonstrate that approved projects met all the merit criteria.

Recommendations to the Minister

42. The Minister was briefed on all the projects submitted for consideration in both rounds, including those recommended (nine) and not recommended (three) for funding. The briefings included documentation to support the Minister's mandatory grants approval obligations along with documentation to support the reasons for recommendations. DSEWPaC advised the Minister of the general lack of clarity and detail provided in all applications and the challenges this posed to the department's assessment of applications. To manage the consequential risks from funding PIIOP applications in Round 1, the Minister approved funding on the basis that extensive conditions were placed on successful applicants to address identified risks and uncertainties flowing from the gaps in their applications. While DSEWPaC did not recommend imposing conditions on Round 2 applicants, the project risks and stakeholder issues identified in the briefing to the Minister should be considered and addressed as part of the negotiations of Round 2 funding agreements.

Development of funding agreements and management of projects

Negotiation of funding agreements for Round 1 projects

43. DSEWPaC negotiated funding agreements that committed PIIOs to transferring to the Australian Government the quantity of water access entitlements that PIIOs offered in their applications in return for government funding. As funding agreement negotiations progressed, most PIIOs requested changes to their project parameters. In general, DSEWPaC considered favourably those requests that: were for eligible activities consistent with the PIIOs' applications; maintained the projects' value for money; and did not increase the approved maximum contribution to the projects. The original Round 1 funding agreements negotiated by DSEWPaC accurately reflected the PIIOP projects approved by the Minister and satisfactorily addressed the preconditions attached to the projects' approval.

44. Under the PIIOP funding agreements, PIIOs are required to report to DSEWPaC on their projects' contributions towards the elements of the

program's objective related to the generation of water savings and productive improvements. However, PIIOs are not required to report on the extent to which their projects contribute to the 'helping to secure a sustainable future for irrigation communities' element of PIIOP's objective. Further, DSEWPac has not established key performance indicators (KPIs) to measure the extent to which the program is achieving its objective. DSEWPac's development of an appropriate set of KPIs for PIIOP, aligned with the objectives of the SRWUIP investments, and the collection of relevant performance data, would better position the department to demonstrate the achievement of PIIOP's objective.

45. The execution of most Round 1 funding agreements was extensively delayed pending the resolution of the taxation treatment of PIIOP funding. While DSEWPac considers that the PIIOP taxation issues were raised with the appropriate agencies in a timely manner once there was clear evidence that action was warranted, the resolution of the taxation issues was overly protracted due to the department's reliance solely on private binding rulings between the ATO and PIIOs. Although other options were canvassed, none were pursued concurrently or as alternatives to obtaining private binding rulings for many months, including the legislative amendment option that ultimately resolved the taxation issue. DSEWPac's pursuit of alternative options in parallel with private binding rulings sought by PIIOs would have better positioned the department to resolve the PIIOP taxation issues in a more timely manner.

Project monitoring by DSEWPac

46. Central to the original monitoring arrangements established by DSEWPac for PIIOP Round 1 projects was the department's approval of annual workplans for the projects. However, the submission and approval of PIIO's workplans has not occurred in accordance with DSEWPac's original expectations. Workplans were required to be resubmitted numerous times to address the concerns of the department's technical advisors. Further, the detail DSEWPac expected in the first project workplans was not available until subsequent milestones were achieved, which necessitated the department's approval of 'interim' workplans and the submission and approval of 'updated' workplans at later dates. Nonetheless, DSEWPac's technical consultants, who cleared the contents of all workplans prior to their approval by the department, have provided assurance about the reasonableness of the timeliness, cost and effectiveness of the PIIO's proposed construction and project management activities.

47. From mid-2011, DSEWPaC negotiated additional PIIOP funding agreement obligations and revised monitoring arrangements that significantly strengthened the department's framework for monitoring project progress and the expenditure of project funding. The revised arrangements have simplified the PIIOs' preparation of milestone and expenditure documentation. Payment delegates now receive documentation evidencing the achievement of each project milestone, including certifications from PIIO management and independent auditors.

DSEWPaC's management of project implementation issues

48. Under the funding agreement model selected for PIIOP, PIIOs were required to enter into legally-binding agreements with participating irrigators in their scheme to deliver the on-farm works component of the PIIOP projects and transfer the required water access entitlements to PIIOs. The contracting of irrigators by PIIOs under the program has not been straightforward. Information provided by irrigators to the ANAO indicated that many found their contracts with the PIIO complex and daunting. As a consequence, some irrigators withdrew from PIIOP projects, while others executed contracts based primarily on the assurance they received from other irrigators in their community entering into similar agreements.

49. DSEWPaC has established effective working relationships and communication channels with PIIOs and their project managers. Issues arising from PIIOP projects have been considered in a timely manner, and their resolution clearly communicated to all parties. The most common issues impacting on PIIOP Round 1 projects have been related to the slow rate of progress—most of which are beyond the control of the Australian Government, and some of which are also beyond the control of PIIOs.

50. At times, DSEWPaC has also received requests from PIIOs to vary funding agreements, including changes to the parameters of irrigation projects or the substitution of irrigators and/or irrigator projects. In all cases, DSEWPaC appropriately assessed the impact of the delays or proposed variations on the projects concerns and the PIIOs' rights and obligations, before agreeing or not agreeing to the change requests. Further, DSEWPaC's interventions in disputes between PIIOs and their irrigators and inquiries into third-party complaints have been appropriate and effective to resolve the matters and progress the PIIOP projects.

Progress of PIIOP projects

51. During the establishment of PIIOP, DSEWPaC's initial expenditure forecasts for the program indicated that payments to approved PIIOP projects would commence in 2009–10. However, due to delays with the funding agreement negotiations, the first payments to PIIOP projects occurred early in 2010–11 and the larger milestone payments expected to occur in 2010–11 were delayed until 2011–12. Further, a review of the schedules of the original PIIOP Round 1 funding agreements against progress as at March 2012 indicated that project expenditure on two projects was below original expectations, but transfers of water access entitlements were generally meeting original funding agreement schedules. By March 2012, DSEWPaC had expended \$127.1 million (49.9 per cent) of Round 1 funding, which was significantly less than the original expectations of \$143.3 million, but had received 45.9 gigalitres (69.8 per cent) of water access entitlements, which was more than the 44.9 gigalitres originally expected at this time. DSEWPaC expects that by July 2012 the total project expenditure and water entitlement transfers will exceed the department's original expectations of progress as anticipated in the original funding agreements.

52. Project completion dates for four of the five Round 1 projects have not changed from the original funding agreements—with dates ranging from March 2012 to March 2014. The project completion date for the remaining project has been delayed by 11 months from late February 2012 to early February 2013. As at 31 March 2012, all Round 1 projects were considered by the department to be on track to be completed within their approved budgets.

DSEWPaC's summary response to the proposed report

53. The department's summary response to the proposed audit report is provided below, while the full response is provided in Appendix 1.

The Department of Sustainability, Environment, Water, Population and Communities (SEWPaC) agrees with each of the ANAO's recommendations.

SEWPaC appreciates the ANAO's recognition that the policy intent of the Government was for PIIOP to provide for investment in rural irrigation infrastructure, to achieve long term benefits for irrigation water providers, related communities and the environment.

In particular, SEWPaC welcomes the ANAO's finding that assessment and contract management arrangements progressively applied by the Department from the beginning of 2011 have significantly strengthened SEWPaC's framework for monitoring project progress and the expenditure of Australian Government funding on PIIOP projects.

Recommendations

Recommendation No. 1

Para. 2.78

To improve the implementation of programs within SRWUIP, the ANAO recommends that the Department of Sustainability, Environment, Water, Population and Communities reinforce the arrangements in place to:

- (a) develop and submit for approval program management documentation (including project plans, risk management plans and performance information);
- (b) effectively monitor program progress against planned performance; and
- (c) seek early resolution of significant issues that have the potential to adversely impact on the effective and efficient implementation of programs.

DSEWPaC's response: Agreed.

**Recommendation
No. 2**

Para. 3.79

To improve the quality and transparency of grant assessment processes for future programs within SRWUIP, the ANAO recommends that the Department of Sustainability, Environment, Water, Population and Communities:

- (a) evaluate the benefits and costs of a staged application approach where the size and complexity of applications are likely to require a substantial financial outlay by applicants;
- (b) communicate any order of importance of the merit criteria to potential grant applicants;
- (c) reinforce the importance of documenting the assessment of grant applications; and
- (d) revise departmental processes to limit the transfer of significant risks from the grant application assessment phase to the contracting and management phases of grant programs.

DSEWPaC's response: Agreed.

**Recommendation
No. 3**

Para. 4.87

To enable an assessment of the extent to which PIIOP is achieving its objectives, the ANAO recommends that the Department of Sustainability, Environment, Water, Population and Communities:

- (a) develop key performance indicators that inform an assessment of achievements against the program's objective; and
- (b) determine the performance data required, and collect and analyse this data.

DSEWPaC's response: Agreed.

Audit Findings

1. Background and Context

This chapter provides the context for the Private Irrigation Infrastructure Operators Program, including its origin, objectives and current status. The audit objective, scope and methodology are also outlined.

Introduction

1.1 The Murray–Darling Basin (the Basin) is an area of national environmental, economic and social significance. The Basin contains Australia’s three longest rivers—the Darling, the Murray and the Murrumbidgee—as well as nationally and internationally significant environmental assets, such as wetlands, billabongs and floodplains.²² It covers one-seventh of Australia extending across four states—Queensland, New South Wales, Victoria, South Australia—and the Australian Capital Territory. The Basin is an important resource for rural communities and contributes substantially to Australia’s economy. Irrigated agriculture accounts for over 80 per cent of the Basin’s consumptive water use²³, contributing to an agricultural industry worth more than \$9 billion per year.²⁴ Water from the Basin also directly supports three million Australians.

1.2 In response to the predicted future water scarcity in the Basin, the Australian Government has increased its focus on improving the Basin’s water management. The Government has invested significantly in long-term initiatives designed to better balance the water needs of communities, farmers and the environment, in particular, through the \$12.9 billion *Water for the Future* initiative. This initiative contains a suite of urban and rural policies and programs, including funding for water purchasing, irrigation modernisation, desalination, recycling and storm water capture.²⁵ The \$5.8 billion Sustainable

²² ANAO Audit Report No. 27 2010–11 *Restoring the Balance in the Murray–Darling Basin*, p. 35.

²³ Australian Bureau of Agricultural and Resource Economics–Bureau of Rural Sciences, *Assessing the regional impact of the Murray–Darling Basin Plan and the Australian Government’s Water for the Future initiative in the Murray–Darling Basin* [Internet], ABARE-BRS, Australia, 2010, available from <http://www.daff.gov.au/_data/assets/pdf_file/0011/1812971/regional-impact-mdba-2010.pdf> [accessed 25 October 2011].

²⁴ Department of Sustainability, Environment, Water, Population and Communities, *Murray–Darling Basin* [Internet], DSEWPoC, Australia, 2011, available from <<http://www.environment.gov.au/water/locations/murray-darling-basin/index.html>> [accessed 25 October 2011].

²⁵ Department of Sustainability, Environment, Water, Population and Communities, *Water for the Future: Fact Sheet* [Internet], DSEWPoC, Australia, 2010, available from <<http://www.environment.gov.au/water/publications/action/pubs/water-for-the-future.pdf>> [accessed 6 October 2011].

Rural Water Use and Infrastructure Program (SRWUIP) is the largest component of the *Water for the Future* initiative. A key element within SRWUIP is the \$650 million Private Irrigation Infrastructure Operators Program in New South Wales (PIIOP), which is the subject of this audit.

Water reforms in the Basin

1.3 In recent years there have been a number of reforms aimed at improving the management of water resources and addressing the imbalance between consumptive and environmental water use in the Basin. Major reforms include the:

- passage of the *Water Act 2007* on 3 March 2008, which provided the legislative basis for the Australian Government's intervention in managing the water resources of the Basin;
- establishment (under the *Water Act 2007*) of the Murray–Darling Basin Authority (MDBA) in December 2008, which has responsibility for producing the first Basin-wide water sharing and management plan (the Basin Plan).²⁶ This plan is intended to guide the management of the Basin's water resources in an integrated and sustainable way;
- signing of an Intergovernmental Agreement on Murray–Darling Basin Reform (the Basin Agreement) on 3 July 2008, which committed Basin jurisdictions (the Australian Government and the Queensland, New South Wales, Victorian, South Australian and the Australian Capital Territory governments) to new ways of managing water resources in the Basin; and
- establishment of a Commonwealth Environmental Water Holder (CEWH), in April 2008, to manage Australian Government water holdings for the benefit of the environment.²⁷

The Basin Agreement

1.4 The Basin Agreement underpins the reforms considered necessary to meet the current needs of the Basin and, in the long term, to protect and enhance its

²⁶ The *Proposed Basin Plan* was released on 28 November 2011. After comments on the Proposed Plan received during the consultation period are taken into account, the Government intends to present the final Basin Plan to the Parliament later in 2012.

²⁷ ANAO Audit Report No. 27 2010–11 *Restoring the Balance in the Murray–Darling Basin*, p. 38.

social, environmental and economic values.²⁸ The Basin Agreement, among other things:

- allocated the initial round of Australian Government investment funding for infrastructure-based water recovery projects under the \$5.8 billion Sustainable Rural Water Use and Infrastructure Program (SRWUIP);
- established due diligence criteria for the Australian Government's investment in SRWUIP irrigation infrastructure projects; and
- expanded the Australian Competition and Consumer Commission's powers over water market and charge rules.²⁹

Sustainable Rural Water Use and Infrastructure Program

1.5 The Australian Government is providing \$5.8 billion through SRWUIP to increase water use efficiency in rural Australia. SRWUIP comprises over 40 different projects, programs and initiatives³⁰ ranging in size from \$1.2 million to \$1 billion, both within and outside the Basin. The Department of Sustainability, Environment, Water, Population and Communities (DSEWPaC or the department) manages and coordinates SRWUIP activities. SRWUIP includes 15 State Priority Projects where the Australian Government has indicated its intention of making infrastructure investments in the Basin in return for water access entitlements that can be used by the CEWH for environmental watering purposes, and to progress the Government's water reform agenda.³¹ State Priority Project investments are to be principally directed towards projects that:

- deliver substantial and lasting returns of water for the environment;
- secure a long-term future for irrigation communities; and

²⁸ Council of Australian Governments, *Agreement on Murray–Darling Basin Reform* [Internet], COAG, Australia, 2008, available from <http://www.coag.gov.au/coag_meeting_outcomes/2008-07-03/docs/Murray_Darling_IGA.pdf> [accessed 25 October 2011].

²⁹ *ibid.*

³⁰ SRWUIP initiatives include compliance and enforcement activities, communication campaigns and meter testing facilities.

³¹ State Priority Project investments were contingent on their assessment against the due diligence criteria established in the Basin Agreement, which are summarised at paragraph 2.5 in Chapter 2.

- deliver value for money in the context of the first two tests.³²

1.6 Thirteen of these State Priority Projects are administered by state governments. The other two are Commonwealth-led and administered by DSEWPac—the Private Irrigation Infrastructure Operators Program in New South Wales (the subject of this audit) and the Private Irrigation Infrastructure Program for South Australia.³³

Private Irrigation Infrastructure Operators Program in New South Wales

1.7 The Private Irrigation Infrastructure Operators Program in New South Wales (PIIOP) was developed to deliver on a commitment made by the Basin jurisdictions in the Basin Agreement. Under the program, the Australian Government is providing up to \$650 million to NSW private irrigation infrastructure operators (PIOs) in the Basin to:

acquire water entitlements resulting from water savings from eligible projects to improve the efficiency and productivity of water use and management, both off- and on-farm³⁴, ... helping to secure a sustainable future for irrigation communities.³⁵

1.8 Although PIIOP was viewed by the Government as an investment in the Murray–Darling Basin, DSEWPac considered that PIIOP had more in common with a grants program than a procurement activity. The department, therefore, chose to apply a grants-based framework, underpinned by the *Commonwealth Grant Guidelines* (CGGs), to administer PIIOP, in the absence of a more suitable administrative framework. PIIOP is managed within a section

³² Department of Sustainability, Environment, Water, Population and Communities, *Sustainable Rural Water Use and Infrastructure* [Internet], DSEWPac, Australia, 2011, available from <<http://www.environment.gov.au/water/policy-programs/srwui/index.html>> [accessed 25 October 2011].

³³ The Department of the Environment, Water, Heritage and the Arts (DEWHA) originally had administrative responsibility for PIIOP (and the Private Irrigation Infrastructure Program for South Australia). DEWHA was re-established as DSEWPac through machinery of government changes on 14 September 2010. For the purposes of this report, DSEWPac has been used universally to refer to the department responsible for PIIOP's administration.

³⁴ Examples of eligible off-farm activities include: upgrading channel lining; replacing channels with piping systems; repairing pipes and pumps; and permanently decommissioning sections of the water delivery system. Examples of eligible on-farm activities include: installing or upgrading on-farm meters; and other infrastructure upgrading activities which complement the proposed off-farm delivery system upgrades while contributing to the total water savings.

³⁵ DSEWPac, *Sustainable Rural Water Use and Infrastructure Program: Guidelines for the Private Irrigation Infrastructure Operators Program in New South Wales—Round 2*, February 2011, p. 5.

in DSEWPac's Water Group, with additional oversight provided by the department's Water Group Outcome Board.³⁶

Private Irrigation Infrastructure Operators

1.9 A Private Irrigation Infrastructure Operator (PIIO) is defined in the *Water Act 2007* as an entity that owns or operates infrastructure to store, deliver and/or drain water for the purpose of providing a service to another person, primarily for irrigation.³⁷ The infrastructure used to deliver water to customers, who are typically irrigators, is generally either a system of interconnected open channels or a piped delivery system.³⁸ PIIOs own and manage delivery infrastructure and irrigators make on-farm investments to receive and use the water. An important part of PIIOs' role is ensuring that customers are not delivered more water than their entitlement allows.

1.10 PIIOs across NSW are not homogeneous, varying in structure, size and sophistication. Prior to 1995, much of NSW's irrigation infrastructure was owned and operated by the NSW Government. Over the period 1995–2000, NSW Government-owned irrigation schemes were progressively privatised. NSW irrigation infrastructure operators now include large irrigation corporations, a number of private irrigation districts, private water trusts and small joint water supply schemes. The water delivery systems of NSW PIIOs range from less than 100 kilometres of piping or channels delivering water to less than 20 water access entitlement holders³⁹, to over 3500 kilometres delivering water to more than 3000 entitlement holders. The water entitlement amounts held by NSW PIIOs range from less than 30 gigalitres to greater than 1500 gigalitres.⁴⁰

1.11 It is generally acknowledged by governments, industry and conservationists that irrigation water could be used more efficiently. Between

³⁶ The Water Group Outcome Board comprises a departmental Deputy Secretary, who is the Chair, and the three First Assistant Secretaries who have responsibility for divisions within the Water Group.

³⁷ Department of Environment, Water, Heritage and the Arts, *Regulation Impact Statement* [Internet], DEWHA, Australia, 2009, available from <<http://www.accc.gov.au/content/item.phtml?itemId=878183&nodeId=b81f73bc4b8c83d9c8a0af76f3e61920&fn=Water%20Market%20Rules%202009%20-%20Explanatory%20Statement.pdf>> [accessed 25 October 2011].

³⁸ Some PIIOs also deliver water to commercial or industrial customers.

³⁹ Under NSW legislation, irrigators hold or own water access entitlements. Each irrigator has a legal right to receive and use water allocated against their entitlements in accordance with NSW legislation and the water delivery agreement between the irrigator and their PIIO.

⁴⁰ One gigalitre equals 1000 megalitres or 1 000 000 000 litres.

10 and 30 per cent of the water diverted from rivers into irrigation systems is lost before it reaches the farm gate. Inaccurate measurement of water diversions from rivers and water use on farms is leading to the unintentional and intentional overuse of water.⁴¹ More specifically, losses in irrigation infrastructure systems can arise from:

- outfalls, that is, water flowing from the downstream-end of the delivery system;
- farm irrigation water meter inaccuracy;
- unrecorded usage of water where water usage is not metered or stolen;
- leakage of water from channels through channel banks and structures;
- seepage, that is, the movement of water through the beds of irrigation channels; and
- evaporation in channels and storages.⁴²

1.12 Irrigation infrastructure operators face ongoing costs to maintain irrigation infrastructure, which can be worth hundreds of millions of dollars. Many of these costs are fixed, in that they are incurred whether an irrigator chooses to terminate or remain connected to the operator's irrigation network.

Selecting and contracting PIIOP projects

1.13 On 19 June 2009, the then Minister for Climate Change and Water announced the launch of PIIOP, inviting PIIOs operating in the NSW Basin to submit funding applications. To guide the preparation of applications, DSEWPaC developed and published program guidelines containing eligibility and merit criteria that reflected the economic/social, environmental/technical and value for money criteria to be applied to the assessment of all State Priority Projects under SRWUIP. The application period closed on 27 November 2009, with the department receiving seven applications.

1.14 PIIOP applications were assessed by an assessment panel that included departmental officers and external advisors. Those projects considered to be

⁴¹ Department of Sustainability, Environment, Water, Population and Communities, *Irrigation* [Internet], DSEWPaC, Australia, 2011, available from < <http://www.environment.gov.au/water/topics/irrigation.html> > [accessed 2 November 2011].

⁴² Marsden Jacob Associates, *Improving water-use efficiency in irrigation conveyance systems: A study of investment strategies*, Land & Water Australia, May 2003, pp. 7 and 8.

the most meritorious were recommended to the then Minister for Climate Change, Energy Efficiency and Water for funding approval. On 13 and 14 April 2010, the then Minister announced that \$263 million of PIIOP funding had been allocated to five projects in two catchments across the NSW Basin in return for 69.5 gigalitres in water access entitlements.⁴³ During the period July 2010 to June 2011, funding agreements were executed with all successful applicants. DSEWPac expects that Round 1 projects will be completed by May 2014.

1.15 PIIOP was originally designed to select projects to modernise and upgrade irrigation infrastructure in a single funding round. However, as DSEWPac's recommendations to fund Round 1 PIIOP projects did not exhaust the program's funding allocation, a second funding round was undertaken that fully allocated PIIOP funding.

1.16 On 18 February 2011, the Minister for Sustainability, Environment, Water, Population and Communities (the Minister) launched PIIOP Round 2 and DSEWPac published revised program guidelines. The application period was open for five months and closed on 22 July 2011. The department received five applications under Round 2. An assessment panel similar to the panel constituted for PIIOP Round 1 assessed the applications and provided recommendations for funding to the Minister. On 12 December 2011, the Minister announced that PIIOP funding of \$382.5 million⁴⁴ had been allocated to four projects in three NSW catchments in return for 102.9 gigalitres in water access entitlements.⁴⁵ In April 2012, DSEWPac advised that the funding agreements for Round 2 projects are expected to be executed by June 2012.

1.17 The successful applicants, their projects, funding allocations and the dates on which funding agreements were executed are outlined in Table 1.1.

⁴³ This equates to 39.7 gigalitres of long-term cap equivalent. Long-term cap equivalent (or LTCE) was the method used by DSEWPac at this time to standardise the calculation of expected water recoveries in the Murray–Darling Basin from the different water access entitlement categories across the catchments of the Basin.

⁴⁴ Subsequently, the Minister approved a funding increase of \$3 880 000 for one project to correct a departmental assessment error.

⁴⁵ This equates to 75.1 gigalitres of long-term average annual yield. Long-term average annual yield (or LTAAAY) is the current method used by DSEWPac to standardise the calculation of expected water recoveries in the Murray–Darling Basin from the different water access entitlement categories across the catchments of the Basin. The differences between the current LTAAAY and former LTCE methods are only minor.

Table 1.1**PIIOP projects being funded**

Applicant (catchment)	Description of projects	Maximum funding announced	Date funding agreement signed
Round 1			
Coleambally Irrigation Cooperative Limited (Murrumbidgee)	Includes: channel lining of known hot spots ¹ ; on-farm upgrades; installation of water management technologies; and provision of stock and domestic pipeline	\$51 218 330	7 January 2011
Murrumbidgee Irrigation Limited (Murrumbidgee)	Includes: modernisation of supply system; and rationalisation	\$50 000 000	16 June 2011
Marthaguy Irrigation Scheme (Macquarie)	Includes: rationalising scheme channels; provision of stock and domestic pipeline; and improved channel management technologies	\$9 528 690	13 August 2010
Tenandra Scheme (Macquarie)	Includes: restructuring of channel configuration; channel upgrades; on-farm upgrades; and rationalisation	\$37 475 140	12 July 2010
Trangie-Nevertire Irrigation Scheme (Macquarie)	Includes: provision of a stock and domestic pipeline; channel lining; on-farm upgrades; and rationalisation	\$115 000 000	4 January 2011
Round 2			
Murray Irrigation Limited (NSW Murray)	Includes: water management and metering upgrades; channel lining; system reconfiguration; and rationalisation	\$169 226 315 ²	Under negotiation
Murrumbidgee Irrigation Limited (Murrumbidgee)	Includes: provision of stock and domestic pipelines; automation of system control structures; channel upgrades; and on-farm upgrades	\$149 622 911	Under negotiation
Narromine Irrigation Board of Management (Macquarie)	Includes: channel upgrades; automation of system control structures; upgrade to pumping station; and rationalisation	\$60 237 244	Under negotiation
Coleambally Irrigation Cooperative Limited (Murrumbidgee)	Includes: construction of a storage facility; and meter replacement	\$7 350 000	Under negotiation

Source: Wong, P., *Infrastructure Rolls Out in Macquarie River Catchment*, Media Release, 13 April 2010; Wong, P., *Improved infrastructure for NSW Irrigation Communities*, Media Release, 14 April 2010; and Burke, T., *New Infrastructure projects for NSW irrigation districts*, Media Release, 12 December 2011; and DSEWPac.

Note 1: Hotspots are areas in an irrigation supply system where localised significant water losses are occurring through evaporation, seepage, leakage and operational components.

Note 2: Includes an increase of \$3 880 000 to correct a departmental assessment error.

Related programs

1.18 PIIOP is one of a number of programs funded separately or jointly by the Australian and NSW governments targeted towards NSW irrigation infrastructure operators and irrigators. These programs include the Restoring the Balance (RtB) program⁴⁶, Irrigator-led Group Proposals (ILGP) program⁴⁷, the On-Farm Irrigation Efficiency Program (OFIEP) and Water for Rivers (WfR) program.

1.19 Another Australian Government program relevant to PIIOP is the Irrigation Modernisation Planning Assistance (IMPA) program. Under the IMPA program, irrigation water providers could apply for funding to complete a modernisation plan consistent with the criteria set by the Australian Government. The aim of the program is to assist irrigation water providers to identify and consider a range of options available to increase the efficiency of their irrigation systems and adapt to a future with less water. Eligibility for PIIOP funding required applicants to have undertaken or completed a modernisation plan in accordance with the IMPA program guidelines or equivalent.⁴⁸

Program reviews

1.20 SRWUIP has been the subject of several external reviews and parliamentary inquiries. These include the:

- 2010 Productivity Commission review;
- House of Representatives Inquiry into the proposed Basin Plan; and
- Senate Inquiry into the management of the Basin.

⁴⁶ The Restoring the Balance program was recently subject to a performance audit—ANAO Audit Report No. 27 2010–11 *Restoring the Balance in the Murray–Darling Basin*—which was tabled on 10 February 2011.

⁴⁷ As part of the 2012–13 Budget, the Australian Government announced that the ILGP program would be replaced by the Strategic Sub-System Reconfiguration program from 2012–13. (Source: Commonwealth of Australia, *Budget Measures: Budget Paper No. 2 2012–13*, 8 May 2012, p. 275.)

⁴⁸ All but one of the Round 1 applicants who received PIIOP funding developed a modernisation plan with IMPA funding assistance. The remaining applicant was considered to have undertaken the equivalent of a modernisation plan.

2010 Productivity Commission review

1.21 In March 2010, the Productivity Commission reported on the *Market Mechanisms for Recovering Water in the Murray–Darling Basin* study. While the report focused on the purchase of water access entitlements under the RtB Program, the Productivity Commission concluded that recovering water through subsidising infrastructure was generally much less cost effective and efficient compared to buybacks. The Minister has since acknowledged that infrastructure funding in the Basin returned less water per dollar than buyback programs, but that it provides: ‘a great dividend for those regional communities’.⁴⁹

House of Representatives Inquiry into the Proposed Basin Plan

1.22 In June 2011, the House Standing Committee on Regional Australia tabled the *Of drought and flooding rains* report on the inquiry into the socio-economic impacts of the MDBA’s *Guide to the proposed Basin Plan* (the Guide)—the precursor to the *Proposed Basin Plan*—on communities in regional Australia. Overall, the Committee’s final report acknowledged that the release of the Guide had a significant negative impact on Basin communities. The report proposed new governance and institutional arrangements for the transition to and implementation of the Basin Plan. Two of the report’s 21 recommendations that are of particular relevance to PIIOP related to: rectifying all impediments to irrigation investment in the taxation system⁵⁰; and focusing greater investment in on- and off-farm water saving projects.⁵¹

Senate Inquiry into the Basin

1.23 The Senate Standing Committee on Rural Affairs and Transport is inquiring into the management of the Basin and the development and implementation of the Basin Plan. The committee’s final report is expected to be tabled in the Parliament on 29 June 2012. The committee’s interim report tabled in November 2011 did not comment on irrigation infrastructure-related matters.

⁴⁹ Wilkinson, M., *Backlash in the Basin*, Program transcript from Four Corners, Australian Broadcasting Corporation, first broadcast 28 February 2011, <<http://www.abc.net.au/4corners/content/2011/s3157341.htm>> [accessed 29 March 2011].

⁵⁰ The impact of taxation of PIIOP funding for PIIOs is discussed in Chapters 2 and 4.

⁵¹ House of Representatives Standing Committee on Regional Australia, *Of drought and flooding rains*, The Parliament of the Commonwealth of Australia, Australia, 2011, pp. XVII–XXIII.

Commonwealth grants administration framework

1.24 Australian Government grant programs involve the expenditure of public money and are subject to applicable financial management legislation. Specifically, the *Financial Management and Accountability Act 1997* (FMA Act) provides a framework for the proper management of public money and public property, which includes requirements governing the process by which decisions are made about whether public money should be spent on individual grants.

1.25 Following the introduction in December 2007 of interim measures to improve grants administration, the Government agreed in December 2008 to a suite of reforms, including the development of an improved framework for grants administration. These were given effect through revised Finance Minister's Instructions issued in January 2009 and have now been reflected in the enhanced legislative policy framework for grants administration that came into full effect on 1 July 2009. The new framework has a particular focus on the establishment of transparent and accountable decision-making processes for the awarding of grants, and includes new specific requirements under the financial management framework in relation to grants administration and the CCGs. Officials performing grants administration duties must act in accordance with the CCGs.

Audit objective, criteria and methodology

1.26 The objective of the audit was to assess the effectiveness of DSEWPaC's administration of PIIOP in NSW, including the acquisition of water access entitlements and progress towards achieving the program's objectives.

1.27 The audit examined whether DSEWPaC:

- effectively implemented PIIOP and had appropriate governance arrangements to support the program;
- assessed and selected applications in both funding rounds in accordance with the *Commonwealth Grant Guidelines* (CGGs)⁵²; and

⁵² The *Commonwealth Grant Guidelines* (CGGs) outline seven principles for grants administration, which are: (1) Robust planning and design; (2) An outcomes orientation; (3) Proportionality; (4) Collaboration and partnership; (5) Governance and accountability; (6) Probity and transparency; and (7) Achieving value with public money. (Department of Finance and Deregulation, *Commonwealth Grant Guidelines—Policies and Principles for Grants Administration*, Finance Management Guidance No. 23, July 2009, p. 14.)

- negotiated appropriate funding agreements for Round 1 projects and established effective arrangements to monitor the implementation of the projects and the achievement of the program's objectives.

1.28 While the design and establishment of PIIOP occurred before the CGGs came into full effect from July 2009, the assessment and selection of Round 1 applications and the entire Round 2 application and assessment process occurred after the introduction of the CGGs.

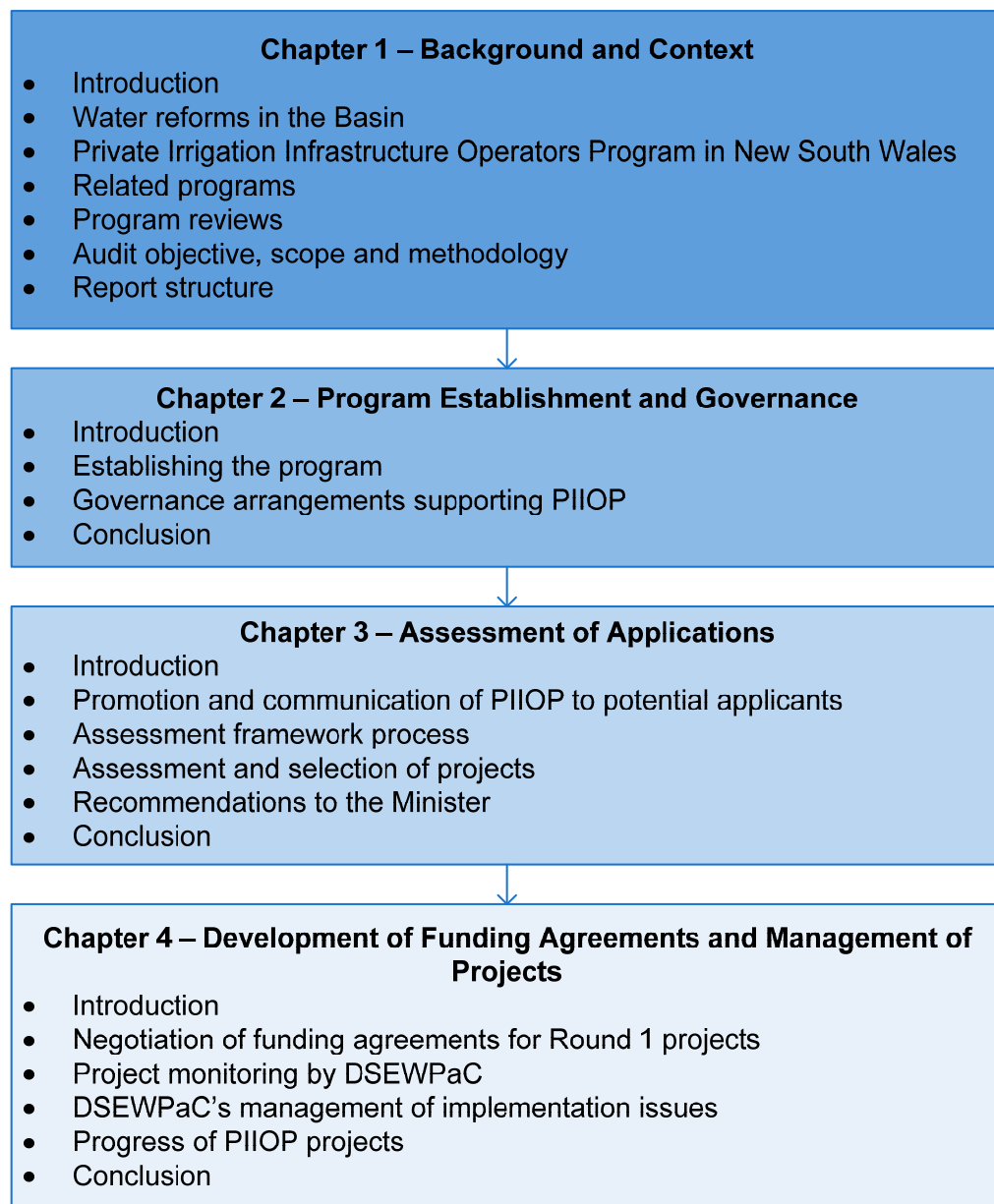
Audit methodology

1.29 In undertaking the audit, the ANAO examined departmental records, including program guidelines, procedures, assessment documentation and funding agreements signed with successful applicants. The ANAO also obtained feedback on DSEWPac's administration of PIIOP from stakeholders, including potential and actual applicants, peak irrigation organisations and relevant state and federal government agencies. In addition, relevant DSEWPac staff and applicants under Round 1 of PIIOP were interviewed.

1.30 The audit was conducted in accordance with the ANAO Auditing Standards at a cost of \$500 000.

Report structure

1.31 The structure of the report is outlined in Figure 1.1.

Figure 1.1**Structure of the report**

Source: ANAO

2. Program Establishment and Governance

This chapter discusses the establishment of PIIOP, including the development of program guidelines, the influence of other irrigation programs and the taxation arrangements for PIIOP funding. The governance arrangements supporting PIIOP are also examined.

Introduction

2.1 Effective program design and planning reflects the objectives of the program, takes account of the business environment within which the program is to operate and the views of the program's stakeholders. An important aspect of program design is identifying and mitigating the risks to the achievement of the program's objectives and establishing effective administrative and governance arrangements to deliver the program.

2.2 The ANAO examined DSEWPac's establishment of PIIOP and the governance arrangements in place to support the program.

Establishing the program

Policy foundation

2.3 Under the Basin Agreement, signed on 3 July 2008 at a meeting of the Council of Australian Governments (COAG), the Australian Government agreed in-principle to provide around \$3.7 billion for significant State Priority Projects located in each Basin jurisdiction, subject to due diligence assessments. As part of the NSW Priority Projects, \$650 million of in-principle funding was allocated to support private irrigators in NSW to upgrade irrigation infrastructure. PIIOP was developed by the Australian Government to meet its commitment to COAG.

2.4 Most State Priority Projects are managed by the relevant Basin jurisdiction. However, negotiations between Australian and NSW Government officials determined that the Australian Government would take responsibility for the administration of PIIOP. The primary reason was that the irrigation infrastructure sector in NSW has been privatised and the Australian Government could work and contract directly with irrigators.

2.5 Aspects of PIIOP's design were determined by the Basin Agreement. For example, all State Priority Projects, including PIIOP, had to meet specific due diligence criteria related to economic/social, environmental, value for money, and water reform aspects of the Projects, as well as compliance with state and Commonwealth environmental legislation. In addition, the Basin Agreement stipulates that State Priority Projects involving irrigation systems require independently-conducted water loss hotspots assessments and modernisation plans to be developed.⁵³ These due diligence requirements have been incorporated into the design of PIIOP through program eligibility and merit criteria.

Key design elements

Administrative framework for PIIOP

2.6 DSEWPaC has established SRWUIP in accordance with the policy intent of the Australian Government to invest primarily in the Basin to achieve fundamental change to water management in Australia. As one of the SRWUIP programs, PIIOP targets funding to PIIOs and their irrigators to improve irrigation efficiency through infrastructure upgrades, in return for a share in the water efficiency gains. Early in the program, DSEWPaC had to determine and apply an administrative framework that acknowledged and facilitated the investment focus of PIIOP. However, PIIOP has features common to two established administrative frameworks relevant to the implementation of government programs—that is, grants management and procurements.

2.7 DSEWPaC considered that PIIOP had more in common with a grants program than a procurement activity. The department therefore chose to apply a grants-based framework, underpinned by the CGGs, to administer PIIOP. While the department informed the ANAO that it consulted with the Department of Finance and Deregulation (Finance)⁵⁴ early in PIIOP's design regarding the appropriate treatment of the program, the details of these consultations were not recorded by DSEWPaC. Nevertheless, as part of the Government's final approval of the guidelines in April 2009, Finance indicated to the Government its support for the grant program as DSEWPaC proposed.

⁵³ Hotspots are areas in an irrigation supply system where localised significant water losses are occurring through evaporation, seepage, leakage and operational components. Irrigation modernisation plans are designed to identify, and allow irrigation water providers to consider, a range of options to increase the efficiency of their irrigation systems and adapt to a future with less water.

⁵⁴ Finance retains policy responsibility for public sector procurements and grants management.

2.8 DSEWPaC's briefings to the Minister indicated that PIIOP would apply the SRWUIP investment principles (outlined in paragraph 1.5 in Chapter 1), and that applications for funding would be selected after their assessment against the due diligence criteria applying to all State Priority Projects (which became the program's eligibility and merit criteria). However, it would have been prudent for DSEWPaC to have informed the Minister, who was responsible for funding decisions made under PIIOP, of the framework being applied to the administration of the program, after consulting with Finance.

Adoption of a one-stage process

2.9 Program design features and the related processes should be commensurate with the scale, nature, complexity and risks involved in the funding activity.⁵⁵ A key design feature for consideration by administering agencies is whether to adopt a one-stage or two-stage application approach.

2.10 Under a two-stage application approach, a form of pre-assessment can be used to assist prospective applicants in determining whether there is likely to be merit in them investing in the preparation of a full application. In the pre-assessment stage, applicants provide a clear and concise expression of interest that provides enough information to allow the department to determine whether the project is likely to be eligible. If the program decision-maker determines from the expression of interest that the applicant and project are likely to meet program eligibility criteria and could be competitive, the applicant is invited to submit a full application. Full applications are then assessed against the program criteria as part of a competitive, merit-based round.⁵⁶

2.11 While DSEWPaC considered adopting a two-stage application approach for PIIOP, the department determined that a one-stage process would be employed. The department's rationale was based on there being a limited number of known potential applicants and the eligibility criteria requiring all potential applicants to have an irrigation modernisation plan or equivalent—the development of which could be funded under the Irrigation Modernisation Planning Assistance (IMPA) program.

⁵⁵ Department of Finance and Deregulation, 2009, *Commonwealth Grant Guidelines: Policies and Principles for Grants Administration*, p. 19.

⁵⁶ ANAO Better Practice Guide, June 2010, *Implementing Better Practice Grants Administration*, p. 48.

2.12 DSEWPaC considered that the IMPA program would underpin the PIIOP application process.⁵⁷ The aim of the IMPA program was to assist Irrigation Water Providers⁵⁸ to identify and consider a range of options available to increase the efficiency of their irrigation systems and adapt to a future with less water. Six of the seven Round 1 PIIOP applicants received IMPA funding assistance ranging from \$80 000 to \$500 000 (the maximum available)—broadly in proportion to their size. DSEWPaC expected the irrigation modernisation plans would provide applicants with the key information required to complete their PIIOP applications.

2.13 The IMPA-funded modernisation plans had to meet established criteria to be accepted by the department. DSEWPaC's analyses of the final modernisation plans submitted by IMPA participants and accepted by the department showed variance in their quality and comprehensiveness.⁵⁹ For example, in addressing issues such as future water availability, some IMPA program participants only provided basic qualitative analysis whereas others provided more detailed analysis. Further, some of the participants did not address, or only briefly addressed, issues such as:

- the way their organisation would adjust their operations to meet new water reform requirements;
- their district's future viability;
- the improvements in water efficiency as a result of identified modernisation options; and
- the cost of each identified modernisation option.

2.14 DSEWPaC informed the ANAO that the modernisation plans resulting from the IMPA program provided the department with useful insights into the state of irrigation infrastructure systems. However, the ANAO considers that the variance in quality and comprehensiveness across modernisation plans had an adverse impact on their usefulness in underpinning the PIIOP application process.

⁵⁷ The IMPA program is administered by the same area within DSEWPaC that administers PIIOP.

⁵⁸ An Irrigation Water Provider is an organisation that owns or operates infrastructure for the purpose of delivering water to other persons for the primary purpose of irrigation. PIIOPs are a subset of Irrigation Water Providers.

⁵⁹ The ANAO did not examine the extent to which modernisation plans met the minimum quality standards under the IMPA program.

2.15 Despite having completed a modernisation plan or equivalent, all six of the PIIOP Round 1 applicants interviewed by the ANAO stated that the PIIOP one-stage application process had been time-consuming, costly and presented a range of risks.⁶⁰ In particular, some PIIOs commented on the lack of readily available management expertise and finances to fund the development of detailed PIIOP applications. PIIOs advised the ANAO that they had to balance the effort and resources they allocated to their application with their likelihood of success.

2.16 Half of the PIIOP Round 1 applicants indicated they would have preferred a two-stage application process, similar to that adopted under the On-Farm Irrigation Efficiency Program (OFIEP)—a program with similar objectives to PIIOP that is administered by the same area within DSEWPaC. The staged approval of an OFIEP application allowed applicants to invest in developing a full application that met DSEWPaC's detailed requirements with greater assurance as to its likelihood of success. Figure 2.1 outlines the application approach taken under OFIEP.

Figure 2.1

The OFIEP two-stage application approach

Under OFIEP stage-one, applicants prepared applications at a whole-of-project level that:

- identified the types of irrigation infrastructure improvements that would be delivered;
- estimated the water savings the project would generate (and the water entitlements that would be offered to the Australian Government); and
- outlined how the applicants would identify and evaluate individual irrigator sub-projects if they were successful in this stage.

The best stage-one applications that met the eligibility and minimum merit criteria thresholds would receive 'in-principle' approval and be invited to submit a stage-two application. Stage-two applications were to contain individual irrigator sub-project information consistent with the parameters of the applicant's stage-one application. Stage-two applications had to meet the same eligibility and merit criteria as applied in stage-one before projects received formal approval.

Source: ANAO from DSEWPaC information.

⁶⁰ Six of the seven Round 1 applicants were interviewed by the ANAO. The remaining applicant declined to be interviewed.

2.17 A two-stage application approach has costs as well as benefits—most notably the extra time and expense involved in seeking and assessing multi-stage applications from applicants. Nevertheless, an effective two-stage application approach that leads to the submission of high quality stage-two applications can make their assessment easier, thus saving time, and provide greater confidence that selected projects will lead to the achievement of program objectives.

2.18 The department identified significant quality issues with Round 1 applications under PIIOP, but again applied a one-stage application approach to Round 2. DSEWPac attempted to provide additional guidance to applicants to improve the quality of their applications, but this was unsuccessful and is discussed later in this chapter. The variable quality of both Round 1 and Round 2 applications had an adverse impact on DSEWPac's assessment process (as discussed in Chapter 3).

Taxation treatment

2.19 The taxation treatment of Australian Government funding can have a significant bearing on the willingness of potential applicants to participate in a funding assistance program. The funding that any one applicant could apply for under PIIOP (up to \$650 million) represents over 10 times the annual turnover of the largest PIIOPs in NSW. Taxation liabilities arising from PIIOP funding for applicants could potentially involve millions of dollars. Consequently, successful PIIOP applicants were unlikely to enter into legally-binding agreements with the Australian Government without an understanding of the manner in which PIIOP funding would be taxed.⁶¹

2.20 The payment of funding assistance by the Australian Government is not subject to a fixed or 'standard' tax treatment. The applicable tax treatment will depend on a combination of factors, including: the nature and characteristics of the funding assistance (in particular, the purpose of the funding assistance and the manner in which the funding will be delivered); the status and circumstances of the funding recipient; and the provisions of any governing legislation.⁶² The *Strategic Review of The Administration of Australian Government Grant Programs* (July 2008) recommended that the expected tax

⁶¹ Grants are generally considered as taxable income to recipients, unless legislation specifically provides otherwise.

⁶² Grant, P., *Strategic Review of The Administration of Australian Government Grant Programs*, 31 July 2008.

treatment should be considered explicitly in the planning and design of any new grant program and that agencies should consult with the Australian Taxation Office (ATO) during the program design stage.⁶³

2.21 DSEWPaC first considered the taxation issues associated with PIIOP funding late in the design of the program—after stakeholder consultations on the draft program guidelines. In late January 2009, DSEWPaC engaged the Australian Government Solicitor (AGS) to provide advice and aid the department's understanding of the capital gains tax (CGT) implications of PIIOP funding.⁶⁴ During the development of the taxation advice the AGS consulted with the ATO. The ATO indicated that:

- the best outcome for applicants would be a CGT outcome rather than an income tax outcome⁶⁵;
- to support a CGT outcome, PIIOP documentation (including the guidelines and funding agreement) would need to indicate that the department was purchasing a water access entitlement; and
- the ATO would take into account all PIIOP documentation when considering the taxation treatment of PIIOP funding.

2.22 DSEWPaC altered the PIIOP guidelines and commenced redrafting the funding agreement in accordance with the AGS's taxation advice and the principles outlined in earlier discussions with the ATO. However, the ATO informed DSEWPaC in November 2009 that the revised funding agreement did not support a CGT outcome. Rather than purchasing water access entitlements, the funding agreement, as drafted, had entitlement acquisitions as a consequence of expenditure on infrastructure upgrades. DSEWPaC

⁶³ *ibid.*, Recommendation 20 (a) and (b).

⁶⁴ Under Australian taxation law, taxable entities are subject to capital gains tax (CGT). When a 'CGT Event' occurs in respect of a 'CGT asset' (such as on the asset's disposal), tax is levied on any capital gain. A capital gain is the difference between the 'capital proceeds' (what is received on the asset's disposal) and the asset's 'cost base' (what it cost to acquire the asset). Water access entitlements are classified as CGT assets. Only assets acquired since tax on capital gains came into effect (on 20 September 1985) are subject to CGT unless specifically excluded.

⁶⁵ If the grant is deemed to be assessable income, income tax is payable in the year the grant is received. Current tax law allows water infrastructure to be depreciated over the following three years (subdivision 40F of the *Income Tax Assessment Act 1997*). The timing of the tax payment and delayed depreciation write-off would have had an impact on cash flow. The applicants would have faced a substantial tax bill in year one when they recorded the whole grant as 'income', but may not have had sufficient income in years two and three to benefit from the remaining deductions.

considered that further amending the draft funding agreement would not alter this outcome.

2.23 After the Water Group Outcome Board⁶⁶ accepted a recommendation from the PIIOP section that the taxation outcomes be allowed to ‘lie as they fall’, DSEWPaC released the draft funding agreement to the five successful PIIOP applicants on 20 April 2010, a week after the announcement of the approved applications. All PIIOs, after consulting with their taxation advisors, identified the potentially significant taxation liabilities that could arise from entering into a PIIOP funding agreement with the Australian Government. The resolution of the PIIOP taxation issue is examined in detail in Chapter 4.

2.24 The consideration of the taxation implications in the design stages of PIIOP and the formulation of the draft funding agreement prior to the launch of the program would have better positioned the department to identify and treat the risks to program delivery from the taxation treatment of program funds.

Coordination of irrigation programs

2.25 As previously noted, there are a number of Australian Government and NSW Government programs with similar goals to PIIOP that target PIIOs and irrigators. The Restoring the Balance (RtB), Irrigator-led Group Proposals (ILGP) and Water for Rivers (WfR) programs all provide opportunities for targeted irrigators in the NSW Basin areas to sell their water access entitlements to the Australian Government. In addition, programs such as ILGP, WfR and OFIEP provide opportunities for targeted irrigators to receive funding for water efficiency and infrastructure projects (including decommissioning infrastructure) in exchange for water access entitlements.

2.26 While the objective, eligibility and funding activities of each program are outlined separately in material published by DSEWPaC, the relationships between the programs and how potential overlaps would be managed was not evident. Round 1 PIIOP applicants interviewed by the ANAO advised that the various Australian and NSW Government programs did not appear to be well coordinated. The limited coordination created uncertainty for PIIOs and their

⁶⁶ The Water Group Outcome Board (the Board) has an oversight role for all programs under SRWUIP, including PIIOP. The role, composition and function of the Board are discussed from paragraph 2.50.

irrigator membership when preparing PIIOP applications. For example, PIIOs commented that:

- the Australian Government could be purchasing water entitlements from the PIIOs' membership while PIIOs were planning to invest, or after they had invested, in modernising their own and their members' irrigation infrastructure under PIIOP; and
- while PIIOs may wish to 'retire' certain farms from their irrigation schemes under PIIOP, those farmers may also see an opportunity under OFIEP to upgrade their on-farm irrigation infrastructure—without the need to inform or involve the PIIO concerned of their intentions.

2.27 DSEWPac advised the ANAO that it recognised the potential for overlaps between water programs and undertook internal reviews to identify 'double-dipping' or 'gaming' on an application-by-application basis. While reviews help to ensure the integrity of government programs, they do not address the potential confusion among PIIOs and their irrigator membership that arises when multiple programs fund similar activities involving similar target groups.

2.28 Greater consideration of the potential overlaps between the various water efficiency and buyback programs during the establishment of PIIOP, such as through the development of a communication strategy, would have better positioned DSEWPac to more clearly articulate the objectives of PIIOP and outline the differences between, and the requirements of, the various programs.

Program guidelines and supporting documents

Development of the program guidelines and launch of the program

2.29 DSEWPac prepared and submitted a draft set of PIIOP guidelines to the then Minister for Climate Change and Water in early October 2008. At this time, the department also sought the Minister's approval to begin consultations with the NSW Government and industry. The Minister subsequently wrote to the NSW Minister for Water on 20 November 2008 seeking feedback on the draft PIIOP guidelines. DSEWPac also held an industry consultation meeting on the draft PIIOP guidelines in December 2008 (involving NSW PIIOs, industry peak bodies and other government agencies).

2.30 In general, DSEWPac considered the feedback received from stakeholders on the PIIOP draft guidelines and reflected this in the guidelines,

where appropriate. For example, DSEWPaC implemented stakeholders' requests that the IMPA program remain open so that PIIOs could apply for irrigation modernisation planning funding to assist their eligibility for PIIOP and that a reference to the IMPA program be included in the PIIOP guidelines. As noted earlier, feedback from PIIOs regarding taxation issues also prompted DSEWPaC's engagement of the AGS and consultations with the ATO on the taxation implications of PIIOP funding. The final PIIOP guidelines were amended to reflect ATO requirements.

Contents of the program guidelines

2.31 The PIIOP guidelines for both Round 1 and Round 2 included key program information, such as the objectives of the program, the amount of funding available, eligible applicants and projects, the merit-based selection criteria, how to apply and the deadline for applications. However, the inclusion of the following information would have improved the comprehensiveness of the guidelines and better informed applicants about the assessment process:

- the amount of funding applicants could apply for (which was up to the total available program funding);
- details of those responsible for assessing applications and making recommendations to the Minister;
- the relative importance of the merit criteria;
- complaint, review or appeal mechanisms; and
- the terms and conditions of funding.

Approval of the program guidelines

2.32 The Minister approved the final PIIOP guidelines on 23 March 2009. As was required by Finance for all new grant programs, the guidelines were sent to the Expenditure Review Committee of Cabinet (ERC) for approval, which was obtained on 8 April 2009.⁶⁷ PIIOP Round 1 was launched on 19 June 2009, with the department advising the ANAO that the timing of PIIOP's launch was at the Minister's discretion.

2.33 At the conclusion of the Round 1 application assessment process in April 2010, DSEWPaC considered that PIIOP Round 2 could be launched as

⁶⁷ The Australian Government subsequently approved the PIIOP guidelines on 22 April 2009.

early as July 2010. However, the Minister was not briefed on the Round 2 process until November 2010 due to departmental resourcing constraints and the 2010 Federal Election. At this time, the Minister agreed with DSEWPaC's recommendation to seek further PIIOP applications under a second round, to be launched at an unspecified future date. PIIOP Round 2 was launched on 18 February 2011.

Draft funding agreement

2.34 The draft funding agreement contains the terms and conditions of funding that apply to successful PIIOP applicants. However, potential Round 1 applicants had not been provided with the program's draft funding agreement, or advised of its contents, at the time of lodging applications.

2.35 DSEWPaC did not begin work on developing the PIIOP draft funding agreement until March 2009, pending the finalisation of the program guidelines. The department used the funding agreement template developed for OFIEP as the basis for the PIIOP funding agreement. DSEWPaC's legal area was involved throughout the development of the PIIOP funding agreement.

2.36 The draft funding agreement was not released until April 2010—after the selection of Round 1 projects—due to the continuing issues with the taxation implications of PIIOP funding and the valuation of water access entitlements. It would have been advantageous for program stakeholders to have been consulted on the contents of the draft funding agreement at the same time as consultations on the guidelines occurred (that is, December 2008). In any event, the draft funding agreement should have been available to potential applicants at the same time as, or soon after, the program guidelines were released (in June 2009) so that applicants could make an informed decision when applying for PIIOP funding.

2.37 Under Round 2 of PIIOP, the draft funding agreement was made available to potential applicants one month prior to the close of the application period. DSEWPaC did not provide the draft funding agreement to potential applicants earlier as the department was revising the agreement structure and the content of the schedule. Although the two successful Round 1 applicants applying for additional funding in Round 2 would have been familiar with the general terms and conditions of PIIOP funding, the other three Round 2 applicants did not have access to this information. Providing the general terms and conditions of the Round 1 funding agreement as preliminary guidance, and noting that it would be updated, would have assisted Round 2 applicants.

Changes to the guidelines and supporting documentation

2.38 At the conclusion of the Round 1 application assessment process, DSEWPaC received feedback from applicants that:

- the guidelines contained insufficient guidance on the level of detail DSEWPaC required for PIIOP applications; and
- the Round 1 application form constrained their ability to effectively present their projects.

2.39 In response to this feedback, and based on DSEWPaC's experience from Round 1, the department made changes to the program guidelines for Round 2 and developed additional guidance material for Round 2 applicants.

2.40 DSEWPaC changed the objectives of PIIOP in the published program guidelines between the two funding rounds (as outlined in Table 2.1). The objectives for Round 1 were based on the objectives of SRWUIP (which includes PIIOP)⁶⁸, with the wording sourced from taxation advice from the AGS (and supported by the ATO) to minimise the possibility of any adverse taxation outcomes for recipients. In Round 2, the program's objective was changed by the inclusion of the separate 'secure a sustainable future for irrigation communities' objective in the Round 1 guidelines, as a sub-element of the 'acquire water entitlements' objective common to the guidelines of both rounds.

⁶⁸ The objectives of SRWUIP are contained in paragraph 1.5 in Chapter 1.

Table 2.1

PIIOP objectives

Round 1 guidelines (June 2009)	Round 2 guidelines (February 2011)
<p>To acquire water entitlements resulting from water savings <u>generated by the implementation of eligible projects</u> to improve the efficiency and productivity of water use and management, both off and on-farm, by private irrigation infrastructure operators, <u>and which also</u> secure a sustainable future for irrigation communities.</p> <p><u>These projects</u> will allow private irrigation infrastructure operators and their customers to <u>minimise</u> water losses and manage their water allocations more efficiently. They will also assist <u>dependent</u> irrigation communities to adapt to a future scenario of reduced water availability due to climate change.</p>	<p>To acquire water entitlements resulting from water savings from eligible projects that improve the efficiency and productivity of water use and management, both off and on-farm, by private irrigation infrastructure operators, helping to secure a sustainable future for irrigation communities.</p> <p>The projects will allow private irrigation infrastructure operators and their customers to reduce water losses and manage their water allocations more efficiently. They will also assist irrigation communities to adapt to a future scenario of reduced water availability due to climate change.</p>

Source: DEWHA, *Sustainable Rural Water Use and Infrastructure Program: Guidelines for the Private Irrigation Infrastructure Operators Program in New South Wales*, June 2009, p. 5; and DSEWPaC, *Sustainable Rural Water Use and Infrastructure Program: Guidelines for the Private Irrigation Infrastructure Operators Program in New South Wales—Round 2*, February 2011, p. 5.

Note: Emphasis added by the ANAO. Underlined text in the Round 1 guidelines has been replaced by the **bold and italicised text** in the Round 2 guidelines.

2.41 DSEWPaC made further changes to the Round 2 guidelines in response to stakeholder feedback and the department's experience from Round 1 including:

- requesting applicants to provide 'comprehensive detail' when addressing the required project specifications⁶⁹;
- removing the application form from Round 2;
- removing the requirement that the Australian Government expected to receive water entitlements representing at least 50 per cent of water being saved as a result of the implementation of approved projects;

⁶⁹ In the Round 1 PIIOP guidelines, the project specifications were listed as points that must be included.

- clarifying the detail required for the benefits-costs analysis for the applicant's projects and the taxation liabilities incurred as a result of participation in PIIOP;
- removing two merit sub-criteria (discussed further from paragraph 3.16 in Chapter 3); and
- requiring successful applicants to appoint a person to review the works funded to ensure they meet the specified targets.

2.42 DSEWPaC advised the ANAO that, apart from receiving oral feedback from PIIOP Round 1 applicants, the department did not consult with stakeholders on the Round 2 guidelines because the changes were considered minimal. In November 2010, DSEWPaC submitted a briefing paper to the Minister indicating that the program guidelines for PIIOP Round 2 were substantially the same as for Round 1, and that consultations with Finance determined that the ERC's reconsideration of the PIIOP guidelines was not required.

2.43 In response to stakeholder feedback requesting additional guidance, DSEWPaC:

- developed additional guidance in the form of explanatory notes and a technical guide; and
- advised applicants that an independent technical consultant would be engaged to provide Round 2 applicants with limited assistance to develop their applications.

2.44 DSEWPaC drafted explanatory notes to replace the Round 1 application form to assist applicants to prepare their PIIOP Round 2 applications. After finalising the explanatory notes in October 2010, DSEWPaC received probity advice advising the department of discrepancies between the explanatory notes and the draft PIIOP Round 2 guidelines. DSEWPaC subsequently decided against providing the explanatory notes to applicants and that the notes would be used to brief the independent technical consultant that would be made available for applicants to contact for assistance in preparing their application. The department subsequently decided against the appointment of this consultant because other *Water for the Future* programs did not provide the same level of support to applicants. There was also the risk that unsuccessful applicants may claim that their applications were not successful despite following the advice of the technical consultant.

2.45 In late March 2011, six weeks after the application period for PIIOP Round 2 commenced, DSEWPac tasked its contracted technical advisors with the development of a Technical Guide for Potential Applicants under PIIOP Round 2.⁷⁰ The technical guide was intended to provide applicants with additional information on the technical detail that DSEWPac sought for Round 2 PIIOP applications, including examples of how technical information could be presented. The drafting of the guide was completed in May 2011. During DSEWPac's clearance of the technical guide with departmental senior management, the department obtained internal legal advice regarding the appropriateness of releasing the guide to applicants at that time. The subsequent legal advice indicated that the technical guide: would constitute an amendment to the guidelines that may require ERC approval before release⁷¹; and could give rise to concerns about inequitable treatment of applications should some applicants choose to follow the technical guide while others did not. In June 2011, DSEWPac decided not to provide the technical guide to PIIOP Round 2 applicants.⁷²

2.46 DSEWPac initially planned to provide expanded guidance materials to Round 2 applicants to address issues identified from Round 1, but these materials were not finalised and/or released prior to the funding round. The information provided to Round 2 applicants was similar to that provided to Round 1 applicants. As a consequence, the variable quality issue encountered in Round 1 was also encountered by the department in respect of Round 2 applications.

Governance arrangements supporting PIIOP

2.47 PIIOP involves the expenditure of a significant amount of Australian Government funding to commercial enterprises for works on private land. Sound governance arrangements are important to manage the risks to the effective implementation of the program and the achievement of the

⁷⁰ The contracted technical advisors had earlier been engaged by DSEWPac to review workplans for the contracted Round 1 projects.

⁷¹ In September 2010, as part of various changes made with the objective of supporting strong and effective Cabinet Government, it was decided that items of a more routine nature, such as draft grant program guidelines, would be removed from the Cabinet agenda. Draft program guidelines are now submitted on a case-by-case basis, according to a risk assessment undertaken by the administering agency. Agencies are required to consult with Finance and the relevant policy area within the Department of the Prime Minister and Cabinet before the risk assessment is finalised.

⁷² The guide would, however, be available for any future rounds.

government's policy objectives. The ANAO examined the effectiveness of the governance arrangements put in place to oversee and support PIIOP, including: management arrangements within DSEWPaC; program planning; risk management; and performance monitoring and reporting.

PIIOP oversight

2.48 PIIOP is managed within a section in the department's Water Group. In addition, the Water Group Outcome Board has an oversight role for all programs under SRWUIP, including PIIOP.

Day-to-day management

2.49 PIIOP is managed on a day-to-day basis by a team of staff led by a project manager, who is responsible for: developing and maintaining project plans; tracking and deploying project resources; ensuring project delivery; and resolving or escalating issues and risks to the project sponsor or the Board. The PIIOP's project sponsor (an Assistant Secretary) provides higher level oversight of key risks and program delivery issues, as well as approving program management documentation and resources. In its early stages, PIIOP was administered by approximately 3.5 full-time equivalent departmental staff. This increased to 6.5 full-time equivalent staff in late 2011, reflecting the increased workload relating to the assessment of Round 2 applications and subsequent funding agreement negotiations.

Water Group Outcome Board

2.50 The Water Group Outcome Board (the Board) is responsible for providing integrated high-level governance to ensure the efficient and effective achievement of significant progress in the delivery of DSEWPaC's Outcome Four programs and projects (including PIIOP) within the Water Group.⁷³ The Board comprises a departmental Deputy Secretary, who is the Chair, and the three First Assistant Secretaries who have responsibility for divisions within the Water Group.

2.51 The Board meets monthly, with out-of-session meetings convened as necessary. The functions of the Board are outlined in the Water Group's

⁷³ DSEWPaC's Outcome 4 is: 'Adaptation to climate change, wise water use, secure water supplies and improved health of rivers, waterways and freshwater ecosystems by supporting research, and reforming the management and use of water resources'. Department of Sustainability, Environment, Water, Population and Communities, *Annual Report 2010–2011* [Internet]. DSEWPaC, Australia, 2011, available from <<http://www.environment.gov.au/about/publications/annual-report/10-11/index.html>> [accessed 8 November 2011].

Administrative Guide to the Project Management Framework and, in the context of PIIOP, include:

- endorsing PIIOP project plans;
- approving PIIOP guidelines and any supporting documentation (including the draft funding agreement) prior to release;
- approving the assessment plan prior to implementation;
- approving PIIOP key performance indicators (KPIs) that align with Outcome KPIs;
- resolving major project issues as required; and
- reviewing the monthly status reports on PIIOP.

Program implementation planning

2.52 Program management documentation that is endorsed by departmental executive management provides the basis for a shared understanding across the department of the requirements, constraints and risks to developing and implementing programs. Project plans also provide a basis for monitoring and reviewing implementation progress against objectives, outputs, timeframes and budgets over time.

2.53 The administrative arrangements for PIIOP were first documented by DSEWPac in a draft Program Annual Plan for the NSW Priority Projects Section (the section in which PIIOP was managed) in February 2009. The plan covered the period from November 2008 to June 2009. The draft plan identified, among other things: program objectives, outcomes and outputs; regulatory constraints on the program; related projects; project funding; governance arrangements; and stakeholder, risk and quality management considerations. Given the Plan covered several NSW Priority Projects, details relating to individual programs (including PIIOP) were limited, particularly for elements such as risk and stakeholder management. The plan was not, however, finalised or endorsed by DSEWPac senior management at that time, nor was the plan submitted to the Board for approval in accordance with the administrative arrangements established for SRWUIP programs.

2.54 In early June 2010, nearly two years after DSEWPac began designing the program, the department developed, and the Board approved, an Annual Plan for the NSW Priority Projects Section. However, it was not until a year later that a PIIOP-specific Project Plan was developed and approved by the

Board. This project plan expanded on the contents of the earlier Annual Plan and included enhanced risk strategies, stakeholder engagement arrangements, deliverables and timeframe information. The approved Project Plan better positions DSEWPaC to manage the ongoing delivery of the program.

Management of PIIOP risks

2.55 An important component of program planning is identifying key risks and developing appropriate mitigation strategies. DSEWPaC did not develop a comprehensive risk management plan or a risk register for PIIOP until the PIIOP-specific Project Plan was finalised in June 2011—nearly three years after the department began the design phase for the program. Prior to the development of the Project Plan, ad-hoc high-level risks and treatments were identified in the Board-approved Annual Plan and earlier draft documentation⁷⁴, but were not consolidated to inform management or executive oversight of the program.

2.56 The current PIIOP risk assessment and treatment plan, prepared in October 2011, identifies nine risks for the program with inherent, residual and target risks ratings⁷⁵ of 'medium' or 'low'.⁷⁶ The department's risk management guidelines emphasise the importance of continually reviewing the risk assessment and treatment plan. At irregular intervals, but generally twice a year, DSEWPaC has conducted risk assessment workshops for PIIOP as a precursor to updating the program's risk assessment and treatment plan. The latest workshop was held in October 2011.

2.57 DSEWPaC's initial informal approach to the management of program risks did not provide a sound basis for identifying, treating and reporting risks and issues impacting on the delivery of PIIOP. The development of a

⁷⁴ The sole high-rated risk identified in the Annual Plan relevant to PIIOP was 'NSW PIIOP participants fail to complete the contracts for funding'. Proposed risk treatments to lower the risk rating, however, did not identify any specific actions in addition to those already in place.

⁷⁵ Inherent risk is risk before existing controls are taken into account. Residual risk is risk after existing controls are taken into account. Target risk is risk after additional treatments are put in place, where applicable.

⁷⁶ Under DSEWPaC's risk management guidelines, residual risks rated 'low' or 'medium' are to be managed within the division. Existing treatments should be maintained and monitored for residual risks rated 'low'. For residual risks rated 'medium', additional treatments may be available to reduce the risk level. For residual risks rated 'high' or 'severe', the Deputy Secretary or Secretary, respectively, should be involved in the consideration of any available additional treatments. Under DSEWPaC's project management framework for PIIOP, the department's management of high-rated or extreme-rated risks is reported to the Board each month.

PIIOP-specific risk assessment and treatment plan will support more informed program delivery. Developing a comprehensive risk management plan prior to the implementation of programs would better position DSEWPaC to identify and manage risks to the successful delivery of departmental programs.

Performance monitoring and reporting

Internal monitoring and reporting

2.58 The Water Group Outcome Board has a key role in the administration of DSEWPaC water programs, including PIIOP. The Board is responsible for approving program management documentation and for monitoring program performance over time. However, the Board has not been provided with all relevant PIIOP management documentation as required by the *Administrative Guide to the Project Management Framework*. Although the PIIOP section prepared the PIIOP Round 1 guidelines and Round 2 draft funding agreement, these documents were not submitted to the Board for approval. In addition, the section did not: submit a PIIOP Project Plan to the Board until some two years after the program commenced; or prepare and submit PIIOP KPIs to the Board. While responsibility for the provision of required documentation to the Board rests with the program manager, the Board did not identify that key program management documents for PIIOP had not been submitted for consideration.

2.59 Since October 2009, monthly status reports outlining PIIOP progress have been submitted to the Board. The status reports include:

- background information, including program: start and finish dates; objectives; output measures; budget; and expected versus actual expenditure;
- major project milestones, including key past and upcoming milestone dates and any variances to these dates;
- current risks with high or extreme ratings, and their treatments;
- project issues and remedial actions; and
- an overall status rating indicated by GREEN, ORANGE or RED indicators.⁷⁷

⁷⁷ A GREEN rating indicates that the project is on track. An ORANGE rating indicates that the project has reached 80 per cent of the agreed tolerance level. A RED rating indicates that the project is forecast to exceed set tolerance levels. The tolerance level refers to the permissible deviation from a plan without the need to bring the deviation to the attention of the Board or Sponsor.

2.60 While the Board's *Administrative Guide to the Project Management Framework* requires that status reports include progress against program KPIs, this information has not been reported to the Board in respect of PIIOP.

2.61 Although the status reports provide a reasonable overview of PIIOP's current status, the absence of key program governance documentation limited the ability of the Board to effectively monitor program progress and risks. Until an approved PIIOP Project Plan was implemented (from July 2011), the Board did not have an opportunity to comprehensively review program progress against planned performance.⁷⁸ In addition, until recently, the high and extreme risks in the status reports have been generally determined independently of risks identified in ad-hoc program risk assessments (that is, risk management information reported to the Board through status reports did not generally align with other PIIOP risk management documentation). For example, in the period from May 2010 to October 2011, all high and extreme risks in the status reports to the Board were either not identified, or were rated a lower risk, in other PIIOP risk management materials. The risks reported in status reports from November 2011 are now aligned with the PIIOP risk assessment and treatment plan.

2.62 A particular and significant risk that was not identified in reports to the Board was the delayed release of a draft funding agreement to PIIOP Round 1 applicants due to the unresolved PIIOP taxation treatment issue. The Board's attention was drawn to this issue once it began to impact on the program's progress. However, the Board did not intervene to resolve the issue, which put at risk the execution of most Round 1 funding agreements (see Figure 2.2).

⁷⁸ The status reports between October 2009 and June 2011 identified future milestones that were expected to be achieved in the short term, which were updated in each successive status report.

Figure 2.2

The Board's involvement in the PIOP taxation treatment issue

On 20 April 2010, DSEWPaC released the draft PIOP funding agreement to successful applicants. In May 2010, despite the taxation treatment of PIOP funding remaining unresolved, the PIOP section advised the Board that funding negotiations with successful applicants could be completed by the following month. PIOP's overall status as at May 2010 was rated as GREEN, that is, the project was on track.

In June 2010, the Board received an exception report outlining the reason for delays to program progress (primarily relating to the PIOP taxation issue), and the program's overall status was changed to ORANGE. From July 2010 to February 2011, a new high/extreme risk was reported to the Board—'applicants withdraw from program due to tax implications'. The program's overall status was changed to RED between July and September 2010 and back to ORANGE for the period October 2010 to February 2011. In February 2011, the taxation issue was essentially resolved when the Australian Government announced that it would seek amendments to the *Income Tax Assessment Act 1997* (ITA Act). PIOP's overall status changed to GREEN in March 2011.

In the period from July to October 2010, the risk treatment identified by the PIOP section in each month's report to the Board was to await the outcome of requests for private binding rulings sought by PIOPs from the ATO. Each month, DSEWPaC expected the issue to be resolved by the following month. As the taxation issue became protracted, the Board noted the continuing delays, but did not intervene by requesting or considering options to resolve the matter. In late October 2010, the PIOP section sought and received the Board's approval to approach the Department of the Treasury to seek amendments to the ITA Act.

Source: ANAO from DSEWPaC information.

2.63 Overall, the Board's monitoring of PIOP has been impeded by the lack of an approved project plan to inform an assessment of actual progress against planned progress. Furthermore, the reporting of high and extreme program risks to the Board was adversely effected by the lack of an endorsed risk management plan for PIOP. Notwithstanding the absence of key program governance documentation, the Board did not intervene to resolve a protracted issue brought to its attention that jeopardised the implementation of the program. There would be merit in DSEWPaC reviewing the systems and processes in place to ensure that all required information is provided to the Board and that the monitoring activities of the Board effectively identify and treat significant risks to program delivery.

External reporting

2.64 Annual reports are an important accountability mechanism for agencies in reporting on their performance to the Parliament. They are designed to provide factual and informative commentary on performance against the

targets and the anticipated outcomes specified in the Portfolio Budget Statements (PBS).⁷⁹ The PBS specifies each government program's deliverables, key performance indicators (KPIs) and performance targets.

Portfolio Budget Statements

2.65 PIIOP is not listed as a discrete program in the DSEWPac PBS. The sole program in the departmental 2010–11 and 2011–12 PBS under Outcome 4⁸⁰ is 'Water Reform', which is being delivered through the Australian Government's \$12.9 billion *Water for the Future* initiative. The *Water for the Future* initiative comprises 12 high-level programs, the largest of which is the \$5.8 billion SRWUIP (which includes PIIOP). The ANAO examined the extent to which DSEWPac's performance in administering PIIOP and the achievement of PIIOP's objective (which is closely tied to SRWUIP's objective) is reflected in the PBS deliverables, KPIs and performance targets for the 'Water Reform' program for 2010–11 and 2011–12 (which are outlined in Appendix 2).

2.66 The quantitative deliverable relevant to PIIOP and SRWUIP reported in the 2010–11 PBS (that is, Commonwealth-led programs under the Basin Agreement on schedule) is reliant on stakeholders possessing an awareness of the delivery schedule for the two Commonwealth-led programs to gauge program performance.⁸¹ Furthermore, the quantitative deliverable relevant to PIIOP and SRWUIP reported in the 2011–12 PBS (that is, the percentage of agreed water savings) does not identify the quantity of water savings that are to be returned to the Australian Government⁸²—which is closely related to one of the objectives of PIIOP and SRWUIP. The specification of PBS deliverables that quantify the Australian Government's share of the expected irrigation water savings to be generated from Australian Government funding,

⁷⁹ Department of the Prime Minister and Cabinet, *Requirements for Annual Reports for Departments, Executive Agencies and FMA Act Bodies*, 11 July 2011, p. 3.

⁸⁰ DSEWPac's Outcome 4 is 'Adaptation to climate change, water wise use, secure water supplies and improve health of rivers, waterways and freshwater ecosystems by supporting research, and reforming the management and use of water resources'.

⁸¹ The two Commonwealth-led State Priority Projects are PIIOP and the Private Irrigation Infrastructure Program for South Australia.

⁸² Further, this deliverable is self-fulfilling as the 'agreed share of water savings' can be altered by the consent of both parties through amendments to agreements over time. The 'agreed share of water savings' under current agreements may not be the same as required under the original agreements.

as occurs for urban water projects⁸³, would place stakeholders in a better position to judge the value for money from irrigation water efficiency programs.

2.67 The quantitative KPIs outlined in the 2010–11 and 2011–12 PBS related to PIIOP and SRWUIP are essentially the same (that is, the percentage increase in water use efficiency on-farm and off-farm), but have different targets. These KPIs, however, provide stakeholders with only limited insights into the extent to which water programs are contributing to the achievement of program objectives for PIIOP and SRWUIP. Without identifying baseline and current levels of irrigation water use efficiency, it is difficult for stakeholders to determine what a 15 per cent efficiency increase means in real terms. KPIs that identify the composite percentage of irrigation efficiency for funded irrigation water providers (off-farm) and funded irrigators (on-farm), with improvement targets set accordingly, would provide stakeholders with greater insights into irrigation water use efficiency improvements over time. In any event, current KPIs do not provide direct indications of whether the improvements in irrigation water use efficiency ‘secure a long-term future for irrigation communities’, which is an objective of PIIOP and SRWUIP.

Annual Reporting

2.68 In accordance with departmental annual reporting requirements⁸⁴, DSEWPac’s annual reports compare planned performance (as outlined in the PBS) to actual performance. The department’s 2010–11 Annual Report identifies performance of the ‘Water Reform’ program against the deliverables and KPIs contained in the 2010–11 PBS. The annual reports also contain a brief commentary on the achievement of key milestones for the program, namely the announcement of PIIOP projects selected for funding (2009–10 Annual Report) and the execution of contracts for Round 1 PIIOP projects (2010–11 Annual Report).

2.69 As the KPI targets for 2010–11 were a zero ‘percentage increase in water use efficiency on-farm and off-farm’ (but increasing over subsequent years to 15 per cent), DSEWPac’s 2010–11 annual reporting of program performance against this KPI was not applicable. The deliverable for 2010–11 was reported

⁸³ One of the deliverables under the ‘Water Reform’ program in the 2011–12 PBS is ‘water savings from urban programs and projects that aim to promote the efficient use of water’ expressed in gigalitres.

⁸⁴ Department of the Prime Minister and Cabinet, op. cit.

in the 2010–11 Annual Report as achieved—that is, 100 per cent of Commonwealth-led State Priority Projects were on schedule. In 2009–10, DSEWPaC also reported the achievement of the same deliverable. However, at the time of the publication of the DSEWPaC 2009–10 Annual Report, the department reported internally to the Water Group Outcome Board that PIIOP’s overall status was RED—indicating that program was not ‘on track’ at that time (see Figure 2.2 above). DSEWPaC’s 2009–10 Annual Report does not include reference to the risk to the program posed by unresolved taxation implications for successful PIIOP applicants that was current at the time of the annual report’s publication.

2.70 As the primary accountability mechanism for the department’s use of Australian Government funding, annual reports should contain appropriate and accurate performance information to allow stakeholders to reliably assess the performance of government programs.

Conclusion

2.71 DSEWPaC established PIIOP to meet the Australian Government’s commitment under the Basin Agreement to invest in the Basin by funding upgrades to private irrigation infrastructure in return for a share in the water efficiency gains. PIIOP has features common to both grants programs and procurement activities. In the absence of a more suitable administrative framework to recognise the investment focus of PIIOP, DSEWPaC established the program using a grants-based framework. In taking this decision, it would have been prudent for the department to have consulted in advance with the Department of Finance and Deregulation (policy owner for public sector grants and procurements) and to have specifically informed the Minister, who would be required to make funding decisions under the grant-based framework.

2.72 DSEWPaC consulted appropriately with a range of industry stakeholders during the design and establishment of PIIOP. However, the department did not recognise the significance of the taxation treatment of PIIOP funding to potential applicants until the program’s design was well advanced. DSEWPaC subsequently sought, and followed, expert advice on the taxation treatment for PIIOP funding. However, the draft funding agreement necessary to enable the Australian Taxation Office (ATO) to provide advice on PIIOP’s taxation status was not available until late in the Round 1 application process. The ATO’s advice was also contrary to the taxation outcome preferred by DSEWPaC. The earlier consideration of PIIOP’s taxation implications and the formulation of the draft funding agreement prior to the launch of the

program would have better positioned the department to have factored into PIIOP's design the preferred taxation outcome for the program.

2.73 DSEWPaC decided that a one-stage application process was appropriate for PIIOP given the limited number of potential applicants and the prerequisite for applicants to have completed an irrigation modernisation plan that would underpin their applications. Notwithstanding this rationale, the variable quality and comprehensiveness of the modernisation plans and the detail sought by DSEWPaC in PIIOP applications necessitated a substantial financial outlay from PIIOs. PIIOs had to balance the effort and resources they allocated to their applications with their likelihood of success.

2.74 Further, the PIIOP Round 1 guidelines did not contain sufficient guidance on the program's terms and conditions (in the form of a draft PIIOP funding agreement) and the level of detail DSEWPaC required from PIIOs to support their applications—where the only restriction on the amount of funding each PIIO could apply for was the total amount of program funding (\$650 million). The limited guidance resulted in Round 1 applications of variable quality that ultimately had an impact on DSEWPaC's assessment process. Despite feedback from applicants and the difficulties encountered by DSEWPaC in Round 1, the department adopted a similar one-stage application approach for Round 2. Although the department intended to provide Round 2 applicants with expanded guidance materials to improve the quality of applications, these materials were not finalised and/or released. As a consequence, the variable quality issue encountered in Round 1 was also encountered by the department in respect of Round 2 applications. Adopting a two-stage application process, which gave greater assurance of the likelihood of success, may have encouraged a greater investment by PIIOs in more comprehensively completing their applications for funding under the program.

2.75 DSEWPaC established appropriate governance structures to manage PIIOP, involving day-to-day management within a section of the department's Water Group and oversight from the Water Group Outcome Board. Nevertheless, the PIIOP section did not submit for Board approval key program governance documentation for PIIOP until some two years after the department began designing the program. The lack of this program documentation had an impact on the department's capacity to implement the program and identify issues early.

2.76 The Board, responsible for overseeing PIIOP, did not ensure that PIIOP's management documentation was submitted for endorsement and did not intervene to resolve the protracted PIIOP taxation treatment issue that had an adverse impact on the program's implementation. There would be merit in DSEWPaC reviewing the systems and processes in place to ensure that all the required information is provided to the Board and that the monitoring activities of the Board effectively identify and manage significant risks to program delivery.

2.77 Although PIIOP is not listed as a discrete program in DSEWPaC's PBS, the PBS and department's annual reports contain performance information (deliverables, KPIs and targets) for the broader 'Water Reform' program related to PIIOP (and SRWUIP). Improving the relevance of KPIs and deliverables would provide greater insights into the extent to which water programs are contributing to the achievement of program objectives for PIIOP and SRWUIP.

Recommendation No.1

2.78 To improve the implementation of programs within SRWUIP, the ANAO recommends that the Department of Sustainability, Environment, Water, Population and Communities reinforce the arrangements in place to:

- (a) develop and submit for approval program management documentation (including project plans, risk management plans and performance information);
- (b) effectively monitor program progress against planned performance; and
- (c) seek early resolution of significant issues that have the potential to adversely impact on the effective and efficient implementation of programs.

DSEWPaC's response

2.79 SEWPaC agrees with this recommendation. SEWPaC notes that the arrangements listed in recommendations 1(a), 1(b) and 1(c) are already in place for implementation of programs within SRWUIP.

3. Assessment of Applications

This chapter examines the Private Irrigation Infrastructure Operators Program in NSW (PIIOP) application for financial assistance and assessment process, including the recommendations to, and project approvals by, the Minister.

Introduction

3.1 The fundamental objective of grants administration is to efficiently, effectively and ethically administer Australian Government funding to approved recipients in accordance with government policy outcomes.⁸⁵ It is also important that applications are assessed in a consistent and fair manner, with accountability and transparency being primary considerations, along with achieving 'value for money'. These principles should be supported by appropriate departmental records—particularly in relation to justifying key funding recommendations and decisions.

3.2 As previously noted, the Australian Government announced two funding rounds for PIIOP. In response, the department received 12 applications from eight applicants⁸⁶ requesting some \$1.79 billion in financial assistance, which was significantly more than the \$650 million funding available under PIIOP. The outcomes from the two funding rounds are outlined in Table 3.1.

Table 3.1

Summary of assessment outcomes from PIIOP funding rounds

Funding round	Initial funding requested (\$m)	Number of applications submitted	Number of projects approved	Range of grants approved (\$m)	Maximum expenditure approved (\$m)
Round 1	1 232.9	7	5	9.5 to 115.0	263.2
Round 2	560.0	5	4	7.4 to 169.2	386.4
Total	1 792.9	12	9	7.4 to 169.2	649.7

Source: ANAO based on DSEWPac: PIIOP (NSW) - Assessment Reports, 2010 and 2011.

⁸⁵ Department of Finance and Deregulation, *Commonwealth Grant Guidelines—Policies and Principles for Grants Administration*, Finance Management Guidance No. 23, July 2009, p. 3.

⁸⁶ Three proponents applied for funding under both rounds of PIIOP.

3.3 Approved funding has been committed to support a range of initiatives which incorporate methods and technologies that are common and well established in the irrigation industry, including:

- upgrading or rationalisation of irrigation channels;
- conversion of open channels to piped supply;
- improved water metering;
- channel lining of known leakage areas; and
- retirement or rationalisation of inefficient or unviable areas or irrigation schemes.

3.4 Projects funded in both rounds were broadly similar, as could be expected given that the guidelines did not substantially change between rounds. The only significant difference between rounds was that on-farm works were excluded during the assessment process in Round 2 because of funding limits and the significant level of funding requested.

3.5 The ANAO examined DSEWPac's selection of projects for funding under PIIOP's two funding rounds including the:

- promotion and communication of PIIOP to potential applicants;
- assessment framework and process; and
- recommendations supporting funding and approval by the Minister.

Promotion and communication of PIIOP to potential applicants

3.6 Appropriate and effective promotion of grant programs is important to raise awareness of the program among potential applicants and to encourage sufficient numbers of applications that could contribute to the program objectives and achieve the outcomes sought by the Australian Government.

Launching and promoting the program

3.7 The then Minister for Climate Change and Water launched PIIOP on 19 June 2009. Applications for Round 1 remained open from 19 June 2009 until 27 November 2009. During this time, the program was promoted by DSEWPac through: advertisements in regional New South Wales newspapers; information on the department's website (this included program guidelines

and a fact sheet); and direct letters to, and face-to-face briefings with, known potential applicants.

3.8 DSEWPac identified the potential number of private irrigator operators in NSW through consultation with relevant state authorities and irrigation representative organisations and from the Irrigation Modernisation Planning Assistance program.⁸⁷ Consultations identified a total of thirteen NSW private irrigation operators that could potentially provide eligible applications for financial assistance through PIIOP.

3.9 In addition to briefings conducted with peak industry bodies in June 2009, the department conducted eight regional briefings with potential Round 1 applicants and six regional briefings with potential Round 2 applicants. These briefings provided detailed information to potential applicants on the funding available under PIIOP, the program guidelines and, for the Round 2 briefings, the lessons learned from Round 1. Round 1 applicants indicated to the ANAO that they were generally satisfied with the department's responsiveness to important issues raised during the application phase; with the one exception being the taxation treatment of the grants.

Taxation issue for applicants

3.10 As previously discussed in Chapter 2, the taxation treatment of PIIOP funding was identified as a significant issue for potential applicants prior to the program launch, as well as at the regional briefings. It was an important issue to resolve, as grant recipients could incur different tax liabilities depending upon the design and intent of the program. Early taxation advice obtained by DSEWPac indicated that the best outcome for applicants would be a capital gains tax (CGT) outcome for PIIOP funding. However, in advance of such an outcome being confirmed with the Australian Tax Office (ATO), DSEWPac provided information to potential applicants on its website that PIIOP funding would create a CGT outcome.⁸⁸ The department informed the

⁸⁷ The Irrigation Modernisation Planning Assistance program is discussed in Chapter 1 (paragraph 1.19) and Chapter 2 (from paragraph 2.11).

⁸⁸ Early in the application process, DSEWPac released an information sheet on its website ('Private Irrigation Infrastructure Operators Program—Taxation Considerations') that gave definitive 'yes/no' answers to a series of taxation questions. Questions and answers included: Will program payments be 'ordinary income' for tax purposes? (Answer: No); Will program payments be 'statutory income' for tax purposes? (Answer: No); Will transfers of water rights to the CEWH in return for funding be generally subject to CGT? (Answer: Yes); and Will CGT on transfers of water rights be calculated by reference to program funding? (Answer: Yes).

ANAO that the website information was based on advice provided by the Australian Government Solicitor (AGS). The department also advised that the AGS advice was based on the ATO's view that a CGT outcome may be attained if the program's documentation, particularly the PIIOP funding agreement, was drafted to accord with certain principles advocated by the ATO.

3.11 DSEWPaC removed the information from its website on 9 October 2009, without explanation to applicants, after receiving feedback from PIIOPs that the contents of the sheet were either confusing or conflicted with advice from the PIIOPs' own tax advisors. Subsequent advice from the ATO was that the finalised program documentation did not support a CGT outcome, instead creating an income tax outcome that could cause severe cash flow problems for PIIOPs.⁸⁹ PIIOPs advised the ANAO that their applications lodged by the closing date of 27 November 2009 assumed either a tax-neutral outcome or a CGT outcome.

3.12 DSEWPaC's communication with potential applicants on the taxation treatment for PIIOP funding during the application process generated expectations of a taxation outcome that did not eventuate.⁹⁰ This contrasted with the department's largely successful promotion and communication process undertaken with potential applicants.

Assessment framework process

3.13 A sound assessment framework provides clear eligibility and merit criteria and provides the primary guidance for conducting the assessment of applications. Ideally, the framework establishes criteria early in the process that are sufficiently precise to provide applicants with a basis for drafting their applications and for assessors to consider the eligibility and relative merits of applications and any subsequent recommendations for funding. The assessment panels for both rounds of PIIOP were composed primarily of departmental officers supported by external advisors. An external probity advisor was also engaged for the assessment process in Round 2. The Minister was responsible for approving applications for funding. Roles and

⁸⁹ The implications of an income tax outcome for PIIOP funding are outlined in Footnote 64 in Chapter 2.

⁹⁰ The resolution of the PIIOP taxation issue is discussed from paragraph 4.26 in Chapter 4.

responsibilities are discussed further in paragraphs 3.31 to 3.32 and illustrated in Figure 3.2.

Eligibility and merit criteria

3.14 The PIIOP guidelines outline the department's requirements regarding eligible applicants and projects under the program. The criteria, set out in Appendix 3, were publicly released as part of the guidelines from the launch of the program and were not significantly varied between Round 1 and Round 2.⁹¹ The criteria were aligned with PIIOP's objectives and provided a reasonable basis for applicants to draft their applications, and for the department to assess the eligibility of applications. For example, the requirements for applicants to have, 'undertaken or completed a modernisation plan in accordance with Commonwealth guidelines or equivalent' and 'have undertaken an assessment of the irrigation district water losses, consistent with the Commonwealth hotspots assessment methodology' relate directly to the program objectives, are specific, concrete and relatively clear for applicants.

3.15 The merit criteria are the primary measure for guiding assessors in the selection of projects that will most likely support the achievement of program objectives. They also assist applicants to prepare applications that address all considerations relevant to maximising their opportunity to receive funding assistance. The PIIOP merit criteria, which were publicly released as part of the Round 1 and 2 guidelines, are also outlined in Appendix 3.

3.16 PIIOP's merit criteria were designed to align with the due diligence criteria applicable to all SRWUIP State Priority Projects (which includes PIIOP). For Round 2, the three primary merit criteria remained the same, but two sub-criteria were deleted. These deleted sub-criteria related to establishing value for money, and environmental and technical matters.

3.17 The value for money sub-criteria were reduced from three to two, with the removal of the 'dollar per megalitre benchmark against local/regional water market prices'. DSEWPac's rationale for the removal of this criterion was that the department had a pre-existing basis for determining a reasonable cost per megalitre and it was considered unnecessary for applicants to address

⁹¹ The only variation was the addition of two requirements in Round 2 that applicants 'must comply with the conditions attached to participation' and that applicants 'must be proposing an "eligible project" in accordance with the guidelines'.

this. While it was reasonable and appropriate for the department to develop a method for calculating value from the cost per megalitre obtained against local market rates, the assessment process would have been more transparent if applicants were aware that the cost per megalitre was still being used by the department to assess the merits of Round 2 projects. Rather than removing this criterion from the guidelines, it would have been appropriate for the department to state that applicants did not need to directly address this aspect as it would be addressed by the department using an established methodology.

3.18 The second change to the criteria in Round 2 related to the deletion of ‘the agreed water entitlement to be transferred to the Australian Government in return for funding must be capable of being used for purposes that reflect the Australian Government’s environmental priorities’ sub-criterion. This sub-criterion was removed primarily because the department had not specified particular environmental priorities.⁹² As the department had not identified environmental priorities, it was not possible for applicants to clearly address this sub-criterion in their applications or to be assessed against it.

3.19 In addition, other merit sub-criteria were also not sufficiently clear or specific to guide applicants—particularly in terms of the standard and level of detail expected in the applications. For example:

- economic/social criteria—‘Projects must contribute towards regional investment and development...’. As DSEWPac had not quantified what was a reasonable level of contribution to regional investment and development, or how it was to be measured, this criterion was largely self-fulfilling through Australian Government funding;
- environmental/technical criteria—‘Projects must demonstrate strategies to minimise adverse environmental impacts...’. The department had not identified any adverse environmental impacts of particular priority. Solutions to address adverse environmental impacts can be complex and there may be trade-offs amongst different priorities, such as water quality management, flood mitigation works and environmental flows; and

⁹² The specification of environmental priorities is integral to the Murray–Darling Basin Plan, which was not finalised prior to the consideration of proposals under PIOP.

- value for money criteria—‘Any in-kind or cash contributions will be taken into account...’. Given the impact of long-term drought on the profitability of irrigation businesses, a substantial cash contribution from applicants was unlikely. However, specifying minimum levels of cash or in-kind contributions from applicants would have helped to demonstrate their commitment to the project—particularly as PIIOP projects are likely to directly contribute to the capital value and longer term profitability of the businesses receiving funding.

3.20 The lack of specificity in respect of some merit criteria increased the likelihood that applicants would prepare PIIOP applications without the level of that detail DSEWPac required to conduct thorough assessments. The need for clear, specific merit criteria was particularly important given the absence of an overall quantitative water recovery target for PIIOP and the critical importance of water savings and sustainability to the objectives of the program. As noted in the *Commonwealth Grant Guidelines* (CGGs):

The more specific the operational objectives the easier it is to develop supporting documentation, limit wasted applications and develop an appropriate performance information framework.⁹³

3.21 As PIIOP funding has been fully committed, these principles should be considered by DSEWPac in the design and implementation of future programs of this type.

Assessment plan and process

3.22 DSEWPac developed assessment plans for each funding round to guide the assessment of PIIOP applications. The development of the first plan commenced in mid-2009 with drafting initially undertaken in consultation with other areas of the department with water infrastructure and grant administration experience. In the later stages of drafting, the department obtained professional technical advice from a consultant on the suitability of the Round 1 assessment plan. The assessment plan was approved by the Water Group Outcome Board in mid-December 2009, seventeen days after the closure of applications. DSEWPac advised that all applications remained unopened until the assessment plan was approved. The Round 2 assessment plan was approved well before the close of applications and allowed for assessment to

⁹³ Department of Finance and Deregulation, *Commonwealth Grant Guidelines—Policies and Principles for Grants Administration*, Finance Management Guidance No. 23, July 2009, p. 17.

commence as soon as the closing date passed. Application documents were stored securely during the assessment process, following the requirements outlined in the assessment plan.

3.23 As the purpose of the assessment plans was to deliver an accountable, transparent, fair and competitive process for assessing PIIO applications, they addressed the following aspects of the assessment process:

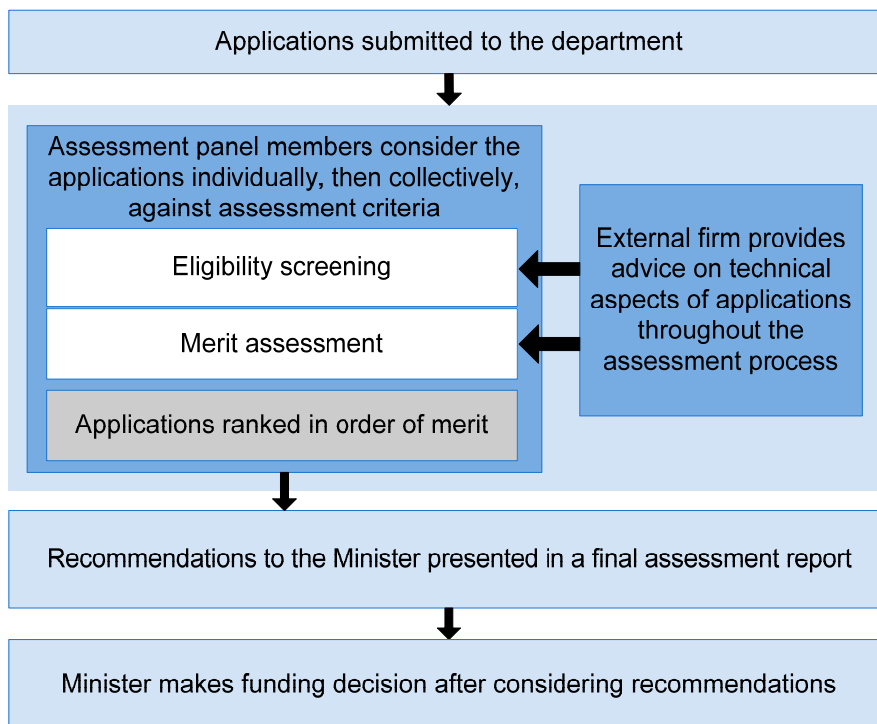
- the aim and overview, including relevant background information relating to the program;
- the composition of the assessment panel that included departmental officers as well as an external advisor⁹⁴ and roles of particular departmental personnel;
- the guiding principles around probity, transparency, accountability, including in relation to: communicating with applicants; conflict of interest; confidentiality; and security of information;
- the assessment process and methodology;
- guidance to score applications against criteria; and
- formal reporting and making recommendations to the Minister.

An overview of the assessment process is provided in Figure 3.1.

⁹⁴ For Round 2, a second external advisor was brought onto the assessment panel. The composition of the assessment panels is illustrated in Figure 3.2.

Figure 3.1

PIIOP assessment process



Source: ANAO based on DSEWPac's *Program Assessment Plan – PIIOP*, December 2009, p. 4.

Limitations of the assessment plans

3.24 While the plans were generally comprehensive and provided a key point of reference for the assessment of PIIOP applications, there were a number of limitations related to:

- benchmarks/weightings within the scoring system;
- guidance on how to assess the benefits and costs identified by applicants;
- assessing the viability of sub-projects; and
- assessing PIIOs' intended compliance with the funding agreement terms and conditions.

Benchmarks within the scoring system

3.25 In Round 1, the assessment plan provided guidance on the interpretation of the merit criteria to form quantitative scores. The plan set out an approach for determining a 'confidence score' from zero to ten, based on supporting statements. Panel members informed the ANAO that this

methodology was a useful starting point, but had limitations. For Round 1, the department required projects to meet a minimum of five ('Good') to pass a criterion. However, this requirement was removed for Round 2. Consequently, there was no benchmark influencing whether or not an application was worthy of financial assistance.

3.26 Furthermore, benchmarks were not used in either round to determine the minimum acceptable ratio of project cost-to-volume of water entitlements offered in applications. This was particularly important as the cost-to-volume of water entitlements was heavily weighted by the department as a key criterion in the assessment process. However, there was no indication within the plan or subsequent advice provided to applicants on the weightings to be applied in the assessment process against different criteria. The weighting of the various merit criteria is discussed at paragraphs 3.53 and 3.60.

Guidance on how to assess the benefits and costs

3.27 PIIOP applicants were required to include a benefits-costs analysis (BCA) within their applications and the BCAs were expected to be an important consideration within the value for money assessment of applications by the assessment panels. However, the assessment plans did not specify how BCAs would be assessed and taken into account during the assessment process. Guidance for the assessment panels was therefore inadequate to address the substantial technical requirements underpinning a robust BCA assessment.⁹⁵

Assessing the viability of sub-projects

3.28 While the assessment plans provided the panels with guidance to assess applications, there was no guidance provided on the assessment of the sub-projects of those applications. Given the large scale of potential projects (involving some hundreds of millions of dollars) and the multi-component nature of applications with significant sub-projects, guidance for assessing the viability of sub-projects would have assisted panel members. As the program guidelines did not limit the amount of funding applicants could seek, it was likely that the department would have to consider limiting funding to some components of some applications—which is what ultimately occurred.

⁹⁵ The guidance provided by the plans on the assessment of value for money focused solely on establishing a dollar per megalitre benchmark against local/regional water market prices.

Compliance with the funding agreement terms and conditions

3.29 The PIIOP guidelines state that applicants are required to indicate if there are any parts of the funding agreement with which they did not fully comply. As noted in Chapter 2, the terms and conditions of the funding agreement were not released prior to the close of Round 1 applications. Consequently, the consideration of applicants' funding agreement compliance was also omitted from the Round 1 assessment plan. While the Round 2 funding agreement was released prior to the close of applications, the Round 2 assessment plan did not address the requirement of applicants' compliance with the funding agreement.

3.30 Despite the limitations of the assessment plans, the department developed relatively comprehensive guidance that provided the assessment panels with a reasonable basis for their role in assessing applications. At the same time, the panels had the discretion to make informed judgements on the process when gaps or shortcomings subsequently became evident in the guidance. The limitations within the plans meant that the task was more challenging for the panels and a higher level of residual risk was carried forward to the contract negotiation and management phases.

Assessment panels

3.31 The Round 1 and 2 assessment panels were composed of departmental officers and external advisors. DSEWPac informed the ANAO that the members of the panels were selected to fill a particular skill or need, or due to their position and function in the PIIOP section. Collectively, the panels contained expertise and experience related to: public sector grant programs; selection panels; irrigation infrastructure and industry; economics; and experience related to other water programs, including the Restoring the Balance⁹⁶ (RtB) program.

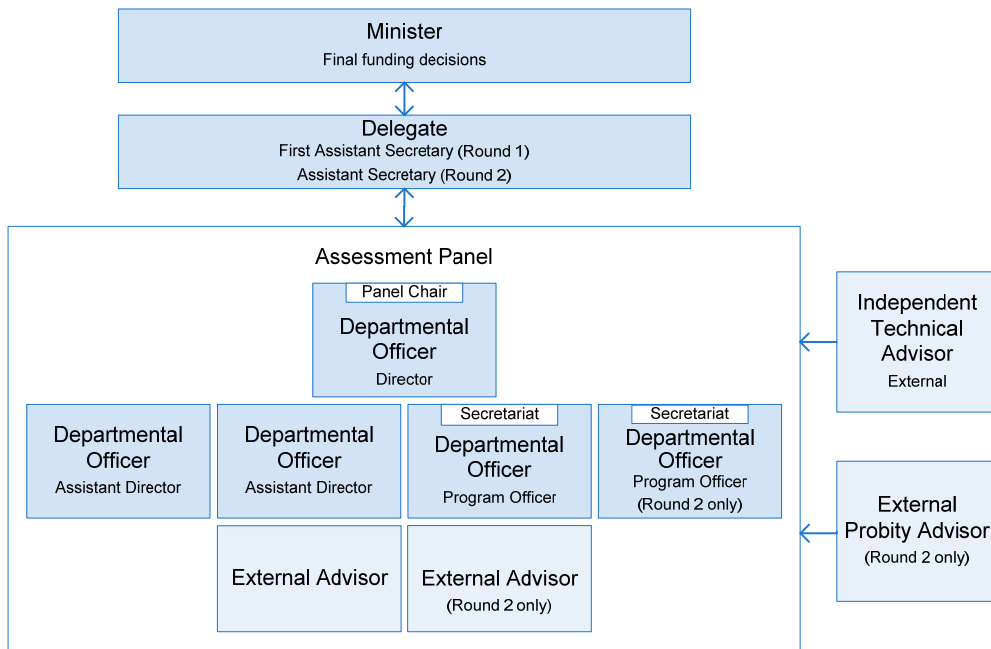
3.32 The department appointed the Director of the PIIOP section as the chair of the assessment panels. The Assistant Secretary of the branch within which the PIIOP section was located provided oversight and strategic guidance to all relevant water infrastructure programs, including PIIOP. In Round 1, the relevant First Assistant Secretary was the delegate, but for Round 2 the Assistant Secretary was the delegate. The delegate's responsibilities included

⁹⁶ Commencing in 2008, and also administered by DSEWPac, the \$3.1 billion Restoring the Balance (RtB) program is designed to procure water entitlements directly.

reviewing the assessment plans and assessment reports, and approving the funding recommendations forwarded to the Minister for approval. The organisational arrangements for the PIIOP assessment processes are illustrated in Figure 3.2.

Figure 3.2

Participants in the PIIOP assessment process



Source: ANAO based on DSEWPac's *Program Assessment Plan — PIIOP*, December 2009, p. 4 and *Program Assessment Plan — PIIOP Round 2*, April 2011, p. 5.

Note 1: An external probity advisor was engaged for Round 2 to provide an additional level of assurance when seeking clarification of information provided in applications. While there was no probity advisor in Round 1, the department accessed internal legal advice. The Round 1 assessment plan also addressed the principles of probity expected to be followed.

3.33 While there were some minor changes in the composition of the assessment panels between the rounds, overall, the composition of the panels was adequate to perform the assessment task for both rounds, with the inclusion of extra participants in Round 2 increasing the degree of assurance regarding the assessment process.

Assessment and selection of projects

3.34 Competitive grant program applications should be assessed consistently and fairly against the published eligibility and merit criteria with the aim of recommending for selection those projects that are the most

meritorious and represent value for money. It is also important that documentation is sufficient to demonstrate that the process is transparent and objective. The ANAO examined the:

- eligibility of applications submitted under PIIOP;
- merit assessment considerations; and
- application scoring and order of merit.

3.35 Applications for PIIOP funding were received from eight applicants from the Murrumbidgee, NSW Murray, Macquarie and Lachlan catchments of the Murray–Darling Basin.

Eligibility of applications submitted under PIIOP

3.36 One of the major challenges that faced the PIIOP assessment panels was the variable quality of applications caused by the lack of detail and gaps in the information provided. The variable quality of applications for both funding rounds made it difficult for the department to effectively assess and compare projects—particularly in terms of the extent to which projects met the merit criteria and the relative costs and benefits of each application. As a consequence, the assessment panels sought clarification from the applicants in both rounds.

Round 1

3.37 In Round 1, the technical advisors provided DSEWPaC with lists of specific technical questions to be asked of applicants. In an attempt to ensure fairness, the department modified and consolidated these into a set of generalised common questions. The panel subsequently found that applicants' responses to these generalised questions were not sufficient to address the identified gaps against key criteria. Particular gaps were noted in relation to the economic and social criteria covering areas such as: the feasibility of proposed water savings; the number of farms to be rationalised; the number of kilometres of channel to be lined; and the viability of the application in the light of future water availability as indicated in reports, such as *Water Availability in the Murray–Darling Basin* by the Commonwealth Scientific and Industrial Research Organisation (CSIRO). These factors were fundamental to any assessment for financial assistance under PIIOP.

3.38 Across all applications in Round 1, the quality of the submitted BCAs were regarded by the department as being 'severely deficient' and not useful in providing an analysis of the benefits and costs of applications.

Consequently, the BCAs were not taken into account in the scoring of Round 1 applications, even though BCAs were intended by the department to be a key consideration in assessing the merits of applications—particularly within the context of value for money. Despite these deficiencies, no applications were assessed as ineligible in Round 1, although the department had concerns about the legitimacy of some claims made in particular applications—such as in relation to the bona-fides of co-contributions or budget and taxation allowances.

Round 2

3.39 In Round 2, DSEWPac also required clarification from applicants relating to the lack of detail and information gaps in their applications. Although the questions asked were tailored specifically to each application, DSEWPac again found that responses did not generally address the department's information requirements. In addition, the department identified ineligible components in applications to the value of \$36.7 million, which were removed from recommended projects.⁹⁷ Nevertheless, no projects were classified as ineligible in Round 2.

3.40 The BCAs included in Round 2 applications were also a problem in terms of the inadequate level of detail provided. DSEWPac instructed its independent technical advisors to adjust each application's BCA using a common set of information across the projects so that reasonable comparisons could be made.⁹⁸ The advisors considered the 'adjusted' BCAs to be useful as an application ranking tool. In the circumstances, this was not an unreasonable approach to inform an assessment of BCAs.

3.41 During Round 2, the independent technical advisors analysed the quality of, and identified gaps in, the information provided in applications. The analysis has been reproduced in Table 3.2. This analysis was not undertaken in Round 1.

⁹⁷ Ineligible components included a solar array, cotton gin and ethanol plant.

⁹⁸ As a consequence of this approach, the 'adjusted' BCAs may not take into account all costs and benefits relevant to the projects.

Table 3.2

Information gaps in Round 2 applications

Criteria	Requested information	Applications				
		H	I	J	K	L
Economic/Social	Evidence of project contribution to the region					
	Impact on additional employment					
	Landowner support					
	Irrigation modernisation plan provided					
Environmental/Technical	Strategies to minimise environmental impacts					
	Ability to deliver and manage the project					
	Water savings and transfer of entitlements					
	Technical feasibility					
Value for Money	Detailed benefits-costs analysis					
	Detailed project budget					
	In-kind or co-contribution	No contribution put forward	No contribution put forward			No contribution put forward
	Operators charging arrangements					

Legend: Adequate information provided More information required No information provided

Source: Stage 1 – High Level Technical Assessment, Technical Advice for Proposals received for funding under the NSW PIOP Round 2, p.4. Prepared by a consultant for the Department of Sustainability, Environment, Water, Population and Communities, 9 September 2011.

3.42 In part, the difficulties in obtaining applications of consistent quality in both rounds reflected gaps in the program’s guidance and the level of specificity in the merit criteria. Although the department had endeavoured to improve the guidance for applicants in Round 2, ultimately additional guidance materials were not provided to meet applicants’ and the department’s requirements. As a consequence, the guidance for both funding rounds was very broad and limited for applicants who were required to prepare comprehensive, technical applications. At the same time, the capacity of PIIOs to undertake or fund BCAs and environmental impact assessments was limited—particularly in situations where some ten years of drought had

created financial difficulties. A staged application process may have assisted applicants where the size and complexity of the application requirements necessitated substantial effort and financial outlay by applicants. The first stage could provide some assurance of the likelihood of the application's success, warranting the further effort and expense required for a second stage of the application process.

3.43 The combination of factors created a difficult environment for DSEWPac to undertake an assessment of applications under PIOP. The department had the option of recommending far fewer or no projects on the grounds that the applications were not complete.⁹⁹ While this position could be justified, it was unlikely that progressing the assessment of few or no applications would have been compatible with the Government's priority to progress water reform in the Murray–Darling Basin. The substantive issue was whether there was sufficient information in the applications to enable an informed judgement on the merits of funding applications.¹⁰⁰ DSEWPac considered that the information was sufficient to progress all applications to a full assessment of their merits in the subsequent assessment phase.¹⁰¹

Merit assessment considerations

3.44 Careful consideration of the applications against the merit criteria is required to achieve a reasonable level of assurance that the projects will deliver value for money within the context of the program objectives. This is particularly important when individual projects can involve substantial levels of Australian Government assistance which, in the case of PIOP, exceeded \$100 million. Key considerations include project costings, the proportion of water savings offered to the Government, the scale and complexity of the

⁹⁹ The guidelines required 'comprehensive detail on matters such as project planning, stakeholder and regional support and the technical feasibility of the proposal'. (DSEWPac, *Sustainable Rural Water Use and Infrastructure Program: Guidelines for the Private Irrigation Infrastructure Operators Program in NSW, Round 2*, February 2011, p. 9.)

¹⁰⁰ Regulation 9 of the *Financial Management and Accountability Act 1997* establishes a single test—comprising a number of elements—which *must* be applied by an approver. In applying the test, an approver is required to balance the various elements, in order to determine whether giving effect to the spending proposal would be an efficient, effective, economical and ethical use of Commonwealth resources that is not inconsistent with the policies of the Commonwealth.

¹⁰¹ It is not generally advisable for applications that have not satisfied mandatory requirements to be assessed and recommended for funding on the condition the proponents subsequently satisfy those requirements. Over time, such practices have been found to cause reputational damage to grant programs which, in turn, can adversely affect whether the desired outcomes are able to be achieved. (ANAO Better Practice Guide, June 2010, *Implementing Better Practice Grants Administration*, p. 72).

project, and the relevance of projects to the Government's policy priorities (in this case, the Government's water reform agenda).

Project costings

3.45 The reasonableness of funding sought by applicants in both rounds was scrutinised by DSEWPaC and its independent technical advisors and moderated as appropriate. In Round 1, project costings were considered on an application-by-application basis and there was no standardised approach applied to assess the appropriateness of allocations for project management fees or contingencies. However, DSEWPaC examined any potential for duplication or 'double funding' with other programs.¹⁰²

3.46 In Round 2, the assessment panel refined its approach to costing projects by limiting the amount of funding allocated for: project management (up to five per cent); planning and design (up to five per cent); and contingencies (up to ten per cent). These benchmarks were discussed with, and supported by, the technical advisors although there was no particular standard used to support these figures. This resulted in a reduction of \$67 million against original Round 2 application requests.¹⁰³

Proportion of water savings offered to the Government

3.47 In PIIOP Round 1, applicants were required to offer to the Australian Government at least 50 per cent of the estimated water that would be saved from the implementation of projects. All approved Round 1 applications offered the Australian Government well in excess of 50 per cent of the projects' estimated water savings—96.7 per cent across these projects. Approved Round 2 applications offered the Government 87.9 per cent of the total estimated water savings, although the requirement to offer the Australian Government at least 50 per cent of savings had been removed for Round 2.

Project scale and complexity

3.48 The assessment panels also considered sub-projects separate to the overall projects when assessing applications from both rounds. For Round 1, the assessment panel members informed the ANAO that, early in the assessment process, the panel found the applications were of variable quality

¹⁰² This scrutiny into potential duplication or 'double funding' was also carried out in Round 2.

¹⁰³ Nevertheless, the department could have given further consideration on whether caps should have been introduced for larger projects, to better account for economies of scale.

overall, but some contained components with potential. In addition to assessing ‘whole’ applications, the panel decided to separately assess sub-projects on their own merits (using the same criteria and principles that were applied to whole applications) to determine whether there were standalone sub-projects that could be recommended to the Minister. The Round 2 assessment panel followed the sub-project assessment approach from Round 1. As noted earlier, the department provided limited guidance to inform the panels’ assessment of sub-projects.

3.49 In Round 2, the assessment panel decided not to recommend the funding of any on-farm components of applications. The assessment panel considered that the exclusion of these components would not adversely impact the implementation of the off-farm works or the resulting efficiency improvements for the schemes. As a consequence of not funding on-farm works, additional off-farm projects and sub-projects were recommended for funding.

3.50 In both rounds, DSEWPac did not consult with PIIOP applicants in advance of recommending some substantially ‘scaled-down’ applications for funding and funding reductions from project costing reviews. Earlier consultation with the applicants in these circumstances would have given the department a greater level of assurance of the viability of the approved projects and the willingness of applicants to accept the reductions in advance of their announcement. The department also has the opportunity to consider the viability of the selected projects after the approval process while negotiating the funding agreement—and could withdraw funding offers for unviable projects.

Relevance of projects to the Government’s water reforms

3.51 PIIOP forms part of a much wider reform agenda designed to enhance the sustainability of the Murray–Darling Basin and provide sufficient water for the environment. In both rounds, the panel sought advice from the Commonwealth Environmental Water Holder (CEWH)¹⁰⁴ on the appropriateness of entitlements offered by PIIOP applicants to the Australian Government. DSEWPac followed this advice in forming its recommendations

¹⁰⁴ The *Water Act 2007* established the position of CEWH to manage the Commonwealth’s environmental water holdings to protect or restore environmental assets in the Murray–Darling Basin and other areas where environmental water is held. The CEWH is a Senior Executive Service officer within DSEWPac. Available from: <<http://www.environment.gov.au/ewater/publications/cewh-ar-10-11.html>>, [accessed 6 February 2012].

to fund projects. This was important in order to integrate the results of PIIOP with the wider Australian Government agenda of promoting more sustainable water use.

Application scoring and order of merit

3.52 An appropriately conducted competitive, merit-based grant selection process should involve all eligible, compliant applications being assessed in the same manner against the same criteria, and then being ranked in priority order to receive the available funding, based upon the outcomes of those assessments.¹⁰⁵ Probity and transparency are particularly important and are achieved by ensuring that decisions relating to granting activity are impartial, appropriately documented and publicly defensible.

Round 1

3.53 Assessments against the value for money criteria were the primary determinant of the assessment panel's recommendation for funding in Round 1. The panel established an order of merit based on a 'market multiple', which was the ratio of funding sought to the market value of the water access entitlements offered in return. However, the Round 1 assessment plan required the panel to arrive at a score out of ten against the value for money criteria for each application after assessing: the ratio of funding sought to the market value of the water access entitlements offered in return; the BCA analysis; and co-contributions offered by the applicant. In practice, the BCA analyses were inadequate to be taken into account in the assessments and co-contributions were also not included in the assessments. The panel used the calculated market multiple in place of the intended score out of ten for the value for money criteria.

3.54 The panel's approach to scoring against the value for money criteria meant that a total score per application could not be determined for Round 1 applications. The scoring of the Round 1 applications recommended for funding is illustrated in Table 3.3. The panel assessed the two unsuccessful Round 1 applications as either not meeting the minimum scores (five out of 10) against the economic/social and environmental/technical criteria, or were not competitive on value for money as calculated by the assessment panel.

¹⁰⁵ ANAO Better Practice Guide, op. cit., June 2010, p. 75.

Table 3.3**Application scoring and order of merit for PIOP Round 1**

Criteria	Applications ¹				
	A	B	C	D	E
Economic/social criteria - out of 10	6	5	5	6	5
Environmental/technical criteria - out of 10	6	6	5	6	5
Value for money criteria - market multiple ²	1.3	1.9	2.6	3.1	3.0
Total³	Unable to be determined	Unable to be determined	Unable to be determined	Unable to be determined	Unable to be determined
Order of merit⁴	1	2	3	4	5

Source: ANAO from DSEWPac information.

Note 1: Applications may be either full applications or components.

Note 2: Contrary to the requirements of the assessment plan, value for money was not scored using the ten-point scale. Instead, DSEWPac calculated a 'market multiple'—the ratio of funding sought to the market value of the water access entitlements offered in return.

Note 3: Total scores were not able to be determined as assessments against the value for money criteria were not scored using the intended ten-point scale.

Note 4: The order of merit was determined by firstly ranking full projects recommended on basis of the market multiple, then ranking recommended project components on the basis of the market multiple.

3.55 There were also some inconsistencies between the assessments of the panel and those of the independent technical advisors on particular merit criteria. For Round 1, the technical advisors clearly experienced difficulties assessing the limited detail in the applications and were not able to make any definitive comments against some of the program's merit criteria. This was particularly evident in relation to the economic/social criteria and environmental/technical criteria. For example, in relation to the 'secures a long term sustainable future for its irrigation community ...' merit criterion, the technical advisor's assessment on one funded application indicated that 'the analysis provided [did] not present a strong case for the proposal resulting in increased production and a more sustainable irrigation community'. However, the assessment panel considered that while there were deficiencies in the supporting evidence provided, overall the application was viewed as, 'supporting the long-term sustainable future of its irrigation community'.

3.56 While the assessment panel can form an opinion contrary to the technical advice, the decision should be documented and substantiated with

appropriate analysis or evidence. The Round 1 assessment report did not acknowledge the difference of opinions, or provide a justification for the panel's contrary opinion.

3.57 The ANAO sought to examine the formal meeting minutes of the assessment panel and individual panel member assessments of applications to determine whether either contained additional information that would provide clarity over the alignment of applications and the assessments of the assessment panel and technical advisors. However, the assessment panel members advised the ANAO that:

- the assessment panel secretariat was instructed to record only high-level decision points and action items in the formal meeting minutes. Information normally recorded in meeting minutes, such as discussion topics and points of contention, were not documented. The handwritten notes of meeting deliberations from Round 1 have not been retained by DSEWPac; and
- individual panel member assessments were not conducted in accordance with the assessment plan (including the use of the required template and the scoring of applications against the established criteria). Documentation associated with individual panel member assessments has not been retained by DSEWPac.

3.58 The narrow focus of the assessment process for Round 1 on market multiples as a basis for value for money was an appropriate consideration for recommending applications for funding. It is particularly relevant as the program objective aims to 'acquire water entitlements resulting from water savings from eligible projects that improve the efficiency and productivity of water use and management...'. However, it still remains to be established how recommended applications will meet wider economic/social and environmental/technical criteria and the extent to which they will 'secure a sustainable future for irrigation communities'. Assessment documentation retained by DSEWPac for Round 1 was substantially less than that required to support a transparent process, as required by the *Commonwealth Grant Guidelines* (CGGs).

Round 2

3.59 The scoring of Round 2 applications and the establishment of an order of merit was more closely aligned with the assessment plan than in Round 1. In addition, the issues relating to the sufficiency of assessment documentation in Round 1 were not evident in Round 2. All Round 2 assessment documentation—

including assessments from the technical reports, the individual panel member assessments, minutes of meetings and the final assessment report—highlighted the lack of detail and information gaps in applications, which had an adverse impact on the assessment process. Nevertheless, all criteria and sub-criteria were factored into the scoring of Round 2 applications, total scores for each application were determined and an order of merit established based on the information available. Table 3.4 illustrates the scoring of the Round 2 applications recommended for funding by the assessment panel.

Table 3.4

Application scoring and order of merit for PIOP Round 2

Criteria	Applications ¹			
	H	I	J	K
Economic/social criteria —out of 30	13	12	18	16
Environmental/technical criteria —out of 30	7	6	13	11
Market Multiple score ² —out of 100 (market multiple)	66 (1.69)	68 (1.60)	51 (2.45)	49 (2.53)
BCA score ³ —out of 20 (Adjusted BCA result)	12 (0.60)	14 (0.72)	10 (0.54)	10 (0.46)
Value for money criteria —out of 20	5	2	7	7
Total—out of 200	103	102	99	93
Order of merit	1	2	3	4

Source: ANAO adapted from DSEWPac information.

Note 1: Applications may be either full applications or components.

Note 2: The Market Multiple score is out of 100, using a linear scale where a market multiple of zero scored 100 and a market multiple of 5 or more scored zero. The market multiple reflects the ratio of funding sought to the market value of the water access entitlements offered in return.

Note 3: The BCA score is out of 20, using a linear scale where an 'adjusted' BCA result of 1.0 or more scored 20 and an 'adjusted' BCA score of zero scored zero. The derivation of the 'adjusted' BCA score is discussed in paragraph 3.40.

3.60 As occurred in Round 1, the dominant scoring component for applications was assessments against the value for money criteria. However, unlike Round 1, value for money assessments were based not only on the market multiple, but also included a form of BCA analysis and a review of cash/in-kind co-contributions. Assessment against the value for money criteria in Round 2 accounted for 70 per cent of the total potential score for each application. The only unsuccessful application for Round 2 funding was

competitive (relative to other applications) on the economic/social criteria and environmental/technical criteria, but not competitive on value for money as calculated by the assessment panel. Using value for money is a key consideration in the CCGs. However, the weighting of value for money considerations was not conveyed to applicants in the guidelines or prior to the closing of the funding round. It is important that program guidelines clearly identify any threshold requirements that must be satisfied in order for an application to be considered for funding. Well-constructed merit criteria should be effectively communicated to potential applicants so that applications submitted can reflect the appropriate priorities set by government.

3.61 Importantly, there was no benchmark set for achieving success—that is, there was no score that could be regarded as a ‘pass’. Scores against all the sub-criteria for all applications were either ‘marginal’ (3–4 out of 10) or ‘poor’ (0–2 out of 10) except for the ‘provide the Irrigation Modernisation Plan’ sub-criterion (where all applicants scored 10 out of 10) and one applicant that scored ‘satisfactory’ (5–6 out of 10) for one sub-criterion.¹⁰⁶

3.62 Despite these scores, the briefing paper prepared by DSEWPaC to the Minister recommending the approval of Round 2 projects stated:

For each scheme, the sub-projects recommended for funding form a package of integrated system efficiency improvement measures that the assessment panel believes meet the assessment criteria and are capable of generating a positive outcome for the relevant irrigation scheme and the region. ... The projects are technically feasible and the water savings can be realised.

3.63 The ANAO considers that the assessment panel’s assessment of Round 2 applications does not clearly demonstrate that the approved projects met either the program’s economic/social criteria or environmental/technical criteria. Consequently, it is unclear as to the extent to which projects are likely to contribute to the program objectives overall. However, the focus on water savings and the transfer of some of those savings to the Australian Government is likely to have positive economic, social and environmental benefits. For example, greater water efficiencies from piping water to farms or lining trunk irrigation channels can enhance the value and profitability of agricultural production and reduce leakage of saline water into the water table. Nevertheless, these benefits were not well documented in the applications or

¹⁰⁶ The economic /social criteria contain three sub-criteria. The environmental/technical criteria contain three sub-criteria. The value for money criteria contain two sub-criteria.

in the assessment process, and substantial ‘downstream’ risks were apparent in those higher-ranked projects recommended for funding.

Recommendations to the Minister

3.64 The CGGs require that Ministers responsible for approving grants first receive agency advice on the merits of the proposed grants before approving the grants.¹⁰⁷ In practice, advice on the merits of a grant application should include a clear agency recommendation to the Minister concerning whether funding should be approved for that application under the program guidelines. Advice and related briefing material provided to Ministers on grant approvals should also explicitly address the requirements of the *Financial Management and Accountability Act 1997* (FMA Act).

3.65 The Minister approved all the projects recommended for funding by DSEWPac without change for both Round 1 and Round 2. All applicants were formally advised of the result of the assessment of their applications and debriefings were offered to unsuccessful applicants. A summary and analysis of the advice to the Minister is discussed for each funding round.

Round 1

3.66 The Minister was comprehensively briefed on all the projects submitted for consideration in Round 1, including those recommended (five) and not recommended (two) for financial assistance. The briefing included documentation to support the Minister’s mandatory grants approval obligations. This included reference to compliance with the FMA Act, as required, along with documentation to support the reasons for the recommendations. Particular sensitivities or considerations were noted in the briefing in relation to matters such as:

- actions to avoid duplicate funding with other *Water for the Future* programs;
- conditions of approval to manage risks in relation to matters such as environmental and planning approval requirements; and

¹⁰⁷ Department of Finance and Deregulation, *Commonwealth Grant Guidelines—Policies and Principles for Grants Administration*, Finance Management Guidance No. 23, July 2009, p. 10.

- water savings expected to be acquired for the CEWH from the projects recommended for funding (69 509 megalitres of water access entitlements (or 39 740 megalitres of long-term cap equivalent¹⁰⁸)).

3.67 The brief commented on the difficulties with the ‘general lack of clarity and detail provided in all applications and the need to seek clarification from each applicant’. The detailed assessment report attached to the brief commented on the ‘significant deficiencies in some applications even following clarification’.¹⁰⁹ The Minister was also advised of:

- weaknesses in the BCAs accompanying the applications;
- reservations held by the technical advisor in relation to the potential for projects to be delivered within the proposed costs and timeframes; and
- applications generally not being effective in demonstrating the value of their projects against the economic/social merit criteria intended to ensure that projects secured a long-term sustainable future for their irrigation communities.

3.68 DSEWPaC acknowledged, in its advice to the Minister, that shortcomings in the applications had increased the consequential level of residual risk for the Australian Government. The key risk mitigation measure was to impose extensive conditions on successful applicants to address identified risks and uncertainties flowing from gaps in their applications. These conditions were tailored to the particular circumstances applying to each application. However, some conditions were common across recipients, and covered responsibilities for matters such as:

- budget estimates—particularly in relation to the transfer of water entitlements;
- environmental and planning approvals;
- liability for any cost increases;
- project management arrangements; and
- ongoing operational and maintenance costs.

¹⁰⁸ Long-term cap equivalent (or LTCE) was the method used by DSEWPaC at this time to standardise the calculation of expected water recoveries in the Murray–Darling Basin from the different water access entitlement categories across the catchments of the Basin.

¹⁰⁹ These applications were deemed to have failed the merit criteria.

3.69 It is preferable to address risk as early as possible in the grant assessment process rather than transferring risks to the funding agreement phase. However, given the Australian Government's stated priority to progress water reform in the Murray–Darling Basin, the department considered that the optimal position was to recommend the highest ranked projects and impose comprehensive conditions on successful applicants.

Round 2

3.70 The Minister was comprehensively briefed on all the projects submitted for consideration in Round 2, including those recommended (four) and not recommended (one) for financial assistance. As for Round 1, the briefing included documentation to support the Minister's mandatory grants approval obligations along with documentation to support the reasons for the recommendations.¹¹⁰ Particular sensitivities or considerations were noted in the briefing in relation to matters such as:

- the return of water access entitlements of 102 549 megalitres (75 100 megalitres of long-term annual average annual yield¹¹¹) to the Australian Government from successful projects;
- actions to avoid duplicate funding with other *Water for the Future* programs;
- the combination of whole projects and sub-projects as part of an integrated package of measures capable of generating a positive outcome for the relevant irrigation scheme and region; and
- amendments to the taxation arrangements that caused delays in Round 1.

3.71 The detailed assessment report attached to the brief to the Minister commented that 'many of the criteria in the guidelines were either not

¹¹⁰ A subsequent briefing paper provided to the Minister after the approval of Round 2 projects indicated that one of these projects received \$3 880 000 less than it requested due to the department's misinterpretation of the PIIO's application. The Minister agreed to DSEWPac's recommendation to increase funding for the project by \$3 880 000 on the basis that: the assessment panel would have recommended the increase had it correctly interpreted the PIIO's application; and sufficient uncommitted PIIO funds were available to cover the increase.

¹¹¹ Long-term average annual yield (or LTAAY) is the current method used by DSEWPac to standardise the calculation of expected water recoveries in the Murray–Darling Basin from the different water access entitlement categories across the catchments of the Basin. The differences between the current LTAAY and former LTCE methods are only minor.

addressed or were addressed in a cursory manner, leading to low scores for individual criteria'. In general, the assessment panel found that 'the applications were disappointing in the level of detail provided'. Nevertheless, the Minister was advised that there was enough information in the applications, if supplemented with questions of clarification, on which to assess three of the six areas that were key parts of the merit criteria—value for money, budgets and the capacity of the projects to deliver water efficiency savings and other technical issues. The other three areas—stakeholder participation in rationalisation and associated legal issues, stakeholder commitment to on-farm works and the involvement of third parties with assets affected by the projects—remained uncertain at the time of approval.

3.72 Despite these deficiencies in Round 2, the department did not attach any conditions to the successful applications, although the risks were highlighted to the Minister and stakeholder issues for each project to be followed up during negotiations were documented. Consequently, considerable pressure was placed on the department to manage the achievement of results through the funding agreement phase. Chapter 4 examines how risks associated with the approved Round 1 projects were dealt with during the contracting and ongoing management of the projects. However, as the results from Round 2 had only recently been announced at the time of the audit, the Round 2 contracting phase was not examined by the ANAO.

Conclusion

3.73 From the twelve applications submitted to DSEWPac, up to \$649.7 million has been approved for nine selected PIIOP projects over the two funding rounds. The promotion of PIIOP was well targeted to potential applicants and effective, with the exception of the taxation issues that caused delays with the progression of Round 1 projects.

3.74 The assessment framework adopted by DSEWPac for assessing applications was generally well designed and was intended to provide clear guidance to applicants and the assessment panel. However, there was a lack of clarity and precision around the economic/social and environmental/technical criteria in particular. This was important given the absence of an overall quantitative water recovery target for PIIOP and the critical importance of water saving and sustainability to the program objectives. Greater compliance with the requirements of the assessment framework and the assessment plan in Round 1 would have produced a more transparent outcome. In particular,

the weaknesses in assessment documentation made it difficult for the department to demonstrate compliance with the assessment plan and explain the basis of its assessment decisions. The assessment documentation supporting the Round 2 process provided a clear alignment of the assessments in the technical reports, the individual panel member assessments, minutes of meetings and the final assessment report to the Minister.

3.75 The process of assessing applications was particularly challenging given the lack of detail and information gaps in the applications received. While the department endeavoured to address the information shortfall through the use of technical advisors, external panel members and additional clarification from the applicants, there were clearly substantial risks created from the missing information in the applications. DSEWPaC had the option of rejecting applications on grounds that these applications were not complete. However, the department considered that there was sufficient information to progress all the applications to a full merit assessment. A staged application process may have assisted applicants where the size and complexity of the application requirements necessitated substantial effort and financial outlay by applicants.

3.76 The merit assessment process was heavily weighted towards the value for money criteria, and the market multiple for each project in particular. Applicants generally provided sufficient data in respect of this requirement. However, information used in the assessment against other criteria was lacking and it remains to be established how the recommended projects will meet the wider economic/social and environmental/technical criteria and the extent to which they will 'secure a sustainable future for irrigation communities'. The communication of the order of importance or weighting of the assessment criteria would have also assisted applicants to better align their applications with the requirements of the department.

3.77 The Minister was advised of the risks and his obligations under the FMA Act. The reasons for decisions were relevant to the program's objectives and were documented. The Minister accepted the department's recommendations for both rounds without alteration.

3.78 The department is well placed to measure and report on water savings achieved under the program. However, because of the gaps in the applications and the uncertainties around project outcomes, substantial residual risks remain. These will need to be addressed in the funding agreements and through ongoing project management by DSEWPaC. Conditions attached to

the approval for Round 1 applications will need to be carefully monitored. Despite the absence of any conditions of approval for Round 2 applications, DSEWPac should factor the stakeholder issues identified during the assessments into the development of funding agreements, as appropriate.

Recommendation No.2

3.79 To improve the quality and transparency of grant assessment processes for future programs within SRWUIP, the ANAO recommends that the Department of Sustainability, Environment, Water, Population and Communities:

- (a) evaluate the benefits and costs of a staged application approach where the size and complexity of applications are likely to require a substantial financial outlay by applicants;
- (b) communicate any order of importance of the merit criteria to potential grant applicants;
- (c) reinforce the importance of documenting the assessment of grant applications; and
- (d) revise departmental processes to limit the transfer of significant risks from the grant application assessment phase to the contracting and management phases of grant programs.

DSEWPac's response

3.80 SEWPaC agrees with this recommendation.

3.81 In relation to PIIOP and recommendation 2(a), SEWPaC considers that the early judgement to provide a one-stage application process for PIIOP was appropriate at the time, principally because applicants had already been funded by SEWPaC to complete modernisation plans to clearly establish their infrastructure needs. Having completed a modernisation plan (or equivalent) was a key eligibility criterion for PIIOP applications. In contrast, other programs under the SRWUIP, such as the On-Farm Irrigation Efficiency Program, have established a two-stage application process because of the need for a ground-up assessment by applicants of the type and cost of infrastructure improvements for which funding will be sought.

3.82 SEWPaC notes the ANAO finding that PIIOP has established additional funding agreement obligations and revised monitoring arrangements that have significantly strengthened SEWPaC's framework for monitoring project progress and the expenditure of Australian Government funding on PIIOP projects. This includes clearly identifying funding conditionality for successful applicants prior to contract signing which, in SEWPaC's view, means the identified risks of a one-stage application process are being effectively managed.

4. Development of Funding Agreements and Management of Projects

This chapter examines the development of funding agreements for Round 1 PIIOP projects, the monitoring and management of projects by DSEWPac and project progress to date.

Introduction

4.1 Effective implementation of approved projects is critical to the successful administration of grant programs. This requires administering agencies to:

- manage program and project risks;
- establish funding agreements that are consistent with the decision-maker's approval;
- establish an effective ongoing monitoring regime to ensure funding recipients are meeting agreed milestones and other key funding agreement provisions; and
- establish the outcomes achieved through the projects individually and collectively.

4.2 The ANAO examined the development of funding agreements for the approved PIIOP Round 1 projects¹¹², the arrangements put in place by DSEWPac to monitor and manage the delivery of these projects, and the progress achieved to date.

Negotiation of funding agreements for Round 1 projects

4.3 After the approval of Round 1 projects by the Minister in April 2010, DSEWPac commenced funding agreement negotiations with the successful PIIOs. Legally-binding funding agreements establish the objectives of each project and the parameters within which both parties must operate to deliver the projects in return for Australian Government funding.

¹¹² The contracting and project management of PIIOP Round 2 projects was not examined as selected Round 2 projects were announced in December 2011. As at April 2012, funding agreements were being negotiated for selected Round 2 projects.

4.4 The ANAO examined: the funding agreement model selected and the appropriateness of the provisions to protect the Australian Government's interests; the effectiveness of DSEWPaC's translation of the approved projects into legally-binding funding agreements with PIIOs; and the timeliness of the execution of PIIOP funding agreements.

Funding agreement model for PIIOP

4.5 The successful implementation of PIIOP projects required DSEWPaC to institute appropriate contractual arrangements with multiple parties, including:

- PIIOs that controlled and managed the irrigation schemes' common infrastructure and off-farm metering control and monitoring equipment that would be upgraded under PIIOP; and
- irrigators that owned or held water access entitlements that were to be transferred to DSEWPaC, and owned the land upon which on-farm works would be undertaken.¹¹³

4.6 In designing the delivery model for PIIOP, there were a number of funding agreement models and permutations available. DSEWPaC decided to contract with each PIIO directly, and require PIIOs to establish contracts with each irrigator to deliver the on-farm works component of PIIOP projects (where applicable) and transfer the required water access entitlements to the PIIO. The department considered that PIIOs should remain responsible for delivering their chosen modernisation works and managing the needs of the schemes' irrigators. As PIIOs interact with their irrigators on a regular basis, they are well placed to deal with any project issues that arise. It was also considered to be less efficient for the department to contract directly with a large number of irrigators.

4.7 To give effect to this arrangement contractually, DSEWPaC drafted PIIOP funding agreements that required PIIOs to:

- carry out their PIIOP projects and ensure that their irrigators carried out their on-farm works:
 - within the specified timeframe;

¹¹³ Other potential stakeholders included financial lending institutions that may have a lien over irrigators' water access entitlements and land.

- in accordance with the funding agreement;
- diligently, effectively and to a high professional standard; and
- in good faith;
- engage and provide funding only to irrigators who:
 - can enter into a legally-binding contract;
 - have a project approved by DSEWPaC; and
 - hold, and can legally transfer, water access entitlements to the Australian Government; and
- enter into contracts with irrigators that are consistent with, and give effect to, the PIIOs' obligations under the PIIOP funding agreements, including that:
 - irrigator contracts reflect clauses in the funding agreement¹¹⁴;
 - PIIOs manage and monitor irrigator compliance with each irrigator contract; and
 - PIIOs enforce the PIIOs' rights, the Australian Government's rights and irrigators' obligations when required by DSEWPaC.

4.8 The funding agreement model selected by DSEWPaC to engage PIIOs and irrigators under the program requires a sound project management and governance approach from PIIOs—to not only manage their own performance, but to also monitor and manage the contracting, performance and compliance of irrigators to meet the Australian Government's requirements. The assessment of Round 1 PIIOP applications by the assessment panel rated the risk to the projects' success from the PIIOs' lack of project management and governance as 'moderate' to 'high'. Although the PIIOP funding agreements contain specific measures to address the risk posed by the variability in PIIO's

¹¹⁴ DSEWPaC used two forms to reflect PIIOP funding agreement requirements in irrigator contracts. PIIOs were required to impose and enforce obligations on irrigators through irrigator contracts that either:

- mirrored those that DSEWPaC imposed and enforced on PIIOs through the funding agreements (for example, the irrigator must carry out projects in accordance with the contract with the PIIO diligently, effectively and in good faith); or
- were effectively the same as those DSEWPaC imposed and enforced on PIIOs through the funding agreements (for example, to give the Auditor-General, the Privacy Commission and persons authorised by the Australian Government powers to access, inspect and copy records and materials associated with the irrigator's project).

project management and governance arrangements¹¹⁵, this issue nonetheless emphasises the importance of DSEWPaC instituting a robust monitoring framework to ensure that PIIOPs meet all provisions of their PIIOP funding agreements.

Translation of approved projects into funding agreements

Negotiation and content of the draft funding agreement

4.9 On 20 April 2010, DSEWPaC released the draft funding agreement to the five successful PIIOP applicants. Bilateral negotiations on the contents of agreements commenced shortly thereafter, with changes agreed to with one PIIOP reflected in the draft funding agreements of other PIIOPs.¹¹⁶ In all instances, changes to the general terms and conditions of the agreement were either negotiated in the presence of representatives from DSEWPaC's legal area or were cleared with DSEWPaC's legal area before acceptance by the department.

Features of PIIOP funding agreements

4.10 The funding agreements between DSEWPaC and PIIOPs contractually commit PIIOPs to transfer to the Australian Government the quantity of water access entitlements that PIIOPs offered in their applications in return for PIIOP funding¹¹⁷—that is, the Australian Government receives its 'agreed share of water savings' irrespective of whether the project achieves its estimated water savings. The PIIOP funding agreements contained other specific provisions designed to protect the Australian Government's interests, including in respect of: the use of funding; record keeping; access by DSEWPaC or its representatives to records and works sites; and compliance with other Australian Government policies.

Measuring the achievement of PIIOP objectives

4.11 Under the PIIOP funding agreements, each PIIOP is required to submit a standalone final report on the completion of the project. The final report must fully account for the expenditure of project funds and the performance of the

¹¹⁵ One of the conditions attached to the approval of Round 1 PIIOP projects was that applicants confirm their project management and governance arrangements.

¹¹⁶ For example, the draft funding agreement was amended after one PIIOP recommended inclusions that allowed irrigators selling their farm to pass on the rights and obligations to complete their PIIOP projects to the buyers.

¹¹⁷ Subject to funding agreement negotiations, which are discussed from paragraph 4.18.

projects against their intended outputs. PIIOs are also required to report against the achievement of part of PIIOP's objectives, namely:

for the Commonwealth to acquire water entitlements that arise as a result of water savings achieved through the implementation of the [project] which improves the efficiency and productivity of water use and management both off and on farms within the [PIIO] irrigation area.

4.12 However, PIIOs are not explicitly required to report to DSEWPaC on the remaining part of PIIOP's objectives, which is the extent to which the PIIOP projects have 'help[ed] to secure a sustainable future for irrigation communities'. Implicitly, any government contribution towards improving and updating PIIO irrigation infrastructure will aid the sustainability of the irrigation systems. However, measuring and reporting on the contribution government funding makes to irrigation system sustainability would allow stakeholders, including the Parliament, to make better informed judgments about the effectiveness of, and value for money obtained under, the program.

4.13 Further impeding DSEWPaC's measurement and reporting of irrigation system sustainability is the absence of key performance indicators designed to measure the projects' and program's performance against this part of PIIOP's objective.

4.14 The PIIOP funding agreements allow DSEWPaC to require that PIIOs provide additional material in their final reports.¹¹⁸ DSEWPaC's development of an appropriate set of KPIs for PIIOP, aligned with the objectives of the SRWUIP investments, and the collection of relevant performance data, would better position the department to demonstrate the achievement of PIIOP's objective.

Preconditions for funding projects

4.15 The PIIOP funding agreements should also reflect how DSEWPaC has addressed the particular conditions attached to the approval of Round 1 projects (that is, preconditions for funding projects). As noted in Chapter 3, the variable quality of Round 1 PIIOP applications led to DSEWPaC recommending, and the Minister accepting, that conditions be imposed on all announced funding recipients.

¹¹⁸ This material could include modelling of the impacts that reduced water losses have on the local water table and analyses of the impact the projects had on the PIIOs' capital and maintenance budgeting and expenditure.

4.16 DSEWPaC satisfactorily addressed the preconditions that were common to all applicants through the contents of the funding agreements or during funding agreement negotiations. These preconditions related to applicants:

- confirming the nominated water entitlements and budget figures;
- confirming that all necessary environmental and planning approvals have been obtained as one of the first project milestones;
- confirming project management arrangements and appropriate governance structures are in place to manage project delivery;
- bearing any cost increases of the projects, including in respect of taxation liabilities and inflation increases;
- agreeing on the linkage between payment milestones and a requisite quantum of water entitlements being transferred to the Australian Government;
- confirming they understand that all ongoing operations and maintenance costs associated with the infrastructure upgrade funded by PIIOP are the applicants' responsibility.

4.17 Furthermore, preconditions that related to specific projects, which involved confirming governance arrangements with related irrigation water providers, have been addressed through funding agreement workplans, legal agreements established between the PIIOP and the related irrigation water provider, or a change to project parameters (which are discussed in *Negotiation of project deliverables* below).

Negotiation of project deliverables

4.18 The *Commonwealth Grant Guidelines* (CGGs) require grant funding agreements to be consistent with the terms of the approval given under FMA Regulation 9 (which, in the case of PIIOP, was exercised by the Minister in approving Round 1 PIIOP projects).¹¹⁹ Accordingly, the funding agreement

¹¹⁹ Under FMA Regulation 9, an approver can only approve a spending proposal that involves a proper use of Commonwealth resources. As expenditure on PIIOP projects would extend beyond the current financial year (2009–10), DSEWPaC obtained FMA Regulation 10 approval in advance of seeking FMA Regulation 9 approval. FMA Regulation 10 approval is required in situations where expenditure is expected to occur in future years under a future appropriation of the Parliament.

schedules, which specify the project parameters¹²⁰ must reflect the project as described in the PIIO's approved application for funding. Any changes in the grant or project parameters that are of sufficient scope to represent a new spending proposal require referral back to the program decision-maker (that is, the Minister).

4.19 As funding agreement negotiations progressed, most PIIOs requested changes to their project parameters. DSEWPaC assessed each proposed change before deciding to agree to some and not agree with others. In general, DSEWPaC considered favourably those requests that:

- were for eligible activities, as described in the program guidelines, that were consistent with the PIIOs' applications;
- maintained the projects' value for money, as determined by the ratio of PIIO funding to the market value of the water access entitlements to be transferred to DSEWPaC; and
- did not increase the Australian Government's approved maximum contributions to the projects.

4.20 Over the course of program implementation, the department has:

- agreed to two PIIOs' requests to substitute the water access entitlements offered in their project applications with a quantity of entitlements of a different category that maintained the projects value for money¹²¹;
- agreed to a PIIO's request to replace one sub-project with another in the same area using a different water saving technology to obtain the support from a related irrigation water provider required by a funding precondition. DSEWPaC also received assurance that the replacement sub-project would generate water savings as similar infrastructure

¹²⁰ Project parameters include the description of each PIIO project, the maximum amount of Australian Government contributions, contributions from other parties, and the amount and value of water access entitlements to be transferred to DSEWPaC.

¹²¹ Under NSW legislation, each regulated catchment has a water sharing plan that specifies the various categories of water access entitlements to which water is allocated year to year. Examples of categories include: general security, high security, conveyancing, stock and domestic, and supplementary. Each category of water access entitlements has its own conditions of use, trading rules, and priority for water allocation. These, and other factors, influence the different market valuations for each category of water access entitlements.

upgrades were considered favourably by the assessment panel on another section of the PIIO's channel system; and

- excised a small quantity of stock and domestic water access entitlements at market value from one PIIO's project after a suitable replacement for these water entitlements could not be negotiated.

4.21 Funding agreement negotiations of the project deliverables extended beyond the substance of the works to also include the timing of Australian Government funding and PIIO water access entitlement transfers over the life of the projects. Some PIIOs requested scheduling upfront water transfers in exchange for upfront funding. However, DSEWPaC decided that Australian Government funding and water transfers for all projects would be scheduled according to the projects' program of works, along with initial payments on funding agreement execution (of between 1.8 and 5.5 per cent of project funding) and final payments on project completion (of between 4.4 and 21.6 per cent of project funding).

4.22 Table 4.1 compares the announced and contracted: Australian Government funding for each Round 1 project; and total water entitlement transfers to DSEWPaC. Two projects have entered into funding agreements for amounts less than that announced by the Minister. The funding agreements for Round 1 projects negotiated by DSEWPaC have maintained the value for money proposition approved by the Minister.

4.23 The original Round 1 funding agreements negotiated by DSEWPaC accurately reflect the PIIO projects approved by the Minister and satisfactorily address the preconditions attached to the projects' approval. In accordance with better practice, the funding agreements incorporate sufficient final payments to encourage the satisfactory completion of all project requirements.

Table 4.1**Announced and contracted Round 1 PIIOP projects**

Applicant (Catchment)	Maximum funding announced (\$)	Maximum funding contracted (\$)
Coleambally Irrigation Cooperative Limited (Murrumbidgee)	51 218 330	43 764 727
Murrumbidgee Irrigation Limited (Murrumbidgee)	50 000 000	50 000 000
Marthaguy Irrigation Scheme (Macquarie)	9 528 690	9 407 190
Tenandra Scheme (Macquarie)	37 475 140	37 475 140
Trangie-Nevertire Irrigation Scheme (Macquarie)	115 000 000	115 000 000
Total funding	\$263 222 160	\$255 647 057
Australian Government's share of water access entitlements¹	69 509 ML (or 39 740 ML LTCE)²	65 826 ML (or 36 292 ML LTCE)²

Source: ANAO from DSEWPaC information.

Note 1: The announced and contracted water entitlement transfers to the Australian Government per project have not been disclosed for commercial confidentiality reasons.

Note 2: LTCE or Long-term Cap Equivalent standardises the calculation of expected water recoveries in the Murray–Darling Basin from the different water access entitlement categories across the catchments of the Basin.

4.24 However, the authorised DSEWPaC delegate who executed the PIIOP funding agreements¹²² was not explicitly informed: that the preconditions for funding had been met; and of the agreed changes to project parameters negotiated after the projects' approval. DSEWPaC's adherence to the requirements of the CGGs that grant funding agreements be consistent with the terms of the approval given under FMA Regulation 9 would have been better demonstrated had the delegate been informed of these matters at the time of executing the PIIOP funding agreements.

4.25 Figure 4.1 illustrates some of the PIIOP sites before and after funded works.

¹²² Depending on the amount of funding involved, the delegate was either the relevant First Assistant Secretary or Deputy Secretary in the department.

Figure 4.1

Examples of PIIOP sites before and after funded works



(From top-left clockwise) Unremediated irrigation channel in the Trangie-Nevertire Irrigation Scheme; Remediated irrigation channel in the Trangie-Nevertire Irrigation Scheme. Unremediated irrigation channel in the Murrumbidgee Irrigation Scheme; and Decommissioned and filled-in irrigation channel in the Marthaguy Irrigation Scheme.

Source: ANAO.

Timing of the execution of Round 1 PIIOP funding agreements

4.26 The execution of most Round 1 PIIOP funding agreements were delayed extensively pending the resolution of the taxation treatment of PIIOP funding. As outlined earlier in Chapter 3, during the PIIOP application period, DSEWPaC advised potential applicants that PIIOP funding would attract a capital gains tax (CGT) outcome and applicants prepared their applications assuming either a CGT or tax-neutral outcome. However, on the release of the draft funding agreement in April 2010, all PIIOs, after consulting with their taxation advisors, identified the potentially significant income tax liabilities that could arise from entering into a PIIOP funding agreement with the Australian Government.¹²³

¹²³ The implications of an income tax outcome for PIIOP funding are outlined in Footnote 64 in Chapter 2.

4.27 Since taxation was first raised as an issue, DSEWPaC has consistently stated that it would not pursue a class ruling for PIIOP—despite requests from potential applicants and advice from the ATO.¹²⁴ The department considered that the various corporate structures of PIIOs and individual circumstances would limit the applicability of a class ruling. After consultations between successful PIIOP applicants and the ATO, two PIIOs sought to obtain a private binding ruling from the ATO to resolve the taxation status of their PIIOP funding.¹²⁵ Of the remaining three PIIOs:

- one confirmed its tax-exempt status and signed the PIIOP funding agreement;
- one signed the PIIOP funding agreement aware of the taxation risks, but considered that other PIIOs may resolve the issue; and
- one PIIO decided not to seek a private ruling, and instead raised options with DSEWPaC to vary the draft funding agreement or pursue minor amendments to the taxation legislation.

4.28 In July and August 2010, DSEWPaC's senior executives considered alternative or concurrent options to the private binding rulings being pursued by PIIOs to progress the unresolved taxation issue. DSEWPaC identified the following options and their implications:

- taking no action—which could present a risk to project implementation or bankruptcies of applicants and irrigators if agreements were entered into as currently drafted;
- seeking an ATO class ruling—which may not have assisted applicants to manage their taxation liability even if obtained (for reasons outlined in paragraph 4.27);

¹²⁴ Class rulings are public rulings that enable the Commissioner of Taxation to provide legally binding advice in response to a request from an entity seeking advice about the application of a relevant provision to a specific class of persons, in relation to a particular scheme. The purpose of a class ruling is to provide certainty to participants to minimise the need for individual participants to seek private rulings. ATO, *What is a class ruling?*, available from <<http://www.ato.gov.au/businesses/content.aspx?menuid=0&doc=/content/34038.htm&page=1&H1>>, (accessed on 3 February 2012).

¹²⁵ Private binding rulings provide specific written advice to a particular taxpayer on how the ATO considers the law applies to that taxpayer. Private binding rulings are provided in response to requests for advice from taxpayers and practitioners. Private binding rulings are not binding on the ATO in relation to other taxpayers. Department of the Treasury, *Discussion Paper: Review of Aspects of Income Tax Self Assessment*, March 2004, available from <<http://selfassessment.treasury.gov.au/content/download/discussionpaper/pdf/06Chapter2.pdf>>, (assessed on 3 February 2012).

- seeking amendment to the *Income Tax Assessment Act 1997* (ITA Act)—which requires support across government and involves a long lead-time; and
- reimbursing participants' taxation liability—which is incongruous with the program guidelines.

4.29 AGS, who had been requested by DSEWPaC to provide legal advice on taxation options proposed by PIIOs, considered that the department's wider interests may be better served by pursuing minor amendments to the ITA Act. However, DSEWPaC continued to rely exclusively on the private rulings process in progress for two of the PIIOs, and encouraged the remaining PIIO to also seek a private ruling. During this period, PIIOs and DSEWPaC operated on the basis that the ATO private rulings were imminent. However, delays continued for several months. Deadlines for PIIOs to enter into funding agreements with the department were extended on numerous occasions on account of the unresolved taxation situation.

4.30 By late October 2010, DSEWPaC considered that action was necessary to address the taxation situation as taxation liability issues could adversely impact on: the willingness of potential participants to apply for PIIOP Round 2 funding; and other infrastructure programs under SRWUIP, including OFIEP, the Private Irrigation Infrastructure Program for South Australia and other State Priority Projects. In mid-November 2010, and in advance of the private binding rulings, DSEWPaC commenced discussions with the Department of the Treasury (Treasury) regarding possible ITA Act amendments to obtain a tax-neutral outcome for SRWUIP participants, including PIIOP.

4.31 The ATO issued the private rulings in mid- to late November 2010. Shortly thereafter, the two PIIOs informed DSEWPaC that the rulings were favourable and confirmed their intention to sign their PIIOP agreements—which they did in early January 2011 (over eight months after funding was approved). Notwithstanding the provision of private rulings for two applicants, funding agreement negotiations with the PIIO who had not sought a private ruling had stalled due to the taxation issue.

4.32 Independent and separate to the DSEWPaC/Treasury taxation discussions, the then Minister for Regional Australia, Regional Development and Local Government¹²⁶ wrote to the Treasurer on 6 December 2010 informing

¹²⁶ Currently, the Minister for Regional Australia, Local Government, Arts and Sport.

him of the taxation issues impacting PIIOP and recommending that potential solutions be pursued as a matter of urgency. Consultations between DSEWPaC and Treasury continued in late 2010 and early 2011, culminating in the Minister for SEWPaC and the then Minister for Regional Australia, Regional Development and Local Government announcing on 18 February 2011 that the Government would seek amendments to the ITA Act to: eliminate the timing discrepancy between the taxation of payments and the availability of deductions for grant applicants under SRWUIP; and exempt SRWUIP payments from CGT. Legislative amendments to give effect to the Government's announcement are yet to be presented to the Parliament. If and when given effect, all PIIOP payments to PIIOs are expected to achieve a tax-neutral outcome, although the full impact on irrigators is yet to be confirmed.

4.33 On the same day as the Government announced that it would seek taxation legislative amendments, the PIIO who had not sought a private binding ruling announced its intention to endorse the PIIOP funding agreement. The agreement was executed on 6 June 2011 (over 13 months after the funding was approved).

4.34 The CGGs require agencies to list all executed grant funding agreements on the agencies' website within one week of the agreement's execution. DSEWPaC listed four of the five PIIOP funding agreements on the department's website within the required period. The remaining PIIOP funding agreement was listed two days late—due to technical and communication issues within other areas of the department.

4.35 The taxation issues that affected PIIOP's implementation illustrate the importance of resolving taxation issues early in the design of grant funding programs. While DSEWPaC considers that the PIIOP taxation issues were raised with the appropriate agencies in a timely manner once there was clear evidence that action was warranted, the resolution to the taxation issues was overly protracted and unduly reliant on applicants requesting and obtaining private binding rulings from the ATO—a process over which the department had no control or influence. While private binding rulings offered a possibly favourable resolution for PIIOP Round 1 applicants, it left uncertain the situation for PIIOP Round 2 applicants or applicants under other SRWUIP infrastructure programs. DSEWPaC's pursuit of alternative options in parallel with the private binding rulings sought by PIIOs would have better positioned the department to resolve the PIIOP taxation issues in a more timely manner.

Project monitoring by DSEWPaC

4.36 Active departmental monitoring of projects appropriate to the circumstances is an essential element of the effective and efficient delivery of government funded projects and the achievement of the funding program's objectives. In the case of PIIOP, DSEWPaC's project monitoring arrangements were designed to manage the risk posed by the lack of expertise and experience of some PIIOs in managing works of the magnitude of the PIIOP projects.

4.37 The original monitoring arrangements established at the time the funding agreements for the first PIIOP projects were executed have been revised over time. The effectiveness of the original and revised monitoring arrangements was examined by the ANAO.

Original monitoring arrangements

4.38 The original monitoring arrangements established by DSEWPaC for PIIOP Round 1 projects were based on the:

- PIIOs' submission, and DSEWPaC's approval after a technical review, of an annual workplan for each project (covering off-farm and on-farm works of PIIOs and irrigators, respectively);
- achievement of specified major milestones (for example, the calling for tenders, obtaining all environmental and planning approvals, and obtaining NSW Government approval to transfer water access entitlements) by certain dates in the funding agreement Schedule;
- PIIOs' submission, and DSEWPaC's approval, of regular progress reports against the workplan and reconciled project payments made to date;
- periodic site inspections by DSEWPaC and the technical consultants on progress and on the PIIO's adherence to occupational health and safety requirements; and
- regularly scheduled progress meetings between DSEWPaC and PIIOs.

Annual workplans

4.39 The workplans, updated annually, were to be the central planning document against which DSEWPaC monitored project progress. The workplans were to include details of the projects': management and governance arrangements; timeline and progress monitoring; budget and

cashflow schedule; risks and occupational health and safety management; management documentation; and activities (including engineering designs and schematics). DSEWPaC contracted technical consultants to analyse the water infrastructure construction and project management related issues of the proposed workplans.

4.40 However, the submission and approval of PIIOs' workplans has not occurred in accordance with DSEWPaC's original expectations. Workplans submitted by the first two contracted PIIOs in the second half of 2010 required resubmission several times to address the concerns of DSEWPaC's technical consultants. Further, provision of the detail DSEWPaC expected in the first project workplans was not possible until subsequent project milestones—such as the engagement of the head contractor, major procurements, and obtaining environmental and planning approvals—had occurred. Consequently, the funding agreements of the first four contracted PIIOP projects were varied to require the department's approval of 'interim' workplans and the submission and approval of 'updated' workplans at later dates. The funding agreement of the last PIIO contracted included the approval of 'interim' and 'updated' workplans in its original milestone schedule.

4.41 The time between the submission of 'interim' workplans of the first contracted PIIOs and their approval by DSEWPaC ranged between six weeks and four months. However, DSEWPaC expects that approval of 'updated' workplans will occur in closer accordance with the timeframes contained in varied milestone schedules due to the experience gained by both parties. DSEWPaC's technical consultants, who cleared the contents of all workplans prior to their approval by DSEWPaC, provided assurance to the department about the reasonableness of the timeliness, cost and effectiveness of the PIIOs' proposed construction and project management activities.

Progress reports and progress meetings

4.42 The funding agreements required PIIOs to submit project progress reports at regular intervals that contained a reconciliation of all progress payments made to date. The lack of specificity of DSEWPaC's requirements for these progress reports led to the department receiving reports that varied greatly in presentation, structure and content for each project. Further, the review of some progress reports by DSEWPaC was not evident and, at times, it was unclear whether the department had accepted the report as finalised. The lack of specificity in the progress reports weakened their effectiveness as a

project monitoring tool for DSEWPaC, leading to the department requesting further information from PIIOs to ascertain the achievement of milestones.

4.43 Under the funding agreements, progress meetings between PIIOs and DSEWPaC were required to be held between specified dates. In practice, progress meetings frequently occurred at other points in time, were not held, or were deemed to have been held. DSEWPaC advised that the purpose served by scheduling regular meetings was to emphasise the importance of both parties to the funding agreement discussing project progress and any associated issues. The meetings also provide an opportunity for DSEWPaC to view the worksites and obtain direct accounts of project performance. DSEWPaC has generally visited Round 1 projects twice each year and documented its discussions and observations during these visits.

Monitoring of milestone achievement and progress payments

4.44 After making the initial payments to Round 1 PIIOs on the signing of their funding agreements with DSEWPaC, subsequent payments were to be made only on the achievement, to the department's satisfaction, of specified funding agreement milestones. Generally, before authorising payment, DSEWPaC's payment delegate (a Senior Executive Service level officer) placed reliance on written advice by the Director and his team that the required milestones had been achieved. All payments made to PIIOs up to 31 December 2011 were approved by the appropriate departmental delegate after the required FMA Regulations (namely FMA Regulations 9 and 10) had been addressed.

4.45 During the first seven months of PIIOP project implementation, the departmental staff officer assigned to manage each project monitored: upcoming project milestones; the achievement of milestones; and the evidence obtained to demonstrate milestone achievement. DSEWPaC did not, however, provide administrative guidance to assist officers to perform their project monitoring task consistently and comprehensively. Consequently, the monitoring arrangements in place early in the implementation of PIIOP projects were not fully effective in all cases.

4.46 On one occasion, the payment delegate authorised a project payment for almost \$6 million on the basis of inaccurate assertions of PIIOP staff that all the required milestones had been achieved. At the time of payment authorisation, four of the nine milestone components had not been achieved. Three of these milestone components were rescheduled for a later date in a funding agreement variation executed three weeks after the payment. The

fourth milestone component—‘all necessary environmental, planning and water approvals obtained and provided to the department’ was not achieved until four months after the payment was made.

4.47 From February 2011, DSEWPaC introduced milestone performance reporting for each project that tracked the achievement of all milestones that had fallen due, cross-referenced to the evidence on files or in the department’s IT systems. While an improvement on the earlier milestone monitoring arrangements, these milestone monitoring arrangements did not provide DSEWPaC visibility in respect of upcoming milestones. DSEWPaC has since introduced a revised monitoring approach for PIIOP projects that places a stronger emphasis on:

- identifying and taking action in respect of upcoming milestones; and
- delegates being provided with source documentation verifying the achievement of milestones before payments are authorised.

Revised monitoring framework

4.48 From mid-2011, DSEWPaC progressively introduced additional obligations on PIIOs, irrigators and subcontractors, in association with revised arrangements for monitoring PIIOP Round 1 projects. These additional obligations included:

- requiring irrigators and subcontractors contracted by PIIOs to keep full and accurate accounts and records of their involvement in the project;
- allowing DSEWPaC to conduct independent audits of the finances of PIIOs, irrigators and subcontractors, at the department’s discretion;
- allowing persons authorised by the Australian Government to access locations where the PIIO or its irrigators will undertake, is undertaking or has undertaken the project¹²⁷; and
- PIIOs procuring subcontractors and assets in accordance with the procurement principles of: obtaining value for money; encouraging competition (encompassing non-discrimination and competitive procurement processes); ensuring an efficient, effective and ethical use of resources; and ensuring accountability and transparency of process.

¹²⁷ This was in addition to the existing requirement for access to locations where the project’s accounts and records are maintained.

4.49 The revised monitoring arrangements for PIIOP projects, now incorporated into the first four PIIOP projects contracted¹²⁸, have simplified the PIIOs' preparation of milestone and expenditure documentation by clearly specifying in advance the documentation needed to satisfy each milestone¹²⁹ — most of which is routinely collected or maintained by PIIOs as they manage their projects. The new requirements for the certification of milestone achievement by PIIO management and the production of independent auditor's reports has provided additional assurance to DSEWPaC's payment delegate that milestones have been achieved before project payments are authorised.

4.50 The additional PIIOP funding agreement obligations and revised monitoring arrangements have significantly strengthened DSEWPaC's framework for monitoring project progress and the expenditure of Australian Government funding on the PIIOP projects.

4.51 Figure 4.2 illustrates PIIOP works at one PIIO.

¹²⁸ The original funding agreement of the last PIIOP project contracted already incorporates most of the additional obligations and revised monitoring arrangements.

¹²⁹ The milestones of the PIIOP funding agreement also encompass or summarise the milestones of the agreements between PIIOs and their irrigators.

Figure 4.2

Examples of PIOP sites after funded works



(Left to right) Excavated irrigation channel at Coleambally; and Solar-powered flow regulator and meter at Coleambally.

Source: ANAO.

DSEWPaC's management of implementation issues

4.52 The development and delivery of complex multi-million dollar projects rarely occur in strict accordance with schedules outlined in grant funding applications and original funding agreements. It is incumbent on Australian Government project managers to assess each project issue that arises and take action appropriate to enable the fulfilment of the projects' and funding program's objectives, and to protect the Australian Government's interests. Proposed changes from the approved/contracted project should be assessed on their merits and any agreed changes reflected in legally-binding agreements, after obtaining appropriate legal advice.

4.53 The ANAO examined DSEWPaC's management of:

- the transfers of water access entitlements from PIIOs;
- issues associated with irrigators' on-farm works components of PIOP;

- issues affecting the progress of, or the PIIOs' management of, the PIIOP projects; and
- third-party complaints.

Transfers of water access entitlements

4.54 As the PIIOP projects progress, tranches of water access entitlements are transferred to DSEWPaC in accordance with the quantities specified in the funding agreement Schedules. Trading in water access entitlements is regulated by the NSW Government (specifically, the NSW Office of Water) under the *Water Management Act 2000* (NSW) through a formal conveyancing process that is summarised in Figure 4.3. Transfers of water access entitlements under PIIOP up to the end of 2011 ranged between three weeks and five months from the conduct of the due diligence assessment through to settlement. Registration of the trades by the NSW Office of Water generally takes a further three months.

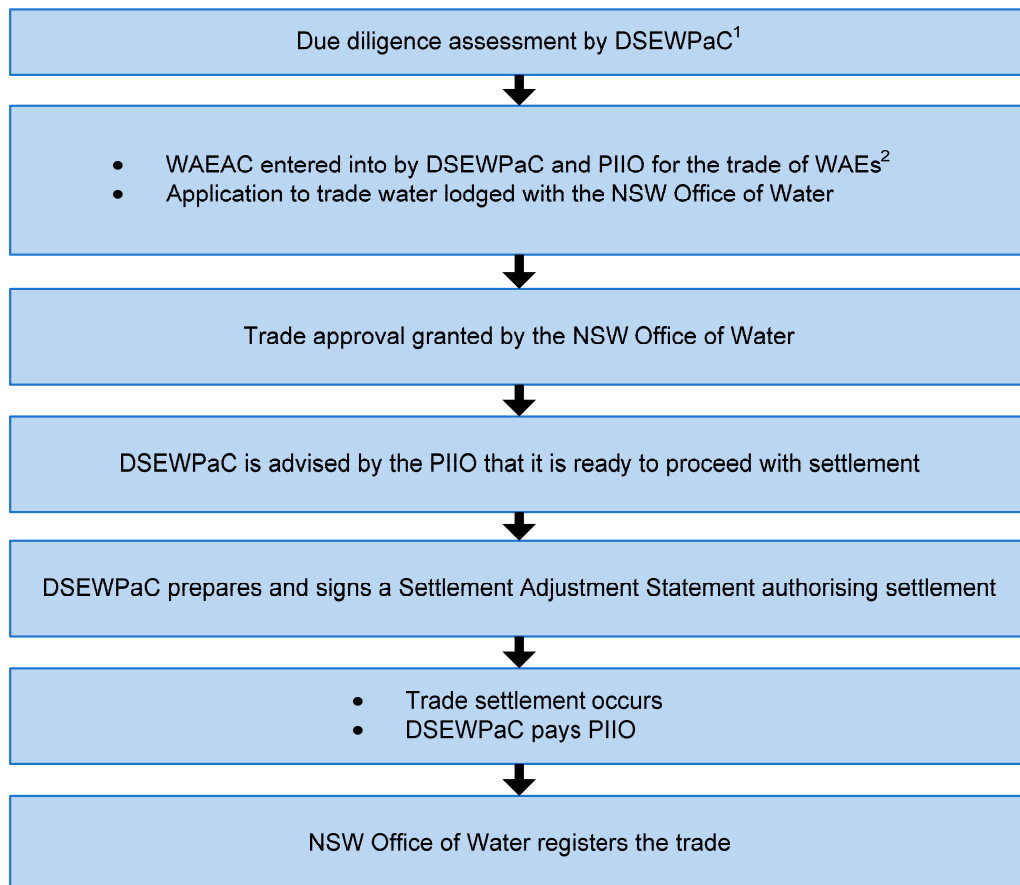
4.55 At the commencement of PIIOP, DSEWPaC's exposure to the NSW Government's water access entitlement conveyancing process was limited. Consequently, it took time for the department and its legal advisors to become familiar with the requirements of the conveyancing process, develop the generic water access entitlement assignment contract; and establish internal clearance processes to authorise water transfers.

4.56 DSEWPaC has now established an appropriate process to approve water access entitlement transfers that requires the:

- department to recommend to the delegate to proceed with the transfer after receipt of a satisfactory due diligence assessment report;
- delegate to execute the water access entitlement assignment contract and application to trade water on behalf of DSEWPaC;
- delegate to approve the PIIOP funding agreement milestone payment associated with the transfer and authorising settlement; and
- delegate to sign the Settlement Adjustment Statement instructing the department's legal advisors to proceed with settlement.

Figure 4.3

Summary of PIIO water access entitlements conveyancing process



Source: ANAO from DSEWPaC information.

Note 1: Due diligence assessments involves legal title searches to ensure, among other things, that the entitlements are: registered in the name of PIIO; have sufficient quantities of the correct water access entitlements required for the trade; and are free of encumbrances (such as, liens from the PIIO's financial institutions).

Note 2: WAEAC—Water Access Entitlement Assignment Contract, and WAE—water access entitlements.

4.57 DSEWPaC has followed the established processes for approving water access entitlement transfers, except on one occasion where the delegate did not evidence his approval of the department's recommendation to proceed with the transfer process.¹³⁰

¹³⁰ All subsequent approvals for the particular water transfer by the delegate were appropriately documented.

4.58 On most occasions, the department has effectively and efficiently received water access entitlements under the conveyancing process. However, in two cases, DSEWPaC could not process the water entitlement transfers by the intended dates, which caused delays to the settlement of the transfers. In both cases, DSEWPaC determined that the department did not hold a water access entitlement of the same category necessary to accept the PIIOs' water entitlements. In one case, DSEWPaC became aware of the issue after completion of the due diligence report and the execution of the water access entitlement assignment contract with the PIIO and the submission of the application to NSW Office of Water to trade water. To resolve these issues, DSEWPaC applied to the NSW Office of Water to create a water access entitlement of the correct category, which delayed the progression of the conveyancing process. To avoid any repetition of the transfer problems encountered, DSEWPaC should determine whether the department holds the correct category of water access entitlement in advance of all intended transfers.

Irrigator-related issues

4.59 The involvement of numerous irrigators in the delivery of the on-farm works components of three of the five Round 1 PIIOP projects creates complications in managing the successful delivery of these projects. In the same way that DSEWPaC entered into funding agreement negotiations with PIIOs of the approved projects, PIIOs had to enter into contractual negotiations with each of their irrigators who agreed to be part of the on-farm works component of the PIIOP application (which ranged in number from three to 80 irrigators per project). Under the funding agreement model adopted by DSEWPaC for PIIOP, PIIOs are primarily responsible for dealing with irrigators. However, DSEWPaC has an interest in the outcomes of these dealings, and has intervened at times to progress the PIIOP projects.

4.60 The contracting of irrigators by PIIOs under the program has not been straightforward. Each PIIO had to draft irrigator contracts that reflected the terms and conditions under which the PIIO was bound under its funding agreement with DSEWPaC, including provisions from the funding agreements that had to be reflected in the irrigator contracts. Information provided by irrigators to the ANAO indicated that many irrigators found their contracts with the PIIO complex and daunting. As a consequence, some irrigators withdrew from PIIOP projects, while others executed contracts based primarily on the assurance they received from other irrigators in their community

entering into similar agreements. The types of on-farm works funded under PIIOP included:

- irrigation infrastructure (such as high/low pressure drip irrigation and soil moisture monitoring), storage, recycling systems, and channel lining;
- stock and domestic system (including necessary pipes, valves, storages, telemetry monitoring, tanks and troughs);
- bores and meters;
- earthworks to fill decommissioned channels;
- removal of structures related to decommissioned channels (such as pipes, storages or channel off-takes);
- erosion stabilisation works in fields to be decommissioned;
- fencing to replace channels and structures;
- field excavations to improve water flows; and
- other eligible integrated on-farm activities.

4.61 At times, DSEWPaC has become involved in disputes between PIIOs and irrigators concerning aspects of PIIOP projects, including situations where:

- irrigators questioned whether their PIIOs had received sufficient support for their PIIOP application from their irrigator membership. At DSEWPaC's request, PIIOs made representations and provided documentary evidence confirming membership support for the PIIOP applications and intended distribution of PIIOP funding among members in respect of the on-farm works components; and
- DSEWPaC facilitated the resolution of PIIOP contractual issues between a PIIO and one irrigator when negotiations between the parties stalled.

4.62 DSEWPaC has also been required to assess PIIOs' requests to vary the parameters of irrigation projects or include new irrigators and/or irrigator projects to replace irrigators who were part of the PIIO's original application, but no longer wished to be involved or were unwilling to enter into the contract with the PIIOs for their on-farm works. Generally, DSEWPaC considered favourably those requests that:

- were for eligible activities, as described in the program guidelines, that were consistent with the PIIOs' applications;
- maintained the projects' value for money, as determined by the ratio of PIIOP funding to the market value of the water access entitlements to be transferred to DSEWPac; and
- did not increase the Australian Government's approved maximum contributions to the projects.

4.63 The majority of PIIOP requests for irrigator and/or irrigator project variations and substitution have been relatively straightforward for DSEWPac to assess and make a decision. However, several cases have required greater consideration and judgment from DSEWPac, including PIIOs' requests to:

- allow a NSW Government entity to participate as an irrigator in a PIIOP project¹³¹—after obtaining legal advice and considering submissions from the PIIOP and the NSW Government entity, DSEWPac determined that the entity was eligible to participate;
- allow irrigators involved in particular on-farm works on one PIIOP project to retain any unused project funding¹³²—DSEWPac agreed to allow irrigators to retain unused project funding, subject to the irrigators meeting certain preconditions, due to the value for money benefit offered by these works and to manage the risk of the project not proceeding; and
- fund additional on-farm works for a particular class of water access entitlement holders not part of the PIIOP's original application—DSEWPac advised that these additional works are necessary to gain access to, and provide easements for, the PIIOP project works, but the additional works will be funded from within the project's current budget.¹³³

4.64 DSEWPac has appropriately considered and actioned PIIOs' requests to vary the parameters of irrigation projects or the substitution of irrigators

¹³¹ Under the PIIOP Guidelines, 'state' agencies' were not eligible to 'apply for the program'.

¹³² The funding agreement requires that PIIOs seek DSEWPac's agreement to retain and use uncommitted PIIOP funds held by PIIOs or irrigators at the funding agreements' end dates for purposes agreed by DSEWPac (otherwise the funds must be returned to the department).

¹³³ The PIIOP is expected to provide DSEWPac with the specific details of the additional works in an updated workplan due in June 2012.

and/or irrigator projects. DSEWPaC's interventions in disputes between PIIOs and their irrigators have been appropriate and effective in progressing the PIIOP projects.

PIIO-related issues

4.65 DSEWPaC has established effective working relationships and communication channels with PIIOs and their project managers (often organisations contracted by PIIOs). Issues arising from PIIOP projects have been considered in a timely manner, and their resolution clearly communicated to all parties.

4.66 The most common issues affecting PIIOP Round 1 projects have been related to project progression—most of which are beyond the control of the Australian Government, and some of which are also beyond the control of PIIOs. PIIOP Round 1 projects have not progressed as rapidly as originally envisaged by DSEWPaC and the PIIOs for numerous reasons, including delays:

- in obtaining approval of the project's workplan;
- due to poor weather (flooding and rain);
- in obtaining NSW Government planning and environmental approvals (including one project that was delayed by over a year due to the extensive time taken to obtain floodplain management approval from the NSW Government and resolve the native title aspects associated with project works crossing Crown land);
- in irrigators entering into legally binding agreements with their PIIOs in respect of on-farm works; and
- in the PIIOs' procurement of head contractors.

4.67 At times, DSEWPaC has received requests from PIIOs for variations to funding agreements (or variations to the approved project proposal) in respect of other issues—some of which were related to project delays—including:

- restructuring or rescheduling of project works (which commonly occurred after the engagement of a head contractor);
- irrigator and/or on-farm works substitution (as discussed earlier);
- permission for water to be delivered to irrigators against entitlements that are to be transferred to the Australian Government;

- milestone splitting to allow for partial payments (in respect of the portion of the milestones that had been achieved); and
- water entitlement substitutions.

4.68 In all cases, DSEWPaC assessed the rationale for the delay and its impact on the overall project before approving variations to funding agreements. In each case, DSEWPaC appropriately assessed the impact of the delay or proposed variation on the projects concerned and the PIIOs' rights and obligations, before either agreeing or not agreeing to the change request. On one particular occasion, a PIIO requested that an irrigator that had access to irrigation water removed under PIIOIP be allowed to access alternative water delivery arrangements from the PIIO. After obtaining legal advice, DSEWPaC refused this request as it conflicted with the PIIO's commitments made under the funding agreement.

Handling of third-party complaints

4.69 At times, DSEWPaC has reviewed third-party complaints about the actions of PIIOs in relation to their PIIOIP projects, including in respect of the:

- efficacy of a PIIO's choice of irrigation channel lining material;
- tendering process for the supply and installation of one PIIO's irrigation channel lining material; and
- cost of the stock and domestic pipeline for one PIIO's project.

4.70 In each instance, DSEWPaC sought additional information from PIIOs to make an informed assessment of the situation. Documentation supplied by, and representations from, PIIOs allowed DSEWPaC to address the complaints. In each case, DSEWPaC determined that the provisions of the PIIOIP funding agreements had been adhered to, and verified that the cost and quality of the project deliverables were appropriate for the projects.

4.71 In one case, DSEWPaC conducted its own inquiries after sighting emails between a PIIO and an irrigator that called into question the eligibility of the irrigator's on-farm works funded under PIIOIP. The PIIO's response addressed the department's concerns by acknowledging that the emails were poorly written, and providing specific representations confirming the eligibility of the irrigator's on-farm works.

4.72 DSEWPaC has appropriately considered and actioned PIIOs' requests to vary the funding agreements to take into account issues arising as PIIOIP

projects have progressed. DSEWPaC has also taken appropriate action to investigate and resolve third-party complaints about the action of PIIOPs in respect of their PIIOP projects.

Progress of PIIOP projects

4.73 During the establishment of PIIOP, DSEWPaC's initial expenditure forecasts for the program had the first payments to approved PIIOP projects commencing in 2009–10. However, due to delays to the funding agreement negotiations, the first payments to PIIOP projects occurred early in 2010–11 and the larger milestone payments expected to occur in 2010–11 were delayed until 2011–12. Table 4.2 outlines DSEWPaC's expenditure forecasts for the program as at November 2009, October 2010 and March 2012. The table demonstrates that, although program expenditure to date is less than original forecasts, DSEWPaC expects that all payments for Round 1 and 2 projects will occur by 2015–16, over a year in advance of the program's completion date of June 2017.

Table 4.2

PIIOP expenditure forecasts over time

PIIOP Expenditure Forecasts (\$m)			
Year	Baseline (November 2009)	As at October 2010	As at March 2012
2009–10	80.0	-	-
2010–11	100.0	116.2	41.6
2011–12	110.0	201.1	146.0
2012–13	110.0	174.6	142.9
2013–14	100.0	83.1	140.0
2014–15	80.0	55.2	120.1
2015–16	40.0	19.7	59.2
2016–17	30.0	-	-
Total	650.0	650.0¹	650.0¹

Source: ANAO from DSEWPaC information.

Note 1: Figures have been rounded.

4.74 A review of the schedules of the original PIIOP Round 1 funding agreements against progress as at March 2012 indicates that project expenditure was behind original expectations and the transfers of water access entitlements slightly exceeded original expectations. By March 2012,

DSEWPaC had originally expected to make disbursements to Round 1 PIIOP projects totalling approximately \$143.3 million (56.3 per cent) of the approved funding and to have received 44.9 gigalitres (68.2 per cent) of water access entitlements. By this date, DSEWPaC had actually disbursed \$127.1 million (49.9 per cent) of funds and received 45.9 gigalitres (69.8 per cent) of water access entitlements. As at 31 March 2012, of the five projects:

- three were meeting or exceeding original expenditure and water entitlement transfer expectations; and
- two were meeting (or close to meeting) original water entitlement transfer expectations, but not meeting original expenditure expectations.

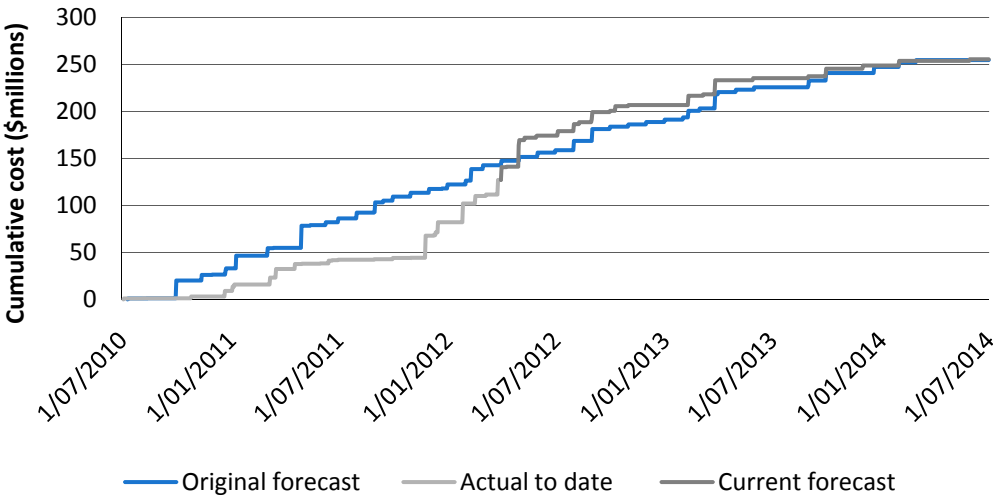
4.75 The funding agreements of four of the projects have been revised over time to reflect issues that have had an impact on the projects as they have progressed, including project delays, as discussed earlier. Project expenditure and water access entitlement transfers were well behind schedule as at mid-November 2011, but both have increased significantly. DSEWPaC expects that by July 2012 total project expenditure and water entitlement transfers will exceed the department's original expectations of progress as anticipated in the original funding agreements.

4.76 Project completion dates for four of the five projects have not changed from the original funding agreements—with dates ranging from March 2012 to March 2014. The project completion date for the remaining project has been delayed by 11 months from late February 2012 to early February 2013.

4.77 Figures 4.4 and 4.5 summarise actual and forecast Round 1 PIIOP project expenditure and water entitlement transfers as at 31 March 2012, respectively.

Figure 4.4

Actual and forecast expenditure on Round 1 projects

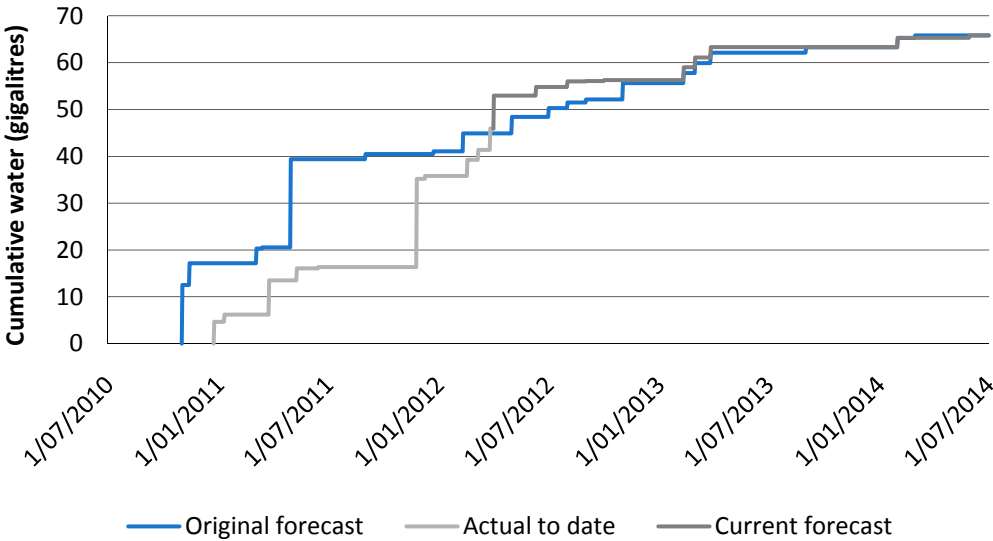


Source: ANAO from DSEWPaC information.

Note 1: In the absence of definitive milestone payment amounts and dates for one PIIO project, the ANAO has assumed payments match the project's forecasted annual expenditure paid in equal monthly instalments.

Figure 4.5

Actual and forecast water entitlement transfers under Round 1 projects



Source: ANAO from DSEWPaC information.

4.78 At the time Round 1 PIIOP projects were approved, the Minister agreed to a DSEWPac recommendation to allocate an additional \$14.8 million as a contingency during funding agreement negotiations for selected projects. This contingency, which was in addition to the funding announced for each project, was to provide the department with some limited scope to fund the removal of structures (such as, road culverts and pump stations associated with channel decommissioning), particularly where these works improved public safety. As noted in Table 4.1 above, all original funding agreements with PIIOs were for amounts equal to or less than the funding announcements.

4.79 As the Round 1 projects have progressed, two of the five PIIOs informally approached DSEWPac to seek additional Australian Government funding to complete their projects. DSEWPac advised these PIIOs to lodge written requests outlining their reasons for seeking additional funding, and the extent to which PIIOs were able to contribute to cost overruns. As at 31 March 2012, no PIIOs had formally sought additional Australian Government funding from the contingency to complete their projects. In December 2011, DSEWPac received Ministerial approval to reallocate the \$14.8 million set aside for public safety works to the funding of PIIOP Round 2 projects.

4.80 While the implementation of PIIOP Round 1 projects has not progressed in line with DSEWPac's original expectations, as at 31 March 2012 the projects were on track to be completed within the approved budget and within the program's completion date of June 2017.

Conclusion

4.81 Overall, DSEWPac has effectively engaged with PIIOs and irrigators to support the delivery of the Round 1 PIIOP projects. Under the funding agreement model selected for PIIOP, the department contracted with each PIIO directly and PIIOs were required to enter into legally-binding agreements with participating irrigators in their scheme to deliver the on-farm works component of the PIIOP projects and transfer the required water access entitlements to PIIOs. DSEWPac has negotiated funding agreements between the department and PIIOs, in close association with the department's legal area, that: accurately reflect the Round 1 PIIOP projects approved by the Minister; satisfactorily address the preconditions attached to the projects' approval; and effectively protect the Australian Government's interests.

4.82 The timing of the execution of PIIOP Round 1 funding agreements was extensively delayed pending the resolution of the taxation treatment of PIIOP funding, highlighting the importance of resolving taxation issues early in the design of grant funding programs. The resolution of the taxation issues was overly protracted due to DSEWPaC's reliance solely on private binding rulings between the ATO and PIIOs. Although other options were canvassed, none were pursued concurrently or as alternatives to obtaining private binding rulings for many months, including the legislative amendment option that ultimately resolved the taxation issue.

4.83 The funding agreements require PIIOs to produce a final report that accounts for the expenditure of project funds, the delivery of intended outputs and achievement against part of PIIOP's objective. However, PIIOs are not required to report project performance against the 'helping to secure a sustainable future for irrigation communities' element of PIIOP's objective and DSEWPaC has not developed key performance indicators to measure irrigation sustainability. DSEWPaC would be better placed to demonstrate the achievement of PIIOP's objective were the department to develop appropriate KPIs for the program and determine and collect the relevant performance data.

4.84 In light of the Round 1 assessment panel's concerns about the variability in PIIO's project management and governance arrangements, DSEWPaC required robust monitoring arrangements to ensure PIIOs met all provisions of the PIIOP funding agreements and irrigators met the requirements of their contracts with PIIOs. DSEWPaC's original monitoring arrangements for PIIOP were not sufficiently robust to consistently monitor PIIO and irrigator performance, compliance and expenditure. The revised monitoring arrangements established for PIIOP projects from mid-2011 have significantly strengthened DSEWPaC's framework for monitoring project progress and the expenditure of Australian Government funding on the PIIOP projects.

4.85 As the projects have progressed, PIIOs have requested numerous variations to the funding agreements. DSEWPaC considered each request and took action to accept or reject the requests, as appropriate, to maintain the integrity of the projects approved by the Minister and protect the Australian Government's interests. DSEWPaC has also taken appropriate action to investigate and resolve third-party complaints about the actions of PIIOs in respect of their PIIOP projects, and intercede in disputes between PIIOs and their irrigators to progress the PIIOP projects.

4.86 Delays to the funding agreement negotiations have resulted in PIIOP expenditure occurring slower than DSEWPaC's original forecasts. Nevertheless, the department expects that all program payments will occur well in advance of the program's completion date of June 2017. Although water entitlement transfers to March 2012 are generally meeting original funding agreement schedules for all five Round 1 PIIOP projects, project expenditure on two projects is below original expectations. However, DSEWPaC expects that by July 2012 total project expenditure and water entitlement transfers will exceed the department's original expectations of progress as anticipated in the original funding agreements. Project completion dates for four of the five projects have not changed from the original funding agreements, with all Round 1 projects expected to be completed on budget by May 2014.

Recommendation No.3

4.87 To enable an assessment of the extent to which PIIOP is achieving its objectives, the ANAO recommends that the Department of Sustainability, Environment, Water, Population and Communities:

- (a) develop key performance indicators that inform an assessment of achievements against the program's objective; and
- (b) determine the performance data required, and collect and analyse this data.

DSEWPaC's response

4.88 SEWPaC agrees with this recommendation.

4.89 The development of key performance indicators and performance data is already being undertaken, including through requirements in Funding Agreements for more detailed articulation of the requirements for proponents to describe in project final reports the extent to which their PIIOP project has contributed to achieving the program's objectives.



Ian McPhee

Auditor-General

Canberra ACT

5 June 2012

Appendices

Appendix 1: DSEWPaC's response to the proposed report



Australian Government

Department of Sustainability, Environment, Water, Population and Communities

Secretary

Ref: 2012/03418

Ms Barbara Cass
Group Executive Director
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Dear Ms Cass

Thank you for your letter of 20 April 2012 seeking input from the Department of Sustainability, Environment, Water, Population and Communities on the proposed audit report of the Private Irrigation Infrastructure Operators Program in NSW.

I enclose the Department's response as text for inclusion in the final audit report. The Department accepts the recommendations of the audit but has provided, as a further attachment to this letter, some additional comments on key matters particularly in the area of audit findings on taxation issues. I would be grateful for your consideration of the matters raised.

I would like to acknowledge the professional approach taken by the members of your audit team.

Thank you for providing the opportunity to comment on the proposed performance audit report.

Yours sincerely

A handwritten signature in black ink, appearing to read 'P Grimes'.

Paul Grimes
21 May 2012

**Department of Sustainability, Environment, Water, Population and Communities
(SEWPaC) comments on ANAO Audit of the Private Irrigation Infrastructure
Operators Program in NSW (PIIOP).**

Summary of the Department's response

The Department of Sustainability, Environment, Water, Population and Communities (SEWPaC) agrees with each of the ANAO's recommendations.

SEWPaC appreciates the ANAO's recognition that the policy intent of the Government was for PIIOP to provide for investment in rural irrigation infrastructure, to achieve long term benefits for irrigation water providers, related communities and the environment.

In particular, SEWPaC welcomes the ANAO's finding that assessment and contract management arrangements progressively applied by the Department from the beginning of 2011 have significantly strengthened SEWPaC's framework for monitoring project progress and the expenditure of Australian Government funding on PIIOP projects.

Department's detailed response to recommendations

Recommendation 1

To improve the implementation of programs within SRWUIP, the ANAO recommends that the Department of Sustainability, Environment, Water, Population and Communities reinforce the arrangements in place to:

- a) develop and submit for approval program management documentation (including project plans, risk management plans and performance information);*
- b) effectively monitor performance progress against planned performance; and*
- c) seek early resolution of significant issues that have the potential to adversely impact on the effective and efficient implementation of programs.*

Department's response:

SEWPaC agrees with this recommendation. SEWPaC notes that the arrangements listed in recommendations 1(a), 1(b) and 1(c) are already in place for implementation of programs within SRWUIP.

Recommendation 2

To improve the quality and transparency of grant assessment processes for future programs within SRWUIP, the ANAO recommends that the Department of Sustainability, Environment, Water, Population and Communities:

- a) evaluate the benefits and costs of a staged application approach where the size and complexity of applications are likely to require a substantial financial outlay by applicants;*

- b) communicate any order of importance of the merit criteria to potential grant applicants;*
- c) reinforce the importance of documenting the assessment of grant applications; and*
- d) revise departmental processes to limit the transfer of significant risks from the grant application phase to the contracting and management phases of grant programs.*

Department's response:

SEWPaC agrees with this recommendation.

In relation to PIOP and recommendation 2(a), SEWPaC considers that the early judgement to provide a one-stage application process for PIOP was appropriate at the time, principally because applicants had already been funded by SEWPaC to complete modernisation plans to clearly establish their infrastructure needs. Having completed a modernisation plan (or equivalent) was a key eligibility criterion for PIOP applications. In contrast, other programs under the SRWUIP, such as the On-Farm Irrigation Efficiency Program, have established a two-stage application process because of the need for a ground-up assessment by applicants of the type and cost of infrastructure improvements for which funding will be sought.

SEWPaC notes the ANAO finding that PIOP has established additional funding agreement obligations and revised monitoring arrangements that have significantly strengthened SEWPaC's framework for monitoring project progress and the expenditure of Australian Government funding on PIOP projects. This includes clearly identifying funding conditionality for successful applicants prior to contract signing which, in SEWPaC's view, means the identified risks of a one-stage application process are being effectively managed.

Recommendation 3

To enable an assessment of the extent to which PIOP is achieving its objectives, the ANAO recommends that the Department of Sustainability, Environment, Water, Population and Communities:

- a) develop key performance indicators that inform an assessment of achievements against the program's objectives; and*
- b) determine the performance data required, and collect and analyse this data.*

Department's response:

SEWPaC agrees with this recommendation.

The development of key performance indicators and performance data is already being undertaken, including through requirements in Funding Agreements for more detailed articulation of the requirements for proponents to describe in project final reports the extent to which their PIOP project has contributed to achieving the program's objectives.

Appendix 2: Outcome 4 PBS performance information relevant to PIOP

Program 4.1: Water Reform	
2010–11 Program Objective	2011–12 Program Objective
... Improved regulation and better information will increase market efficiency and lead to more investment and improved productivity. This will deliver more efficient and flexible water use, greater security and sustainability, and better environmental outcomes. ...	To achieve more efficient and flexible water use, greater security and sustainability, and better environmental outcomes
2010–11 Deliverables	2011–12 Deliverables
... Irrigation is significantly more efficient and water savings are shared between irrigators and the environment. This will be achieved by improving the efficiency of irrigation by investing with ... industry in upgrading irrigation infrastructure both on and off farm; funding communities and irrigation providers to ... upgrade on and off farm irrigation infrastructure to support efficient water management, with water savings shared between irrigators and the environment; ...
Commonwealth-led programs under the [Basin Agreement] (projects are on schedule) Target for 2010–11 to 2013–14 inclusive is 'Yes' or 100%	Percentage of agreed share of water savings from funded on farm and off farm irrigation efficiency projects that are returned to Commonwealth Target for 2011–12 to 2014–15 inclusive is 100%
2010–11 Key performance indicators	2011–12 Key performance indicators
... The impact of the Department's investment in projects to modernise irrigation will be demonstrated by figures of improved on-farm and off-farm water use efficiency, with a target of 5% increase by 2011–12. ...	From 2011–12 onwards, DSEWPaC will: Recover water through infrastructure ... programs to reduce the gap between current diversions and Sustainable Diversion limits that will be included in the Basin Plan; ...
Rural water project efficiency—off-farm [% increase in systems where investments are made] Target for 2010–11 is 0%; 2011–12 is 5%; 2012–13 is 10%; and 2013–14 is 15%	Percentage increase in irrigation water use through funded off farm irrigation projects Target for 2011–12 to 2014–15 inclusive is 15%
Rural water project efficiency—on-farm [% increase in systems where investments are made] Target for 2010–11 is 0%; 2011–12 is 5%; 2012–13 is 10%; and 2013–14 is 15%	Percentage increase in irrigation water use through funded on farm irrigation projects Target for 2011–12, 2012–13 and 2013–14 is 15%. Target for 2014–15 is 'not applicable'

Source: Environment, Water, Heritage and the Arts Portfolio Budget Statements 2010–11, pp. 58, 60–62; and Sustainability, Environment, Water, Population and Communities Portfolio Budget Statements 2011–12, pp. 58, 60–62.

Appendix 3: PIIOP eligibility and merit criteria

Eligible applicants and projects for PIIOP funding rounds

Conditions attached to participation in PIIOP	
<p>Applicants must:</p> <ul style="list-style-type: none"> • be willing to implement water reforms agreed to by the Council of Australian Governments under the <i>National Water Initiative</i> and Agreement on Murray–Darling Basin Reform; and • comply with the Water Market Rules 2009 and Water Charge (Termination Fees) Rules 2009 	
Eligible applicants	Eligible projects
<ul style="list-style-type: none"> • Private entity that owns or operates irrigation infrastructure within the Murray–Darling Basin in NSW • Have undertaken or completed a modernisation plan in accordance with Commonwealth guidelines or equivalent • Have undertaken an assessment of the irrigation district water losses, consistent with the Commonwealth ‘hotspots’ assessment methodology • Must be a legal entity capable of entering into a Funding Agreement with the Commonwealth • Must have a valid ABN 	<ul style="list-style-type: none"> • Upgrading, closure, restructuring or reconfiguration of water delivery systems • Upgrading of on-farm irrigation for direct customers • Installation or upgrading of on-farm meters • Upgrading or installation of delivery system operation technologies and bulk meters • Changes to river operation or storages where there are both environmental benefits and water savings
Ineligible applicants	Ineligible projects
<ul style="list-style-type: none"> • Individual irrigators or informal or unincorporated groups of irrigators • State agencies or local government 	<ul style="list-style-type: none"> • Research and development projects • Projects that establish new irrigation areas or expand existing areas • Upgrading existing or installing new irrigation systems for urban or industrial land uses • Projects applying different management approaches for example, crop rotation or new plant types requiring less water • Ongoing labour costs, operational and maintenance costs • Capacity building activities • Projects that have been completed or have already commenced • Projects involving financial restructuring

Source: DEWHA, *Sustainable Rural Water Use and Infrastructure Program: Guidelines for the Private Irrigation Infrastructure Operators Program in New South Wales*, June 2009, pp. 5-7.

Round 1 and 2 merit criteria

Round 1	Round 2
Economic and social criteria	
<p>Projects must contribute to the long-term sustainable future for irrigation communities, in the context of climate change and expected reduced water availability in the future:</p> <ul style="list-style-type: none"> • Projects must contribute towards regional investment and development, <u>secure</u> regional economies and support the local community • Projects must demonstrate long-term economic and environmental benefit <u>that can be sustained</u> over a 20 year horizon, supported by an Irrigation Modernisation Plan 	<p>Projects must contribute to the long-term sustainable future for irrigation communities, in the context of climate change and expected reduced water availability in the future:</p> <ul style="list-style-type: none"> • Projects must contribute towards regional investment and development, contribute to regional economies and support the local community • Projects must demonstrate long-term economic and environmental benefit over a 20 year horizon, supported by an Irrigation Modernisation Plan • <i>Applicants should also provide a copy of their Irrigation Modernisation Plan or equivalent, consistent with the Australian Government's guidelines for Irrigation Modernisation Planning Assistance program.</i>
Environmental and technical criteria	
<p>Projects must deliver substantial and lasting returns of water to the environment to secure real improvements in river health:</p> <ul style="list-style-type: none"> • Projects must <u>demonstrate</u> strategies to minimise adverse environmental impacts from activities • Projects must be based on technically valid calculations of net water savings, with projects to take into account the impacts of climate change • Projects must be able to deliver <u>water in the form of</u> secure and transferrable water entitlements to the Commonwealth • <u>The agreed water entitlement to be transferred to the Commonwealth in return for funding must be capable of being used for purposes that reflect the Commonwealth's environmental priorities</u> 	<p>Projects must deliver substantial and lasting returns of water to the environment to secure real improvements in river health:</p> <ul style="list-style-type: none"> • Projects must include strategies to minimise adverse environmental impacts from activities • Projects must be based on technically valid calculations of net water savings, with projects to take into account the impacts of climate change • Projects must be able to deliver secure and transferrable water entitlements to the Commonwealth

Round 1	Round 2
Value for money criteria	
<p>Projects must deliver value for money in the context of economic, social and environmental criteria:</p> <ul style="list-style-type: none"> • <u>Projects must have a suitable dollar per megalitre benchmark against local/regional water market prices and represent cost- and time-effective strategies for achieving water savings</u> • The Benefit-Cost Analysis for the project, compared with a no change action, will be taken into account • Any in-kind or cash co-contributions will be taken into account. 	<p>Projects must deliver value for money in the context of economic, social and environmental criteria:</p> <ul style="list-style-type: none"> • The Benefit-Cost Analysis for the project, compared with a no change action, will be taken into account • Any in-kind or cash co-contributions will be taken into account.

Source: DEWHA, *Sustainable Rural Water Use and Infrastructure Program: Guidelines for the Private Irrigation Infrastructure Operators Program in New South Wales*, June 2009, pp. 9–10; and DSEWPac, *Sustainable Rural Water Use and Infrastructure Program: Guidelines for the Private Irrigation Infrastructure Operators Program in New South Wales – Round 2*, February 2011, pp. 9–10.

Note: Emphasis added by the ANAO. Underlined text in the Round 1 Guidelines has either been omitted from, or replaced by the ***bold and italicised text*** in, the Round 2 Guidelines.

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Fighting Terrorism at its Source

Australian Federal Police

ANAO Audit Report No.31 2011–12

Establishment and Use of Procurement Panels

Australian Securities and Investments Commission

Department of Broadband, Communications and the Digital Economy

Department of Foreign Affairs and Trade

ANAO Audit Report No.32 2011–12

Management of Complaints and Other Feedback by the Department of Veterans' Affairs

Department of Veterans' Affairs

ANAO Audit Report No.33 2011–12

Management of ePassports

Department of Foreign Affairs and Trade

ANAO Audit Report No.34 2011–12

Upgrade of the M113 Fleet of Armoured Vehicles

Department of Defence

Defence Materiel Organisation

ANAO Audit Report No.35 2011–12

Indigenous Early Childhood Development. New Directions: Mothers and Babies Services

Department of Health and Ageing

ANAO Audit Report No.36 2011–12

Development and Approval of Grant Program Guidelines

Department of Finance and Deregulation

ANAO Audit Report No.37 2011–12

The Child Support Program's Management of Feedback

Department of Human Services

Current Better Practice Guides

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