



Administration of the Water Smart Australia Program

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Introduction

1. Since 1997, drought conditions have affected large parts of Australia. The most heavily populated cities—Sydney, Melbourne, Brisbane, Adelaide and Perth—have experienced severe and prolonged reductions

in rainfall. Major food producing regions have also been affected, with surface and ground water resources under considerable stress.

2. The prolonged drought has had serious implications for water users and those responsible for water management. Water restrictions are standard in most capital cities, and all mainland state capitals have embarked on large projects to ensure adequate water supplies including, for example, building desalination plants to secure 'climate-independent' water sources. Governments of all levels have responded to the unprecedented water shortages by implementing new programs, cross-jurisdictional frameworks and regulatory reforms.

The National Water Initiative

3. The National Water Initiative (NWI) is Australia's key intergovernmental agreement on water reform, which has been signed by all governments.¹ The agreement builds on the 1994 Water Reform Framework, and commits signatories to actions that achieve a more nationally cohesive approach to the way that Australia manages, measures, plans for, prices and trades water.

National Water Commission and the \$2 billion Water Fund

4. In December 2004, the re-elected Coalition Government established an independent statutory body, the National Water Commission, to oversee and report on the implementation of the NWI. The former Government also created a \$2 billion Water Fund, comprised of three separate programs:

- Water Smart Australia (\$1.6 billion);
- Raising National Water Standards (\$200 million); and
- Community Water Grants (\$200 million).

5. The NWC was given responsibility for administering the first two of these programs. In July 2008, the Water Smart Australia (WSA) program was transferred to the Department of the Environment, Water, Heritage and the Arts (DEWHA). WSA is now one of many water programs that DEWHA is administering under the Australian Government's \$12.9 billion *Water for the Future* plan.

¹ The NWI was initially signed in June 2004 by the Governments of New South Wales, Victoria, Queensland, South Australia, the Northern Territory, the Australian Capital Territory and the Australian Government. The Tasmanian Government signed in July 2005, and the Western Australian Government in April 2006.

The Water Smart Australia program

6. The WSA program aims to accelerate the development and uptake of smart technologies and practices in water use. It also aims to promote the objectives and outcomes of the NWI. The program was originally scheduled to run until 30 June 2010, but funding has now been re-phased to 30 June 2011.

7. When the program was first established, the NWC proposed a two-stage approach, which was approved by the former Prime Minister. The first stage would be used to fund projects announced as part of the Coalition Government's 2004 election platform, while 'competitive bidding' would be used to select projects for the remainder of the program. This approach subsequently evolved, with program funding being made available to eligible applicants through a number of different pathways, which included:

- First Stage—predominantly used to fund the Coalition Government's 2004 election commitments, open only to State and Territory governments;
- Round 1 and Round 2—more conventional funding rounds, open to State and Territory governments, local governments, the private sector and other organisations and community groups;
- National Icon stage—introduced to fund large 'iconic' water projects, open only to State and Territory governments; and
- Other—projects that were not funded under the other pathways, including projects initiated through direct approaches to the former Minister for the Environment and Water Resources.

Assessment and approval of funding proposals 8. Across the five funding pathways, the NWC assessed a total of 382 proposals, and 74 projects were awarded funding by the responsible Minister. In most cases, the Commonwealth made a contribution to total project costs (generally between 30–50 per cent), rather than funding projects outright. As of 30 June 2009, a total of \$1.52 billion has been committed under the program, with individual grants ranging from \$50 000 to \$408 million. A wide range of projects have been funded, all of which have been categorised against NWI reforms.² These reforms include: water reuse and recycling; water planning; returning overused/allocated systems to sustainability; improving environmental outcomes; and securing reliable water supplies.

9. Although the assessment process and selection criteria for the funding pathways were not identical, the majority of funding proposals were subject to: a preliminary eligibility assessment; subsequent detailed assessment and due diligence by the NWC staff and, where necessary, by technical experts. Commissioners³ then considered and recommended projects to the responsible Minister for a final funding

decision. Under the National Water Commission Act 2004 (the Act), the Minister is responsible for determining and awarding funding assistance to applicants. The former Prime Minister was originally responsible for the program. Changes to the Administrative Arrangements Order then resulted in responsibility being assigned to the then Minister for the Environment and Water Resources, and to the current Minister for Climate Change and Water. In March 2009, the Minister for Climate Change and Water delegated responsibility for the management of the WSA program to the Parliamentary Secretary for Water.

Ongoing administration of grants

10. From July 2008, DEWHA has been responsible for the ongoing administration of the program, including: developing and executing funding agreements; monitoring progress and outcomes against the agreements; and making payments to proponents.⁴ The Minister, and subsequently the Parliamentary Secretary, retained responsibility for approving any major variations to projects and making decisions on whether to withdraw funding or terminate agreements for under-performing projects.

11. As of 30 June 2009, eight projects have been completed, while all other projects are in various stages of progress or had yet to commence. Some \$1.02 billion has been paid out to project proponents. A further \$500 million is available to be paid before the program ends on 30 June 2011.

² Since some projects address more than one NWI objective, similar projects may be categorised differently.

³ Seven Commissioners are appointed in recognition of their expertise in water resource policies, natural resource program management, relevant scientific disciplines, and public sector governance. When the program was transferred to DEWHA, Commissioners were no longer involved in the program.

⁴ The NWC was responsible for administering the program from December 2004 to June 2008 and DEWHA from July 2008 onwards.

Legislative framework and better practice guidance

12. Within the Commonwealth, the provision of grants is governed by a range of legislative requirements, supported by better practice

guidance.⁵ One of these requirements, which was in place when the majority of funding decisions were made under the WSA program, was that approvers of spending proposals:

... must not approve a proposal to spend public money (including a notional payment under the meaning of section 6 of the [FMA] Act) unless the approver is satisfied, after making such inquiries as are reasonable, that the proposed expenditure:

- (a) is in accordance with the policies of the Commonwealth; and
- (b) will make efficient and effective use of the public money; and
- (c) if the proposal is one to spend special public money, is consistent with the terms under which the money is held by the Commonwealth.⁶

13. New Commonwealth Grant Guidelines were issued in July 2009 by the current Minister for Finance and Deregulation, following amendments to the *Financial Management and Accountability Regulations 1997* (FMA Regulations). All agencies subject to the *Financial Management and Accountability Act 1997* (FMA Act), including DEWHA, are required to adhere to the *Commonwealth Grant Guidelines*. The Guidelines list mandatory actions for Ministers and officials and set out seven principles for sound grant administration. The regulation relating to the approval of spending proposals has also been amended. It now states that:

An approver must not approve a spending proposal unless the approver is satisfied, after reasonable inquiries, that giving effect to the spending proposal would be a proper use of Commonwealth resources (within the meaning given by subsection 44 (3) of the [FMA] Act).⁷

⁵ See, for example, the ANAO's Better Practice Guide on Administration of Grants, May 2002.

⁶ Sub-regulation 9(1) of the Financial Management and Accountability Regulations 1997, prior to 1 July 2009.

⁷ Regulation 9 of the Financial Management and Accountability Regulations 1997, effective 1 July 2009. When this regulation commenced, subsection 44(3) of the FMA Act defined proper use to mean efficient, effective and ethical use that is not inconsistent with the policies of the Commonwealth.

Audit objective, scope and methodology

14. The objective of this audit was to assess whether the WSA program has been administered effectively by the NWC/DEWHA⁸, as relevant, and is achieving its stated program objective. Specifically, the ANAO examined whether:

- funding proposals have been assessed and approved in a fair, consistent manner and in accordance with applicable criteria, program guidelines and better practice;
- appropriate funding arrangements have been established with proponents, having regard to the size of the grant, the type of entity involved and the nature of the project; and
- DEWHA (and previously the NWC) is actively monitoring whether proponents are complying with their obligations, and grant payments are made only in accordance with funding agreements.

More broadly, the audit examined DEWHA's strategy for evaluating and reporting on the long-term benefits of the program.

⁸ The audit covers the periods that each agency was responsible for administering the program—that is, December 2004 to June 2008 for the NWC, and July 2008 onwards for DEWHA.

Overall conclusion

15. WSA is a large discretionary grants program established against the backdrop of a severe and worsening drought. The program co-funds projects that provide more efficient and effective ways of using available water resources. It was part of a broader government response aimed at securing Australia's water future.

16. Program funding has been awarded to projects that seek to provide better management or use of water resources. The previous Government's intention was to use 'competitive bidding' to gain maximum effect from the investment in water projects. As the program evolved, this did not occur. Only 18 per cent of committed program funding (\$270 million) was awarded through the two open funding rounds. More than \$1 billion has been awarded to 2004 and 2007 election commitments and to National Icon or 'Other' projects, where the assessed merit of proposals was not always the key criterion in determining funding.

17. Overall, the program has been administered effectively by the NWC and DEWHA. The NWC was initially responsible for administering the program, with DEWHA taking over the ongoing administration of the program in July 2008. The NWC established, and generally followed, a sound framework for assessing the merits of the projects against approved selection criteria. Both agencies had adequate arrangements in place for developing funding agreements, monitoring the progress of projects following approval, and managing financial risks when making milestone (or advance) payments.

18. Notwithstanding these effective administrative arrangements, the full and timely achievement of funded water objectives has been adversely impacted by: significant delays in signing funding agreements; projects failing to meet agreed milestones; decisions not to terminate funding agreements where little or no progress has been made; and, for some projects, insufficient rainfall to generate agreed water savings.

19. The full benefits of the program may not be known for several years after funding ceases on 30 June 2011. It will, therefore, be important for DEWHA to have arrangements in place for monitoring proponents' ongoing evaluation reports. Also, since WSA was the first major grants program aimed at improving the management and use of Australia's water resources, there are obvious benefits in disseminating the good practices and 'lessons learned' from the program, to inform the design and delivery of other departmental grant programs. This includes the water programs that DEWHA administers under the Government's \$12.9 billion Water for the Future plan.

20. The NWC advised the responsible Minister where proposals were assessed to be uncompetitive and/or inconsistent with relevant NWI reforms when putting forward projects for funding, including three examined by the ANAO.⁹ In addition, there were two National Icon projects where the funding awarded was materially higher than recommended by the NWC.¹⁰ Also, one project was announced by the former Prime Minister prior to the proposal being received and assessed by the NWC.¹¹

21. Although advice provided by the NWC was not accepted, it was the prerogative of the responsible Ministers to reach a different decision, providing they were satisfied that the expenditure they approved was in accordance with government policy and represented an efficient and effective use of public money. Under the rules applying at the time these funding decisions were made, Ministers were not required to document any additional advice sought, or the specific reasons for approving funding; and no such documentation was evident from departmental records. The current Government has subsequently strengthened the administrative arrangements applying to the assessment and approval of grants. While not affecting a Minister's right to decide on the allocation of grants, there is now an expectation that

there will be greater transparency and accountability for the funding decisions made.

22. The ANAO has not made any specific recommendations on the administration of the program, given the mandatory requirements and better practice principles outlined in the new *Commonwealth Grant Guidelines*, which have been informed by earlier ANAO audits on grant administration.

⁹ These projects were: NQ Water (\$40 million); Waterproofing the South (\$34.5 million); and Statewide Wastewater Recycling (\$20 million).

¹⁰ Funding of \$247.6 was recommended by the NWC for the Western Corridor project and \$408 million was awarded. Funding of \$31 million was recommended for the Ballarat Superpipe project and \$90 million was awarded.

¹¹ Funding of \$80.3 million was awarded to the Wyong-Mardi Link project.

Key findings by chapter

Selecting projects for funding (Chapter 2)

23. The WSA program was first announced in the Coalition Government's 2004 election policy statement, *Securing Australia's Water Future*.¹² In this statement, the Coalition said that:

- funds would be made available to projects, taking into account the financial contribution offered by local government bodies, State and Territory governments and/or industry; and
- to gain greatest effect from these investments, competitive bidding will be the primary mechanism for allocating grants.

24. Following the Coalition Government's re-election in October 2004, the NWC proposed that the program be established in two stages. The first stage would be a small tranche of projects drawn from the list of projects already announced as election commitments, or from examples of projects contained in *Securing Australia's Water Future*. The second stage would proceed as soon as the normal documentation for a competitive bidding program could be completed. The former Prime Minister approved this two-stage approach, along with assessment criteria for the First Stage.

Assessment framework

25. The NWC was responsible for developing and administering the assessment framework for the program. There were no overall guidelines for the program. Instead, the NWC developed guidelines and an assessment framework for Rounds 1 and 2, which were approved by the former Prime Minister. The NWC also developed criteria for the National Icon stage, which were broadly similar to the open funding rounds, but aimed at funding large, 'transformative' water projects. No separate guidelines or criteria were developed for projects classified as 'Other', which were not approved under a conventional funding round.

26. The ANAO examined a sample of 20 (of 74) projects, which accounted for \$1.1 billion, or some 79 per cent of total committed funding. The NWC followed sound processes for assessing proposals against the relevant criteria, and provided advice to the responsible Minister on the merits of projects. All projects examined by the ANAO were assessed appropriately by the NWC, with the exception of the Wyong-Mardi Link project, which was funded under the 'Other' pathway. For this project, the former Prime Minister announced funding of \$80.3 million before any proposal was received. The NWC was given an opportunity to provide preliminary advice before the announcement was made, but was not supportive of the project being funded under the WSA program. Aspects of the assessment process for Round 1 could have been better documented by the NWC, but were improved upon for Round 2 (when the NWC used an electronic database to record project assessments).

27. The assessed merits of proposals by government agencies do not necessarily determine the ultimate success of projects, once funding is provided. Two of the election commitments that the NWC assessed as being unfavourable have since gone on to generate water benefits in their regions (Statewide Wastewater Recycling and Waterproofing the South). In contrast, three of the five projects that received favourable assessments by the NWC in Rounds 1 and 2 have experienced problems, following the offer of funding.¹³

Funding decisions

28. As previously noted, when the program was established, the former Government's intention was to use 'competitive bidding' to select projects after the First Stage, which was reserved for its 2004 election commitments. However, in practice, this did not occur. Across the program, less than 18 per cent of total funding was allocated to projects from the two open funding rounds. The remaining program funding, some \$1.23 billion, has been awarded to election commitments, National Icon projects and projects classified as 'Other'. All sampled projects were approved for funding by the responsible Minister, as required under the Act, with the exception of NQ Water (\$40 million). In this case, the project was publicly announced by the former Prime

Minister, but was not followed up by written approval, despite multiple requests by the NWC to obtain this approval.

29. For seven sampled projects (total funding of \$663 million), funding was awarded where:

- projects were proceeding anyway, and the level of funding was materially higher than recommended by the NWC; or
- projects announced as 2004 election commitments failed to meet the selection criteria for the open funding rounds; or
- a formal assessment had not been undertaken, and/or preliminary advice was unfavourable.

Establishing funding agreements (Chapter 3)

30. Once funding had been approved, the NWC and DEWHA were responsible for developing and executing funding agreements with proponents. All proponents were required to sign legally binding agreements and, as of 30 June 2009, some 74 agreements have been signed. In some cases, MOUs were signed with State governments to support project objectives and to advance particular NWI reforms.

31. Signed funding agreements with detailed project schedules were in place for all 20 projects reviewed by the ANAO. The agreements were well-developed and included clauses that specified the respective roles and obligations of the parties, protected the Commonwealth investment and set out each project's objectives. Nevertheless, in seven cases where water savings were being funded, project objectives were not expressed with sufficient precision to assist with subsequent monitoring and evaluation of project outcomes.

Delays in signing funding agreements

32. For 11 projects reviewed by the ANAO, it took over six months for funding agreements to be signed following the offer of funding, and in seven of these cases, the delay exceeded 12 months (with one agreement taking two and a half years to finalise). A major reason for the delays was negotiations between the NWC and the relevant State governments over the nature and terms of the legally enforceable funding agreements.

33. The time taken to finalise funding agreements has delayed the realisation of funded water benefits and, in some cases, has contributed to cost increases and later variations to projects. Overall, this has resulted in program funding of \$152 million being re-phased to the year ending 30 June 2011, to allow payments to be made for projects that will not be completed by the original end date of 30 June 2010. In 2007, the NWC established a framework for withdrawing offers of funding, which gave proponents five months to sign agreements from the date that funding was offered. This framework remains in place at

DEWHA, although the decision to withdraw funding ultimately rests with the Minister.

Cost increases and other variations

34. As of 30 June 2009, nine of the 74 projects approved under the program have received additional funding of \$156 million, just over 10 per cent of total committed funding. The three projects with the largest cost increases (totalling \$141 million) were assessed and approved as 2004 election commitments under the First Stage.

35. The ANAO examined six of the nine projects that incurred cost increases. In all six cases, the cost increases were approved by the responsible Minister, and, where relevant, matched by other funding contributors. The total cost increases across the program exceeded the amount in the program's contingency fund (\$40 million). As a result, additional funding of \$99 million was obtained from another water program administered by DEWHA¹⁴ or one project, and \$33 million through additional appropriations for two other projects.

Progress payments and outcomes (Chapter 4)

36. As of 30 June 2009, some \$1.02 billion has been paid to proponents, from total committed funds of \$1.52 billion. At this date, eight projects had been completed, another 62 were in progress and three were still to sign agreements.

Milestone payments

37. Most payments are made in arrears for work that has already been completed. In some cases, however, proponents received advance payments (usually paid quarterly), which had to be acquitted at the end of each period and before any further payment would be made. One exception to these payment arrangements was the Western Corridor Recycled Water Scheme, which received a one-off, up-front payment of \$408 million approved by the previous Government.

38. No material payment errors were identified in the 20 projects examined by the ANAO. The risks of misused and/or misspent payments have also been adequately managed. DEWHA's practice of making part-payments to proponents where milestones are only partially met is an effective way of managing financial risks, while still allowing projects to progress. The monitoring mechanisms used by NWC/DEWHA to inform payment decisions were reasonable, given available resources and the relative risks presented by projects. In particular, site visits are beneficial in addressing instances of non-compliance with reporting requirements or delays in meeting milestones, and could be used more often to actively manage project risks.

Managing non-compliance or delays

39. The main area of non-compliance with reporting requirements, which applied to 11 projects reviewed, was the failure of proponents to provide audited financial statements—at all, on time or in the required format. Both agencies have generally managed this risk effectively by withholding payments until the statements are submitted by proponents.

40. Across the program, a number of proponents have made little progress since their funding agreement was signed. As of 30 June 2009, four agreements have been terminated. Both agencies have advised the responsible Minister of projects suitable for termination, recognising that the final decision rests with the Minister. Although there is a framework in place for withdrawing offers of funding, neither agency had developed a similar framework to guide decisions on when to terminate funding agreements for under-performing projects. The ANAO reviewed several projects where such a framework could have been usefully applied, to allow better overall use of program funds.

Achievement of project and program objectives

41. Although only eight projects have fully completed their milestones, most have ongoing evaluation requirements—and, in some cases, the final outcome may not be known until 2016 or beyond. However, for five projects examined by the ANAO, there are indications that the funded water objectives may not be delivered in the timeframe, or to the extent, required. In some cases, this is because there has been insufficient rainfall to generate required water savings for the environment. In other cases, it is because projects have not made satisfactory progress in meeting agreed milestones.

Program evaluation

42. In 2007, the NWC developed an evaluation strategy for the program. It then undertook an assessment of 25 projects, the results of which were included in its 2006–07 Annual Report. Since taking over administration of the program, DEWHA has continued to monitor the progress of projects against requirements in the funding agreements. It has also continued, and refined, the NWC's approach of asking proponents to complete an annual assessment of project benefits. These assessments help to inform DEWHA on the achievement of project outcomes. DEWHA advised that a more formal program evaluation will be a major focus of the work plan for the last two years of the program. Among other things, the evaluation would be expected to consider whether the funded projects have contributed to the program objective of accelerating the development and uptake of smart technologies in water use.

¹² Securing Australia's Water Future, The Coalition Government, 2004 Election Policy.

¹³ Dalby Water Supply has been terminated by mutual agreement; Tasmanian Metering is significantly behind schedule and has been reduced in scope; and Hydrometric Network Expansion experienced extensive delays.

¹⁴ The \$5.8 billion Sustainable Rural Water Use and Infrastructure Program, which is part of the Australian Government's \$12.9 billion Water for the Future plan.

Agency responses

43. The following comments constitute each agency's full response to the audit.

National Water Commission

44. The Commission welcomes the ANAO's assessment that the Water Smart Australia program has been administered effectively by the Commission for the first four years of the program's operation.

45. The Water Smart Australia program is seen as successful in meeting some of the water reform objectives in the National Water Initiative and, when the program is taken as a whole, providing for the delivery of important water reform outcomes through the funding of significant infrastructure projects that might not otherwise have occurred. The role of the Commission and its Commissioners in providing independent advice to the Minister on projects has been acknowledged in the report as sound governance for the administration of a grant program of this type.

46. While the ANAO has made no specific recommendations in the report, the Commission acknowledges that the report provides some better practice guidance which the Commission intends to consider for adoption in the administration of its other programs.

Department of the Environment, Water, Heritage and the Arts

47. The Department welcomes the overall conclusions of the audit. The Department will work to ensure the good practices and lessons learned from the Water Smart Australia program are used to inform the design and implementation of other programs it administers, including *Water for the Future* programs.

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