

WaterNSW Pricing Proposal to the Independent Pricing and Regulatory Tribunal

Regulated prices for Greater Sydney 2020-2024

Attachment 1 – Investment governance and decision-making framework

This page is intentionally blank.

Contents

1.	Introduction	3
2.	WaterNSW’s governance framework for expenditure.....	4
2.1	WaterNSW Code of Conduct	4
2.2	Compliance obligations	4
2.3	Risk management framework.....	6
2.4	Asset management framework	7
3.	Scope of decision-making framework for pricing proposals	8
3.1	Annual budget process.....	8
3.2	Budget preparation	8
3.2.1	Capital expenditure	8
3.2.2	Operating expenditure.....	9
3.2.3	Executive Review	9
3.3	Board review	10
3.4	Scope of the annual budget process	10
3.5	Approval to spend framework.....	10
3.6	Procurement framework	13
3.7	NSW Government investment gateway.....	13
3.7.1	Notification.....	14
3.7.2	Assurance.....	14
3.7.3	Approval	15
3.7.4	Reporting	15
4.	WaterNSW decision-making bodies for expenditure forecasts	16
4.1	Overview.....	16
4.2	WaterNSW Board of Directors.....	16
4.3	Chief Executive Officer	17
4.4	Investment Review Committee.....	17
4.4.1	Purpose	17
4.4.2	Authority and duties.....	18
4.5	Pricing Proposal Steering Committee.....	19
4.5.1	Purpose	19
4.5.2	Objectives.....	19
4.5.3	Authorities.....	19
4.5.4	Membership.....	20
4.5.5	Reporting and disclosure	20
4.6	Pricing Proposal Project Teams	20
5.	Prudent and efficient outcomes	21

1. Introduction

WaterNSW makes every effort to make sure that every dollar we spend is in the interests of our customers. WaterNSW has a transparent and robust governance framework designed to ensure that our expenditure decisions are prudent, efficient and good value for money. Our expenditure governance framework forms part of WaterNSW's Commercial Policy Framework.

The governance framework for expenditure decisions is based on adhering to the WaterNSW risk, compliance and asset management frameworks. There are clear lines of accountability and assessments proportionate to the value of the expenditure.

The operating and capital expenditure (opex and capex) decisions in the current regulatory period and forecasts for the 2020-24 determination have been made under this robust governance process.

The governance framework for capital and operating expenditure decisions incorporates clear and robust processes for:

- Review and approval of annual budgets and longer-term plans. This includes the opex and capex forecast for the 2020-24 determination; and
- Review and approval process for individual projects and programs known as the Approval to Spend (ATS) framework
- Procurement of services based on transparent processes and best practice.

The purpose of this document is to outline the decision-making process for our actual and forecast capex and opex expenditures incorporated in the 2020 pricing proposal for Greater Sydney.

Our decisions must also adhere to responsible decision-making provisions in our Code of Conduct.

This document forms part of our pricing proposal and should be read in conjunction with the Pricing Proposal and other supporting material.

2. WaterNSW's governance framework for expenditure

2.1 WaterNSW Code of Conduct

The WaterNSW Code of Conduct contains provisions for responsible decision-making to ensure that the decisions and actions of everyone who works for, or on behalf of WaterNSW, meet the expectations of stakeholders, are conducted in a professional manner and are of a high standard.

Under the Code of Conduct our decisions and actions must be:

- Lawful
- Consistent with this Code of Conduct, as well as relevant Policies, Procedures or other internal documents
- Transparent and responsible
- Fair and impartial
- Able to withstand public scrutiny.

These principles have guided development of the pricing proposal.

2.2 Compliance obligations

WaterNSW functions and regulatory requirements are set out under the *Water Act 1912 (NSW)*, the *Water Management Act 2000 (NSW)*, and the *Water NSW Act 2014*. WaterNSW is subject to a wide range of regulatory compliance obligations that include, but are not limited to:

- Laws and regulations
- Permits, licences and other forms of authorisations
- Licences, orders, rules and guidance issued by regulatory agencies
- Relevant industry codes and compulsory standards.

WaterNSW has implemented a compliance management framework as part of embedding compliance management practices within the broader risk management and governance frameworks and integrating compliance into all business processes and operations to drive consistent, effective and accountable decision-making.

The compliance management framework is consistent with the Australian and International Standard AS ISO 19600:2015. The compliance framework aligns with our Code of Conduct, which represents WaterNSW's commitment to the highest standards of integrity, fairness and ethical behaviour. The framework details responsibilities, governance, processes and communication requirements; and provides guidance on the management system's tools and

procedures, monitoring and reporting, and continual improvement.

ISO 19600:2015 provides guidance to establish, develop, implement, evaluate, maintain and improve an effective and responsive compliance management framework and system. A key part of this International Standard is the importance placed on risk management as an essential aspect of a compliance management system, and as well as focusing on compliance as part of the culture of the organisation.

Non-compliance with our externally imposed regulatory compliance obligations can result in fines, increased external reporting, increased regulation, efficiency impacts, stop work orders and suspension or withdrawal of our operating licence. Penalties for non-compliance can be imposed on an individual or WaterNSW as an organisation.

Our externally imposed regulatory compliance obligations are managed in the same way as other business risks. This ensures that WaterNSW can address its compliance risks and mitigate the causes and consequences of non-compliance.

2.3 Risk management framework

Risk management is a key factor underlying the development of our capex and opex forecasts. The risk management framework implemented by WaterNSW is consistent with International Standard ISO 31000:2009 Risk Management. This standard emphasises an enterprise approach to managing risk which involves integrating systems and practice at all levels of the business and as part of all activities and programs. Where risks are identified, and management action is required, management will ensure that actions are appropriately resourced and incorporated into business unit plans. WaterNSW is required to meet other risk management standards, such as the Australian National Committee on Large Dams Guidelines for Risk Assessment of Dams 2003.

There are two key decision-making processes for governing the decisions made about expenditure. These are the annual budget process and the Approval to Spend framework.

The annual budget process is designed to establish essential spending envelope for each business unit. A key input into the budget setting process is the approved opex and capex allowances from our pricing proposals. We aim to achieve our key obligations below these allowances wherever possible. The Approval to Spend process is designed to ensure the spending is within the approved budget and is as efficient and prudent as possible.

2.4 Asset management framework

WaterNSW has implemented an Asset Management System (AMS) that sets out how we manage assets to support the strategic objectives of the organisation. The AMS provides a structured and systemic life-cycle approach to optimise value from assets to achieve organisational objectives. The AMS applies to all physical assets owned, operated and controlled by WaterNSW in the conduct of its business.

WaterNSW is committed to an AMS that supports responsible management of assets to deliver value to customers and support business objectives. Our AMS complies with Australian Standard AS ISO 55001:2014 Asset Management – Management systems – Requirements.

The AMS specifies how WaterNSW will deliver the appropriate level of service from its assets. This involves a combination of maintaining the capability of the asset base, augmenting the capability of the asset base and creating new capability within the asset base.

Implementing the AMS provides assurance that the way we manage assets including maintenance and augmentation is prudent and complies with Australian Standards.

3. Scope of decision-making framework for pricing proposals

WaterNSW maintains a robust governance and decision-making process as part of our business-as-usual project and expenditure approval process. WaterNSW's governance process was established to provide confidence that the right level of strategic guidance, risk management, review and challenge occurs with regards to expenditure decisions.

3.1 Annual budget process

WaterNSW implements an annual budgeting process that incorporates several opportunities for review and challenge while budgets are being developed and finalised. The criteria for review and challenge of the developing budgets include whether the budgets and programs and projects that make-up the budget are prudent and efficient and meet corporate objectives.

The information prepared for the 2019-20 budgeting process has formed the basis of the opex and capex forecasts for the Greater Sydney.

3.2 Budget preparation

The budgeting process commences in August each year with business units developing draft 10-year budgets for opex and capex based on achieving their contribution to WaterNSW's Corporate Objectives and legislative/compliance obligations. The budgets are also based on ensuring that we meet our obligations under the WaterNSW Operating Licence. The first-round capex and opex budgets are completed by end of September and mid-October respectively and are refined following testing and review by Finance, the Executive Team, the Shareholder and ultimately the Board. This review period occurs over the period Dec to May.

3.2.1 Capital expenditure

The first round of the 10-year capital plan is submitted to the Investment Review Committee (IRC) on an annual basis in December. The 10-year plan is reviewed annually to ensure currency.

The IRC pays close attention to the short to medium term investment proposals in the 10-year capital plan. The IRC role is to review and challenge capex projects and programs. The IRC reviews projects and programs against:

- The need and logic for the project or program;
- Options analysis; and
- Alignment with approved IPART allowances.

The capital expenditure forecasts have been informed by improvements in the asset management system. Our asset management system has been certified compliant with ISO 55001. The asset management system has been framed based on the risk management framework.

3.2.2 Operating expenditure

Proposed opex budgets are prepared by business units and are reviewed by Finance. In reviewing the proposed opex budgets, Finance tests against:

- Detailed support for resources including staff;
- Wages in line with NSW Government wages policy;
- Whether or not there is sound justification for expenditure requests (i.e. alignment with customer needs, compliance obligations and corporate objectives);
- Sensitivity analysis; and
- Approved IPART allowances.

The first-round reviews occur over September to October and are returned to business units for amendments.

Second-round budgets are submitted to IRC and Finance for review and challenge by mid-October. Finance conducts a further round of reviews of the second-round budgets with each of the business units.

By end November, Finance prepares a draft budget by business unit and consolidated views.

3.2.3 Executive Review

The draft budgets for capex and opex are reviewed by the Chief Finance Officer (CFO) and Chief Executive Officer (CEO). The budgets are presented for review on an individual business unit basis and on a consolidated basis.

Following CFO and CEO review, this information is used to prepare financial information for the Statement of Corporate Intent (SCI) and Business Plan. This is completed by the first week in December.

Information on the initial SCI is submitted for review by the Executive prior to submission to the Board.

3.3 Board review

Information on the initial SCI, Budget and Business Plan is presented to the Board at the end of February each year. The final for approval SCI Budget and Business Plan is submitted to the Board for final approval in early May. This submission includes amendments following Board and NSW Treasury feedback on earlier drafts.

As a government-owned corporate entity, WaterNSW submits this information to the NSW Government. The final SCI and Business Plan is submitted to NSW Treasury at the end of June each year.

3.4 Scope of the annual budget process

The annual budget setting process does not provide a standing approval to spend for projects, programs or services. All proposed expenditure must be submitted for further review through the governance process and must be supported by business cases closer to the time of the expenditure. This is done through the Approval to Spend framework.

3.5 Approval to spend framework

Spending against the approved budget follows a separate process. The Approval to Spend Framework is WaterNSW's expenditure and investment evaluation and governance framework for reviewing and approving all expenditure made on behalf of WaterNSW. The Approval to Spend Framework operates alongside the procurement framework as discussed below and in the main pricing proposal document.

The Approval to Spend framework was designed to ensure that WaterNSW makes prudent and efficient decisions that ensure effective delivery of customer and business objectives and are value-for-money. The Approval to Spend framework also aims to ensure that appropriate consultation and review on major investment decision occurs across the business, prior to proceeding.

The Approval to Spend framework is underpinned by a hierarchy of financial delegations. Delegation of authority to legally bind WaterNSW for expenditure is provided by the Board to the CEO and from the CEO to Management and staff under the financial delegations.

The Approval to Spend process operates on the principles that expenditure:

- Justifiable – that a need has been established;
- Prudent – only incurred when required; and
- Efficient – by providing value for money.

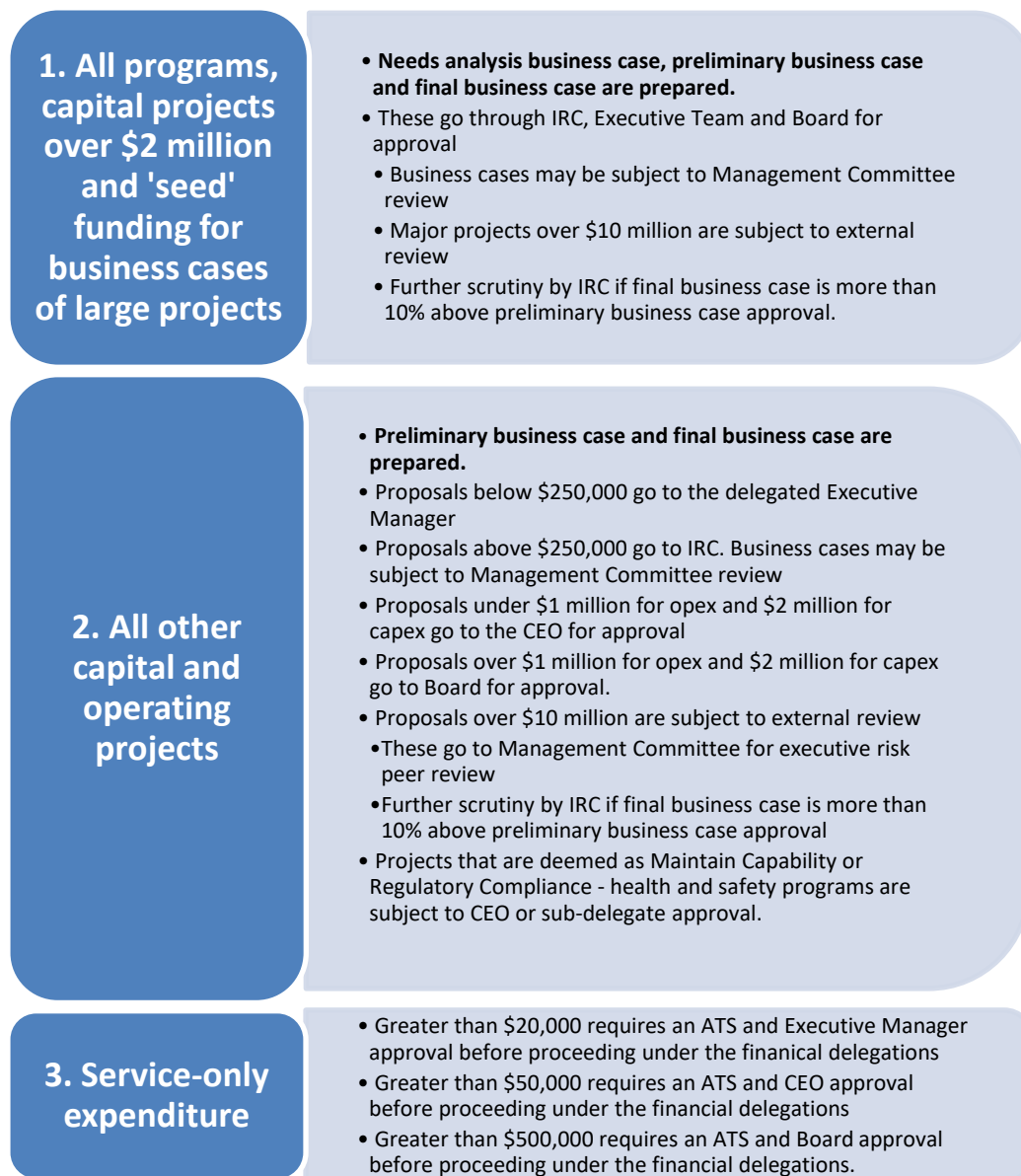
The Approval to Spend includes a hierarchy of delegations for approval levels from executive manager to Board level depending on the value of the expenditure.

The Approval to Spend framework incorporates different processes for different types and expenditure/project/program levels of investment:

1. All programs, capital projects over \$2 million and funding for business cases for large projects.
2. All other capital and operating projects.
3. Service-only expenditure.

The Approval to Spend process for the various types and expenditure levels are summarised in Figure 1 below.

Figure 1 WaterNSW Approval to spend processes



Source: WaterNSW Approval to Spend framework

The different types of investment follow a similar approval framework and are proportionate to the level of expenditure that is being considered. The higher the level of investment, the greater the scrutiny and the more approval gateways that the investment is subjected to.

For expenditure proposals above \$20,000 Approval to Spend documentation is to be prepared with consultation and review gateways according to the relevant processes. These are set out in WaterNSW Approval to Spend document.

Expenditure proposals under \$20,000 require documentation detailing the need being addressed, options considered, justification of recommended option and demonstration of value for money. Approval to Spend is provided under the financial delegation (such as Manager or Executive Manager) before proceeding.

The Approval to Spend framework applies to all WaterNSW personnel seeking to incur expenditure on behalf of WaterNSW.

3.6 Procurement framework

The ATS process is complemented by our procurement framework which is another key part of WaterNSW commercial policy framework. The procurement framework supports the delivery of our strategic priorities.

The procurement framework was implemented to provide value for money by:

- Seeking best value for money including lowest life-cycle cost
- Encouraging competition and innovation amongst suppliers.

We consider risk management and risk allocation as part of our value for money analysis and the degree of procurement process complexity.

The procurement framework supports ensuring that we get the best value for money from our service providers. This supports efficient outcomes of our expenditure decisions.

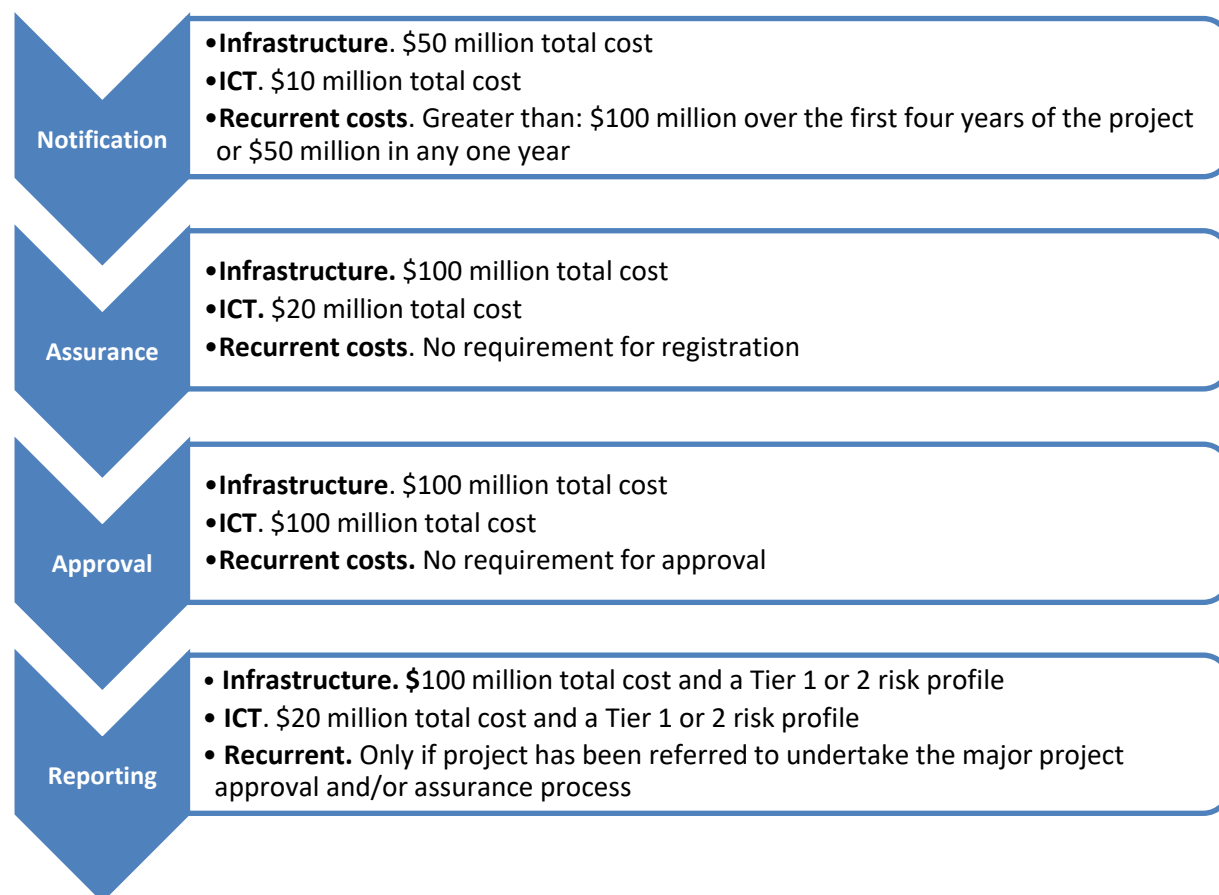
3.7 NSW Government investment gateway

Major projects proposed by WaterNSW are subject to external scrutiny by the NSW Government. The Major Projects Policy for Government Businesses forms part of NSW Government's Commercial Policy Framework and applies to State-owned corporations, such as WaterNSW.

The purpose of the Major Projects Policy for Government Businesses is to ensure that government businesses deliver major projects that are needed, effectively and efficiently, and that benefit the people of NSW. The gateway assurance process aims to improve delivery outcomes and better manage the risks associated with projects led by government entities.

The Major Projects Policy sets requirements according to levels of project risk, the type of entity involved, the nature of the project, and the project status. Figure 2 shows the four main steps in the gateway process and requirements that apply to WaterNSW as a high-threshold State-owned Corporation.

Figure 2 NSW Government investment gateway for major projects



Source: WaterNSW from NSW Treasury information

3.7.1 Notification

WaterNSW prepares a Statement of Intent and annual Business Plan which includes an overall capital investment plan. WaterNSW provide details in the annual Business Plan of any projects being considered for the upcoming four years in accordance with the thresholds shown in Figure 2 above.

3.7.2 Assurance

Gateway assurance process involves independent peer review of major projects at key stages or 'gates' during project justification, delivery and benefit realisation. Investment categories subject to gateway include infrastructure projects, Information and Communications Technology (ICT) projects and major recurrent projects. The level of scrutiny depends on the risk profile of the project.

Three risk-based frameworks focus on these specific areas of investment:

- Infrastructure Investor Assurance Framework for capital infrastructure projects;
- ICT Assurance Framework for ICT projects, both capital and recurrent funded; and
- Recurrent Investor Assurance Framework for major recurrent programs.

Two critical features of these risk-based frameworks are project 'gates' and 'risk tiers':

- Gates refer to decision points during consideration of a project at which time a gateway review may be undertaken; and
- Risk tiers refer to the risk profile of a project according to one of four tiers, with tier 1 being the highest risk profile and tier 4 the lowest. A project's risk tier depends on its total estimated cost and a weighted risk score calculated using qualitative risk criteria.

3.7.3 Approval

All projects that meet the specified thresholds are required to receive in-principle approved from the Cabinet Expenditure Review Committee (ERC). This will give ERC an opportunity to review, at an early stage in their development, projects with a significant estimated total cost and those considered to be high risk.

WaterNSW provides information to ERC on proposed major project's benefits, costs, budget and balance sheet impacts, and risk.

3.7.4 Reporting

WaterNSW is required to report to the NSW Government the status of any major projects that meet the specified criteria on a quarterly basis. The project reporting requirement applies in the planning and delivery phases and includes progress on project actual expenditure compared to estimates, a planned schedule to track the delivery of milestones and updates to the risk profile.

The external scrutiny provided by the NSW gateway process for major projects provides further assurance that our investments are prudent, needed and justified.

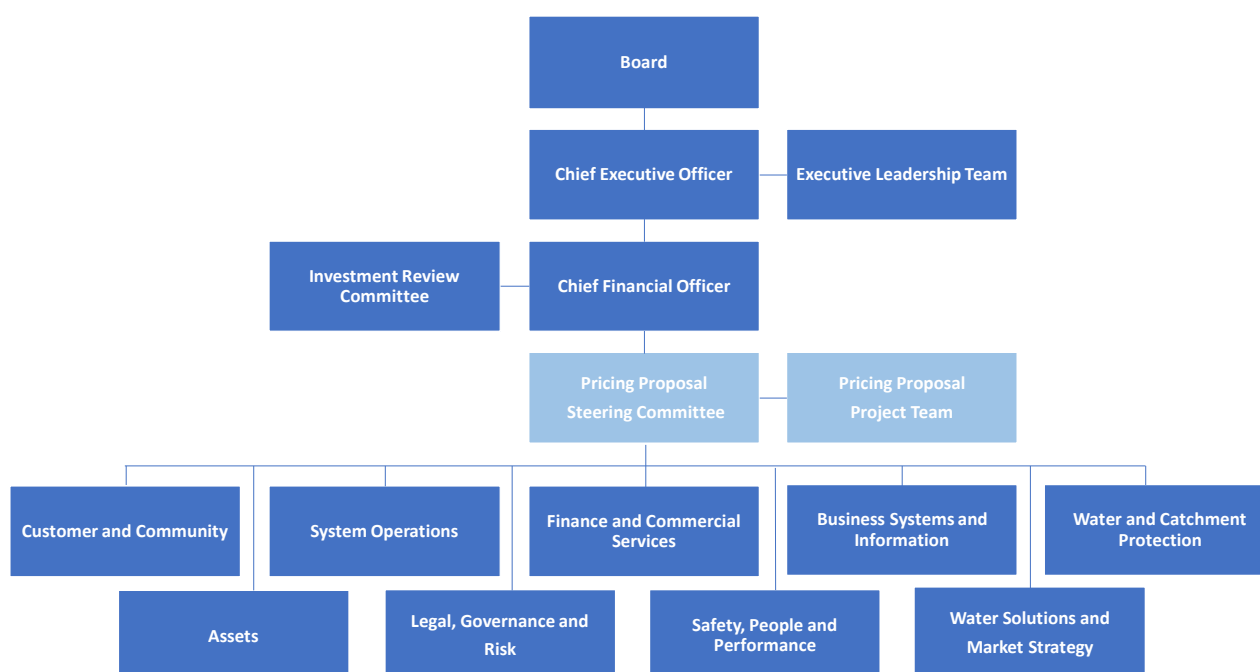
4. WaterNSW decision-making bodies for expenditure forecasts

4.1 Overview

The expenditure forecasts for the pricing proposals were reviewed, challenged and approved by key decision-making bodies under a governance framework. Each Officer/Committee has a clear role to play in developing WaterNSW pricing proposals.

The key bodies involved in preparing, reviewing, challenging and approving expenditure decisions is shown in Figure 3 below.

Figure 3 Governance and decision-making structure for expenditure decisions



Source: WaterNSW

4.2 WaterNSW Board of Directors

The role of the WaterNSW Board of Directors was to set the strategic direction of the organisation and provide oversight and guidance on the strategy, risk management, commercial direction, review and challenge and final approval of the forecasts in the pricing proposals.

The Board played an important role in guiding and approving the content of the pricing proposals including the forecasts for the operating and capital expenditure. The Board reviewed the pricing

proposal at two Board meetings and had input into the underlying assumptions and strategy in the lead up to approving the proposal.

4.3 Chief Executive Officer

The CEO with support from the Executive Leadership Team provided strategic guidance on the preparation of the pricing proposals. At a high level, the pricing proposals were developed to align with the WaterNSW corporate vision and strategic directions.

The pricing proposals are certified by the CEO, in accordance with the Guidelines for Water Agency Pricing Submissions, December 2017 (the Guidelines), in accordance with IPART requirements. The CEO declares that:

- a) the information provided in our pricing submission submitted is the best available information of the financial and operational affairs of WaterNSW and has been checked in accordance with the Guidelines; and*
- b) there are no circumstances of which (that the CEO is aware) that would render the information provided to be misleading or inaccurate.*

The CEO is supported by his Executive Leadership Team in reviewing the pricing proposals.

4.4 Investment Review Committee

4.4.1 Purpose

The Investment Review Committee (IRC) is a Management Committee of WaterNSW established to guide and assist the WaterNSW Executive Team and Board to effectively discharge responsibilities in relation to governance, commerciality and the prudence and efficiency review of major expenditure.

The IRC's objectives are to:

1. Review major expenditure and investment proposals, based on business cases, for their alignment with WaterNSW corporate objectives, regulatory obligations and commercial, prudence and efficiency objectives.
2. Review capital investment and operating expenditure programs, forecasts and long-term plans to ensure overall portfolio and program prudence and efficiency, by:
 - Reviewing and endorsing the Capital Investment Strategy, annual and long-term Capital Investment Plans, consistent with the company's corporate strategy, risk framework, IPART/ACCC regulatory requirements, customer affordability, credit rating and capital constraints;

- Reviewing and endorsing WaterNSW's annual Financial Plan and Budget capex and opex programs prior to submission to the Board;
 - Reviewing quarterly year end forecasts with respect to capital and operating programs; and
 - Considering all viable alternative options in prioritising and selecting the optimal portfolio of capital and operating expenditure projects and programs for delivery. This is achieved using consistent capital evaluation principles.
3. Undertaking a portfolio wide risk review role by:
- Reviewing and consulting on commercial implications of proposed changes to internal standards and policies prior to approval in accordance with company procedures.
4. Providing independent peer review and corporate governance role by:
- Endorsing business case approval documentation, including related relevant papers, prior to submission to the CEO or Board of Directors as appropriate; and
 - Reporting any material breaches of Investment Governance policies and procedures to the WaterNSW Executive Management Team, CFO and CEO.

4.4.2 Authority and duties

The IRC has been given the following authorities:

- Endorsing Investment Governance policies, procedures and processes;
- Endorsing annual capital and operating expenditure budgets and forecasts, and the principles and constraints on which they are developed;
- Endorsing individual capital or/ and operating expenditure projects and programs for submission to the WaterNSW CEO and Board of Directors, in accordance with the Approval to Spend framework thresholds noted below:
 - Maintain Capability Program capital expenditure proposals over **\$500,000 or above the Executive Sponsor's financial delegation** (whichever is lesser) are to be reviewed by the IRC prior to approval under the Staff Delegations;
 - All other expenditure proposals over **\$250,000 or above the Executive Sponsor's financial delegation** (whichever is lesser) are to be reviewed by the IRC prior to approval under the Staff Delegations; and
- Confirming, through evaluation of benefits realisation reviews, the extent that capital and major operating expenditure projects and programs achieve their intended benefits.

Finance provides investment evaluation quality assurance support to the IRC and review all business cases before they are considered by the IRC. Investment proposals being considered

by the IRC require endorsement and sponsorship by the relevant Executive Leadership Team member, or their delegated Level 3 Manager.

4.5 Pricing Proposal Steering Committee

The WaterNSW Pricing Proposal Steering Committee (Steering Committee) was established to oversee the preparation of the pricing proposals. The Steering Committee performed the role of guiding, reviewing and challenging key aspect of the regulatory proposal including the opex and capex plans and forecasts.

4.5.1 Purpose

The Steering Committee was established to ensure effective preparation and lodgement of regulatory submissions to IPART for WaterNSW's revenues and prices for Greater.

The role of the Committee was to ensure that the regulatory submission:

- Complies with IPART's requirements and other regulatory obligations;
- Provides funding to support Strategic Initiatives, aimed at improving customer outcomes;
- Reflects the views of the community; and
- Ensures appropriate governance and assurance.

4.5.2 Objectives

The key objectives of the Committee are to ensure the following outcomes:

- Constrain customer prices to acceptable levels for the regulatory period starting 1 July 2020;
- Attain sufficient regulatory revenues to fund future investment programs;
- Promote transparency of costs and responsibilities;
- Effectively communicate and consult with key stakeholders; and
- Ensure efficient resource management and value for money for customers.

4.5.3 Authorities

The Committee had the authority to:

- Endorse strategies proposed by the Project Team consistent with the implementation of the agreed regulatory strategy;
- Endorse expenditure projects / programs for Executive Leadership Team / Board approval; and

- Review and endorse positions on key issues raised by stakeholders including the Project Team, industry, customers and the NSW Government.

4.5.4 Membership

The membership of the Steering Committee included senior members of the executive team including:

- Chief Executive Officer (CEO and Committee Chair);
- Chief Financial Officer (CFO);
- Executive Manager, Customer and Community;
- Executive Manager – Assets;
- Executive Manager Water & Catchment Protection;
- Executive Manager Water Solutions & Markey Strategy;
- Manager Economic Regulation; and
- Project Advisor.

4.5.5 Reporting and disclosure

The Committee meets on a regular (fortnightly) basis on the overall progress of the project and provided updates through Board Reports as appropriate.

4.6 Pricing Proposal Project Teams

The Steering Committee was supported by a Project Team for the Greater Sydney pricing proposal. The Project Team was not a decision-making body itself. Rather, matters where unanimity was reached between project team members was reported to the Steering Committee for endorsement. Matters where unanimity was not reached was escalated to the Steering Committee for resolution.

5. Prudent and efficient outcomes

The robust governance and decision-making process provides strong assurance that our capex and opex forecasts prepared for the Greater Sydney pricing proposal are prudent and efficient and in accordance with IPART's requirements. The robustness of our governance process is complemented by the NSW Government gateway process for major projects.

Expenditure is subject to review and challenge to ensure alignment with corporate objectives and a strong focus on outcomes for customers.

Expenditure decisions are underpinned by our risk management framework and commercial policy framework.

The annual budget process provides a top-down review of expenditure forecasts. The Approval to Spend Framework provides detailed bottom-up assessment of the need, options and timing for individual projects and programs.

The procurement framework complements the investment governance framework by ensuring that we get best value for money from our service providers.

The governance and decision-making process provides confidence that our proposals deliver good value for money by balancing risks, costs and benefits for customers.

Glossary

ATS	Approval to Spend
AMS	Asset Management System
Capex	Capital expenditure
CEO	Chief Operating Officer
CFO	Chief Financial Officer
ERC	Expenditure Review Committee
IPART	Independent Pricing and Regulatory Tribunal
ICT	Information and Communications Technology
IRC	Investment Review Committee
Opex	Operating expenditure
SCI	Statement of Corporate Intent