NSW GOVERNMENT Finance & Services

Sydney Water

Information Technology and Communications Expenditure Review

20/09/2013

thirdhorizon Consulting Partners

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1 Document Intent and Overview

The Department of Finance and Services (DFS) engaged Third Horizon to conduct an external strategic review of Sydney Water's (SW) actual and budgeted expenditure for the period 1 July 2010 to 30 June 2016 with a specific focus on the period 1 July 2012 to 30 June 2013.

The objectives of the strategic review were to provide DFS with a high level independent evaluation and assessment of expenditure across the IT and Communications divisions to identify potential areas that warrant further analysis.

This project was divided into two phases:

- Phase 1 – Conduct an initial high level IT and Communications expenditure "reasonableness" review to identify any potential areas for further investigation.
- Phase 2 – Although currently out of scope, the objective of Phase 2 is to conduct a detailed review and/or follow the proposed next steps of any areas identified for further review during Phase 1.

This summary report represents the output from Phase 1, with scope consisting of:

- Review of expenditure categories including:
  - Transaction analysis
  - Trend analysis
  - Comparative analysis
  - High-level process review
  - Diagnostic interviews
- Leveraging the above analysis to prioritise the specific spend items for further, detailed review.
- Draft Report – Develop draft report for review and validation.
- Final Report – Validate analysis and obtain feedback from key stakeholders (DFS and SW) and finalisation of report.

The initial high level review (Phase 1) was conducted over a three week period to scan the broad range of expenditure categories across IT and Communications.

This review has been limited to reviewing data provided by Sydney Water and selected interviews with key Sydney Water stakeholders. We have not independently verified the accuracy of the provided information and have relied on its integrity for our analysis and conclusions.

Document Outline

The Sydney Water IT and Communications Expenditure Review is structured in four sections, as outlined below:

Section 1: Document Intent and Overview

- Presents the objective and scope of the review and document.

Section 2: Information Technology

- Executive Summary
- Transaction Analysis
- Trend Analysis
- Comparative Analysis
- Process Analysis
- Existing Reforms and Management Action
- Areas for Further Investigation

Section 3: Communications

- Executive Summary
- Transaction Analysis and Trend Analysis
- Process Analysis
- Existing Reforms and Management Action
- Areas for Further Investigation

Section 4: Appendices

- Supporting information collated and derived during the Sydney Water IT and Communications Expenditure Review.

2 Information Technology

2.1 Executive Summary

2.1.1 Context and Background

Third Horizon was engaged by DFS to conduct a "reasonableness" review of Sydney Water's IT expenditure and governance processes. During the three week reasonableness review of Sydney Water's IT expenditure, a high level analysis of key IT expenditure categories was conducted. The review included analysis of major transactions, trends, comparison to industry benchmarks, processes and existing reforms. Each of the areas of analysis were divided into operating expenditure and capital expenditure categories which then, based on the analysis, were prioritised into areas for further review.

2.1.2 Key Findings

2.1.2.1 Transaction Analysis

The purpose of the transaction analysis was to identify the major IT operating and capital expenditure cost "buckets".

Key operating expenditure observations:

- The top three operating expenditure categories were Labour, Managed Services and Software and Hardware Maintenance, which accounted for 80% of the total IT operational expenditure.
- Labour represented the most significant operating expenditure component with major contributing cost components being IT Operational Services (including the data centre) and Program Delivery.

Key capital expenditure observations:

- Three categories accounted for all the IT capital expenditure, and were Business Efficiency Projects, Renewals and Systems Replacement.

2.1.2.2 Trend Analysis

The purpose of the trend analysis was to identify the major operating and capital expenditure trends during the actual period FY11 to FY13 and forecasted period FY14 to FY16.

Key operating expenditure observations:

- The operating expenditure trend indicated a 7% compound annual growth rate (CAGR) between FY11 and FY13.
- Managed Services and Agency Hire trends however increased by 34% and 13% CAGR's respectively over that same time period.

Key capital expenditure observations:

- Capital expenditure had a declining CAGR of 35%, which was a result of the completion of capital projects and increased rigour in project approvals that resulted in deferred planned projects.
- The accuracy of capital expenditure allocation (i.e. comparison of project allocation to spend) decreased during the period FY11 to F13.
- An assessment of the project variances related to budgeted project expenditure (as per the original business cases) and actual expenditure at completion within FY13, revealed that all projects had a variance of at least 10%.

2.1.2.3 Comparative Analysis

A high-level comparative analysis was conducted in order to gain an understanding of how Sydney Water compared against global utilities industry benchmarks.

Key observations:

- IT spend as a percentage of revenue decreased but was still 0.7% higher than the Gartner Utilities industry benchmark.
- IT FTE as a percentage of total FTE compared well to the Gartner industry benchmark.
- IT capital expenditure as a percentage of total IT spend was consistently higher than the Gartner Utilities industry benchmark for the past five years.

2.1.2.4 Process Analysis

The process analysis was conducted to review the governance, rigour and "reasonableness" built into Sydney Water's IT operating and capital expenditure processes.

Key operating expenditure observations:

- The budgeting process applies the necessary governance and rigour. However, limited evidence was provided to suggest the same capital expenditure "reasonableness" expenditure testing process was conducted.

Key capital expenditure observations:

- The Capital Program Management process provides the necessary governance, rigour and "reasonableness" testing. However, interviews have indicated that historically, procurement lacked the IT expertise to challenge the reasonableness of IT procurement requests received. Reforms within the IT Division (i.e. the formation of IT Commercial team) and the Finance Division (i.e. Procurement team reform) have been initiated to address this observation, but are yet to be completed.

2.1.2.5 Existing Reforms and Management Action

Sydney Water IT is currently undergoing a large transformation and the following key aspects were identified:

- IT strategy reforms which have been developed by the CIO (appointed in June 2012).

- IT organisation restructures as a result of the recognised need to align new capabilities to the organisational structure for effective strategy delivery.
- Achievements to date from organisational changes.
- It is expected that these reforms will have an impact on the areas identified for further review.

2.1.3 Recommendations - Priority Areas for Further Review

The analysis highlighted areas that should be further investigated during a subsequent review. It is acknowledged that Sydney Water is internally addressing many of these concerns through existing reforms.

It is further proposed that Sydney Water:

- Review the existing reforms in light of these priority areas and ensure they are included in the scope of these reforms; and
- Conduct a formal review upon completion of these reforms to confirm all concerns raised have been addressed.

Key operating expenditure areas prioritised for further review include:

- **High Priority –** IT Labour was the most significant IT operating expenditure cost "bucket" at 32% of total IT operating expenditure, with Operational Services (including the data centre) contributing 42% of the cost and 56% of IT headcount. It is recommended that a strategic review of the data centre operations is conducted in order to identify possible efficiencies including alternative methods of delivery.
- **Medium Priority –** Agency hire CAGR increased at a rate of 13% between FY11 and FY13. It is recommended that Agency hire is further reviewed in order to identify possible efficiency gains.
- **Low Priority –** Although limited evidence was provided regarding recent reforms, the operating expenditure budgeting process did not appear to have the same level of rigour as capital expenditure processes. It is recommended that further reviews be conducted in order to investigate the need for external representation when the "reasonableness" expenditure assessment is conducted.

Key capital expenditure areas prioritised for further review include:

- **High Priority** – Aging website content and supporting architecture prompted the need for the Website Rebuild Project. Our analyses and review indicates that despite the Website Rebuild Project delivering value from Go-Live in Q2 2013 through updated content and an improved supporting architecture, there were issues relating to:
  - Project governance, as project delivery took nearly three years to complete (i.e. from Business Case approval in Q4 2010 to Public Go-Live in Q2 2013)

- The delivery cost exceeded the originally approved business case by approximately 13%, despite the delivered scope being reduced to exclude self-service transactional capability. The proper governance process was followed to approve the business case variation.
- The business requirement and the associated delivery complexity and cost was not clearly understood, resulting in Procurement going to market on three separate occasions only awarding the external hosting contract on the third occasion.
- The lack of Project Management skills and capabilities in managing website rebuild projects similar in complexity to Sydney Water's requirement.

These observations have also been detailed in the KPMG gate review, Helmsmann lessons learned review and Helmsmann post execution review, initiated by Sydney Water IT.

Recent IT reforms are addressing the issues above through an improved IT Organisation structure, governance process improvements and IT Procurement reforms. It is recommended that these IT reforms are further reviewed upon completion in order to confirm that the reforms have addressed all the issues raised.

- **Medium Priority** – The apparent existence of consistent variations in capital projects (budget vs. actual) suggest issues with the Capital Program Management processes – especially with renewal projects. It is recommended that a more detailed review of IT projects variations and their root causes is undertaken in order to identify possible opportunities for improvement.
- **Medium Priority** – The Procurement processes emerged as a consistent theme in relation to IT projects. Past completed projects demonstrated the need to enhance the level of procurement expertise to assist with optimising the procurement, value and management contracts. Current reforms within the IT division (i.e. the formation of IT Commercial team) and the Finance Division (i.e. Procurement team reform) have been initiated, but are yet to be completed. It is recommended that these Procurement reforms are further reviewed upon completion in order to confirm that the reforms have addressed all the concerns raised.

2.2 Transaction Analysis

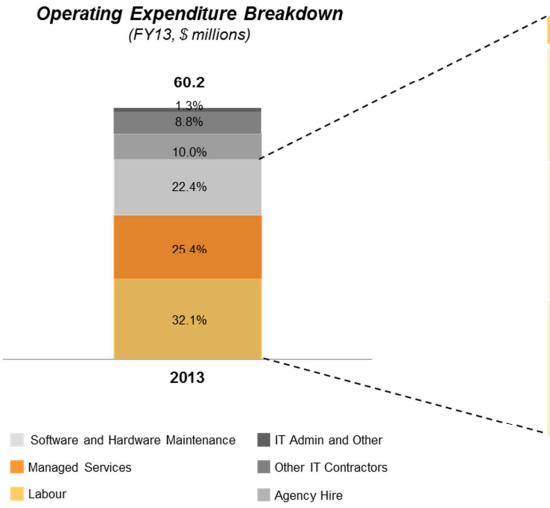
The IT operating expenditure and capital expenditure financial data were analysed, in order to identify:

- The major operating expenditure cost "buckets" as well as the associated major expenditure components.
- The major capital expenditure on capital projects.

The identification of these major expenditure buckets helped provide initial hypotheses regarding the areas for further review. Once the hypotheses had been formulated, further interviews and financial data were requested to validate the findings.

2.2.1 Transaction Analysis – Operating Expenditure Breakdown

A transaction analysis was conducted to identify the major operating expenditure components and to analyse the underlying components that contribute to these expenditure components. The diagram below details the key expenditure components:



Category	Components	% of Category
Software and Hardware Maintenance ($13.5m)	Software Maintenance Costs	93%
	Hardware	6%
	Leasing costs	1%
Managed Services ($15.2m)	WAN	25%
	Logica	9%
	Maximo Support	6%
	Other	60%
Labour ($19.3m)	Operational Services	42%
	Applications Portfolio	37%
	Architecture Solutions	12%
	Other	9%

Figure 1: Transaction Analysis – Operating Expenditure Breakdown

Key Observations:

The top three operating expenditure categories were Labour (32.1%), Managed Services (25.4%) and Software and Hardware Maintenance (22.4%) which accounted for 80% of the total IT operating expenditure.

The most significant cost components in each of these spend categories included:

- **Labour** – Operational Services (42%), Applications Portfolio (37%), and Architecture Solution (12%).
- **Managed Services –** WAN (25%), Logica[1] (9%), and Maximo Support[2] (6%).
- **Software and Hardware Maintenance –** Software Maintenance Costs (93%), Hardware (6%) and Leasing Costs (1%).

[1] Logica – Managed security services and alerting

[2] Maximo – Asset management system

2.2.2 Transaction Analysis – Labour FTE Breakdown

As Labour represented the most significant operating expenditure component a further assessment was made to understand the key Labour components and has been illustrated below:

IT Division	Actual	Planned	Variance
IT Operational Services	**84.4**	**88.0**	**3.6**
Application Services	20.8	21.8	1.0
Infrastructure Services	43.6	44.5	0.9
Operational Services	14.0	14.7	0.7
Security	5.0	6.0	1.0
Telecomms	1.0	1.0	0.0
Program Delivery	**38.7**	**40.0**	**1.3**
Enterprise Architecture	**12.0**	**14.0**	**2.0**
Capability Partner	**10.0**	**13.0**	**3.0**
CIO Office	**4.0**	**4.0**	**0.0**
Commercial	**2.0**	**4.0**	**2.0**
Total	**151.1**	**163.0**	**11.9**

Table 1: Transaction Analysis – Labour FTE Breakdown

Key Observations:

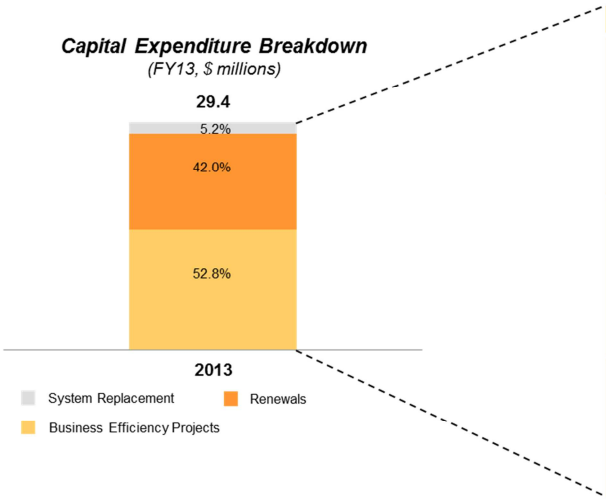
- The analysis showed that Labour currently consisted of a 151.1 FTE, but this constituted a staff shortfall of 12 FTE as compared against the 163 FTE as per the budget.
- IT Operational Services (including the data centre) and Program Delivery respectively had 84.4 FTE (approx. 56%) and 38.7 FTE (approx. 26%).

Areas for Further Analysis and Review:

The data centre is currently hosted internally. It is recommended that a strategic review of data centre operations is conducted in order to identify possible efficiencies

2.2.3 Transaction Analysis – Capital Expenditure Breakdown

A transaction analysis was conducted to identify the major capital expenditure components and to analyse the underlying components that contribute to these expenditure components. The diagram below also details the key expenditure components:



Category	Component	% of Category
System Replacement ($1.5m)	Meter Reading Collection	28%
	ARP Program Management	28%
	Leasing Costs	25%
	Other	18%
Renewals ($12.4m)	Website Rebuild	25%
	Integration Platform Renewal	10%
	Server Platform Refresh	8%
	Other	57%
Business Efficiency Projects ($15.5m)	SWIM 2	22%
	Inventory Management	17%
	Contracting Partners	16%
	Other	45%

Figure 2: Transaction Analysis – Capital Expenditure Breakdown

Key Observations:

Three capital expenditure categories accounted for all IT capital expenditure and were Business Efficiency Projects (52.8%), Renewals (42%) and System Replacement (5.2%).

The most significant cost components in each of these spend categories included:

- **Business Efficiency Projects** – SWIM 2[3] (22%), Inventory Management[4] (17%), and Contracting Partners[5] (16%).
- **Renewals –** Website Rebuild (25%), Integration Platform Renewal (10%), and Server Platform Refresh (8%).
- **System Replacement –** Meter Reading Collection (28%), ARP Program Management[6] (28%) and Leasing Costs (25%).

[3] SWIM 2 – Sydney Water Information Management Program 2 (Migration of high value legacy solutions into a new Enterprise Content Management System)

[4] Inventory Management – Integration of Maximo and FMIS systems.

[5] Contracting Partners – Use of contracting partners to provide program, project and service delivery support for a new delivery model.

[6] ARP Program Management – Access Replacement Program (Billing system replacement).

Areas for Further Analysis and Review:

The Website Rebuild project accounted for 25% (the highest cost component) of IT Renewals capital expenditure during FY13.

Our analyses and review indicates that despite the Website Rebuild Project delivering value from go-live in Q2 2013 through updated content and an improved supporting architecture, there were issues relating to:

- Project governance, as project delivery took nearly three years to complete (i.e. from Business Case approval in Q4 2010 to public go-live in Q2 2013)
- The delivery cost exceeded the originally approved business case by approximately 13%, despite the delivered scope being reduced to exclude self-service transactional capability. The proper governance process was followed to approve the business case variation.
- The business requirement and the associated delivery complexity and cost was not clearly understood, resulting in Procurement going to market on three separate occasions only awarding the external hosting contract on the third occasion. This contributed significantly to the delivery timeframe extension
- The lack of Project Management skills and capabilities in managing website rebuild projects similar in complexity to Sydney Water's requirement. This includes concerns raised regarding proper issue and risk management as well as the management of key project dependencies to ensure delivery of the project critical delivery path.

These observations have also been detailed in the KPMG gate review, Helmsmann lessons learned review and Helmsmann post execution review, initiated by Sydney Water IT.

Recent IT reforms are addressing the issues above through an improved IT Organisation structure, governance process improvements and IT Procurement reforms.

It is recommended that these IT reforms are further reviewed upon completion in order to confirm that the reforms have addressed all the issues raised.

2.3 Trend Analysis

The IT operating and capital expenditure financial data were reviewed, in order to identify trends during the period FY11 to FY13 as well as forecasted trends until FY16. The figure below illustrates the relationship between the operating and capital expenditure Actual,[7] Allocated,[8] and Budget trends:[9]

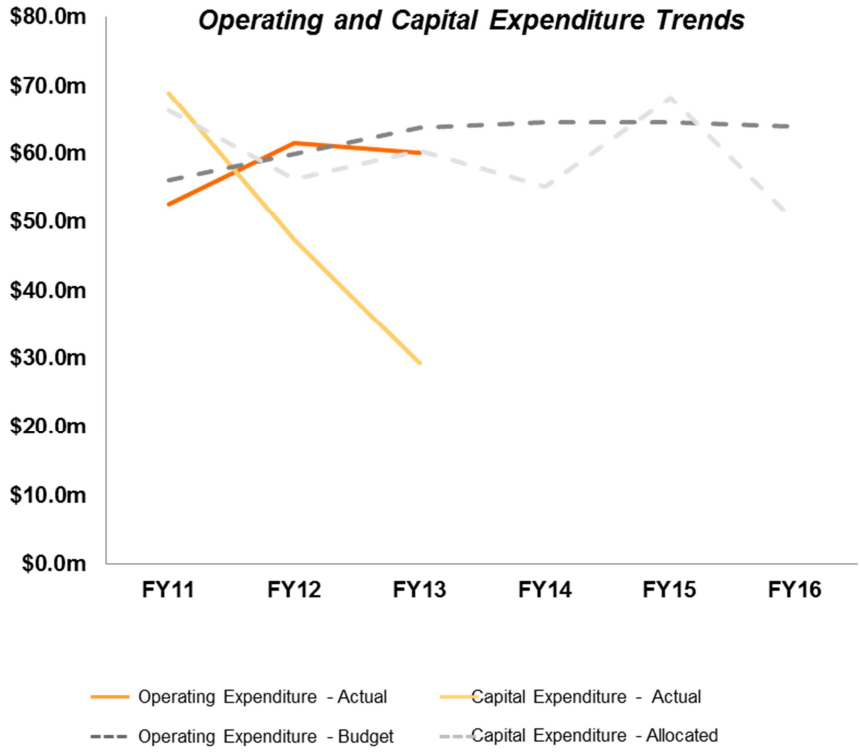


Figure 3: Trend Analysis – Operating and Capital Expenditure Trends[10]

Key Observations:

- The graph represents operating expenditure and capital expenditure trends during the period FY11 to FY13, as well as forecasted trends until FY16.
- The operating expenditure trend showed that the actual and budget trends are closely aligned.
- The operating expenditure budget trend is expected to increase slightly due to a strategic move towards operationalising some current capital investment (i.e. Office 365).
- The capital expenditure trends illustrated a gap between Actual and Allocated spend.

[7] Actual expenditure is costs that have been incurred.

[8] Allocated expenditure is the P80 estimated cost of a capital project.

[9] Budgeted expenditure is the planned operating expenditure cost or the P50 estimate of a capital project.

[10] Capital expenditure amounts in FY11-FY13 are expressed in nominal dollars. Future projects FY14-FY16 are expressed in real non escalated dollars.

2.3.1 Trend Analysis – Operating Expenditure

The trend analysis for operating expenditure assessed:

- The operating expenditure for the period FY11 until FY16.
- The operating expenditure Actual vs. Budget.

The operating expenditure trends indicated that the operating expenditure is projected to be relatively steady with a few bucket areas that have potential to be assessed for further review.

2.3.1.1 *Operating Expenditure (FY11 to FY16)*

The operating expenditure trends for the period FY11 to FY16 were analysed in order to identify the growth rate of the total operating expenditure as well as the key expenditure components as per below:

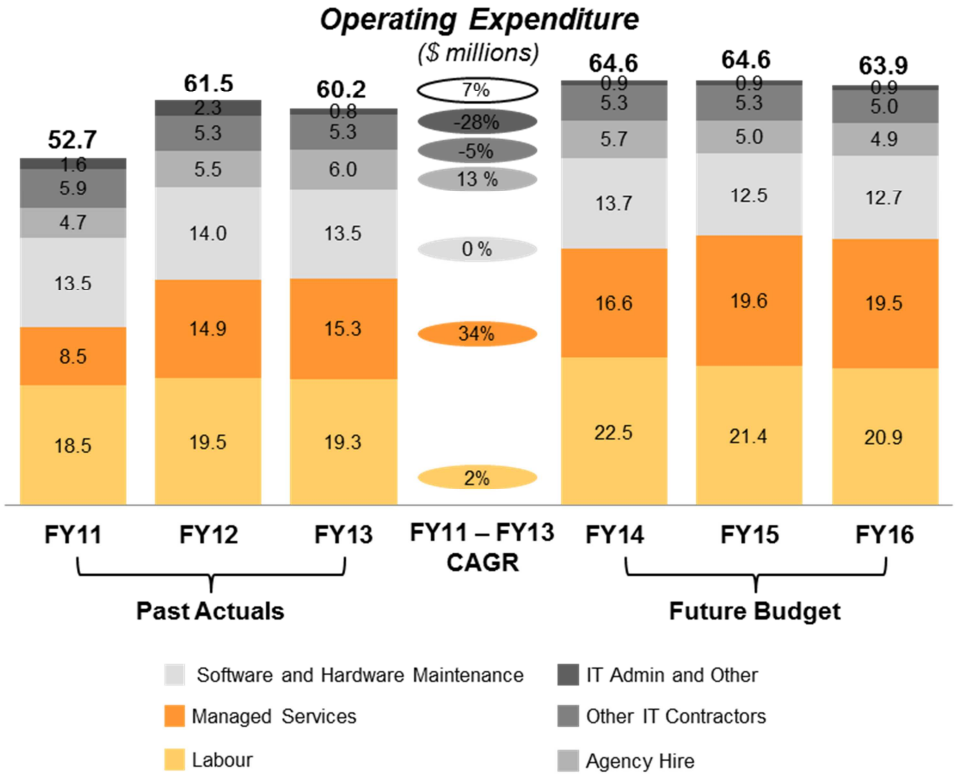


Figure 4: Trend Analysis – Operating Expenditure

Key Observations:

- The operating expenditure trend indicated a 7% compound annual growth rate (CAGR) between FY11 and FY13.
- IT Admin and Other expenditure decreased by 28% during this period and was expected to remain at current expenditure levels during the next three year period.
- Managed Services and Agency Hire trends however indicated 34% and 13% CAGR respectively. The Managed Services growth rate was attributed to the addition of telecommunications costs that became part of the IT budget as well as the completion of multi-year capital projects, such as mainframe, webhosting, CMS and Maximo, which resulted in Managed Services contracts.

Areas for Further Review:

Agency hire CAGR increased at a rate of 13% between FY11 and FY13. It is recommended that Agency hire is further reviewed in order to identify possible efficiency gains.

2.3.1.2 *Operating Expenditure (Actual vs. Budget)*

The operating expenditure actual expenditure compared to budget expenditure for the period FY11 to FY13 was assessed to determine budgeting accuracy and expenditure planning trends during this period as illustrated in the figure below:

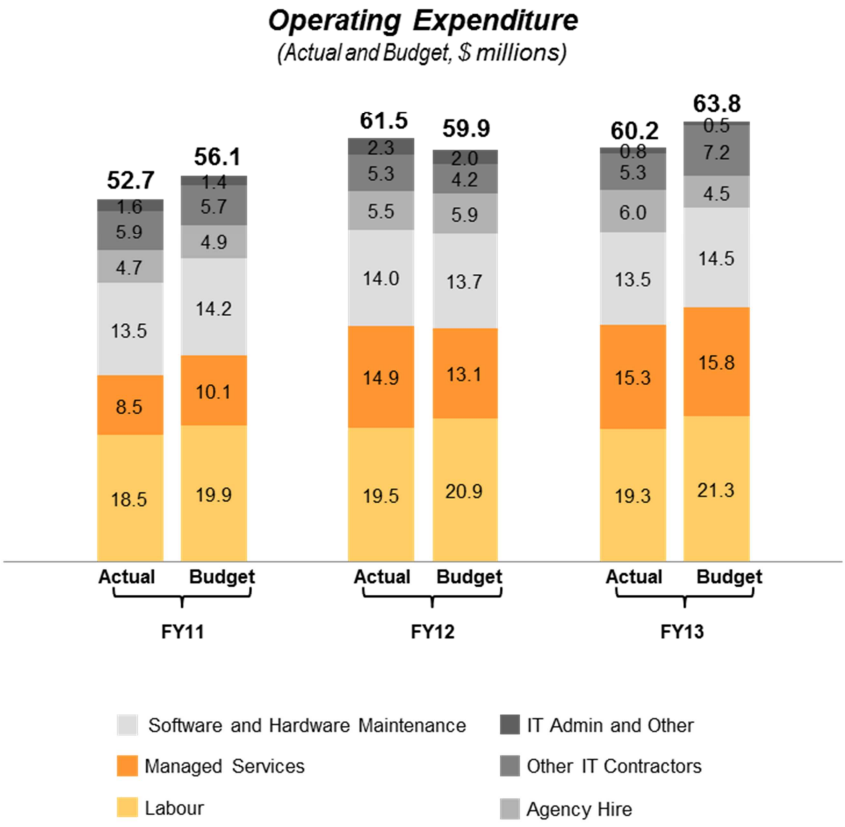


Figure 5: Trend Analysis - Operating Expenditure (Actual vs. Budget)

Key Observations:

- With the exception of FY12, Sydney Water IT has been able to reduce actual operating expenditure by approximately 6%, compared to the budgeted operating expenditure.
- Actual Labour expenditure has been consistently below, the budgeted operating expenditure. This was mainly attributed to a labour shortfall as specified in Section 2.2.1.
- Managed Services had the most significant upward trend and was budgeted to continue the upward trend as capital projects are delivered. Growth in Managed Services can be attributed to increases in mainframe, webhosting and website, CMS[11] and Maximo support. As discussed before, telecommunication costs have become part of the IT budget and contributed towards the upwards trend in Managed Services.

[11] CMS – Customer Management System

2.3.2 Trend Analysis – Capital Expenditure

The capital expenditure trend analysis aimed to identify key trends across the period under review. The following trends were analysed:

- Capital expenditure for the period FY11 – FY16
- Capital expenditure (Actual vs. Allocated)
- Capital expenditure – Project Variances

The capital expenditure budgeting processes differ from operating expenditure budgeting processes. Capital funds are allocated based on a prioritised list of capital projects that are expected to proceed at a P80 allocation. Once the allocation has been confirmed, the project approval proceeds to business case whereby projects are budgeted at a P50 estimate. A contingency is provisioned to account for the gap between P50 and P80.

Capital expenditure trend analysis revealed that expenditure was much more volatile than operating expenditure due to the nature of IT projects that drive the trends. However, there are definitely areas that will benefit from further review which will help provide a better assessment of the volatile spending trends.

2.3.2.1 *Capital Expenditure (FY11 - FY16)*

The capital expenditure trends for the period FY11 to FY16 were analysed in order to identify the growth rate of the total capital expenditure as well as the key expenditure components.

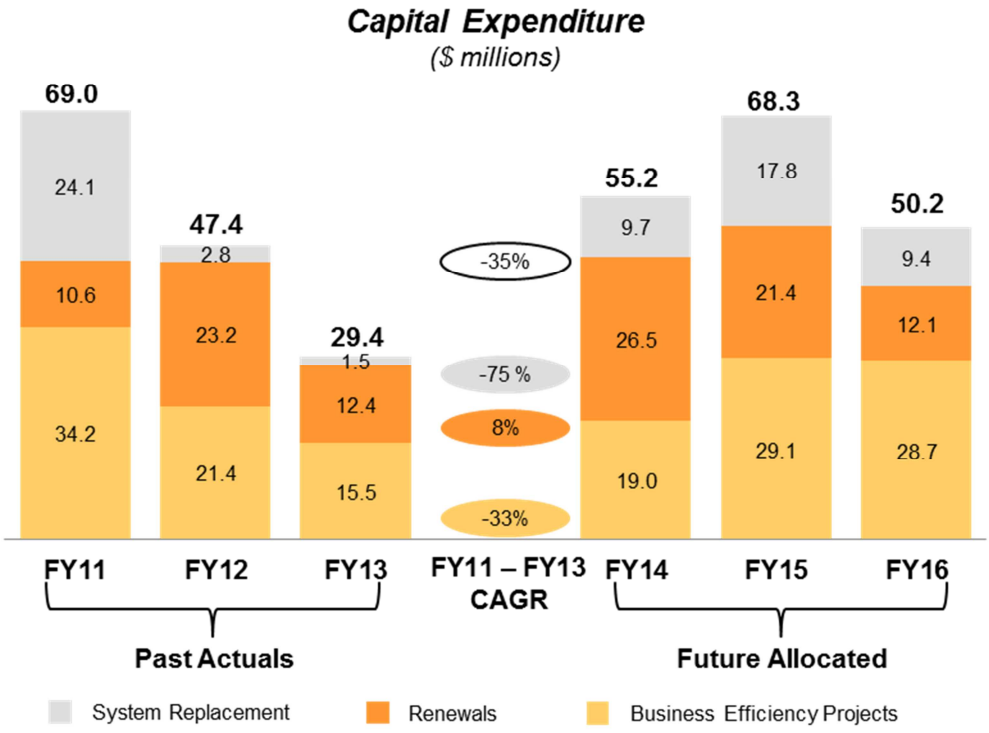


Figure 6: Trend Analysis – Capital Expenditure[12]

Key Observations:

- Sydney Water's capital expenditure had a declining CAGR of 35%.
- The decline in actual spend was a result of the completion of capital projects (i.e. System Replacement and Business Efficiency Projects had declining CAGR's of 75% and 33% respectively).
- The increased rigour in project approvals deferred planned projects in FY13.
- Allocated funds were based on P80 estimates of projects, forecasting for a 5 year cycle.
- Renewals were budgeted to increase due to a focus on replacing the entire billing system.

[12] Capital expenditure for FY11 – FY13 is expressed in nominal dollars. Future allocated capital expenditure for FY14 – FY16 are expressed in real (non-escalated) dollars.

2.3.2.2 *Capital Expenditure (Actual vs. Allocated)*

The capital expenditure Actual vs. Allocated expenditure analysis was conducted to determine fund allocation accuracy trends, compared to actual expenditure at completion.

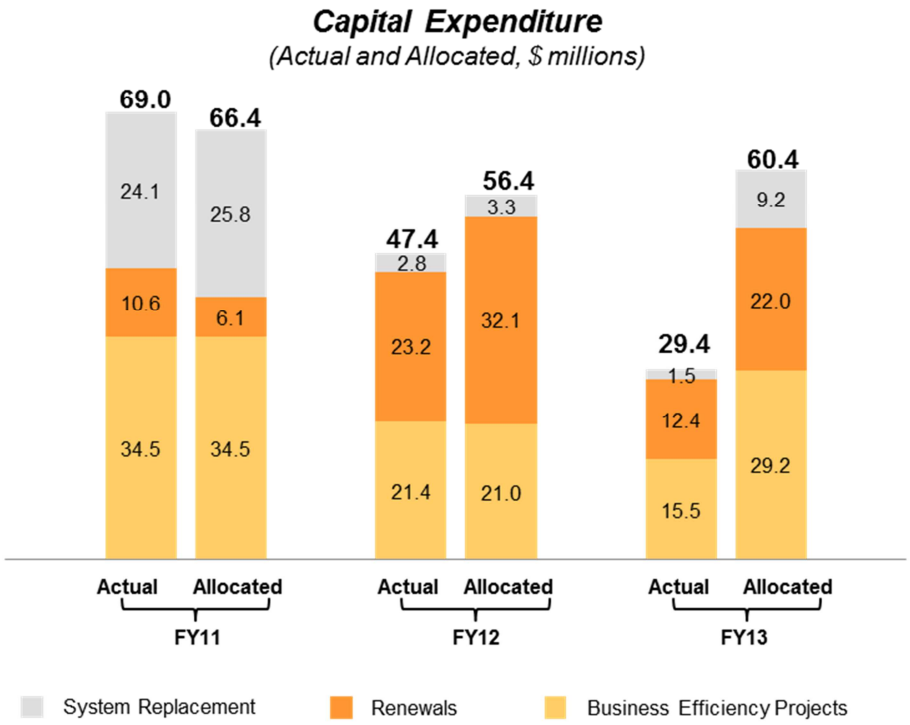


Figure 7: Trend Analysis – Capital Expenditure (Actual vs. Allocation)

Key Observations:

The analysis indicated that the capital expenditure allocation accuracy trend decreased during the period FY11 to FY13. In FY13, the actual capital expenditure was only 49% of allocated expenditure. This was the result of:

- Business cases for approximately $14 million of proposed expenditure were not sufficiently developed for approval under the Business Efficiency and Access Replacement Programs.
- The Contracting Partners Program delivered below their approved budget due to adoption of AGILE delivery frameworks.
- Two projects released $0.25 million in contingency as it was not required.
- Seven projects were delayed in starting moving a further $13 million into FY14.
- $5 million of planned expenditure under the Hydra Asset Data Capture project was released as the project cancelled following a proof of concept that showed that the proposed benefits would not be realised.

2.3.2.3 *Capital Expenditure – Project Variances*

An analysis of budgeted project expenditure (as per the original business cases) and actual expenditure at completion within FY13 (of projects over $2 million), revealed the following variances:

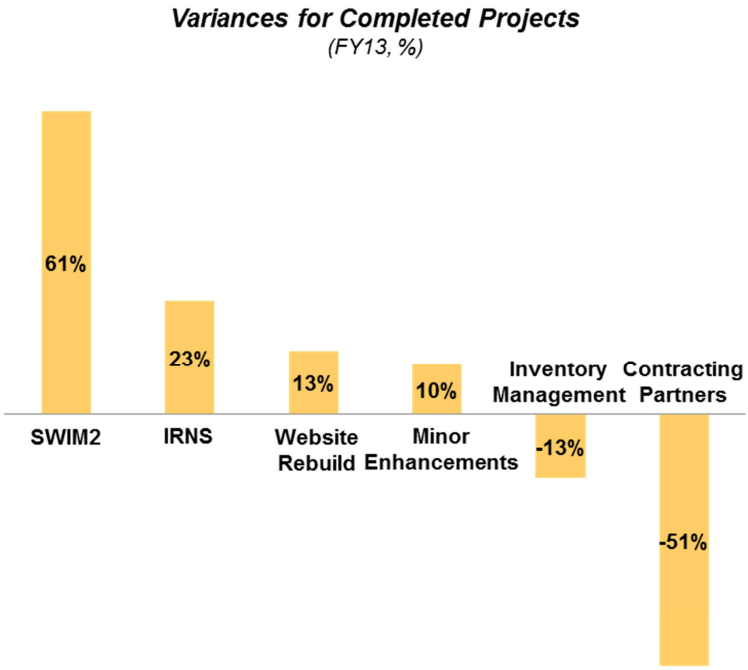


Figure 8: Trend Analysis – Capital Expenditure (Project Variances)

Key Observations:

- The highest variance over the budget in FY13 was the Sydney Water Information Management Program 2 (SWIM2) project which exceeded the budget by 61% or $6 million.
- The highest variance below the budget was Contracting Partners Phase 1 project which underspent 51% or $2.6 million.
- Funds were budgeted at a P80[13] estimate once projects had been approved.

Areas for Further Analysis and Review:

All projects over $2 million completed during the FY13 had budget variations (above or below budget) of 10% or more when compared to the original business cases. Budget variation business cases may had been approved for these projects, however it is recommended that this be further assessed.

[13] P80 is the estimated cost at which there is an 80% chance of delivering the project for less than the estimated cost. The project forecast completion cost is set at the P50 estimate at the time of project approval.

2.4 Comparative Analysis

A comparative analysis was conducted in order to gain an understanding of how Sydney Water compared against local and global utilities industry benchmarks. As such, the Gartner IT Key Metrics - Summary Reports (2009, 2010, 2011, 2012 and 2013) were used for comparative analysis purposes. This section however does not constitute a detailed benchmarking exercise.

The key benchmark metrics used for comparative analysis purposes, included:

- IT Spend as a percentage of revenue
- IT FTE as a percentage of total FTE
- Operating and capital expenditure as a percentage of IT spend

2.4.1 IT Spend as a Percentage of Revenue

Total IT spend has been defined as "IT costs incurred from anywhere in the enterprise and is not limited to the IT organisation. It is calculated on an annualised 'cash out' basis and therefore, contains capital spending and operational expenses but not depreciation and amortisation".[14]

The benchmark group included 106 utility organisations from which their primary revenue stream is derived from one or more of the following: Electric Utilities, Retail Energy Communications, Independent / Merchant Power, Water Utilities, Wastewater Treatment, Water Distribution etc.

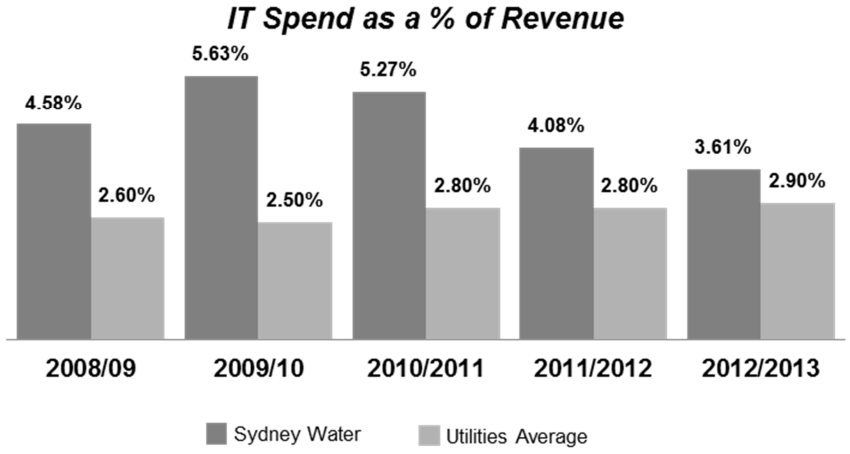


Figure 9: Comparative Analysis - IT Spend as a % of Revenue

Key Observations:

- Sydney Water IT spend as a percentage of revenue decreased during the review period, but was still higher than the benchmark.
- Sydney Water is however going through significant transformation at the moment and has multi-year capital projects, such as the Billing System Replacement project, that are due to start within the current period. As such, it is expected that Sydney Water expenditure will trend upwards in comparison to the Gartner benchmark during the subsequent period.

[14] IT Key Metrics – Summary Reports, Gartner, 2009, 2010, 2011, 2012, 2013

2.4.2 IT FTE as a Percentage of Total FTE

This analysis, compared the IT FTE as a component of the total organisation's FTE and provided a benchmark to gauge the IT headcount against. Using Gartner's IT Key Metrics Data - Summary Reports (2009, 2010, 2011, 2012 and 2013) as benchmarks, the diagram below indicates how Sydney Water compares.

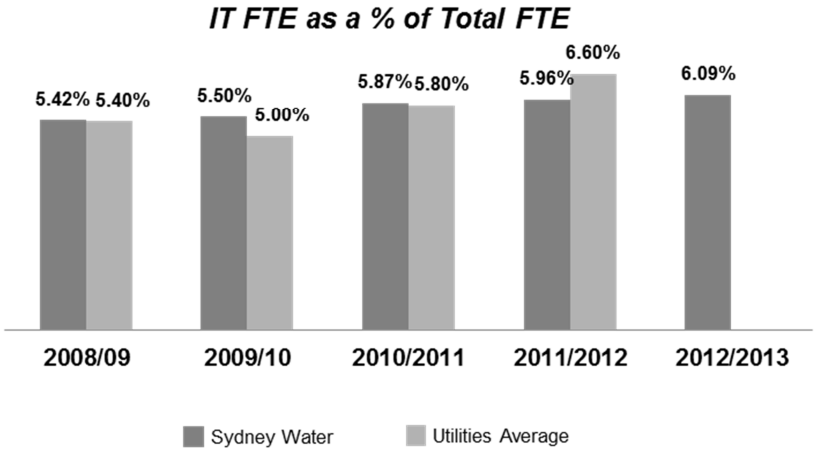


Figure 10: Comparative Analysis - IT FTE as a % of Total FTE

Key Observations:

- Sydney Water's IT FTE as a percentage of Total FTE compared well to the Gartner Industry benchmark.
- During the period FY10 to FY12, the Gartner Industry benchmark showed an increased IT FTE as a percentage of Total FTE of 1.6%, while comparatively Sydney Water showed an increased IT FTE as a percentage of Total FTE of 0.46%.

2.4.3 Operating and Capital Expenditure as a Percentage of IT Spend

This comparison illustrated operating and capital expenditure as a percentage of total IT spend and provided insight regarding IT operating and capital expenditure ratios. In order to identify any possible trends, the analysis below was conducted for the period FY09 to FY13.

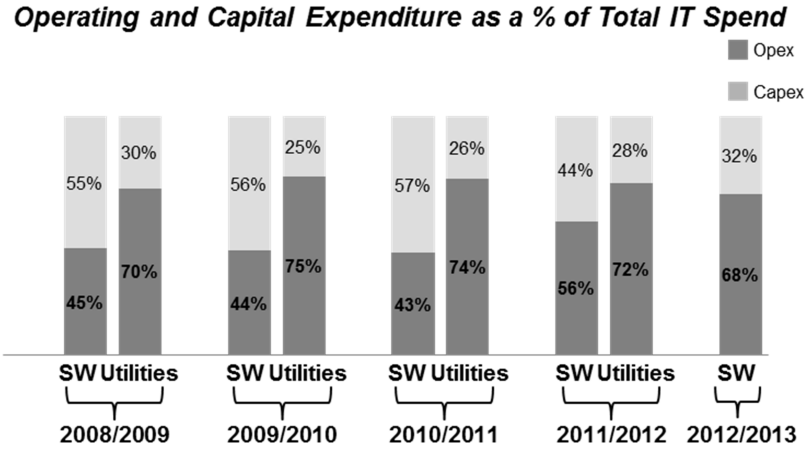


Figure 11: Comparative Analysis - Operating Expenditure and Capital Expenditure as a % of IT Spend

Key Observations:

- Although more in line with the Gartner industry benchmark in FY13, Sydney Water's IT capital expenditure as a percentage of total IT spend has been consistently higher that the Utilities industry benchmark for the past five years.
- During the period FY11 to FY13, Sydney Water's IT operational and capital expenditure as a percentage of total IT spend trended closer towards the Garner industry benchmark.
- Sydney Water's IT operational and capital expenditure as a percentage of total IT spend has been explained through a number of large, multi-year capital programs, such as Maximo, CMS, SWIM2 and the Website Rebuild that were implemented during this timeframe. The completion of these programs is seeing Sydney Water's IT operational and capital expenditure normalising.

2.5 Process Analysis

The aim of this analysis was to confirm that the necessary processes, to ensure the proper governance, rigour and expenditure reasonableness, have been defined. The level of adherence to these processes was determined through the interviews with the various stakeholders and qualitative data.

The process analysis investigated the:

- High-level IT operating expenditure
- High-level capital expenditure processes

The observations revealed that at a high level, the necessary governance, rigour and expenditure reasonableness were applied in the processes. However, upon further review and assessment of supporting areas such as project variances, it was evident that there were some gaps that may need to be addressed in more detail.

2.5.1 High-level Operating Expenditure Process Analysis

The high-level operating expenditure process analysis focussed predominantly on the budgeting and forecasting process. Sydney Water applies a standard process for all divisions across the organisation and therefore the analysis presented below is an illustration of the overall process that is facilitated by Finance.

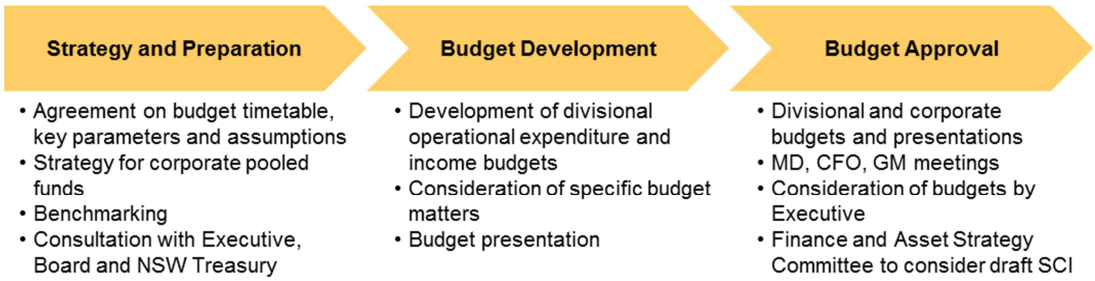


Figure 12: High-level Operating Expenditure Budgeting Process

Key Observations:

- The operating expenditure budgeting process aims to align to the business plans and drive efficiencies with Chief Financial Officer (CFO) and Managing Director (MD) oversight.
- The outcomes of the process include a Statement of Corporate Intent and tracking to the IPART determination.
- Divisional input is included in the process with separate processes that govern the divisional operational budget requirements.
- Tools include heat maps, IPART determinations, presentation templates, benchmarking reports, and scenario analysis.

Areas for Further Analysis and Review:

Operating expenditure processes did not seem to have the same level of rigour than capital expenditure processes. With the shift in expenditure from capital expenditure to operating expenditure a process similar to the "pink slip" process[15] should be consistently applied for all processes above an agreed limit.

External representation should be considered to provide the "reasonableness" perspective, as currently Sydney Water is providing this through the Business Governance portfolio.

[15] Pink Slip Process – An independent review of the business case to assess the project need, the risk, governance stage gates the business case went through as well as the "reasonableness" of spend from a customer perspective.

2.5.2 High-level IT Capital Expenditure Process Analysis

The capital project expenditure process is governed by a detailed Capital Investment Policy, which is readily available to anyone within the organisation through various channels such as the Sydney Water intranet. The figure below provides a high-level overview of a very detailed, multi-layered process:

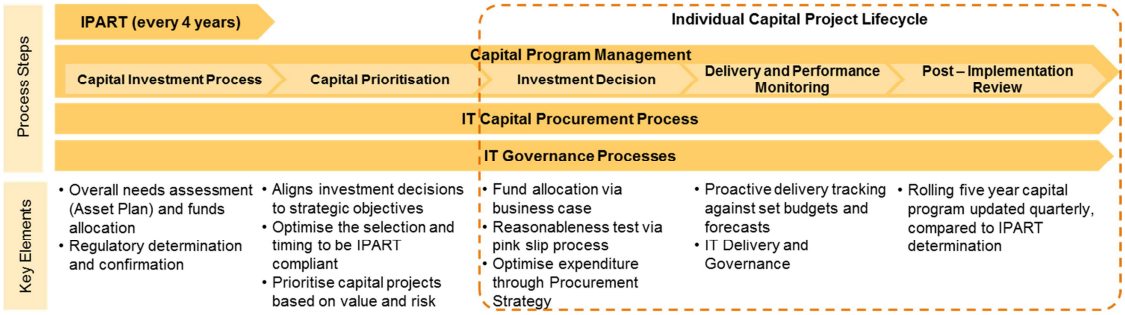


Figure 13: High-Level IT Capital Expenditure Process Overview

The high-level IT capital expenditure process consists of the following key sub-processes:

- Capital Program Management process
- IT Capital Procurement process
- IT Governance process

2.5.2.1 *Capital Program Management Process*

The high-level capital program management process was reviewed to confirm that the necessary governance, rigour and "reasonableness" have been built into this process.

Figure 14: IT Capital Expenditure - Capital Program Management

Key Observations:

The Capital Program Management process, which is governed by the Capital Investment Policy, consists of the following sub-processes:

- ***Capital Investment Process*** – Identifies the need and facilitates corporate wide budget allocation for all capital expenditure within Sydney Water, including IT. This is also used as bases for the IPART price determination every four years.
- ***Capital Prioritisation Process*** – Ensures the optimum mix of projects to achieve the corporate strategy and manage corporate risk. Capital prioritisation is based on risk and value thresholds set by the Executive. The five year capital program is prioritised by the Executive and approved by the Board annually. It is also reviewed by the Executive quarterly to ensure the optimum mix of projects.
- ***Investment Decision Process*** – Facilitates obtaining capital project funding through the necessary governance stage gates and approvals. In order to get the budget allocation for capital projects, a detailed business case is completed and verified through the "pink slip" process. This "pink slip" process also determines the "reasonableness" of the proposed expenditure.
- ***Delivery and Performance Monitoring Process*** – Supports the delivery performance monitoring and benefits tracking of all IT capital projects and expenditure. This process is governed by the IT Project Delivery Framework and supported by the IT Project Management Office (PMO).
- ***Post-Implementation Review Process*** – Post-implementation planning, monitoring and benefits realisation tracking.

The Capital Program Management process ensures that the necessary governance, rigour and "reasonableness" testing is conducted prior to IT Capital project expenditure.

Areas for Further Review:

The Capital Program Management process presented gaps in rigour as variances were consistently high – especially with renewal projects. It is recommended that IT project Allocation, Budget and Actual spend, be further reviewed in order to identify possible efficiency and optimisation opportunities.

2.5.2.2 IT Capital Procurement Process

Procurement is a decentralised process undertaken by various divisions, businesses groups and staff. The figure below depicts the high-level procurement process and key steps:

Figure 15: High-level Capital Procurement Process

The procurement policy that governs Sydney Water procurement aims to:

- Obtain the best value for money.
- Efficient and effective procurement processes.
- Demonstrate probity equity and transparency.
- Adopt and adhere to the NSW government Code of Practice for Procurement.

Responsibilities, activities and interactions are between the procurement system owners and the rest of the organisation (process users).

Key Observations:

- The necessary governance and rigour is built into processes with flexibility around differing activities and costs.
- Documentation training and support readily available to staff and on the intranet (i.e. via iConnect).
- Accountabilities and responsibilities are delegated appropriately to Procurement team and the rest of the organisation.

Areas for Further Review:

The Procurement processes emerged as a consistent theme in relation to IT projects. Past completed projects demonstrated the need to investigate the expertise to assist with optimal value contracts. Current reforms within the IT Division (i.e. the formation of IT Commercial team) and the Finance Division (i.e. Procurement team reform) have been initiated, but are yet to be completed. It is recommended that these procurement reforms are further reviewed upon completion in order to confirm that the reforms have addressed all the concerns raised.

2.5.2.3 IT Governance Processes

The IT Governance process ensures projects and programs receive the intended business outcomes and benefits in line with Sydney Water's strategic objectives. This process is facilitated by Steering Committees who provide support to the Sponsor through monitoring and reviewing the project status and providing oversight of the successful execution of the project.

The figure below depicts the high-level IT Governance processes, including:

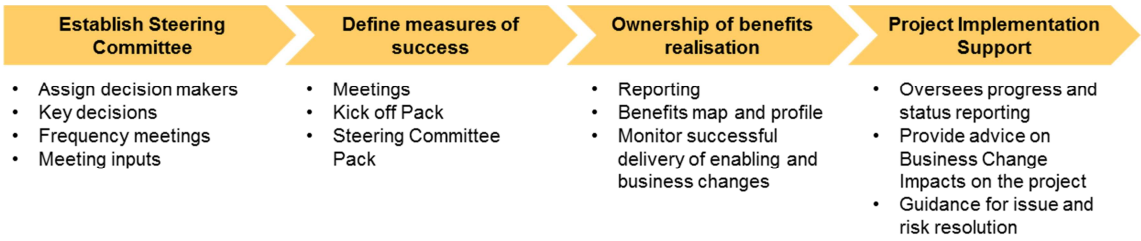


Figure 16: High-level IT Governance Process

Key Observations:

- Documentation is extensive, easy to understand and readily available through channels such as iConnect, Finance and project managers.
- Accountabilities are clearly defined in documentation and tools such as RACI.
- Support for process facilitation is provided by IT and PMO.
- Business stakeholders now sign off the solution designs.
- Further assessment into projects that had high variances revealed the rigour within the governance processes have potential for questioning.

Areas for Further Analysis and Review:

It is recommended that the IT Governance process is further investigated to ensure it caters for projects of varying complexity and to determine whether gaps exist in process implementation.

The proactive management of issues and risks, especially on complex projects such as the Website Rebuild Project, should form an integral part of this process.

2.6 Existing Reforms and Management Action

A significant portion of the review was interlinked to the large scale of change that Sydney Water IT is currently undergoing. Key aspects of this reform include:

- IT strategy
- IT organisation structure
- Achievements to date from organisational changes

It has been acknowledged that the transformation process is far from being completed and there are still areas that need to be addressed. The importance of understanding the changes currently taking place in the organisation allows an understanding of the context in which the potential further areas for review will be taking place.

2.6.1 The IT Strategy

Sydney Water has is currently undertaking a strategic transformation which began in June 2010 when a new CIO was appointed to develop a new strategy through iterative workshops. The newly revised strategy included:

- Delivery of a range of mobile applications to internal and external customers.
- Shift away from IT servers and systems to cloud style solutions.
- Focus on service oriented architecture to prepare to deploy new services to customers.
- Revision of procurement strategies and leveraging available panels.

The transformation impacts are as follows:

- Builds relationships with other business units and simplifies engagement across divisions.
- Clearer accountabilities and governance.
- Reaching a 25% improvement in customer value by 2018.
- Adoption of the NSW ICT Services Scheme for acquisition of services.
- Implementation of AGILE project approaches that deliver more effective outcomes and lower risk.

2.6.2 The IT Organisation Structure

Recognition that the division would require new capabilities and organisational restructure to deliver the strategy resulted in a new organisational structure which is currently underway with the following key goals:

- IT Capability Partner team to be delegated responsibility for engagement with Sydney Water divisions.
- Commercial team to provide strategic and commercial advice.
- Applications Portfolio Management to deliver available, secure, cost effective applications portfolio management and development services.
- Strengthening of the Enterprise and Solutions team to deliver and maintain IT capability roadmaps, enterprise architecture, standards and appropriate solution designs.

This transformation impacted as follows:

- Benefits achieved to date include:
  - Refinement of governance processes and responsibilities in support of IT projects.
  - Enablement of business strategies and value creation through delivering customer IT portfolios.
  - Establishment of effective applications portfolio management and development services.
- By 2018 Sydney Water IT aims to:
  - Quantify and categorise 100% of information assets.
  - Document 100% of IT systems life cycle and roadmaps.

2.6.3 Achievements to Date

- A contingent workforce review has taken place recently to create efficiencies from external hire.
- Establishment of five streams of focussed activity within the division to underpin the delivery of the strategic plan.
- A five percent efficiency target for expenditure related to use of contingent workforce.
- Internal benchmarking of resource costs to ensure prudent expenditure.
- A shift in capitalisation resourcing of 20%.
- A review of standby and programmed overtime against system and business coverage.
- Adoption of the NSW ICT Services Scheme for the acquisition of information technology services with all appropriate contracts moving across.

These achievements have resulted in:

- Enhanced delivery and drives efficiencies through:
  - Trusted partners and shared outcomes
  - Simplified engagement across divisions
  - Planning and anticipation for the future
  - Collaborative, proactive and capable engagement.
- Prudent expenditure.
- Strengthened initial project planning activities through capitalisation shifts.
- Identification of potential savings around 30% from the overtime review.

2.7 Recommendations - Areas for Further Review

The key findings in the transaction, trend, comparative, process formed an initial set of hypotheses that were then validated with Sydney Water. From this validation process, the following areas that warrant further investigation were categorised:

- Operational Expenditure
- Capital Expenditure
- Procurement

These categories were then prioritised into high, low and medium to determine which would benefit most from a further review.

The areas requiring further review have been listed in order of priority:

- The Website Rebuild Project
- Capital Management Program
- Data Centre
- Agency Hire
- Procurement
- Operating Budgeting Process

The review of existing reforms indicated that Sydney Water is currently undertaking actions to address the some of the areas for further review. This has been acknowledged. However, it is recommended that further investigation is conducted to ensure the changes are implemented to address the potential areas of review.

2.7.1 Operational Expenditure

The following operational expenditure areas warrant further investigation:

- Data Centre FTE - Insourced
- Agency Hire – Upward trend
- Operating Expenditure Budgeting Process – Increased rigour

2.7.1.1 Data Centre FTE – Insourced (Priority – High)

Rationale:

The transaction analysis found that IT Labour was the most significant IT operating expenditure cost bucket at 32% of total IT operating expenditure, with Operational Services (including the data centre) contributing 42% of the cost and 56% of IT headcount.

Proposed Next Steps:

- It is recommended that a strategic review of data centre operations is conducted in order to identify possible efficiencies.

2.7.1.2 Agency Hire – Upward trend (Priority – Medium)

Rationale:

The trend analysis showed agency hire CAGR increased at a rate of 13% between FY11 – FY13.

Proposed Next Steps:

- It is recommended that agency hire is further reviewed in order to identify possible efficiency gains.

2.7.1.3 Operating Expenditure Budgeting Process – Increased Rigour (Priority – Low)

Rationale:

Although limited evidence was provided regarding recent reforms, the operating expenditure budgeting process did not appear to have the same level of rigour as capital expenditure processes.

Proposed Next Steps:

- It is recommended that further reviews be conducted in order to investigate the need for external representation when the "reasonableness" expenditure assessment is conducted.

2.7.2 Capital Expenditure

The following capital expenditure areas warrant further investigation:

- Website Rebuild Project
- Capital Program Management

2.7.2.1 Website Rebuild Project (Priority – High)

Rationale:

The IT capital expenditure transactional analysis and project variance analysis indicated that the Website Rebuild project:

- Accounted for 25% (the highest cost component) of IT Renewals capital expenditure during FY13, and
- Of the completed projects in FY13, had the third highest project variance when compared to the originally approved business case of 13%.

Aging website content and supporting architecture prompted the need for the Website Rebuild Project. Our analyses and review indicates that despite the Website Rebuild Project delivering value from go-live in Q2 2013 through updated content and an improved supporting architecture, there were issues relating to:

- Project governance, as project delivery took nearly three years to complete (i.e. from Business Case approval in Q4 2010 to Public Go-Live in Q2 2013)
- The delivery cost exceeded the originally approved business case by approximately 13%, despite the delivered scope being reduced to exclude self-service transactional capability. The proper governance process was followed to approve the business case variation.
- The business requirement and the associated delivery complexity and cost was not clearly understood, resulting in Procurement going to market on three separate occasions only awarding the external hosting contract on the third occasion. This contributed significantly to the delivery timeframe extension
- The lack of Project Management skills and capabilities in managing website rebuild projects similar in complexity to Sydney Water's requirement. This includes concerns raised regarding proper issue and risk management as well as the management of key project dependencies to ensure delivery of the project critical delivery path.

These observations have also been detailed in the KPMG gate review, Helmsmann lessons learned review and Helmsmann post execution review, initiated by Sydney Water IT.

Recent IT reforms are addressing the issues above through an improved IT Organisation structure, governance process improvements and IT Procurement reforms. It is recommended that these IT reforms are further reviewed upon completion in order to confirm that the reforms have addressed all the issues raised.

Proposed Next Steps:

It is recommended that these IT reforms are further reviewed upon completion in order to confirm that the reforms have addressed all the issues raised, specific to:

- The Governance process
- The Procurement process
- The working relationship between business and IT during requirements definition
- The IT Contractor / Vendor management process

2.7.2.2 Capital Program Management (Priority – Medium)

Rationale:

The trend analysis indicated that capital expenditure variances were consistently high especially with renewal projects. Internal audits of previous large scale projects were also reviewed and revealed that estimation of costs did not encompass enough detail which resulted in inaccurate budgeting.

Sydney Water transformation activities are addressing these estimation issues through the Finance Division Procurement team reforms and the formation of the IT Commercial team which will allow the Procurement division to support and facilitate the project estimation process.

Proposed Next Steps:

- Investigate opportunities to optimise the Allocation; Budgeted and Actual spend on IT Projects.
- Ensure the Procurement reforms are implemented effectively

2.7.3 Procurement (Priority – Medium)

Rationale

The various analyses of key expenditure categories demonstrated that procurement processes were historically a consistent issue. Past completed projects such as the Website Rebuild Project demonstrated the need for procurement to be able to challenge IT procurement requirements and having basic IT skills and expertise. Internal audit reports have also attributed projects running over budget to procurement strategies not being effective enough.

It has been acknowledged that procurement is currently undergoing transformation to address the above mentioned issues such as organisational reforms whereby SME type staff are resourced to provide an experienced view on value contracts.

Proposed next steps

There is potential to review the rigour in which the processes are executed.

3 Communications

3.1 Executive Summary

3.1.1 Context and Background

Third Horizon was engaged by DFS to conduct a "reasonableness" review of Sydney Water's Communications expenditure and governance processes. During the high level review of Sydney Water's Communications expenditure, a high level analysis of key Communications expenditure was conducted. The analysis included: transaction and trends, as well as governance processes. Existing reforms and prioritised areas for further review were also identified.

3.1.2 Key Findings

3.1.2.1 Transaction and Trends Analysis

The top three expenditure categories were Positioning and Online Services, Sponsorship, and Donations which accounted for 60-70% of total Communications expenditure.

The trend analysis identified a CAGR decrease of 6% between FY11 and FY13 with the biggest reductions in Annual Report, and Positioning and Online Services.

3.1.2.2 Process Analysis

The process analysis assessed the governance, rigour and "reasonableness" built into Sydney Water's Communications expenditure processes.

Key observations:

- The operating expenditure budgeting process is the same across the organisation and therefore, IT.
- Governance was evident in budgeting and campaign processes with validation and approvals at various stages.

3.1.2.3 Existing Reforms and Management Action

Sydney Water Communications is currently embarking on a transformation program and the key reforms include a new organisation structure and process optimisation.

3.1.3 Recommendations – Priority Areas for Further Review

The analysis highlighted the following areas for further investigation during a subsequent review:

Low Priority - The transaction, trend and process analyses demonstrated that the Tap Campaign was the top expenditure category within Sydney Water Communications during the review period.

Our analysis and review indicated that the Tap Campaign followed a rigorous governance process with validation and approval obtained from the General Manager of the business unit, Sydney Water Executive team and the Board. External focus groups were also engaged to confirm the best option to facilitate customer engagement.

It is recommended that the "reasonableness" expenditure assessment process of campaigns above an agreed threshold amount, be further reviewed to explore the need for external assessment in future.

Low Priority - The transaction analysis showed that Sponsorships was the second largest spend category and if viewed in conjunction with Donations, would form the largest Communications expenditure category.

An internal review was conducted in 2012 by request of the Board and reported that there were gaps in the governance framework for Sponsorships. Our high-level analysis and review has indicated that the concerns raised by the internal audit team have since been addressed and successfully implemented through new policies and processes that are now rigorously applied.

It is recommended that the "reasonableness" expenditure assessment process of Sponsorships (and Donations) above an agreed threshold amount, be further reviewed to explore the need for external assessment in future.

3.2 Transaction and Trend Analysis

A transaction and trend analysis on Sydney Water's financial data was conducted to identify:

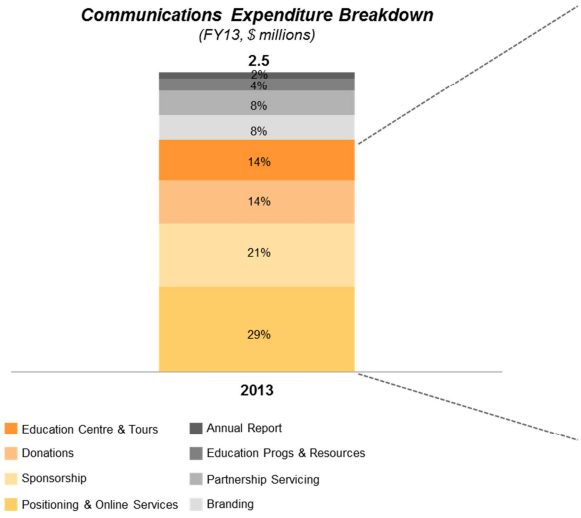
- The major expenditure cost buckets and the associated major expenditure components
- The proportion of the major cost buckets in relation to the total Communications expenditure.
- The underlying trends that drive the major expenditure buckets.

The two areas of analysis were combined to assess whether there was a relationship between the two areas. The analysis illustrated that the major expenditure buckets were correlated with the past and future trends despite large variances between the actual and budgeted spend figures.

The review was conducted through analysis of financial data and validated through interviews with key stakeholders.

3.2.1 Transaction Analysis

The transaction analysis was conducted to ascertain the major operating expenditure buckets and the underlying components. The figure below details the breakdown of the key expenditure components:



Category	Component	% of Category
Donations ($0.36m)	Streamwatch	59%
	Financial Hardship Preventative Programs	26%
	Schizophrenia Fellowship	5%
	Other	10%
Sponsorship ($0.53m)	Taronga Zoo	33%
	Keep Australia Beautiful	20%
	Powerhouse Museum	9%
	Other	39%
Positioning & Online Services ($0.73m)	Tap Campaign	55%
	125 Years	8%
	Social Media	12%
	Other	25%

Figure 17: Transaction Analysis: Communications Expenditure

Key Observations:

- In FY13, there was a total spend of $2.5 million for Communications activities.
- The top three operational expenditure buckets attributed to 60-70% of the total Communications spend.
- These buckets were Positioning and Online Services (29%), Sponsorship (21%), and Donations (14%).
- The biggest single activity of spend was the Tap campaign and it contributed to 55% of the Positioning and Online Services expenditure.

3.2.2 Trend Analysis

A trend analysis on Sydney Water's financial data was conducted to determine any consistent expenditure patterns during the period FY11 until FY16. The trend analysis consisted of three components:

- Communications Expenditure (FY11 – FY16)
- Communications Expenditure Actual vs. Budget
- Communications Budget (FY11 – FY16)

3.2.2.1 *Operational Expenditure (FY11 – FY16)*

The Communications expenditure trend for the period FY11 to FY16 was reviewed to identify the growth rate of the total expenditure by component. This has been illustrated in the figure below:

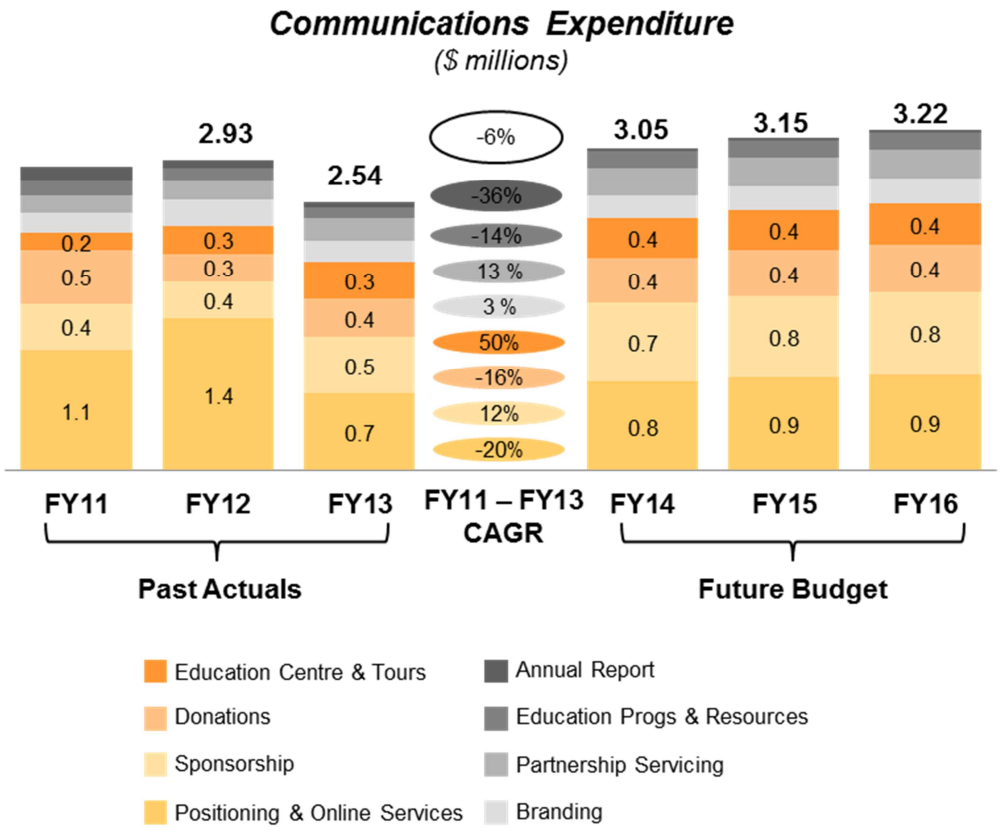


Figure 18: Trend Analysis: Communications Expenditure

Key Observations

- The Communications expenditure trend for FY11 to FY13 resulted in a declining CAGR of 6%.
- The buckets with the largest expenditure reduction were Annual Report, and Positioning and Online Services components which had decreasing CAGR's of 36% and 20% respectively during the same period.
- Further analysis of Positioning and Online Services indicated that it had the most significant movement in actual figures between FY12 and FY13. This was a result of an active decision by management to focus on transforming the strategic direction and temporarily decreasing activity.
- The most significant growth took place in Education Centre and Tours, which had a CAGR of 50%. This increase was mainly due to the employment of two educators at the Water Recycling Centre.

3.2.2.2 *Communications Expenditure Comparison (Actual vs. Budget)*

The actual expenditure compared to the budgeted expenditure for the period FY11 to FY13 was assessed to determine budgeting accuracy or variations during this period as illustrated below:

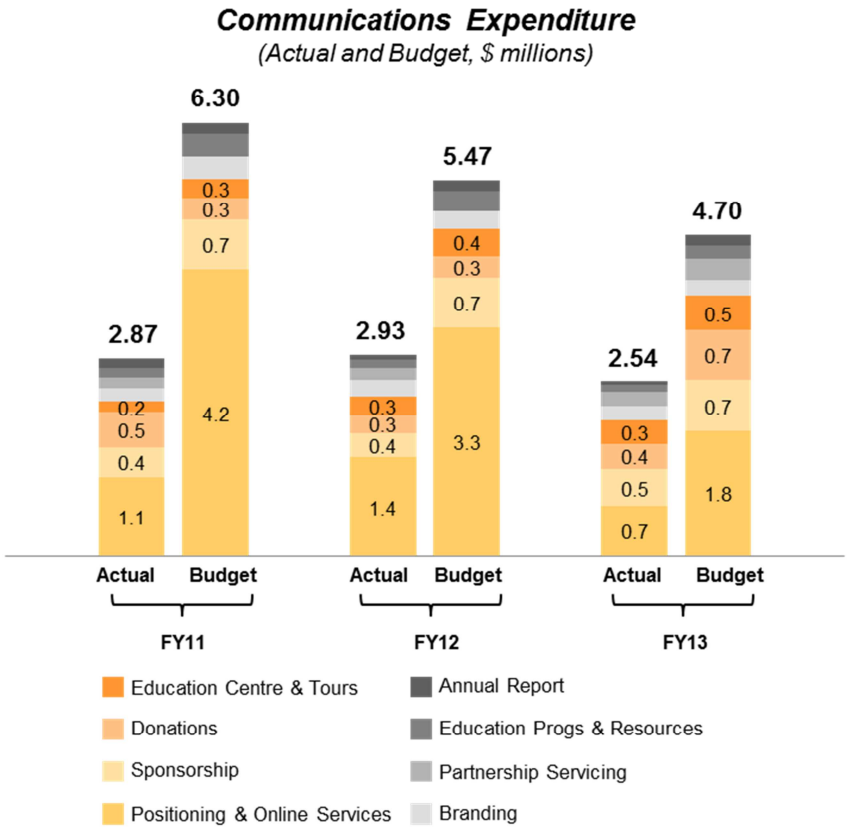


Figure 19: Trend Analysis – Communications Expenditure (Actual vs. Budget)

Key Observations:

- The analysis revealed that the actual expenditure had been consistently under budget by approximately 50%.
- The key driver for spend variation was Positioning and Online services which had been consistently budgeted for almost triple the actual spend.
- The underspend in Positioning and Online services was attributed to water usage remaining constant despite drought restrictions being lifted in FY11, the provision for mass media advertising which did not proceed in FY12, and approval of half the Tap campaign expenditure by the Board in FY13.

3.2.2.3 Communications Budgeting Trends

The Communications expenditure budget trends were analysed to assess whether the budgeting trend was aligned to the trend for actual expenditure for the period FY11 – FY16 as per the figure below:

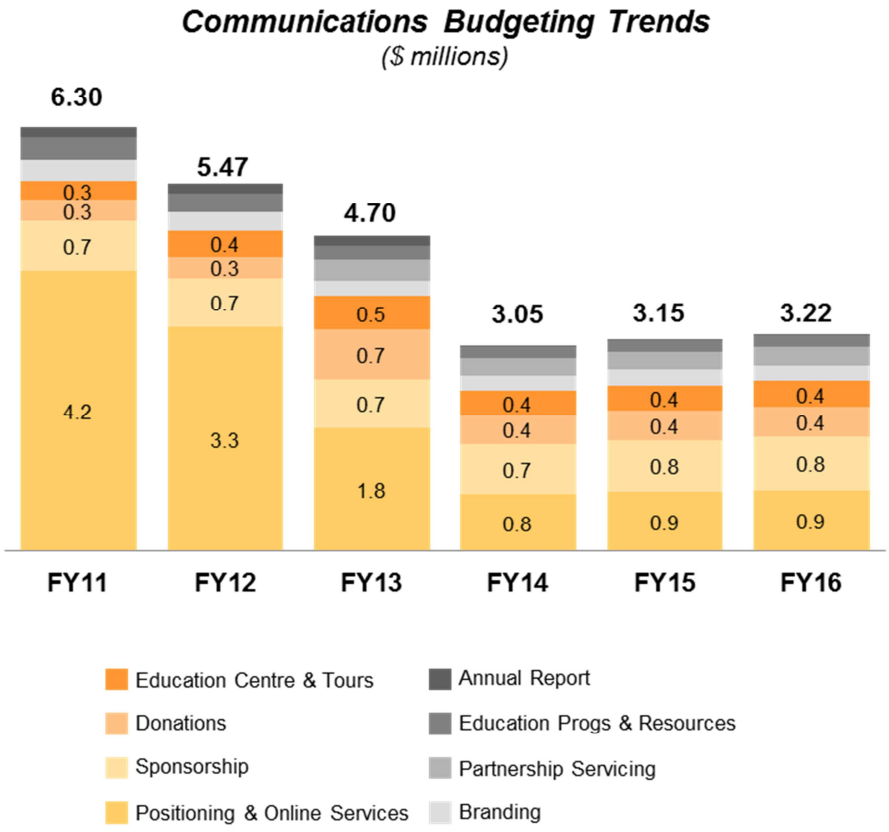


Figure 20: Trend Analysis – Communications Budgeting

Key Observations:

- Figure 19 demonstrated that the actual expenditure was consistently below the budget. Figure 20 shows that it is evident that the budget was also decreasing to align with the actual spend patterns.
- The budget trend illustrated that activities were previously forecasted to drop significantly but are expected to steady in the future.
- The decline in budgeted spend between FY11 – FY13 was mainly from Positioning and Online Services.

3.3 Process Analysis

The purpose of the process analysis was to review the governance, rigour and "reasonableness" built into Sydney Water's Communications expenditure processes.

The following processes were reviewed:

- Budgeting and forecasting process
- Campaign process

3.3.1 High-level Operating Expenditure Process

Communications follows a similar operating expenditure budgeting process to the process described for IT in Section 1.5.1 as it is an organisation wide procedure. This process has been included again in the figure below:

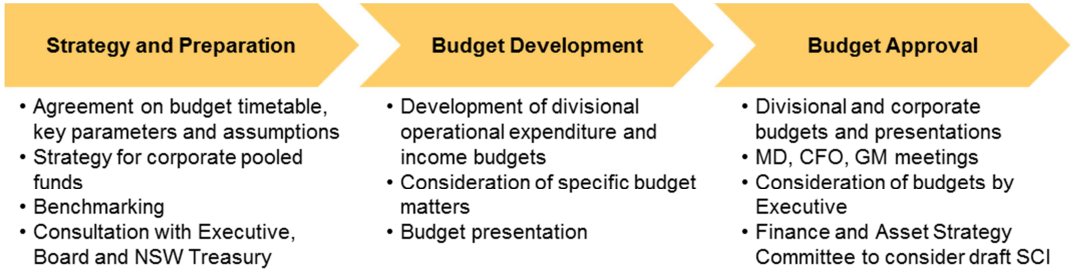


Figure 21: High-level Operating Expenditure Budgeting Process

Areas for Further Review

The Communications expenditure budget was consistently underspent from FY11 to FY13. There is potential to review how much of this underspend can be attributed to the unspent advertising budget and to assess what other factors may have caused such a variance.

3.3.2 Campaign Process

The campaign process is an example of the governance and rigour applied to expenditure for Communications projects. The process accounts for customer value, corporate strategy and seeks approvals from various levels of the organisation and agency including Managers, Executives, the Managing Director, the Board and the Minister's Office.

The figure below depicts the high-level Campaign processes, including:

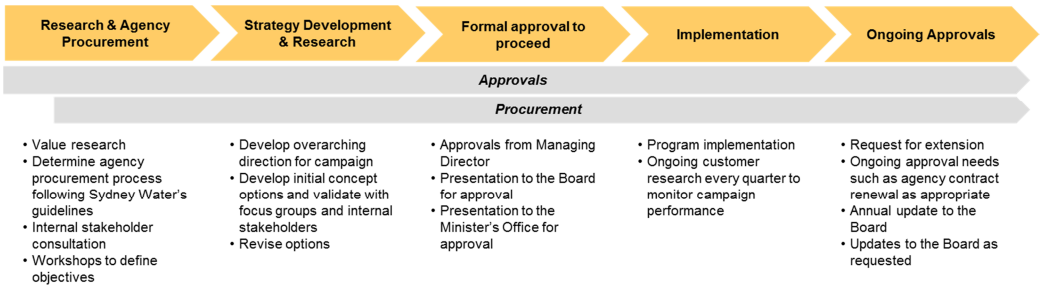


Figure 22: High-level Communications Campaign Process

Key observations:

- Governance was evident in the budgeting and campaign processes with validation from Senior Management, Executive team and Board members at key stage gates.
- Approvals underlined the campaign process from beginning to end from various stakeholders.
- Approval was also pursued from the Minister's Office on major expenditure components, such as campaigns.
- Organisation-wide procurement processes were strictly adhered to.

Areas for further review

Although campaigns are infrequently embarked upon, limited documentation suggested there is potential for inconsistency across future campaigns. A lack of independent "reasonableness" expenditure assessment indicated there was a future possibility that activities may be approved based on the assumption that reasonableness has already been tested.

The nature of the high level review also allows room for a more thorough assessment of the level of detail provided to the Minister's office for approval.

3.4 Existing Reforms and Management Action

Sydney Water Communications is currently transforming:

- The Communications Organisation Structure
- The Communications Processes

3.4.1 The Communications Organisation Structure

The Communications department is currently in the process of a structural transformation. In March 2013, a new manager for the team was appointed to assist with supporting Sydney Water's vision and corporate strategy. An integral part of this role was introducing a new "Corporate Affairs" team with a new proposed structure.

The new structures were announced late August 2013 to align its function with the Corporate Strategy.

These reforms have resulted in:

- Centralisation of functions to ensure optimal utilisation of staff and stronger relationships with the business and key stakeholders.
- Clearer roles and responsibilities within Communications.
- Active support and contribution to Sydney Water's vision and corporate strategy

3.4.2 The Communications Processes

To align with the new organisation structure, changes to approval processes to ensure a more proactive approach to external stakeholder engagement have also been embarked upon.

The processes aim to:

- Improve the preparation and approvals for media and external communications.
- Assign responsibilities and accountabilities for stakeholder relationship management.
- Develop performance measures and data analysis.

These reforms have resulted in:

- More efficient mitigation of reputational risk.
- More effective management community relations.
- Increased strategic, forward thinking and proactive rather than reactive interaction with internal and external stakeholders.
- Improved measurement and evaluation of performance.

3.5 Areas for further investigation

The analysis conducted highlighted areas that had potential for further investigation during a subsequent review:

- Tap Campaign
- Sponsorships

3.5.1 Tap Campaign *(Priority - Low)*

Rationale:

The transaction, trend and process analyses demonstrated that the Tap Campaign was the top expenditure category within Sydney Water Communications during the review period.

The planning for a new campaign began in 2010 after feedback regarding the drought campaign indicated that there was a demand for more customer engagement. With the assistance of a media agency and inspiration from similar initiatives such as London on Tap (a collaboration between the UK's biggest water company, Thames Water, and the Mayor of London), a “Tap” Campaign strategy was created.

In line with Sydney Water’s strategy to drive greater stakeholder engagement, the Tap Campaign aimed to improve customer engagement and perception through the use of social media and generating awareness through the role of cafes. The Tap Campaign has achieved the following results since inception in September 2011:

- According to a Consumer Sentiment Monitoring report[1] (released quarterly), consumers that recognise the Tap Campaign gave Sydney Water a score of 7 out of 10 for corporate reputation, compared to 5.9 out of 10 from non-Tap Campaign recognisers.
- 70% of Sydney Water customers say they value the quality of tap water.
- An online community that has grown to 20,000 Facebook followers and more than 700 twitter followers.
- More than 5,800 people have taking the tap pledge since it launched in June 2013.
- 400 cafes across Sydney interested in promoting sustainable drinking water.

Our analysis and review indicated the Tap Campaign followed a rigorous governance process with validation and approval obtained from internal stakeholders and the General Manager of the business unit, Sydney Water Executive team and the Board. External focus groups were also engaged to confirm the best option to facilitate customer engagement.

[1] Source - Consumer Sentiment Monitor, a market research report on water efficiency, water restrictions and communications tracking (June 2013), by Inside Story

Proposed next steps

Despite the findings that the appropriate rigour and governance processes were applied, it is recommended that the “reasonableness” expenditure assessment process of campaigns above an agreed threshold amount, be further reviewed to explore the need for external assessment in future.

3.5.2 Sponsorship *(Priority - Low)*

Rationale:

The transaction analysis showed that Sponsorships was the second largest spend category and if viewed in conjunction with Donations, would form the largest Communications expenditure category.

An internal review was conducted in 2012 by request of the Board and reported that there were gaps in the governance framework for Sponsorships as activities (Keep Australia Beautiful) were being approved despite non-compliance with sponsorship policies. The internal audit committee issued several recommendations such as approvals by the Board, defining when Chairman and Board should approve or endorse sponsorships and the structure of communications to the Board.

Our high-level analysis and review has indicated that the concerns raised by the internal audit team have since been addressed and successfully implemented through new policies and processes that are now rigorously applied.

Proposed next steps

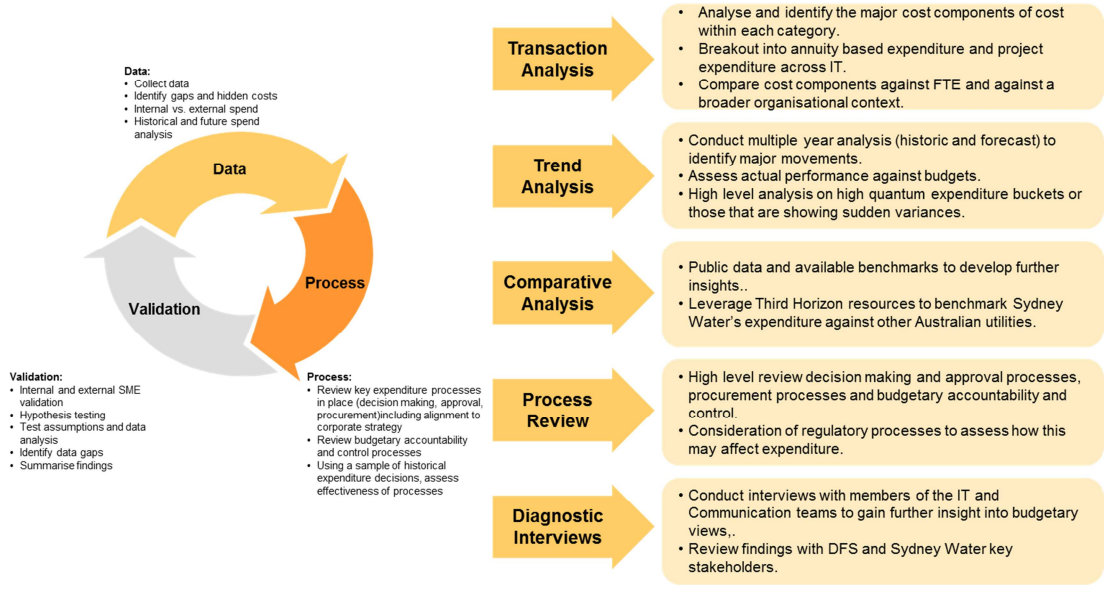
It is recommended that the "reasonableness" expenditure assessment process of Sponsorships (and Donations) above an agreed threshold amount, be further reviewed to explore the need for external assessment in future.

4 Appendix

4.1 Appendix A: Sydney Water IT and Communications Expenditure Review Development

The Department of Finance and Services engaged Third Horizon to conduct an external strategic review of Sydney Water's actual expenditure for the period 1 July 2012 to 30 June 2013, and budgeted/forecast expenditure for the 3 years ending 30 June 2016.

The diagram below outlines the Methodology and Approach used during this expenditure review:



The following were the key steps taken during our approach:

Data Analysis

- Comparison of actual FY13 expenditure vs. forecasted expenditure
- Breakout into annuity based expenditure and project expenditure across both IT and Communications
- Use relevant and available benchmarks to deliver further insights
- More detailed analysis on high quantum expenditure buckets or those that are showing sudden variances e.g.:
  - IT capital expenditure forecast is 70% to 132% above FY13 actual
  - Sponsorships forecast is 39% to 46% above FY13 actual

Process documentation

- Review decision making and approval processes, procurement processes and budgetary accountability and control.

- End to end documentation review including robustness of idea generation and stage gating, prioritisation, sign off, delivery and post implementation reviews.

Validation

- Review findings with DFS and SW key stakeholders.
- Test insights with Third Horizon SMEs.