

Mr J Tripodi MP  
Chairman  
Public Accounts Committee  
Legislative Assembly  
Parliament House  
Macquarie Street  
SYDNEY NSW 2000

Dear Mr Tripodi

I refer to your letter of 9 July regarding matters arising from the Auditor-General's Report of 2001 to Parliament.

The Auditor-General's report to parliament raised the following issues of concern to be addressed by the SCA's management:

***Liquidity***

*There was a decrease of \$16.6 million in the Authority's cash during the year. At 30 June 2001 the Authority's current liabilities exceeded current assets by \$17.0 million (\$4.4 million in 1999-2000) indicating SCA may encounter short-term liquidity difficulties. The Authority obtained a loan of \$10.0 million in August 2001 and has approval for additional loans of \$20.0 million to fund its operations and capital expenditure. The Authority needs to improve its cash flow analysis to more effectively manage its future cash requirements.*

*Last year we reported on the critical need for the Authority to improve its fundamental accounting procedures. This included monthly reconciliations of investments and borrowings, clearing of suspense accounts, asset recording and reconciliation, recording of prepayments and employee entitlements.*

*We noted some improvement towards the end of the year, with the appointment of a new Finance Manager in May 2001. However, significant deficiencies remained in accounting processes and internal controls.*

*Significant findings included:*

- ◆ absence of regular reconciliation of account balances with subsidiary records, errors in recording transactions and incorrect classification of expenditure*
- ◆ inadequate security over the financial system, an incomplete business continuity plan and poor controls over anti-virus protection*

- ◆ *the recording and reconciliation of asset records requires improvement, particularly Warragamba Dam Spillway*
- ◆ *authorisation and documentation of withdrawals from the investment account remained unsatisfactory*
- ◆ *expenditure incurred in excess of the authorisation limits set by the Board of the Authority*
- ◆ *the membership of the Audit Committee has recently changed. The audit committee requires greater accounting/financial experience.*

The SCA's Chief Executive and Board have actively addressed the issues raised by the Auditor-General.

The SCA Board has two standing committee's that focus respectively on Corporate Governance and Audit.

In March 2002 I appointed new members to the SCA Board. In response to concerns raised that the Audit Committee requires greater accounting and financial experience, I appointed Mr Robert Corben to the Board. Mr Corben holds CPA (Certified Practising Accountant) status and is a fellow of the Australian Society of CPAs, is a Registered Company Auditor and has been in practice for some 27 years. He has been appointed to the Audit Committee. The Audit Committee is made up of three Board members and the Chief Executive. Representatives of the Auditor-General's Office and the SCA's Internal Auditors (Internal Audit Bureau) together with the SCA's Chief Financial Officer as invitees attend each Audit Committee meeting.

The Auditor-General raised the issue of liquidity. The SCA has developed a cash flow monitoring system to actively monitor its cash requirements. During the 2001/02 financial year, with careful monitoring of cash requirements, the SCA was required to borrow on only two occasions. These borrowings were short term via the use of the "Come and Go" facility (similar to an overdraft facility) with TCorp. Both loans were repaid within the year. As capital expenditure did not meet budget projections, further long term loans were not required during the 2001/02 year and all expenditure was met through cash reserves.

The SCA operates in a unique commercial environment in that debtors (predominantly Sydney Water which represents 98.6% of sales revenue) remain outstanding for a maximum of 21 days however, dependent upon the date of the transaction, the SCA may enjoy up to 58 days credit from its creditors. This tends to distort traditional working capital analysis.

The development of a new integrated business plan for the period 2002-2007 was undertaken in early 2002. The Board approved the business plan and the Plan was used as the basis for more focused and strategic capital and operational expenditure budgeting within the SCA. To meet the cash requirements of the capital budget, a \$15M long term loan was required in July 2002.

The Audit Committee focuses on internal control issues, accounting policies principles and authorisations, and has pro-actively monitored progress on all issues identified by the Auditor-General as well as undertaking an extensive internal audit program throughout the 2001/02 year.

The following Internal Audit program was undertaken by the Internal Audit Bureau. Audits highlighted in "bold" text have expressly addressed the internal control issues raised within the Auditor-General's Report to Parliament 2001 Volume 7:

- ◆ **31/12/01 Petty Cash/Corporate Cards**
- ◆ **31/1/02 Procurement Review**
- ◆ **28/2/02 Financial Statements - Review System Enhancements**
- ◆ 31/3/02 Fraud/Corruption Risk Assessment
- ◆ **31/3/02 Accounts Payable**
- ◆ **31/3/02 Payroll processing**
- ◆ **30/4/02 Revenue Collections**
- ◆ 30/4/02 Instrument Control & Telemetry
- ◆ **30/4/02 Payroll**
- ◆ 30/4/02 Maintenance Management System (Maximo)
- ◆ **30/4/02 Sundry Debtors**
- ◆ 31/5/02 Maintenance Management System
- ◆ **31/5/02 Fixed Assets**
- ◆ **30/6/02 Purchasing**
- ◆ **30/6/02 Wide Area Network**
- ◆ **30/6/02 Tax Compliance**
- ◆ 30/6/02 Firewall
- ◆ 30/6/02 Spherion Payroll Contract Performance Review against Outsourcing Contract

Further, a major project has commenced regarding integrating current manual and computerised finance and finance related business systems. This project will integrate the largely manual systems shown at **TAB A** to the proposed electronic systems shown at **TAB B**.

This project is currently the subject of a tender evaluation that is expected to be finalised by the end of August 2002 and will take approximately 9 months to complete. The project will involve all staff within the SCA and will incorporate a major change management process including 3 months "hands on" training for all staff with a 12 month help desk facility available from the date of completion.

All processes involved in this project have been identified and mapped by way of flow charts throughout the SCA. A finance manual has been developed in "draft form" to be activated when the integrated systems are in place. Both the Audit Committee and the Board have approved this project and acknowledge that the completed project will address the major internal control deficiencies identified by the Auditor-General.

In addition and directly related to the Auditor-General's comments, the following actions were taken as a matter of priority:

1. Finance staff have been trained in the appropriate methods to be used to reconcile accounts on a monthly basis. These reconciliations including clearing accounts, investments and borrowings have been undertaken monthly and reviewed by appropriately qualified senior finance staff.
2. A more professional standard has been required by all finance processing staff and these staff have been supported by way of increased training in accordance with their professional requirements.
3. The financial system was completely reviewed and new security levels installed by way of position description, ensuring that appropriate segregation of duties were in place throughout electronic transactions within the system.
4. The business continuity plan for the SUN financial system was developed.
5. An anti-virus system now protects all computers within the SCA.
6. The Warragamba Spillway project was fully reconciled to ensure that the project manager's monthly report on the project agreed with the transactions recorded in the general ledger. Procedures have been put in place to undertake this reconciliation on a monthly basis.
7. Procedures were developed and implemented to ensure that only approved transactions occurred within both the Investment and operating accounts.
8. The SCA's financial authorisations were completely reviewed and approved by the Minister and the Chief Executive. Training for Senior Managers and relevant staff in the use of financial authorisations and the commitment process as per Section 12 of the Public Finance and Audit Act 1983 has also been undertaken.
9. A full review of SCA prepayments occurred resulting in the identification of all prepayments at the time of the actual transaction.
10. A full review of SCA payroll function was undertaken with the implementation of the new payroll outsourcing contract. Coding of both the payroll costs and entitlements was reviewed and procedures put in place to record these charges directly into the general ledger.

To ensure that appropriate internal controls are maintained through the interim period when the integration project is being implemented, the SCA's Manager Finance & Procurement personally reviews every invoice to be paid on a weekly basis. This is a mitigating control to satisfy the requirements of section 13 of the Public Finance and Audit Act 1983, until such time as the project is completed. This review is acknowledged by the internal and external auditors as sufficient to maintain an appropriate standard of internal control until the project is completed.

It is clear that the Chief Executive, the Board, and the Authority's Executive have addressed these matters as priorities in the 2001/02 financial year. The development of a comprehensive business plan, implementation of clear processes and procedures and training have been the major achievements during the year. With such improvements in strategic direction and infrastructure the SCA has built a very strong base upon which to build its future.

Should you require any further information on this matter please contact Mr Graeme Head, Chief Executive Sydney Catchment Authority, on telephone 4725 2125.

Yours sincerely

**Bob Debus**