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**Queensland Competition Authority**

**Assessment of SunWater's  
Administration Costs**

24 January 2011

Final

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## Disclaimer

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## Executive Summary

The Queensland Competition Authority (QCA) has been directed by the Queensland Premier and the Treasurer (the Ministers) to develop irrigation prices to apply to 22 of SunWater's Water Supply Schemes (WSS) from 1 July 2011 to 30 June 2016. The Ministerial Direction is outlined in the Minister's Referral Notice (see Appendix A) and requires that bulk water supply and irrigation channel prices be set so as to provide a revenue stream that allows SunWater to recover:

- its efficient operational, maintenance and administrative costs;
- its expenditure on renewing and rehabilitation existing assets, whether through a renewals annuity or a regulatory depreciation allowance;
- a rate of return on assets valued at 1 July 2011 (the initial regulated asset base – RAB); and
- a return on prudent capital expenditure to augment existing assets or construct new assets.

Saha International (SAHA) has been engaged by the QCA to complete an assessment of SunWater's administrative costs for the purpose of improving the QCA's understanding of SunWater's current cost base. SAHA have also been requested to review the organisational structure in place to support the delivery of bulk water and irrigational distribution services to SunWater's irrigation customers across all 22 of the Water Supply Scheme's (WSS's).

The QCA's Terms of Reference for the SunWater administrative cost review require SAHA to provide a report on:

- a) the nature of SunWater's business and the current business structure used to provide services to regional water supply schemes;
- b) the services provided by head office and regional offices to customers (and particularly irrigation schemes/ irrigators) and any changes to those services since the last price review;
- c) the historical development of SunWater (since the last price review), including trends in organisational structure, administration functions, and staffing levels including previous studies of SunWater's functions and any restructuring plans;
- d) historical trends in administrative expenditure and cost allocation broken down into head office and regional office components, including:
  - i. major cost categories and their key cost drivers (and how they tied into SunWater's business objectives);
  - ii. observable trends in the major administration cost categories; and
  - iii. SunWater's policies and procedures for classifying and allocating administration costs;
- e) opportunities for potential efficiency gains in SunWater's administrative costs and their allocation having regard to:
  - i. adjustments to the business structure for irrigation service delivery;
  - ii. key functions of head office and regional business centres; and

- iii. adjustments to current service arrangements at the scheme level;
- f) Identified potential efficiency gains should be supported by reference to appropriate comparators, good industry practice and high level benchmarking data, where appropriate; and
- g) how the Authority could assess the potential for efficiency gains or economies of scale once SunWater provides its projected expenditure.

This engagement has required a high degree of interaction with SunWater personnel. 15 interviews with senior management and staff were undertaken to understand the key activities of the business. Detailed historical cost data was also provided by SunWater to assist in developing our understanding of the current cost structure of the business and key historical developments regarding the way in which administrative functions have been delivered.

This report represents SAHA's findings from the analysis of cost and operational data provided. A draft version of this document was provided to SunWater to review and correct any factual omissions prior to submission of the final draft to the QCA. Subsequent feedback has been included in the final draft of this document.

The main focus of this report is on documenting SunWater's current cost and operational structure and recent developments since the previous price setting process. We have identified high level efficiency opportunities however additional analysis will be required to finalise the assessment of these cost efficiencies once draft NSP's are submitted by SunWater.

SunWater has undergone organisational changes recently that are projected to result in significant operational cost savings to the business (estimated by SunWater to be in the range of \$10million per annum). Most cost savings will result from labour cost reductions achieved through the consolidation of staff levels (estimated savings equivalent to 94.6 Full Time Equivalents (FTE's), and non labour initiatives including vehicle, IT and other cost efficiencies)<sup>1</sup>. We would expect that a significant portion of the identified cost savings will be reflected in SunWater's cost projections for 2011, with all savings in place by June 2012.

The move to a centralised delivery model should result in a more efficient cost structure, however there is a risk that centralised delivery of services will result in a lower level of service. SunWater should continue to monitor the ongoing delivery of services under the new organisational structure.

In addition to the anticipated savings from the recent organisational changes, SAHA have identified a number of potential efficiency improvement opportunities. It should be noted that these are indicative only and based on data collected from SunWater with reference to our previous experience and professional judgement:

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<sup>1</sup> Per data provided via email from N Tran, SunWater, to P McCarthy, SAHA dated 29/9/10 titled *FTE pre & post SLFI*

	Function	Opportunity	Estimated Value \$'000 p.a.	Percentage of 2009/10 costs <sup>2</sup>
1	HSEQ	Consolidated headcount	210	9.8%
2	Finance	Potential for future headcount consolidation	For ongoing review	N/A
3	ICT	System improvement and consolidated headcount	460	5.7%
4	Procurement	Potential for future headcount consolidation	For ongoing review	N/A
5	Legal & Property	Consolidated headcount	110 - 220	6.9% to 13.8%
	Total (Administration and Indirect Functions)		780 – 890 (plus ongoing)	1.9% – 2.1%

We understand that the QCA intends to assess efficiency opportunities further once SunWater have submitted their draft irrigation price submission. SAHA recommends the following approach, methodologies and tools to evaluate the potential for efficiency gains or economies of scale in more detail once the NSP's are submitted.

- 1. Output Based Assessment:** A bottom-up approach to assess the true need for resources (labour and other) to deliver the activities and subsequent output, by function. This style of analysis takes into account the specific nature of the environment in which a business function operates
- 2. Comparison against Actuals:** SunWater cost projections should be assessed with reference to current actual costs and known efficiency improvements. SunWater should be asked to provide justification for any variations from actual. In addition SunWater should justify a cost structure different to comparable business metrics.

Finally, we have also identified a number of additional issues that we think should be addressed as part of the irrigation pricing review. These include:

- 1. Compliance Requirements:** There is a range of compliance requirements placed on SunWater's business, many of which are required of the business' Resource Operating Licences (ROL's), others required by DERM or the Water Supply Act 2000. These reporting and compliance requirements utilise significant resources and are, in most cases, ultimately passed onto customers. While out of scope of this review we believe a review of the compliance and reporting requirements of SunWater should be undertaken to understand the suitability of these charges being passed onto customers, specifically irrigators, or if there are other more suitable cost recovery mechanisms.
- 2. Asset Management Services:** In this review we have not completed a detailed review of the asset management function. Although classified as an indirect cost, the need for asset management services is largely determined by the operations of the business. We recommend a more detailed asset management review be undertaken in parallel with proposed assessments of the capital and operations and maintenance costs.

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<sup>2</sup> Total operating costs by function before administration cost transfer. Note that an annualised operating cost amount based on costs for January to June 2010 has been used as the total operating costs amount. The reason for this is explained in section 4.3.1 below



## 1. ABBREVIATIONS

<b>BAS</b>	Business Activity Statement
<b>CSS</b>	Customer Service Standard
<b>FTE</b>	Full Time Equivalent
<b>GOC</b>	Government Owned Corporation
<b>HSEQ</b>	Health, Safety, Environment and Quality
<b>HUF</b>	Headworks Utilisation Factor
<b>ID</b>	Infrastructure Development
<b>IM</b>	Infrastructure Management
<b>IROL</b>	Interim Resource Operating Licence
<b>LCR</b>	(Standard) Labour Cost Rate
<b>NSP</b>	Network Service Plan
<b>O&amp;M</b>	Operations and Maintenance
<b>OCR</b>	(Standard) Overhead Recovery Rate
<b>QCA</b>	Queensland Competition Authority
<b>QGCPO</b>	Queensland Government Chief Procurement Office
<b>RAB</b>	Regulated Asset Base
<b>ROL</b>	Resource Operating Licence
<b>ROP</b>	Resource Operation Plan
<b>SAHA</b>	SAHA International
<b>SLFI</b>	Smarter, Lighter, Faster Initiative
<b>SSR</b>	Strategy and Stakeholder Relations
<b>SWIMS</b>	SunWater Water Information Management System
<b>Tier 1</b>	State-wide Irrigation Pricing Working Group
<b>TOR</b>	Terms of Reference
<b>WAE</b>	Water Access Entitlement
<b>WHS</b>	Workplace Health and Safety
<b>WoL</b>	Whole of Life
<b>WSS</b>	Water Supply Scheme

## 2. INTRODUCTION

### 2.1 Background to the Price Setting Review

The Queensland Competition Authority (QCA) has been directed by the Queensland Premier and the Treasurer (the Ministers) to develop irrigation prices to apply to 22 of SunWater's Water Supply Schemes (WSS) from 1 July 2011 to 30 June 2016. The Ministerial Direction is outlined in the Minister's Referral Notice (see Appendix A) and requires that bulk water supply and irrigation channel prices be set so as to provide a revenue stream that allows SunWater to recover:

- its efficient operational, maintenance and administrative costs;
- its expenditure on renewing and rehabilitation existing assets, whether through a renewals annuity or a regulatory depreciation allowance;
- a rate of return on assets valued at 1 July 2011 (the initial regulated asset base – RAB); and
- a return on prudent capital expenditure to augment existing assets or construct new assets

This is the first time the QCA has been directed to perform a price review of SunWater's business; the previous irrigation price path (2006-2011) was agreed through a consultative process between SunWater and a representative group of SunWater's stakeholders (called the State-wide Irrigation Pricing Working Group or Tier 1) in 2005.

The 2011-2016 irrigation price setting process has commenced and at the time of this report being finalised, SunWater have indicated their draft Network Service Plans (NSP's) will be submitted to the QCA around late September or early October 2010.

### 2.2 Terms of Reference & Approach

The QCA have sought external, expert advice from Saha International (SAHA) to establish a basis for an assessment of the efficiency of SunWater's administrative costs and the reasonableness of SunWater's allocation of these costs across the business.

For purposes of clarity administrative costs are defined in the QCA's Terms of Reference (ToR) as any cost that is not directly related to the operation of the irrigation schemes. This includes non-operational costs from both Brisbane head office and regional offices. This definition will be adopted throughout this document.

As SunWater do not directly employ an administrative cost category we have included in scope all costs that SunWater classify as either 'overhead' or 'indirect', as each of these cost categories are spread across either the entire business (in the case of Brisbane overheads) or selected, relevant parts of the business (in the case of indirect costs and local overheads). We have also addressed cost centres that are classified as 'neither'. These are used by SunWater to recover administrative and indirect costs from the operational parts of the business, but which SunWater do not want credited to the administrative functions in order to drive certain behaviours by functional managers. A more detailed explanation of the SunWater cost management and allocation methodology is outlined in Section 4 below.

## Terms of Reference

The QCA's Terms of Reference for the SunWater administrative cost review require SAHA to provide a report on:

- a) the nature of SunWater's business and the current business structure used to provide services to regional water supply schemes;
- b) the services provided by head office and regional offices to customers (and particularly irrigation schemes/ irrigators) and any changes to those services since the last price review;
- c) the historical development of SunWater (since the last price review), including trends in organisational structure, administration functions, and staffing levels including previous studies of SunWater's functions and any restructuring plans;
- d) historical trends in administrative expenditure and cost allocation broken down into head office and regional office components, including:
  - i. major cost categories and their key cost drivers (and how they tied into SunWater's business objectives);
  - ii. observable trends in the major administration cost categories; and
  - iii. SunWater's policies and procedures for classifying and allocating administration costs;
- e) opportunities for potential efficiency gains in SunWater's administrative costs and their allocation having regard to:
  - i. adjustments to the business structure for irrigation service delivery;
  - ii. key functions of head office and regional business centres; and
  - iii. adjustments to current service arrangements at the scheme level;

Identified potential efficiency gains should be supported by reference to appropriate comparators, good industry practice and high level benchmarking data, where appropriate; and

- f) how the Authority could assess the potential for efficiency gains or economies of scale once SunWater provides its projected expenditure.

## SAHA Approach

SAHA understand that the findings from this review will inform the QCA's assessment of SunWater's NSP submissions. While the focus of this engagement is on understanding SunWater's current cost and service structure as well as historical developments since the previous price review, we have also identified potential high level opportunities for efficiency improvement and outline a methodology for how to assess the potential for efficiency gains once SunWater's projected expenditure has been received. These findings are suitable to form the basis for a more detailed assessment (as planned by the QCA).

In completing the engagement we have:

- Worked closely with senior personnel of SunWater to understand the current organisation structure and service delivery model, including recent organisational changes to centralise regional business centres

and to create engineering centres of excellence within Brisbane and regional centres in Clare, Eton, Bundaberg and Toowoomba for asset management purposes;

- Completed an extensive interview program to understand key activities in each administrative business function. Interviews were held with 15 senior management and staff as listed in Appendix B;
- Performed a detailed assessment of SunWater's cost allocation and staff utilisation management methodology to understand the process for transferring overhead and indirect costs between profit and cost centres and the quantum of these costs. This report presents current overhead and indirect costs within each WSS and Service Contract (30 Service Contracts of relevance to irrigators);
- Reviewed historical cost trends since 2007 financial year to identify major changes to SunWater's organisational structure and Full Time Equivalent (FTE) numbers including documentation of any efficiency gains delivered during this period. Specifically we reviewed the efficiency opportunities identified in the 2005 Indec Report<sup>3</sup> and identified if initiatives had been implemented to capture these efficiency gains;
- Identified potential efficiency improvements for further investigation on submission of SunWater's NSP's by Service Contract; and
- Presented options for assessing potential efficiency gains once NSP's are submitted.

In completing this project SAHA have not assessed SunWater's 2011-2016 draft NSP's. These are still in development (at the time this report was drafted) and we understand the QCA will complete this assessment once SunWater have formally submitted NSP's to the QCA. Therefore SAHA have not performed analysis on how irrigation price paths have been developed, nor how costs impact on this price setting process. We have not reviewed SunWater's pricing model. We have however reviewed the current business costs, the allocation of these costs to Service Contracts and made an assessment on potential future efficiency gains to be assessed against SunWater's projected expenditure, once submitted.

In undertaking our assessment of SunWater's costs we have used our previous experience across both utilities and a broader range of companies to make a determination of reasonableness. We note that due to the nature of SunWater's business and a lack of normalised, direct comparables, the benchmark assessment is indicative only (as with most benchmarking exercises). Therefore, the results of this exercise should be used as one of many data points in assessing the efficiency or otherwise of SunWater's administrative cost structure. However, where potential opportunities for efficiency improvement have been identified, we believe SunWater should provide the basis for those costs that are above range as part of the NSP review process.

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<sup>3</sup> *Productivity and Cost Efficiency Review of Irrigation Services Provided by SunWater*, prepared by Indec Consulting for Tier 1, dated 16 December 2005

### 3. SUNWATER'S BUSINESS

#### 3.1 Services Provided by SunWater

SunWater is a Government Owned Corporation (GOC) charged with facilitating the provision of safe and reliable bulk water services to the people of regional Queensland. As the largest water service supplier in the state, SunWater owns and operates a network of water infrastructure, as well as providing consulting expertise in water infrastructure design, delivery and management. Its core activities are:

- bulk water storage and distribution;
- water treatment, reticulation and drainage;
- water infrastructure development;
- water facilities management;
- water accounting and management services;
- specialist consultancy services; and
- any activity likely to complement or enhance the above (such as hydro-electricity development).

SunWater is governed by the Water Act 2000, under which it is a registered 'Large Service Provider for Water Supply and Sewerage Services'. It is licensed to provide bulk, irrigation, and retail water services as well as drainage and sewerage services.<sup>4</sup>

These core activities are determined by either shareholder requirement and/or competitive advantage according to SunWater's experience and skill base.<sup>5</sup> SunWater does not charge for water use as it is only responsible for the delivery of water subject to its Resource Operating Licences (ROL's), or (in some cases) Interim Resource Operating Licences (IROL's), which govern the water infrastructure and operating arrangements, water allocation, management and sharing and also water monitoring and reporting requirements for each WSS.

SunWater, in addition to maintaining the infrastructure assets and ensuring WAE delivery under the ROL/IROL's, is required to meet a number of compliance reporting requirements. While most compliance reporting is also required for the delivery of normal business operations (under the ROL/IROL's) there are some requirements that fall outside the scope of normal business operations. These range from the collection and management of customer data to reporting of hydrographical waterway flow rates to the Bureau of Meteorology through to compliance reporting of usage data to the Murray Darling Basin Authority. While not in scope for this review we recommend this be investigated further to test the prudence of these costs being passed onto irrigators.

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<sup>4</sup> *Strategic Asset Management Plan for Water Supply Schemes version 3A* prepared by SunWater June 2009

<sup>5</sup> *Statement of Corporate Intent 2008-09* Prepared by the directors and management of SunWater for the shareholding Ministers

### 3.2 Water Supply Schemes

SunWater delivers bulk water, distribution services (both irrigation and non-irrigation) and drainage services to urban, industrial and irrigation customers across 23 WSS located throughout regional Queensland. In addition SunWater provide services within WSS to non irrigation customers and services outside of WSS that include commercial development projects, consulting services, metering, hydro generation.

SunWater also own a number of subsidiary businesses that operate pipeline assets (i.e. North West Queensland Water Pipeline Pty Ltd, Eungella Water Pipeline Pty Ltd and Burnett Water Pty Ltd). SunWater’s operations (including WSS operations) are managed through Service Contracts. These are separate external subsidiary businesses that do not provide services to irrigation schemes. Costs are not transferred from subsidiaries to irrigation customers. Overhead costs are only transferred into these subsidiaries, not out of them.

A Service Contract is a group of one or more segments (e.g., reticulation, headworks, drainage) that collects both revenue and costs. It is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash flows from other assets or groups of assets. Service Contracts are classified by the type of service they provide and include:

**Table 3-1 Service Contract Types**

Service Contract Type	Number of SunWater Service Contracts
Bulk Water	28 (this includes 23 service contracts in WSS and 5 external service contracts; 22 of the 23 WSS contracts relate to irrigation customers)
Irrigation Distribution	9 (8 relate to irrigation customers)
Commercial Pipeline	13
3rd Party Distribution	2
Hydro Generation	2
Water Treatment	3
Metering	1
Water Trader	1
Infrastructure Development Projects	2
Consulting Projects	1
<b>TOTAL</b>	<b>62</b>

Only 22 of the bulk water Service Contracts and the 8 irrigation distribution Service Contracts require irrigation prices to be set. External Service Contracts and Julius Dam (bulk water) do not service irrigation customers.

SunWater delivers water services to customers holding medium and high priority Water Allocation Entitlements (WAE's). A customer holding a high priority WAE will receive water ahead of a customer holding a medium priority WAE. SunWater's ROL's detail the WAE held by different customers and the water management and operational rules for delivery of these entitlements.

Table 3-2 List of Service Contracts by Water Supply Scheme and External Delivery<sup>6</sup>

Water Supply Scheme and Other	Internal or External Infrastructure	Bulk Water	Distribution	Commercial Pipeline	3rd Party Distribution	Hydro Generation	Water Treatment	Metering	Development Projects	Water Trader	Consulting
Barker Barambah	Internal	Barker Barambah									
Bowen Broken	Internal	Bowen Broken		Collinsville Pipeline	Eungella Offtake Newlands Offtake						
Boyne River and Tarong	Internal	Boyne River & Tarong		Tarong Pipeline							
Bundaberg	Internal	Bundaberg	Bundaberg								
Burdekin-Haughton	Internal	Burdekin-Haughton	Burdekin	Burdekin Moranbah Pipeline			Burdekin Town Water				
Callide Valley	Internal	Callide Valley									
Chinchilla Weir	Internal	Chinchilla Weir									
Cunnamulla Weir	Internal	Cunnamulla Weir									
Dawson Valley	Internal	Dawson Valley	Dawson								
Eton	Internal	Eton	Eton								
Julius Dam	Internal	Julius Dam									
Lower Fitzroy	Internal	Lower Fitzroy		Stanwell Pipeline							
Lower Mary River	Internal	Lower Mary River	Lower Mary								
Macintyre Brook	Internal	Macintyre Brook									
Maranoa	Internal	Maranoa									
Mareeba-Dimbulah	Internal	Mareeba-Dimbulah	Mareeba			Tinaroo Hydro	Mitchuba Town Water				
Nogoa-Mackenzie	Internal	Nogoa-Mackenzie	Emerald	Blackwater Pipeline	Gregory Offtake Oak Creek Offtake Saraji Offtake						
Pioneer River	Internal	Pioneer River									
Proserpine River	Internal	Proserpine River									
St George	Internal	St George	St George								
Three Moon Creek	Internal	Three Moon Creek									
Upper Burnett	Internal	Upper Burnett									
Upper Condamine	Internal	Upper Condamine									
Awoonga Callide	Internal			Awoonga Pipeline							
Goondicum Pipeline	Internal			Goondicum Pipeline (not commissioned)							
Burnett Water	External Subsidiary	Paradise Dam/Kiera Weir				Mini Hydro					
Northwest Pipeline	External Subsidiary			Northwest Pipeline							
Eungella Pipeline	External Subsidiary			Eungella Pipeline Eastern Pipeline Southern Pipeline							
External Service Contracts	External	4 Service Contracts	1 Service Contract	4 Service Contracts			1 Service Contract	1 Service Contract			
ID - Projects	Internal								ID - Projects		
ID - Feasibilities	Internal								D - Feasibilities		
ID - Water Trader	Internal									ID - Water Trader	
ID - Consultancies	External										ID - Consultancies

<sup>6</sup> Provided in email from P McGahan SunWater to M Judkins SAHA dated 31/8/10 titled *Service Contracts*



### 3.3 SunWater Assets

In 2009 SunWater delivered 1.05 million ML of water across all WSS to some 4,900 customers, across regional Queensland. SunWater maintains and operates:

- 19 major dams;
- 63 weirs and barrages;
- 80 major pumping stations;
- 2,500km of pipelines and open channels; and
- 730km of drains.<sup>7</sup>

Table 3.3 provides a summary of the major operational metrics by SunWater WSS or external service.

**Table 3-3 Asset and Customer Metrics by WSS<sup>8</sup>**

Water Supply Scheme and Other	Internal or External Infrastructure	Major Dam Capacity '000 ML	Number of Customers	Customer Allocations '000 ML	Pipeline KM	No. of Pump Stations
Barker Barambah	Internal	136	172	34		
Bowen Broken	Internal	119	56	38	120	3
Boyne River and Tarong	Internal	204	155	44	95	3
Bundaberg	Internal	937	1,093	209		
Burdekin-Haughton	Internal	1,868	392	774	218	4
Callide Valley	Internal	151	139	24		
Chinchilla Weir	Internal	10	34	4		
Cunnamulla Weir	Internal	5	26	3		
Dawson Valley	Internal	67	153	58		
Eton	Internal	66	303	53		
Julius Dam	Internal	108	3	48		
Lower Fitzroy	Internal	36	24	27	25	1
Lower Mary River	Internal	17	187	26		
Macintyre Brook	Internal	70	96	25		
Maranoa	Internal	not listed	4	1		
Mareeba-Dimbulah	Internal	439	1,132	159		
Nogoa-Mackenzie	Internal	1,344	364	203	57	3
Pioneer River	Internal	165	22	76		
Proserpine River	Internal	491	91	60		
St George	Internal	100	160	75		
Three Moon Creek	Internal	89	92	15		
Upper Burnett	Internal	193	157	31		
Upper Condamine	Internal	106	101	34		
Awoonga Callide	Internal		29		53	3
Goondicum Pipeline	Internal				Not commissioned	Not commissioned
<b>TOTALS</b>		<b>6,720</b>	<b>4,985.0</b>	<b>2,020.3</b>	<b>568.0</b>	<b>17.0</b>

### 3.4 Organisational Structure

SunWater's organisational structure has been developed along functional lines. A Corporate group (largely based in Brisbane Head Office) provides HR, Finance, Legal, Procurement and IT support; an Infrastructure

<sup>7</sup> Source: SunWater Annual Report 2008-09

<sup>8</sup> Source: SunWater Annual Report 2008-09 and SunWater website <http://www.sunwater.com.au/management/management/pump-stations-and-pipelines>

Management group is responsible for managing and maintaining SunWater’s assets (dams, waterways, pumping stations, weirs) including managing customer water account data and water customers; and an Infrastructure Development group is responsible for Greenfield infrastructure developments. There is also a Strategy and Reporting group and a Health, Safety and Environmental group reporting directly to the CEO.

SunWater’s business is geographically diverse and is supported by Brisbane Head Office and four major Regional Depots in Clare, Eton, Bundaberg and Toowoomba. Within each of the regions there are service centres and depots, including facilities in: Ayr; Mareeba; Emerald; Moranbah; Maryborough; Biloela; Mundubbera; Theodore; Goondiwindi; and St George.<sup>9</sup>

SunWater’s high level organisational structure is presented in Figure 3-1. This structure reflects the current business structure following recent organisational changes. A description of the changes from the previous structure is provided in section 5.

**Figure 3-1 SunWater Organisational Structure**

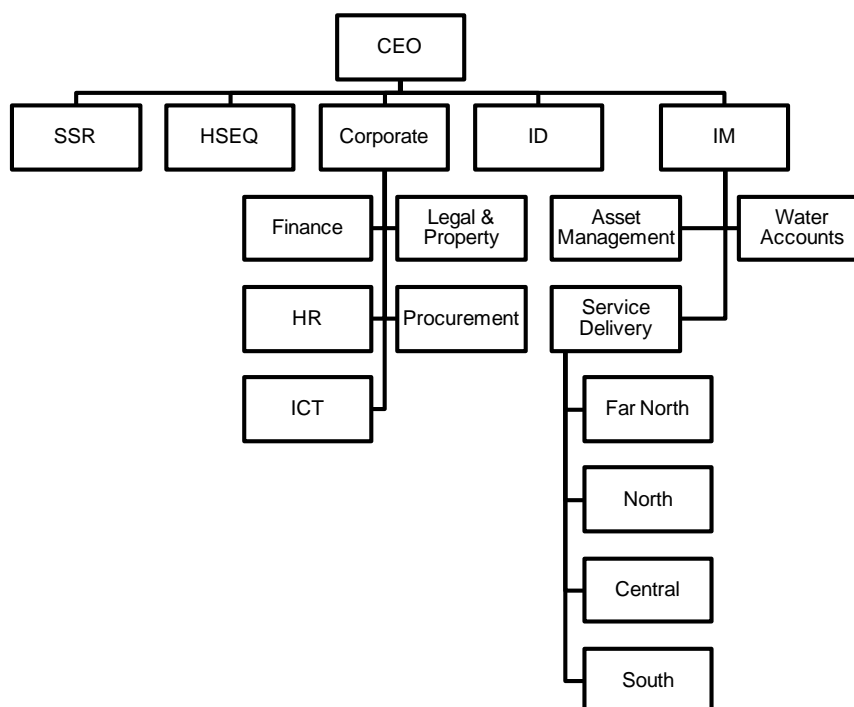


Table 3-4 provides a brief description of the functions of each business unit as well as the number of Full Time Equivalents (FTE’s) as at 30 June 2010. A full description of the functions of each business unit will be detailed in Section 6.

<sup>9</sup> Data from interview conducted on 17/8/10 with B Jeppesen, GM Infrastructure Management, SunWater, P McGahan, Strategy and Planning Manager, SunWater and M Judkins and P McCarthy from SAHA

**Table 3-4 Summary of Business Units<sup>10</sup>**

<b>Business Unit</b>	<b>Function</b>	<b>FTE at 30 June 2010</b>
CEO Office	Oversight of the operations of SunWater. Includes the CEO and SunWater Board. The Internal Auditor also reports directly to the CEO.	3.0
SSR – Strategy and Stakeholder Relations	Responsible for all communications and strategy and planning of SunWater as a whole.	12.0
HSEQ – Health, Safety, Environment & Quality	Responsible for all workplace health and safety, environmental issues and quality assurance and management.	16.0
Corporate	Performs all corporate administration and compliance duties including HR, IT, Finance and Legal.	83.3
ID – Infrastructure Development	Responsible for all consulting projects carried out both internally to SunWater and with external clients.	95.2
IM – Infrastructure Management	Responsible for asset management, operations and maintenance, water reporting and customer service.	284.5
	<b>TOTAL</b>	<b>494.0</b>

<sup>10</sup> Data per email from P McGahan, SunWater per J Dous, SunWater to P McCarthy SAHA, date 14/09/10 titled *Queries re FTE headcount*

#### 4. SUNWATER COST OVERVIEW

This section presents an overview of SunWater's cost structure with a focus on SunWater's administrative functions. We present an overview of SunWater's methodology for transferring overhead and indirect costs to the operational parts of the business (e.g. Service Contracts in each of the supply schemes) on an actual basis. While the focus of this review is on actual costs, this is necessary to develop an understanding of SunWater's forecasts for the next price path period. Actual costs are one of a number of considerations made by SunWater in determining budgeted costs. SunWater also employ a sophisticated management costing system to monitor and manage utilisation of their personnel against targets. In addition they have completed some high level benchmarking of the finance function previously.

For the purpose of this review overhead and indirect costs (as defined in Section 4.1 below) are considered administrative costs and as per the QCA's ToR they represent non-operational costs from both the Brisbane head office and regional offices<sup>11</sup>.

##### 4.1 SunWater Financial Structure

SunWater has a relatively complex financial structure that acts as both a mechanism to manage SunWater's financial accounts and a tool to manage the performance of senior management. Business operations are captured in 62 Service Contracts. Each Service Contract has its own business rules to ensure that the actual direct cost of service delivery, in addition to a share of the costs supporting the activities of the business (both indirect and overhead) are captured. This section presents a simplified explanation of SunWater's financial structure including business rules for the transfer of overhead and indirect costs across the business.

SunWater classifies costs as direct, indirect, overhead or residual/unallocated<sup>12</sup>:

1. **Direct costs** are the costs of activities directly employed in providing services for customers. Direct costs are incurred by Service Contracts, including consulting or development project Service Contracts (accounted for in the same way as other Service Contracts).
2. **Indirect costs** support direct activity and are used for a limited line of business or service type. For example Dam Safety costs are considered to be indirect because they support the delivery of bulk water services. However, they are only relevant to supply schemes that have dams and do not support the provision of channel distribution services. Indirect costs are largely incurred in Brisbane Head Office and the centralised service functions. They are transferred to the Service Contracts (and where relevant ID and consulting) based on the direct labour charged to each Service Contract.

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<sup>11</sup> Note that indirect and overhead costs are different to indirect and overhead cost centres/pools which are introduced later in this document.

<sup>12</sup> Data from interview conducted on 17/8/10 with R Keogh, Asset Management Manager, SunWater, P McGahan, Strategy and Planning Manager, SunWater and M Judkins and P McCarthy from SAHA

**3. Overhead costs** are not directly applicable to any particular line of business or service type and are therefore spread across the entire business using standard business rules. For example, the Finance function supports the operations of the entire business and as such the cost of the function is shared by all operational cost centres.

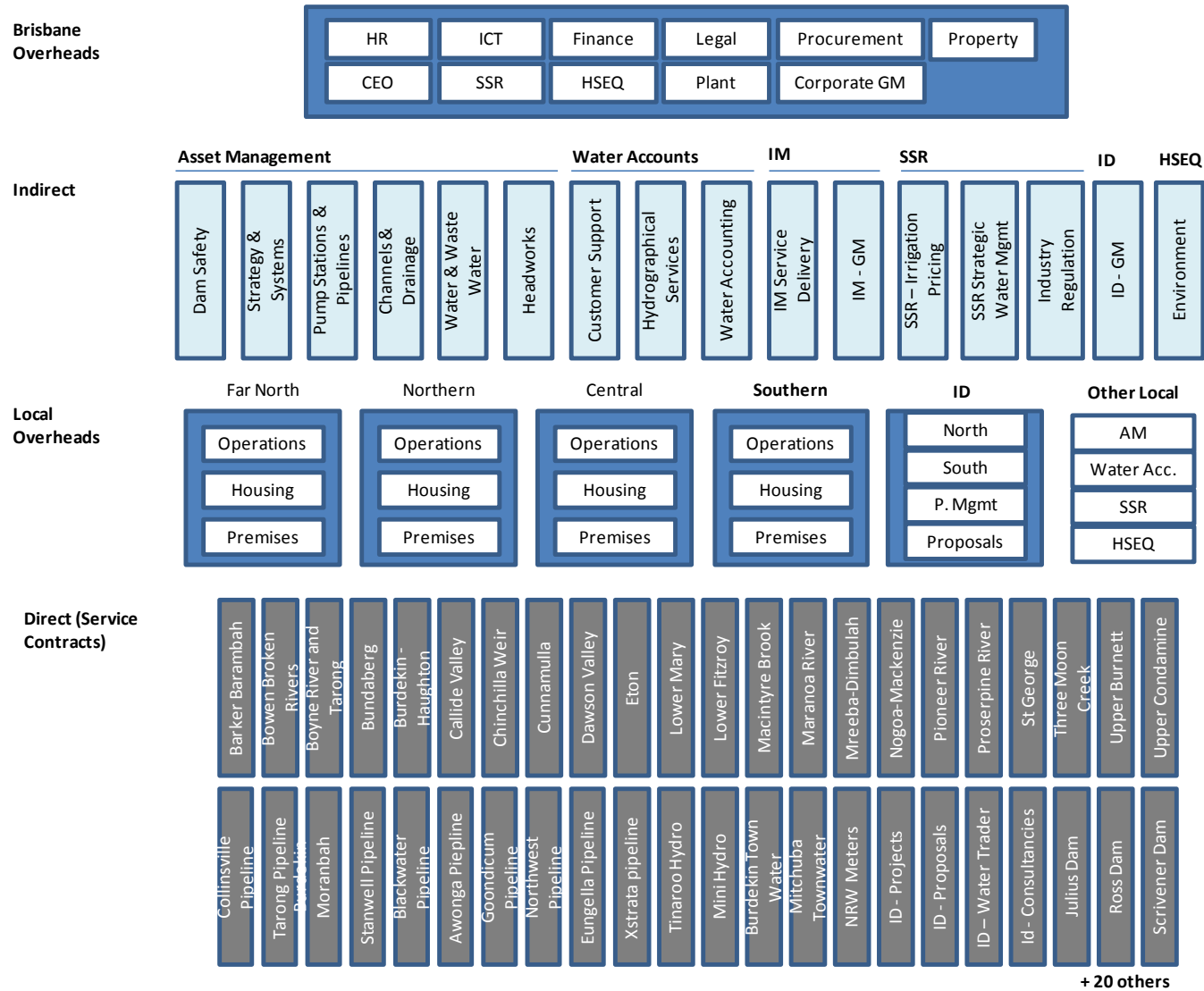
Overhead costs can be classified as local overheads (generated in a regional and other local Resource Centres) or Brisbane overheads (generated in Resource Centres that service the entire business). Resource Centres will be discussed below.

**4. Unallocated costs** are the costs not recovered (via a time sheeting process) to Service Contracts or indirect activities. These include costs such as finance charges/borrowing costs and overhead costs that are not allocated to the schemes.

Likewise, for reporting and cost transfer purposes, SunWater also classifies its profit and cost centres/pools as direct, indirect or overhead according to the nature of the activity that occurs in that cost centre.

Figure 4-1 presents the key cost and profit centres. Appendix C – Conceptual Schematic of Cost Transfer Process between Profit and Cost Centres/Pools provides a more detailed diagrammatical explanation of the cost transfer concept.

**Figure 4-1 SunWater Cost Structure (Profit and Cost Centres/Pools)**



As mentioned above, some overhead cost centres/pools are also Resource Centres which means, amongst other things, that they are the cost centre where staff costs are paid from. Resource Centres initially capture all employee salaries at the beginning of a period. When staff charge time to a Service Contract or indirect cost centre (via a time sheeting process), the relevant Resource Centre is 'drawn down', and the direct labour hours and associated cost is transferred to that Service Contract / indirect cost centre. SSR, HSEQ, Asset Management, Water Accounts and the regional operations cost pools (Far North, North, Central and South) all have indirect cost centres where staff perform a vast majority of their work and charge their time. Labour cost associated with this time is transferred out of the related Resource Centre to indirect cost centres according to employee timesheets. Standard Debit/Credit accounting journals are used to draw down the Resource Centres and allocate cost to the service contracts and indirect cost centres. This ensures overheads are not double counted. There are also business rules to ensure overheads are only transferred to direct and indirect activities not other overhead activities, ensuring no allocated of overheads on overheads. See Appendix D for worked examples of the allocation process. This is discussed in detail in Section 4.2 below.

The focus of this paper is on the indirect and overhead cost centres/pools as these are representative of where administration costs (per the QCA's ToR) are incurred (net of direct labour cost allocation via time sheeting).

#### **4.2 Methodology for Cost Transfer**

This section will discuss the transfer of costs from indirect and overhead cost centres/pools on an actuals basis. As mentioned previously in section 2.2 we have not performed analysis on how irrigation price path forecasts have been developed, nor how costs impact on this price setting process. The methodology for this is still being finalised by SunWater and should form part of the subsequent review proposed by the QCA.

##### **Cost transfer to Service Contracts**

When a staff member performs work on a Service Contract, their time, called direct labour, is transferred to that Service Contract according a time sheeting process that SunWater practises. For simplicity and transparency, the associated cost transferred to the Service Contract is calculated by multiplying the direct labour hours by a standard labour cost rate. The rate used is based on the staff member's level/job band within the firm.

As mentioned previously, overhead costs are also transferred to Service Contracts. The amount of overhead transferred is also based on the above direct labour hours. The associated cost transferred to the Service Contract is calculated by multiplying these direct labour hours by overhead recovery rates.

The overhead recovery rates are determined at the beginning of the financial year and are based on recovering the overhead according to annual budgeted utilisation for that year. There are separate rates for Local Overheads and Brisbane Overheads. Typically, the rate for Local Overhead is higher than the rate for Brisbane Overhead. Pricing rates are reviewed on a quarterly basis throughout the year to track how actual utilisation compares to the budgeted utilisation. However, there is a high hurdle rate to warrant any changes to the rates at each of the quarterly reviews.

Brisbane and Local Overheads will be discussed individually below.

### **Brisbane Overhead Cost Transfer**

Brisbane Overhead is accrued across all Brisbane Overhead functions per Figure 4-1 above. Brisbane Overhead costs are transferred across indirect and direct profit and cost centres (including Service Contracts) according to the direct labour hours performed in those cost centres. For example, if the standard labour cost rate is \$10/hr and the Brisbane Overhead rate is determined to be 30% of the standard labour cost rate, then when 1 hour of direct labour charged to a profit or cost centre (\$10), Brisbane Overhead of \$3 will be also charged to that cost centre. The transfer rates are established at the beginning of the year based on anticipated utilisation of all staff for the year. For example, if through the budgeting process it is established that staff utilisation within the business will be 80% then this will be the rate used to calculate remaining costs within the business (20%) to be recovered as overhead. If utilisation (direct labour hours) in a particular cost centre is different to the budgeted rate then the cost centre will attract more or less overhead and this variation is used to monitor individual manager performance.

### **Local Overhead Cost Transfer**

Local overheads are overhead costs accrued mainly in regional offices (Far North, North, Central and South) and within the Infrastructure Development group (North and South). Some local overhead costs are also specific to the delivery of indirect cost centres (e.g. Asset Management and SSR indirect cost centres). In this case overheads are transferred only over the direct or indirect cost centres that they are servicing. Refer to Figure 4-1 above. The local overhead cost transfer rate, as with Brisbane overhead, is set by the budgeted cost base and forecast utilisation to enable recovery of local overheads. Likewise local overhead costs are transferred to cost centres according to the direct labour hours performed in those cost centres.

As mentioned in Section 4.1 above, a significant portion of cost transfer from local overhead cost pools to indirect cost pools represents direct labour costs being transferred from the centralised Resource Centres to the related indirect cost pools (e.g. when Asset Management direct labour is transferred to Dam Safety, Pump Stations etc.)

### **Indirect Cost Transfer**

Indirect costs are allocated to the direct cost centres that they support based on actual direct labour charged to each cost centre. As with overheads the rate is calculated using budgeted costs and utilisation to create a loading factor to apply on top of the actual direct labour time-sheeted to each direct cost centre.

## **4.3 SunWater's Costs Quantified**

This section will briefly discuss SunWater's total actual operating costs to provide an overall perspective of the cost environment in which administration costs (i.e. indirect and overhead costs) are being transferred, particularly to Service Contracts. Each overhead and indirect cost centre will be addressed to show the quantum of actual administration costs being transferred to Service Contracts.

SunWater uses an internal management 'Line of Business' report to analyse their actual performance. This report breaks down the aggregate Profit and Loss Statement into Service Contracts and unallocated costs. We have used this Line of Business report as our starting point in evaluating SunWater's cost structure and in understanding the administrative costs within the SunWater business.

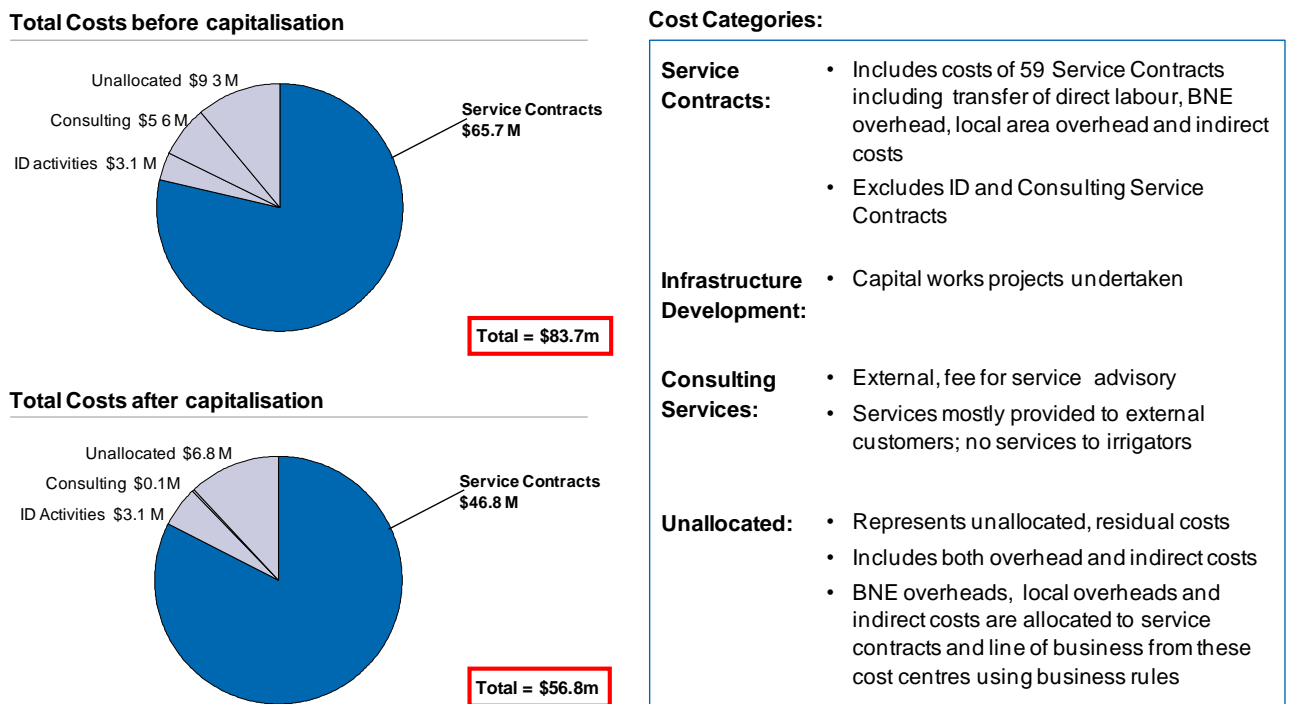


The Line of Business report splits Service Contract costs between infrastructure development activities, consulting activities, and the 59 remaining Service Contracts. As outlined in Section 3, SunWater have a total of 62 Service Contracts including two relating to infrastructure development activities and one relating to consulting activities (these are treated separately to the other 59 Service Contracts as they are somewhat stand alone in nature).

#### 4.4 SunWater Total Operating Costs

Figure 4-2 below presents SunWater’s total costs according to the Line of Business report structure. It represents all SunWater operating costs incurred between 1 Jan 2010 and 30 June 2010. We present this period’s results throughout this report as these are most representative of the current (and future) organisational structure which was put in place as of 1 January 2010 (this restructure will be discussed in further detail in Section 5 below). The impact of seasonality has been assessed as less distorting than the impact of the recent organisational changes.

**Figure 4-2 SunWater Cost Structure – 6 months to 30 June 2010**



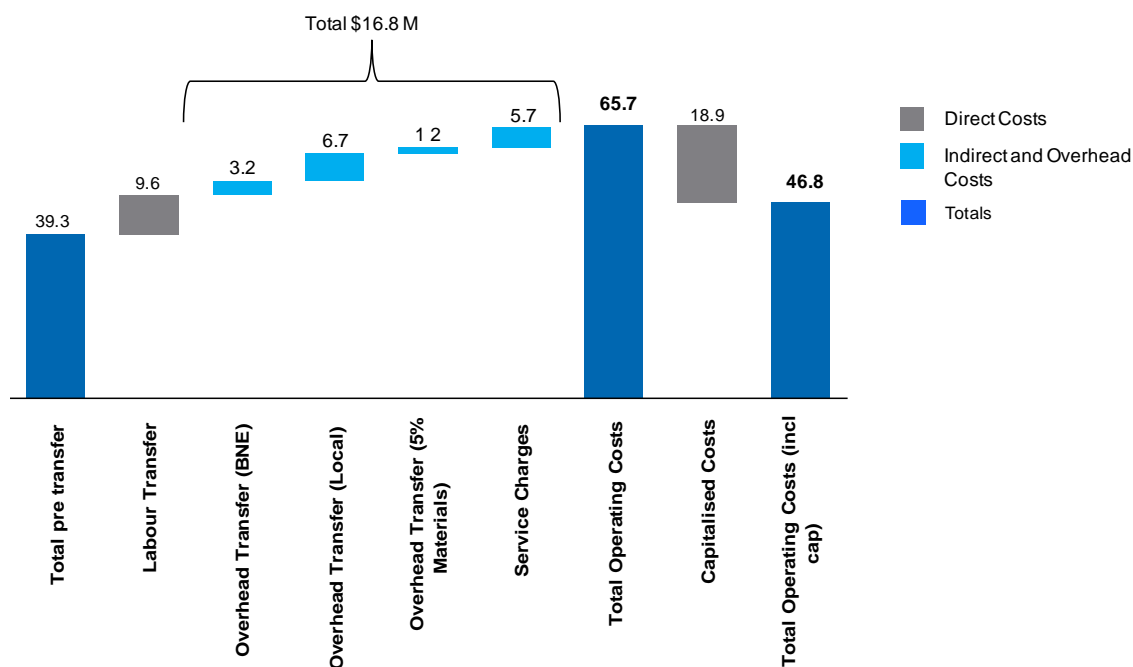
Source: SunWater Line of Business Report, Year Ended 30 June 2010

As shown above, SunWater’s total costs for this period were \$83.7 million (before any costs are capitalised into asset values (capitalisation) or \$56.8 million (after capitalisation). Of this total cost, \$65.7 million (or \$46.8 million after capitalisation) relates to Service Contracts.

## Administration Costs Transferred to Service Contracts

Of the \$65.7 million costs (before capitalisation) attributable to Service Contracts, \$16.8 million represents overhead and indirect costs (or administration costs) as shown in Figure 4-3 below. Definitions of the cost categories presented in the table are also provided below.

Figure 4-3 Service Contract Cost Breakdown – 6 months to 30 June 2010



X Axis Cost Category	Description
Total pre transfer	Total operational costs before any costs are transferred into service contracts.
Labour Transfer	Direct labour costs transferred into service contracts (based on time sheeted direct labour hours).
Overhead Transfer (BNE)	Portion of Brisbane Overhead cost transferred into service contracts (based on time sheeted direct labour hours).
Overhead Transfer (Local)	Portion of Local Overhead cost transferred into service contracts (based on time sheeted direct labour hours).
Overhead Transfer (5% Materials)	Portion of materials transferred into service contracts (Note all material costs incurred in Service Contracts are increased by 5%. This is to cover the centralized procurement cost and some Brisbane material non-labour overhead. This 5% uplift cost is subtracted off total overheads before overhead transfer rates are calculated).
Service Charges	Portion of indirect costs transferred into service contracts.
Total Operating Costs	Total operating costs after cost transfer and before capitalisation.
Capitalised costs	Project costs capitalised.
Total Operating Costs (including capitalisation)	Total operating costs after cost transfer and capitalisation.

The \$16.8 million of overhead and indirect cost equates to 93% of SunWater's \$18.1 million of total overhead and indirect costs (or administration costs). The remaining 7% or \$1.3 million of administration costs are attributable to Consulting and ID activities.

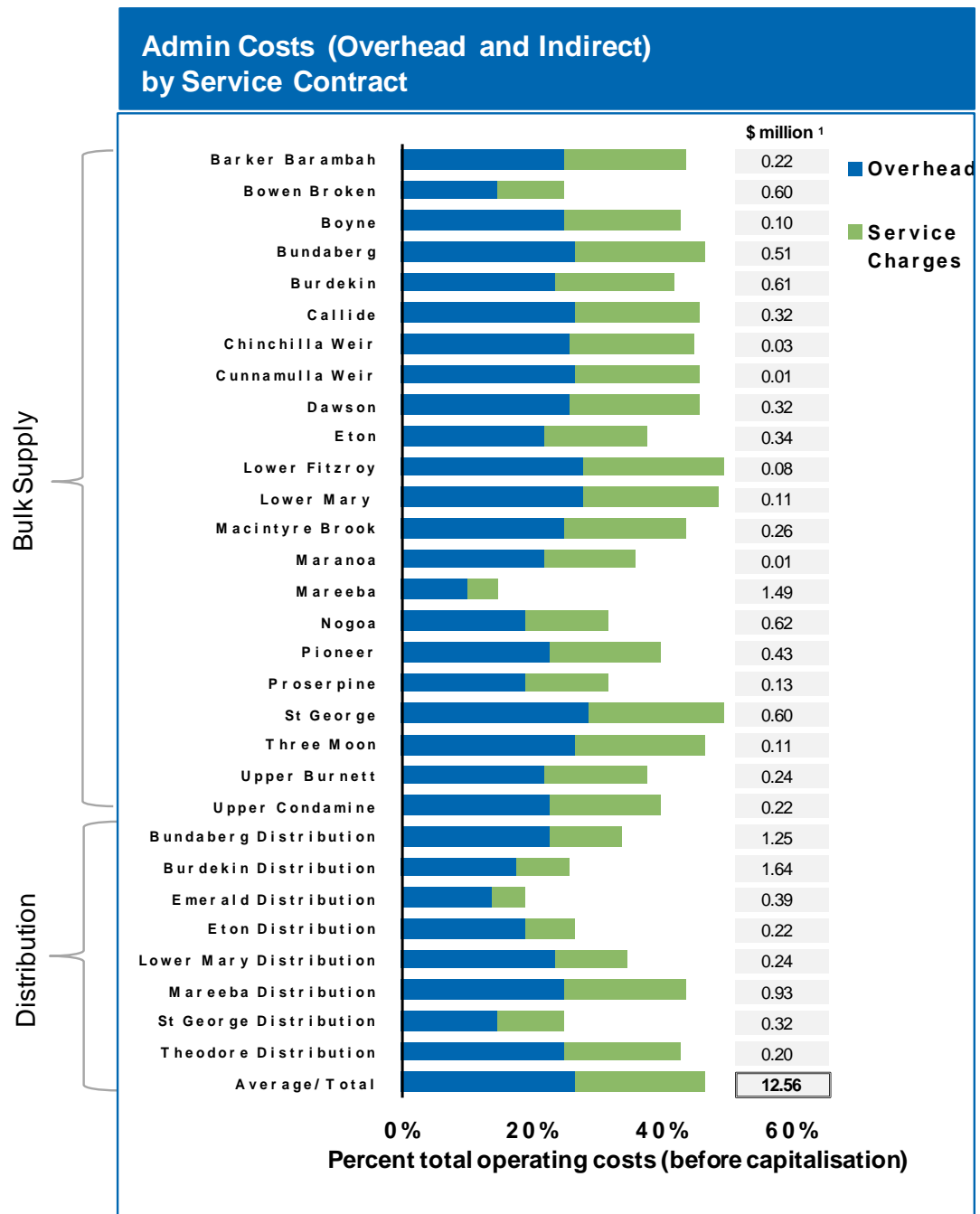
### **Administration Costs Transferred to Service Contracts that Support Irrigation Customers**

As per Figure 4-2 and 4-3, \$65.7 million of SunWater's total costs related to Service Contracts (pre capitalisation) in the 6 months to 30 June 2010. To break this down further, of this \$65.7 million, \$43.8 million relates to the 30 Service Contracts that support irrigators, urban and industrial customers. The \$43.8 million total cost includes operational and administration costs, \$12.6 million is transferred overhead and indirect costs (administration costs), representing 70% of SunWater's \$18.1 million of total administration costs.

To provide some insight on the quantum of these administration costs on a Service Contract level, Figure 4-4 Administration Costs by Service Contract below presents the administration costs for the period as a percentage of total costs on a Contract by Contract basis. Administration costs per customer are also shown (however please note this includes urban and industrial customers as well as irrigators).

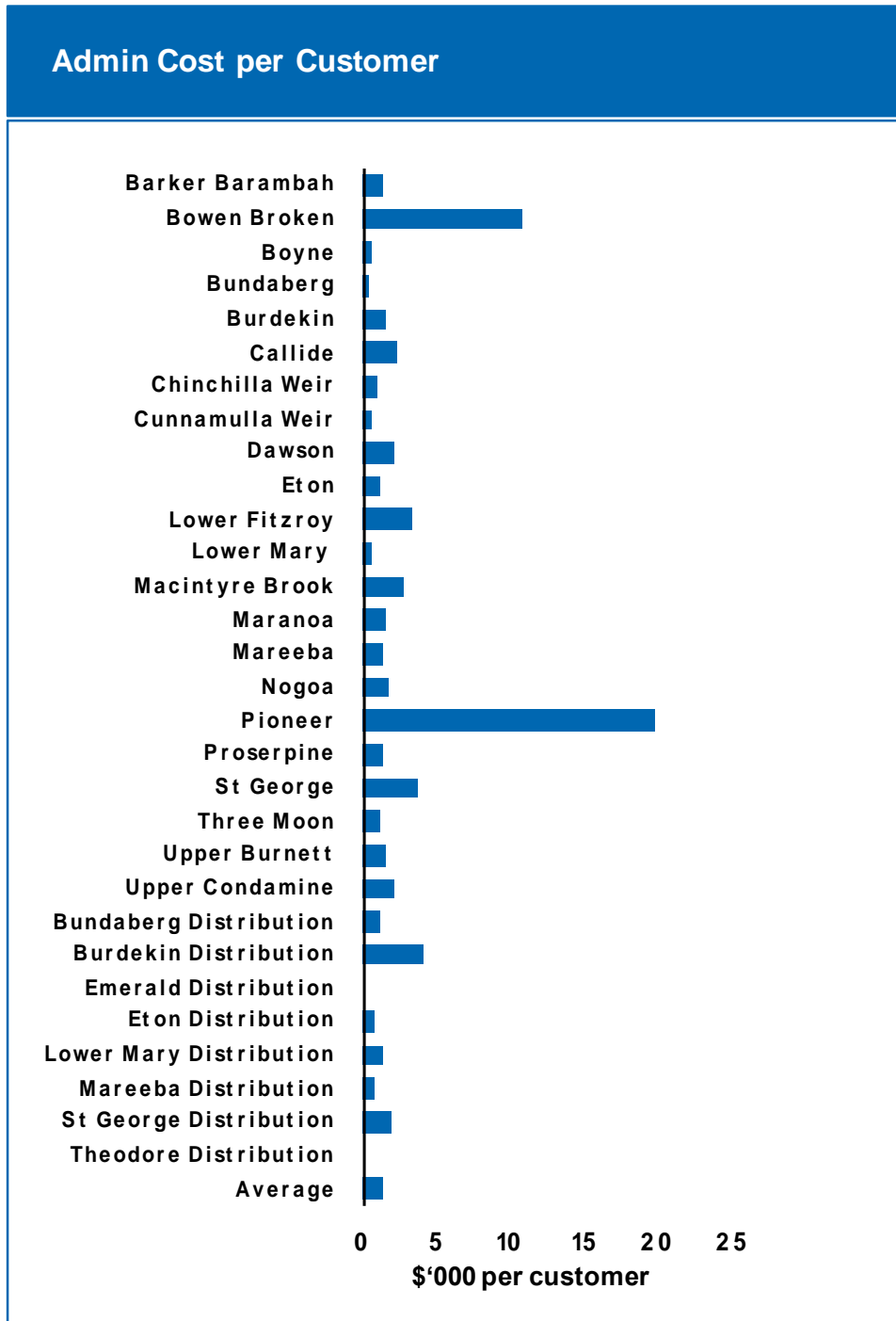
From these diagrams it is evident that there is significant variation in actual administration cost proportions across bulk water service contracts and also across distribution contracts. This variation should be kept in mind and investigated further when forecast costs are analysed in the subsequent review. Variation between service contracts can reflect an efficiency opportunity.

Figure 4-4 Administration Costs by Service Contract



<sup>1</sup> Total overhead and indirect costs \$ million

Figure 4-5 Administration Costs per Customer by Service Contract

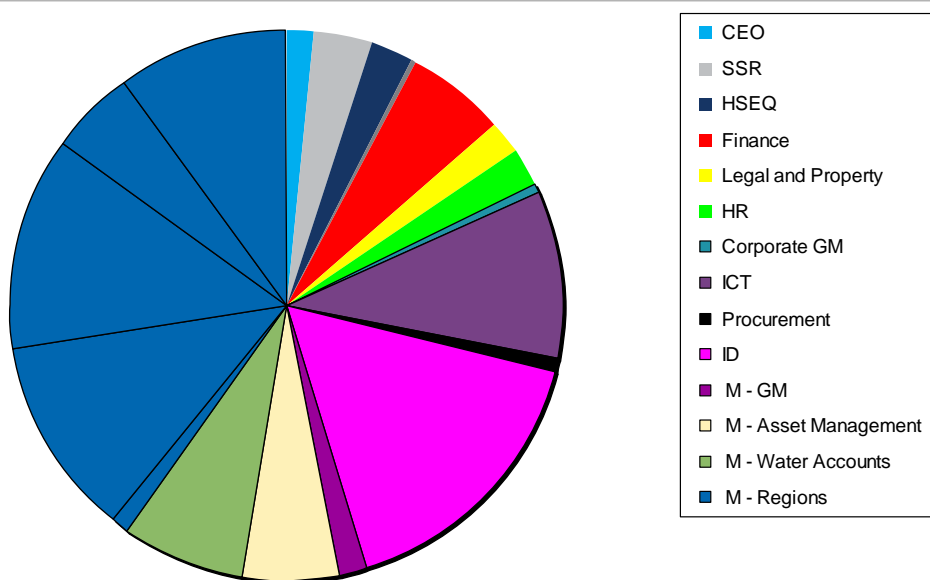


## Administration Costs Prior to Transfer to Service Contracts

In order to assess the efficiency of overhead and indirect costs (or administration costs) that are transferred to the Service Contracts, it is necessary to understand the overhead and indirect cost centres (or administrative cost functions) where these costs originated. Figure 4-6 shows the total costs of these administrative cost functions before transfer of administration costs to the Service Contracts and before any transfer of direct labour from Resource Centres.

Figure 4-6 Overhead and Indirect Costs - 6 Months to June 2010

\$ million



**TOTAL COST \$41.5m**

The \$41.5m above represents all costs in administrative cost pools before admin cost transfer but includes direct labour. Ultimately \$16.8m is transferred out as administrative costs.

Total costs in the administrative cost functions inclusive of direct labour, overhead and indirect costs (or administrative costs) and unallocated costs was \$41.5 million in the six months to June 2010<sup>13</sup>. Note that whilst IM – Regions (being the Service Delivery function) makes up the largest proportion of the \$41.5 million, most of its costs are attributable to direct labour (initially captured in Resource Centres), however it has been included for completeness of our analysis.

Each of these administrative cost functions is reviewed in detail in section 6 in order to assess the efficiency of the \$16.8 million administrative costs transferred to the Service Contracts.

<sup>13</sup> The total of the diagram is slightly different to the Line of Business Report provided by SunWater due to the exclusion of the following cost centres that are not recovered from Service Contracts: Corporate Operations; Corporate Plant; and Water Trading

## 5. RECENT HISTORY

SunWater has undergone significant change since the last price review process moving to a functional organisational structure, centralising a number of support functions and implementing a new chart of accounts. These changes make historical comparison of SunWater's cost structure and efficiency improvements difficult, however there is still merit in assessing the changes over time to understand how SunWater's current cost environment has developed. In this section we present a chronological discussion of major business initiatives from 2006 to the present.

### 5.1 2006: Previous Price Path Review Process

The current price path was established in 2005/06 (for the 2006/07 to 2010/11 period). At this time SunWater's organisational structure was highly regionalised with total staff of 561 Full Time Equivalents (FTE's). Brisbane head office managed corporate administration functions (including finance, HR and ICT), external consulting, asset management, operations and maintenance, however in practice this was often only from a policy, planning and regional oversight perspective.

The six regional business centres at the time were managed by local business managers who had business units that closely paralleled the Brisbane head office structure and operations. Of note, administrative functions conducted locally included accounting, HR and procurement. Customer service and asset management was also locally managed at the regional level. These administrative functions reported into the regional managers rather than head office in Brisbane.

The price path review process (and associated review of SunWater's structure and costs) conducted in 2005/06 also differed from the current process being envisioned by the QCA. At the time SunWater developed its price path in consultation with its customers, represented by the Statewide Irrigation Pricing Working Group (Tier 1).

To assist the review process, in 2005/06, SunWater engaged Indec Consulting to perform a benchmarking study against similar utilities in order to assess the comparative efficiency and reasonableness of SunWater's costs. Subsequent to this, Tier 1 also engaged Indec Consulting to perform a *Productivity and Cost Efficiency Review of Irrigation Services Provided by SunWater* to identify, amongst other things, potential cost savings.<sup>14</sup>

Indec observed a parallel business structure between the Business Centres and Brisbane head office and identified opportunities for cost efficiency gains by removing duplication. They also noted other opportunities in the Brisbane head office, the majority of which related to project management within the engineering consulting business unit. As summarised below, Indec concluded there was potential for total annual cost savings over time of up to \$3 million per annum:

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<sup>14</sup> *Productivity and Cost Efficiency Review of Irrigation Services Provided by SunWater*, prepared by Indec Consulting for Tier 1, dated 16 December 2005

**Figure 5-1 – Summary of Cost Savings Identified by Indec Consulting <sup>14</sup>**

<b>Regional Based Offices</b> <ul style="list-style-type: none"> <li>• Simplify project management processes (which involve Brisbane head office as well)</li> <li>• Streamline administration procedures and interaction between business units within regional business centres and also between Brisbane head office and regional business centres</li> </ul>	<b>\$1.2M</b>
<b>Regional Based Field Operations</b> <ul style="list-style-type: none"> <li>• Continuous improvement measures for resource utilisation to minimise overhead hours</li> <li>• Multi skilling of field staff (across civil construction and operations for eg)</li> </ul>	<b>\$0.5M</b>
<b>Brisbane Head Office</b> <ul style="list-style-type: none"> <li>• \$0.7M relating to Engineering Services: <ul style="list-style-type: none"> <li>• Regionalise day-to-day engineering service (for projects &lt;\$25,000), supported by the implementation of a regional engineering office</li> </ul> </li> <li>• \$0.6M relating to other Brisbane business units: <ul style="list-style-type: none"> <li>• Low value purchases (purchase value &lt;\$2,000) to be done via credit card or electronic requisitioning</li> <li>• Implementing business case to streamline reporting process required for internal trading (current 'BOM' reporting tool being used)</li> </ul> </li> </ul>	<b>\$1.3M</b>
<b>Total Cost Saving Per Annum</b>	<b>\$3.0M</b>

Indec Consulting identified that there would be some costs involved in implementing some efficiency gains opportunities. These \$3 million cost savings represented 7.1% of the 2003/04 controllable costs (excluding electricity, insurance etc).

## 5.2 2006 - 2008: Minor Structural Changes Take Place

Over the two years following the price path review and Indec Consulting's report, there were several structural changes to SunWater. Whilst not necessarily undertaken in response to the Indec Consulting review, these changes were to some extent aligned with the recommendations.

In 2006/07 SunWater's business structure was significantly different to the present structure and was supported by an internal trading model. A Water Supply Services unit acted as an 'asset owner' for SunWater's infrastructure. Using an internal trading regime it 'purchased' its engineering requirements from an Engineering Services unit and did likewise with its Operations and Maintenance unit. There was also a Corporate unit to perform such functions.

It was found that this internal model created a 'silo effect' operationally between the three units, so in 2006/2007 SunWater conducted a system reorganisation and business process review. Following the review process internal trading was abandoned and a new organisation structure was implemented in 2007/08 aimed at streamlining administration and addressing project needs.

The business was redistributed along functional lines of Asset Solutions and Water Services with relevant functions of the former three units divided between each (Asset Solutions was made of part of Water Supply Services (including strategy/planning and water accounting) and Engineering whilst Water Services was made of the remainder of Water Supply Services (regional water services) and Operations and Maintenance). Another two new business units were also established: Business Development and Business



Performance Systems (to oversee quality assurance). Over this period a Chief Operating Officer position was also temporarily implemented, in part to manage this transition.<sup>15</sup>

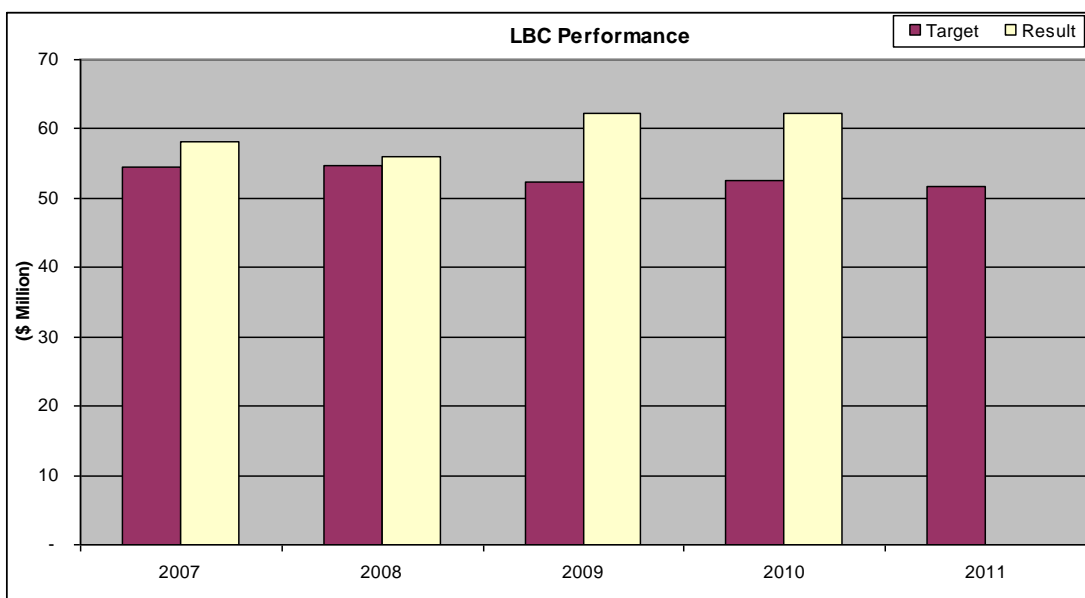
A State Government restructure of the water regulatory system in Queensland and the establishment of a bulk water supply entity in South East Queensland (Seqwater) also affected the structure of SunWater during this period. As a result the assets of 5 SunWater WSS (Central Lockyer, Lower Lockyer, Logan River, Wirril Valley and part of Mary River) and 35 personnel were transferred to Seqwater as of 1 July 2008.

Despite this, the numerous structural changes experienced over this period, as well as the progression of several significant multi-million dollar commercial projects meant staff numbers were projected to continue increasing to 635.5 FTE's in the 2009/10 budget.<sup>16</sup>

### 5.3 2009 - Present: Major Organisational Review

In early 2009 management became aware that business costs were trending above the lower bound cost targets. Whilst previous business restructures were reported to improve the efficiency in administrative and project management processes, the parallel business structures in the regions and Brisbane head office were still believed to be a major contributing factor to the high level of cost. A Review of SunWater's costs over the past four years reveals the slow increase in costs above bound targets from \$3 million in 2006/07 to a peak of around \$10 million in 2008/09 per Figure 5-2 below.

Figure 5-2 Lower Bound Cost Performance 2006/07 – 2009/10



<sup>15</sup> Data in this section per SunWater Annual Report 2006-07, 2007-08 and interview between P Boettcher, CEO SunWater, M Judkins and P McCarthy on 28/9/10

<sup>16</sup> Per data provided in email from N Tran, SunWater, to P McCarthy, SAHA dated 29/9/10 titled *FTE pre & post SLFI*

To address this issue a decision was made in mid 2009 to implement an internal review process with the aim of reducing costs. This internal process, called the Smarter Faster Lighter Initiative (SLFI), identified approximately \$10 million in cost savings across SunWater. These cost savings are to be achieved by implementing a number of efficiency opportunities, consolidating the regional and Brisbane head office functions, as well as improving the efficiency of each business unit. Such efficiency opportunities identified include:

- Six business centres will be replaced by four regional depots;
- Customer service functions in regions to be transferred to a smaller customer support team in Brisbane as a first point of enquiry for all SunWater account enquiries;
- Asset management engineering function in regions to be replaced by 'Centres of Excellence', each focussed on a specific asset group (e.g., dam safety) and located according to skills centres;
- All HR responsibilities to be centralised in Brisbane;
- All procurement responsibilities to be centralised in Brisbane;
- All financial reporting responsibilities to be centralised in Brisbane; and
- Identifying efficiencies in Brisbane head office functions were possible.

Cost savings are mainly to be achieved through headcount efficiencies. Through staff redeployment and review of temporary staff requirements SunWater estimates it can achieve a saving relating to 94.6 FTE's by June 2012 based on 2009/10 budgeted FTE's of 635.5 (reducing FTE's to 540.9 after SLFI is implemented). These savings will mainly be achieved through review of temporary staff requirements with only 43 permanent staff members having been reviewed for redeployment. Around 25% of the savings are hoped to be achieved through non-labour efficiency initiatives relating to fleet vehicles, ITC, and travel and accommodation arrangements.<sup>17</sup>

The SLFI review commenced in July 2009 following an employment freeze on vacant positions enacted in May 2009. Changes to the business units to deliver efficiency improvements were implemented in the most part by 1 March 2010, following the implementation of the current organisational and financial reporting structure (as shown previously in Figure 3-1) in December 2009.

Employee FTE efficiency gains continue to be carried out. At 30 June 2010 there were 494 FTE's, which is lower than the final post SLFI target of 540.9 FTE's. The target of 540 FTE's was developed after allowing for the transfer of staff to Seqwater in 2008. This is due to the employment freeze still in place which means some positions are currently vacant.

SunWater is reportedly on track to achieve the \$10 million cost reduction by June 2012. Therefore it would be expected that the SLFI process would result in some reduction in these administration costs in the Service Contracts over the next pricing period. This should be assessed in the subsequent review proposed by the QCA.

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<sup>17</sup> Per data provided by SunWater (dated 11/11/09) at interview between P Boettcher, CEO SunWater, M Judkins and P McCarthy on 28/9/10 and an email from N Tran, SunWater, to P McCarthy, SAHA dated 29/9/10 titled *FTE pre & post SLFI*

## 6. SUNWATER ADMIN COST REVIEW

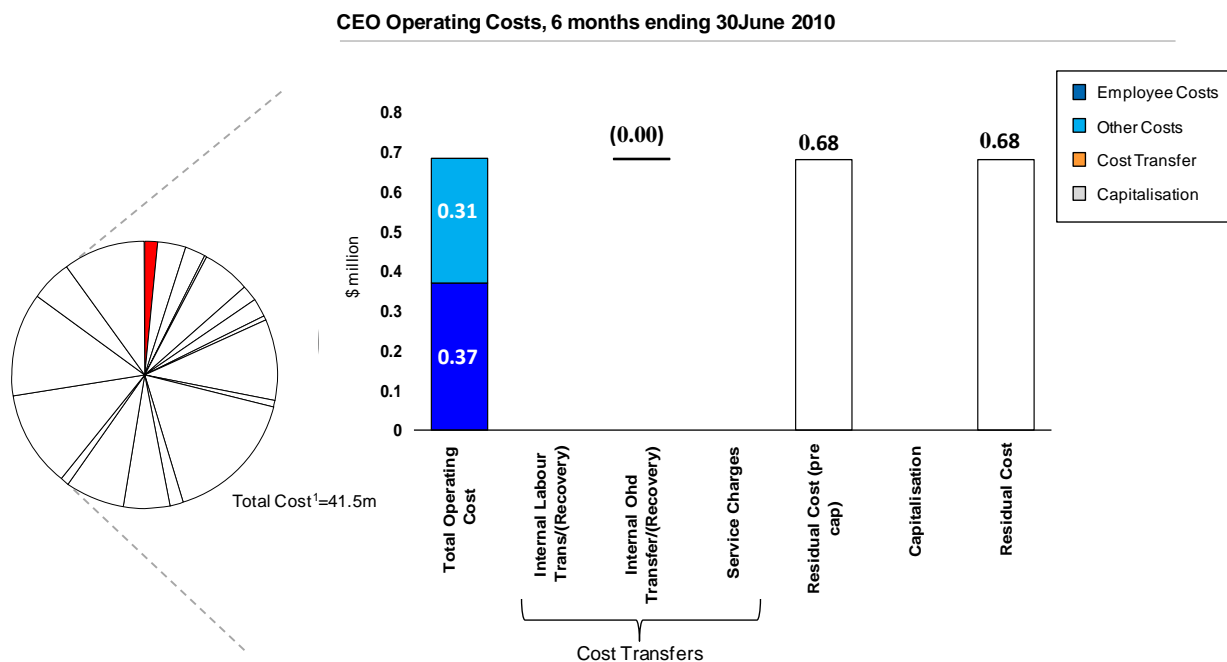
The focus of this paper is a review of SunWater’s administrative cost. As mentioned previously, SunWater do not utilise a separate classification of administrative cost, therefore, per the QCA’s ToR, we have treated all overhead and indirect costs (as opposed to overhead and indirect cost centres) as administrative for the purposes of the review as they represent the non-operational costs from both head office and regional offices that are applied to the Service Contracts on an actuals basis. In this section we assess each of overhead and indirect cost functions separately, including an evaluation of the following items as they impact on administration costs:

- Total operating cost (prior to cost transfer);
- Services provided by the function;
- FTE’s and structure to deliver services; and
- Cost reasonableness based on previous experiences/professional judgement.

### 6.1 CEO Office

The CEO function includes costs related to the board, the CEO’s office and the internal audit function. The total CEO Office cost (for the six months ending 30 June 2010), prior to any cost transfer) was \$0.684 million of which 54% was attributable to labour. The CEO Office is the only cost pool in this function. The cost categories in the figures in this section are shown in the following table.

**Figure 6-1 CEO Office Cost Analysis**



**Notes:**

1. Total of all Indirect and Overhead cost centres for 6 months ending 30 June 2010
2. Highlighted red pie slice presented in waterfall chart

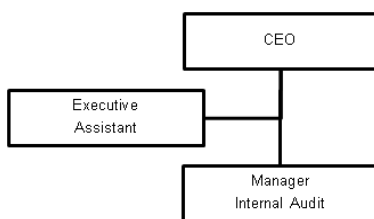
X Axis Cost Category	Description
Total Operating Cost	Total operational costs before any costs are transferred into service contracts.
Internal Labour Transfer/(Recovery)	Direct labour costs transferred into / (recovered from) service contracts (based on time sheeted direct labour hours).
Internal Ohd Transfer/(Recovery)	Portion of Brisbane and local Overhead cost and 5% Materials transferred into/ (recovered from) service contracts (based on time sheeted direct labour hours).
Service Charges	Portion of indirect costs transferred into service contracts.
Residual Cost (pre-cap)	Total operating costs after cost transfer and before capitalisation.
Capitalisation	Project costs capitalised.
Residual Cost	Total operating costs after cost transfer and capitalisation.

The main activities undertaken by the CEO's Office and related costs include:

- Governance and strategy oversight;
- Risk management and compliance;
- Internal audit and compliance;
- Strategic and operational management of the business; and
- External stakeholder management.

Total FTE's within the CEO's Office as of 30 June 2010 was 3. Targeted FTE's on completion of SLFI is 3.6 per the review conducted at the end of 2009, however currently it is understood the intention is to keep the FTE count at 3<sup>18</sup>. The structure of the CEO's office post SLFI is as follows:

**Figure 6-2 CEO Office structure (post SLFI)<sup>19</sup>**



From experience the costs and structure of the CEO's office are well within expected bounds based on our experience. It would be reasonable to expect the Executive Assistant to provide some support to the broader management team where available.

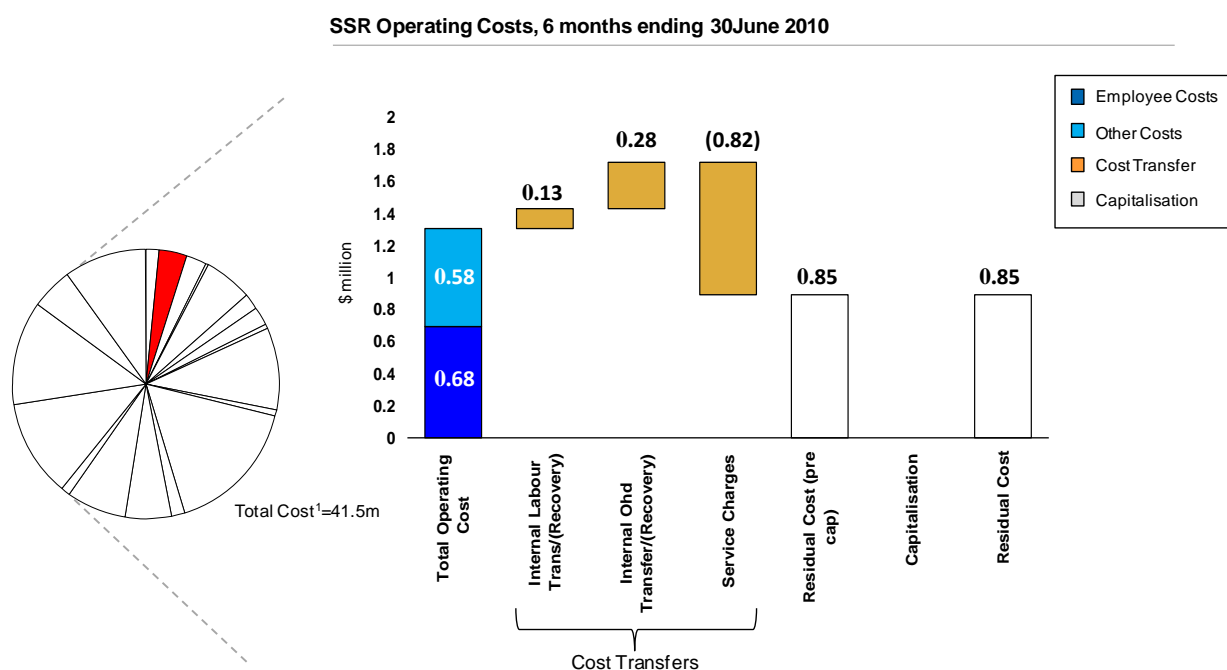
<sup>18</sup> Per data provided via email from N Tran, SunWater, to P McCarthy, SAHA dated 29/9/10 titled *FTE pre & post SLFI*

<sup>19</sup> Source email from P McGahan and J Stokes of SunWater to M Judkins and P McCarthy of SAHA titled *Updated org charts* dated 9/8/2010

## 6.2 Strategy and Stakeholder Relations (SSR)

The SSR function was formed as a result of the SLFI review and includes costs related to strategic planning and risk management, management of ROP's and ROL's, irrigation pricing, general industry regulation and corporate relations. The total cost (for the six months ending 30 June 2010, prior to cost transfer) was \$1.26 million of which 54% was attributable to labour. SSR function has both a Brisbane Overhead cost pool (which is the Resource Centre) and also indirect cost pools.

**Figure 6-3 SSR Cost analysis**



Source: SunWater Profit Centre P&Ls

Notes:

1. Total of all Indirect and Overhead cost centres for 6 months ending 30 June 2010
2. Highlighted red pie slice presented in waterfall chart

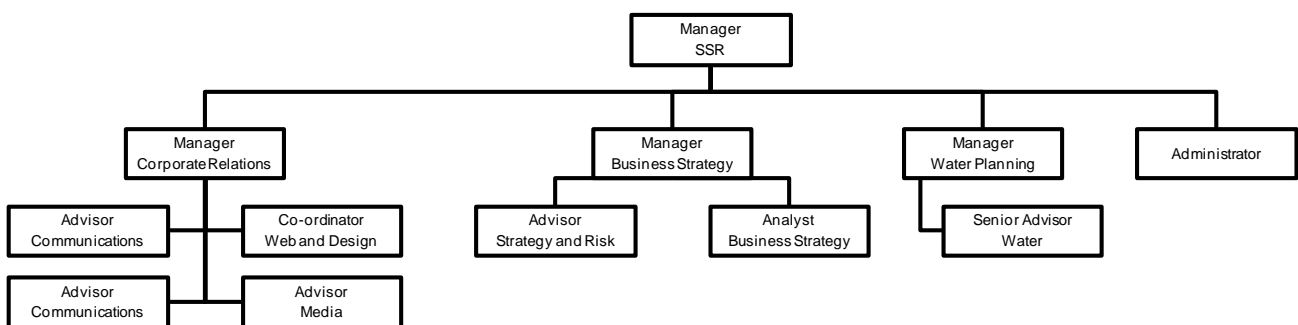
The main activities undertaken by the SSR function includes:

- Corporate Governance
  - Manage SunWater's risk framework and corporate risk management
  - Maintain Statement of Corporate Intent and Corporate Plan
  - Perform quarterly reporting (largely compliance) and annual reporting responsibilities
  - Manage governance of water pricing
  - Manage economic policy and regulation;
- Water Planning
  - Governance of operating licences (including liaison with DERM);
- Corporate relations
  - including internal and external communications (intranet and internet)
  - shareholder communication
- Corporate planning and reporting

- Hydrology oversight; and
- Support for projects.

Total FTE's at 30 June 2010 was 12. Targeted FTE's on completion of SLFI is to remain the same<sup>18</sup>. The structure and headcount of SSR post SLFI is as follows:

**Figure 6-4 SSR structure (post SLFI)<sup>19</sup>**



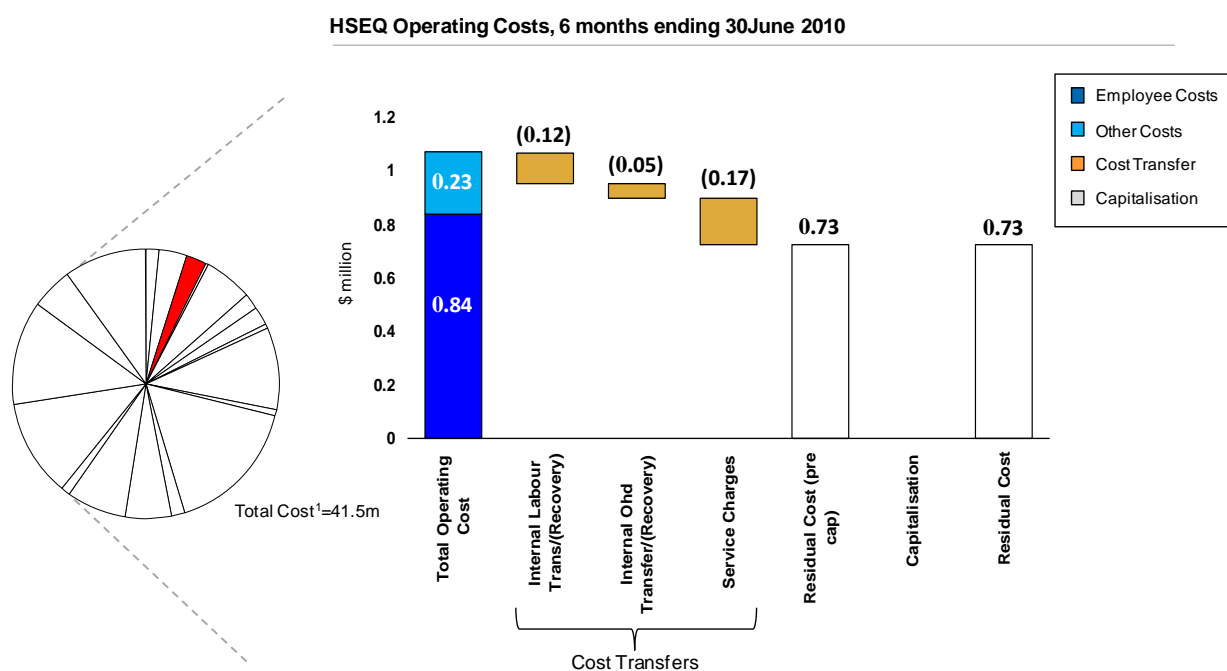
While the workload of the SSR function is somewhat constant over a year, there are periods when additional resources are required (for example during the current irrigation pricing review process underway). During these periods of high demand contractors and consultants are employed to meet the work demand. 44% of SSR's non labour cost during the period was due to the use of consultants to assist with the current irrigators pricing review (\$231k). We would therefore only expect to see this as a one off cost in the next pricing period (with allowance made for additional consulting resources as the next price review period approaches).

The costs and structure of the SSR business unit seem reasonable given their functional responsibilities.

## 6.3 Health, Safety, Environment and Quality (HSEQ)

The HSEQ function was formed as a result of the SLFI review and includes costs related to workplace health and safety, environmental management and quality control. The total cost (for the six months ending 30 June 2010, prior to cost transfer) was \$1.069 million of which 78% was attributable to labour. HSEQ function has both a Brisbane Overhead cost pool (which is the Resource Centre) and also indirect cost pools.

**Figure 6-5 HSEQ Cost analysis**



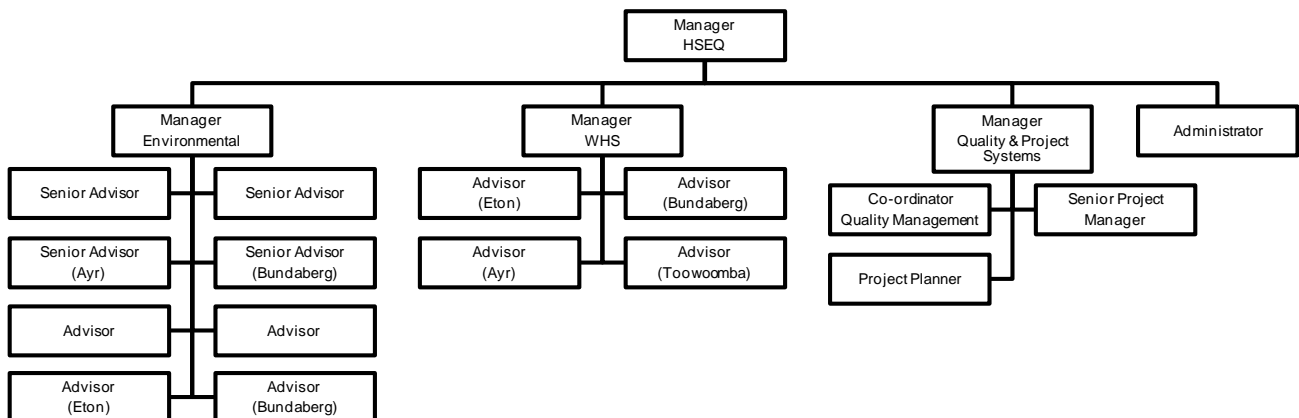
The main activities undertaken by the HSEQ function are:

- Environmental Management
  - Maintain environmental accreditation and perform environmental audits across business
  - Manage water quality
  - Manage aquatic weeds
  - Manage fish passage along waterways
  - Environmental studies for new development project (ID);
- Work Health and Safety (WHS)
  - Advise SunWater business on compliance with WHS requirements
  - Ensure appropriate WHS controls are in place
  - WHS reporting (legal group deals with communications); and
- Quality Projects and Systems
  - Maintain quality accreditation (and quality system)
  - Develop systems and procedures to support Environment and WHS groups

- Develop project standards across the business.

Total FTE's at 30 June 2010 was 16. Targeted FTE's on completion of SLFI is an increase to 20 FTE's<sup>18</sup>. The structure of HSEQ post SLFI is as follows:

**Figure 6-6 HSEQ Structure (post SLFI)** <sup>19</sup>



Currently the SSR Manager is acting HSEQ Manager however SunWater are actively recruiting for this role.

Many of the HSEQ functions previously undertaken in the regions have been centralised delivering savings in headcount but also in reducing the cost of environmental audit training and reduced system duplication.

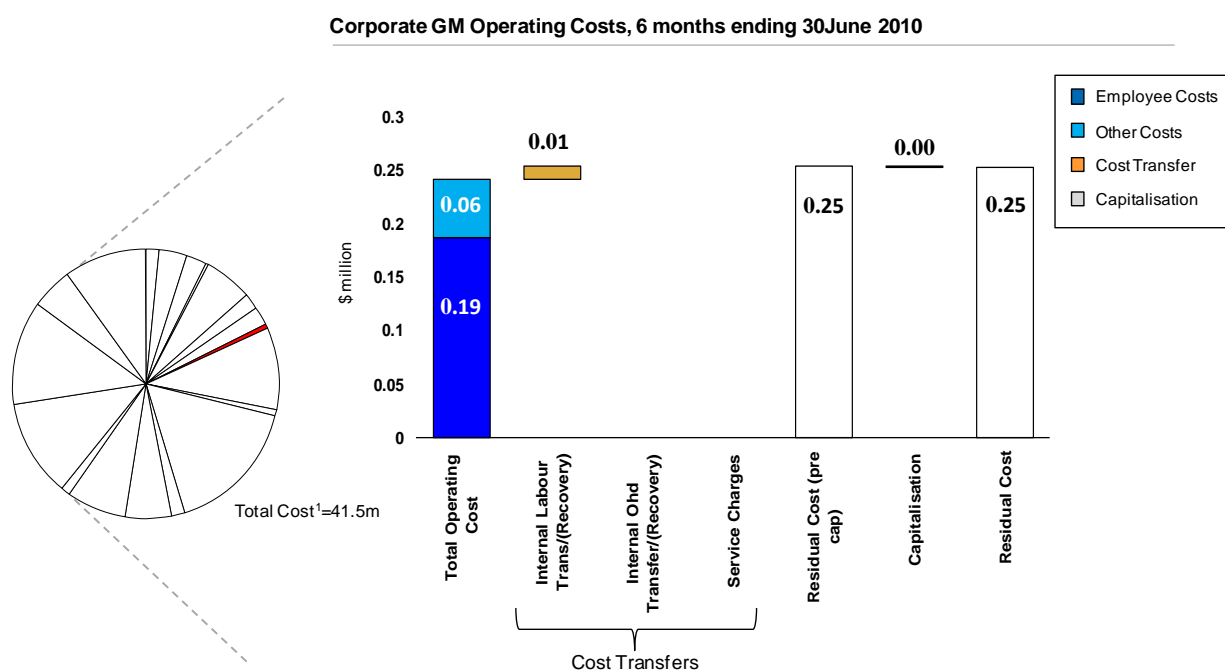
The total headcount required of the HSEQ function is high, based on our previous experience. This can be partially explained by the environmental compliance requirements placed on SunWater's business. In addition there is a growing WHS compliance requirement across all businesses requiring additional resources to manage potential risks. SunWater also maintain a highly regional operation requiring some resources to be based within the regional offices (especially environmental and WHS officers), increasing the required headcount when compared to urban/centralised operations. However we would anticipate a potential 1-2 FTEs headcount reduction across the function based on our experience. The focus of the potential FTE savings should be in the environmental group and quality and project systems. We would expect some basis for these additional FTEs in SunWater's NSP.



## 6.4 Corporate – GM Office

The Corporate GM's office includes costs related to the support and management of the corporate group and the company secretariat. The total cost (for the six months ending 30 June 2010, prior to cost transfer) was \$0.242 million of which 77% was attributable to labour. The Corporate GM's office is the only cost pool in this function.

**Figure 6-7 Corporate GM Cost Analysis**



Source: SunWater Profit Centre P&Ls

**Notes:**

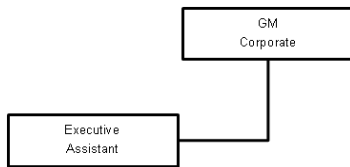
1. Total of all Indirect and Overhead cost centres for 6 months ending 30 June 2010
2. Highlighted red pie slice presented in waterfall chart

The main activities undertaken by the Corporate GMs Office include:

- Management of Corporate function
- Administrative support for Corporate Group; and
- Company Secretariat activities.

Total FTE's at 30 June 2010 was 2. Targeted FTE's on completion of SLFI is 2.5 per the review conducted at the end of 2009, however currently it is understood the intention is to keep the FTE count at 2<sup>18</sup>. The structure of the Corporate GM's post SLFI is as follows:

**Figure 6-8 Corporate GM’s Office Structure post SLFI (including direct reports) <sup>19</sup>**

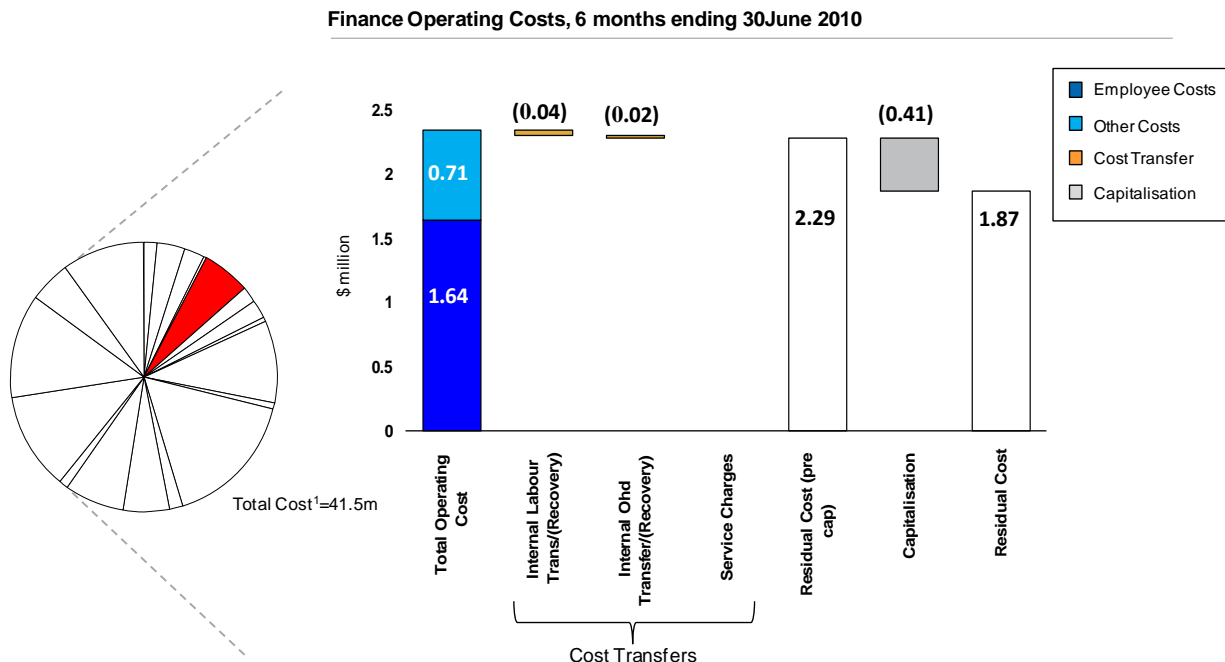


The costs and structure of the Corporate GM’s Office are well within expected bounds, based on our experience, as it is normal practice for management support to be provided to the various head office overhead functions including finance and HR. Although seasonal, company secretariat duties can be significant. A full time executive assistant to provide support across the group is reasonable.

## 6.5 Corporate – Finance

The Finance function includes costs related to the financial accounting, management accounting, tax advice, credit services and support service functions. The total cost (for the six months ending 30 June 2010, prior to cost transfer) was \$2.346 million of which 70% was attributable to labour.

**Figure 6-9 Finance Cost Analysis**



Source: SunWater Profit Centre P&Ls

**Notes:**

1. Total of all Indirect and Overhead cost centres for 6 months ending 30 June 2010
2. Highlighted red pie slice presented in waterfall chart

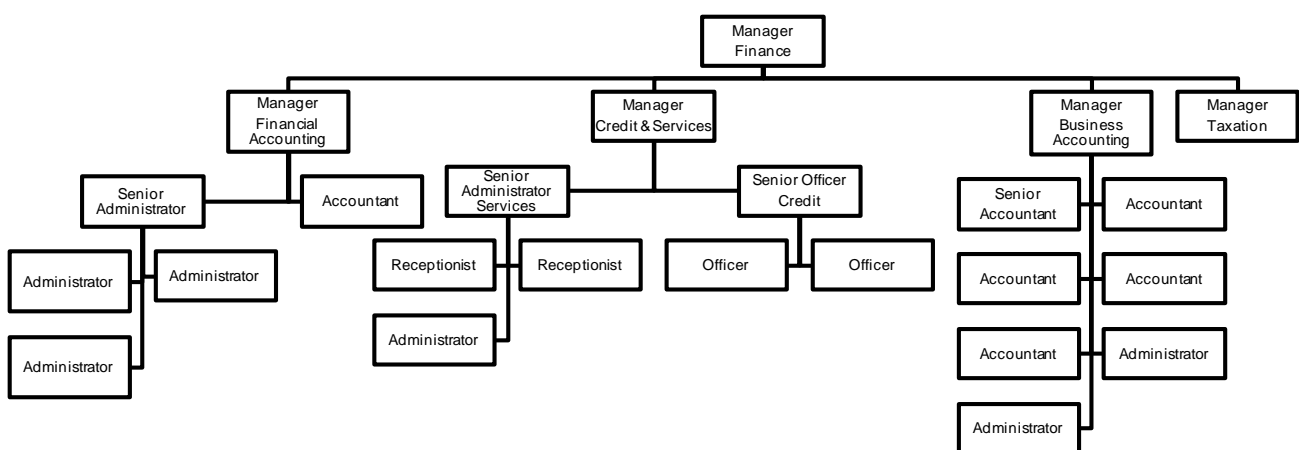
The main activities undertaken by the Finance function include:

- Financial and Management accounting functions (such as financial reporting and budgeting);

- Brisbane Head Office Services (including receptionist function);
- Tax (including Business Activity Statement - BAS);
- Management of insurance policies;
- Management asset register;
- Large commercial customer billing and data (i.e. these are large accounts that are not managed by the SunWater Water Information Management System – SWIMS, which is managed by Water Accounts - to be discussed below); and
- Credit management including risk assessments and bill follow-up.

Total FTE's at 30 June 2010 was 23. Targeted FTE's on completion of SLFI is increase to 25.1 FTE's <sup>18</sup>. The structure and headcount of Finance post SLFI is as follows:

**Figure 6-10 Corp - Finance Structure (post SLFI) <sup>19</sup>**



The finance function has been completely centralised in the recent organisational changes. Previously management accounting personnel and some purchasing and asset management personnel were located in regional offices creating duplication with head office. Under the new structure all finance activities are undertaken centrally, with the regional planners only responsible for receipting goods and preparing purchase orders in the SAP accounting system. All payments and management of billing occurs centrally.

The 7 FTEs in the Business Accounting function were previously in ID (2 FTEs), IM (4 FTEs) and Corporate (1 FTE). However the total number of FTEs has been reduced as centralisation has removed duplication of accounting activities between Head Office and the regions.

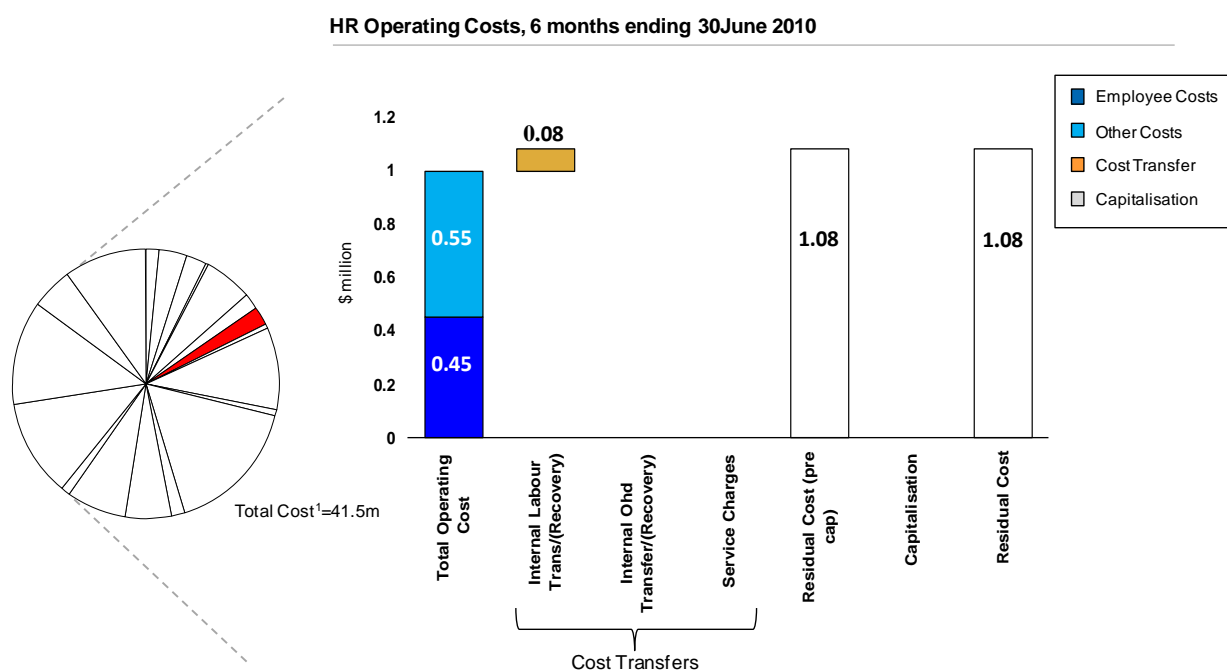
We have not undertaken a comprehensive review of operational metrics to understand the performance of each section of the Finance group. We understand that previous benchmarking exercises undertaken internally have shown the group to be efficient, however we cannot comment on these results. While the centralisation of operations offers immediate efficiency improvement we would expect to see additional improvement as the function addresses any remaining issues with the new arrangements. There is potential to deliver additional cost savings going forward.

Based on previous experience with both utilities but also a broad range of customer facing businesses across multiple industries, each finance function is broadly within the expected cost range, however given the nature of business operations (small customer base and limited pricing analysis relative to other industries) there is potentially some room for savings within the business accounting function. While the need for management accounting resources is largely fixed the demand for payable and receivable resources varies and there is potentially some opportunity when assessed against previous experience to improve efficiency in these functions. Further analysis needs to be undertaken to confirm this. We recommend the finance function be investigated in more detail once SunWater submit their NSP's. This will include an assessment of operational performance (e.g., number of invoices handled per accounts payable FTE)

## 6.6 Corporate – Human Resources (HR)

The HR function includes costs related to recruitment, training, time-sheets, industrial relations issues, remuneration and benefits, system administration and organisation development activities. The total cost (for the six months ending 30 June 2010, prior to cost transfer) was \$0.998 million of which 45% was attributable to labour. HR are the only cost pool in this function.

**Figure 6-11 HR Cost Analysis**



**Notes:**

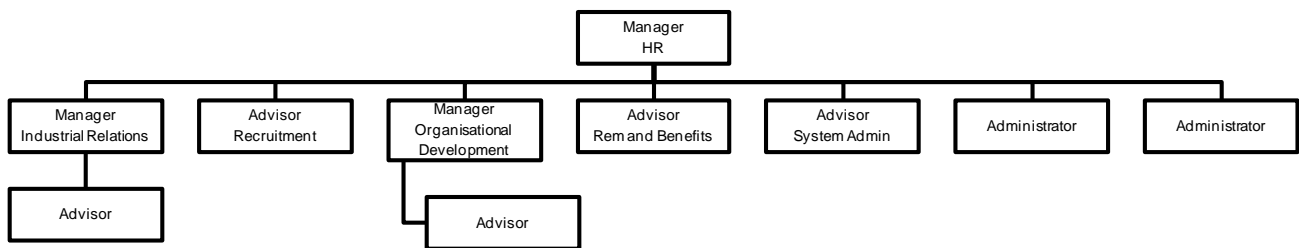
1. Total of all Indirect and Overhead cost centres for 6 months ending 30 June 2010
2. Highlighted red pie slice presented in waterfall chart

The main activities undertaken by HR include:

- Time data administration (time-sheetsing by all SunWater personnel);
- Payroll administration (payroll processing is outsourced to Queensland State Government Shared Service);
- Co-ordination of training (including safety training);
- Recruitment;
- Co-ordination of Enterprise Bargaining Agreements;
- HR general – position descriptions, benchmarking etc; and
- Organisational change management.

Total FTE's at 30 June 2010 was 7. Targeted FTE's on completion of SLFI is an increase to 10 FTE's<sup>18</sup>. The structure of HR post SLFI is as follows:

**Figure 6-12 Corp - HR Structure (post SLFI)<sup>19</sup>**



In the recent re-organisation HR has gained a number of additional roles that were previously performed by the regional offices. These include time data administration, performance management and co-ordination of all training including WHS training. Currently HR has 3 unfilled vacancies and experience indicates these are likely to be required given the recently expanded role of the Brisbane group. We note that the transition away from a regional HR function to a Brisbane centralised function is not without its difficulties and there may need to be additional support for a period as the business transitions.

Overall, SunWater's recent churn rate was 19.38% which is high in comparison to comparable businesses, (where 5-15% would be expected). However 10.4% of this is attributable to voluntary turnover<sup>20</sup>. The current SLFI objectives have impacted on this churn rate however the regional nature of the business and the need to compete with the high demand for skilled labour from mining companies also has some impact. Adjusting for these factors the current churn rate is within expected bounds.

As mentioned previously, the targeted FTE saving post SLFI is 94.6 based on 2009/10 budgeted figures. The majority of this saving relates to temporary staff and a number of additional roles have been created in Brisbane to meet the increased workload of the centralised functions. As changes are ongoing most, but not all, savings will become evident in the current year. All cost savings should be implemented by June 2012 during the next pricing period.

Overall HR appears under-resourced given the additional workload required to carry out the SLFI objectives over the next 12 months (mainly because of 3 vacant positions). In addition the risks associated with managing a regional workforce from Brisbane need to be effectively managed and SunWater should be aware of the significant issues facing other businesses who have removed HR functions from their regional operations. While we consider this best practice there is a need to ensure high levels of communication and visibility between head office and regional staff.

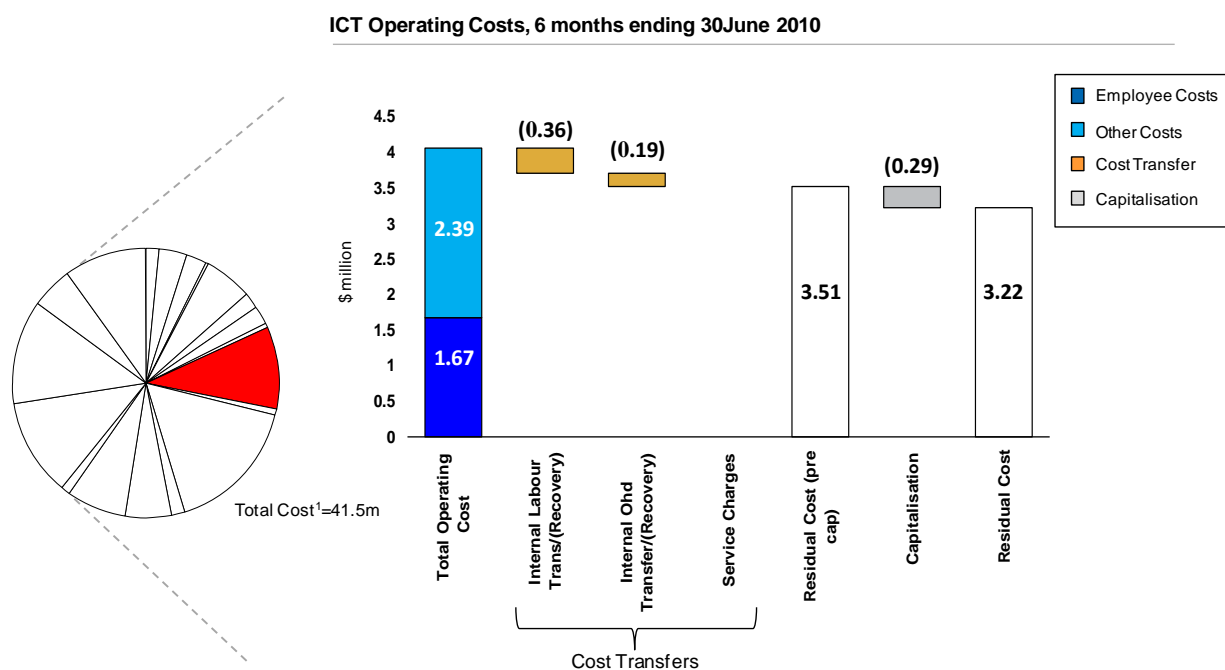
<sup>20</sup> As per email from P Boettcher via P McGahan, SunWater, to P McCarthy and M Judkins, SAHA dated 30/9/10, titled *Turnover Rates*

Non labour costs reflect training costs and contractor costs (use of recruitment specialists mostly). We suggest an operational review of the services delivered by external recruitment agents be undertaken in the subsequent phase e.g., are they value for money based on the level of service that is provided?

## 6.7 Corporate – Information Communication and Technology (ICT)

The ICT function includes costs related to managing information systems, maintenance and management of IT infrastructure, application support and help desk facility. The total cost (for the six months ending 30 June 2010, prior to cost transfer) was \$4.061 million of which 41% was attributable to labour. ITC are the only cost pool in this function.

**Figure 6-13 ICT Cost Analysis**



**Notes:**

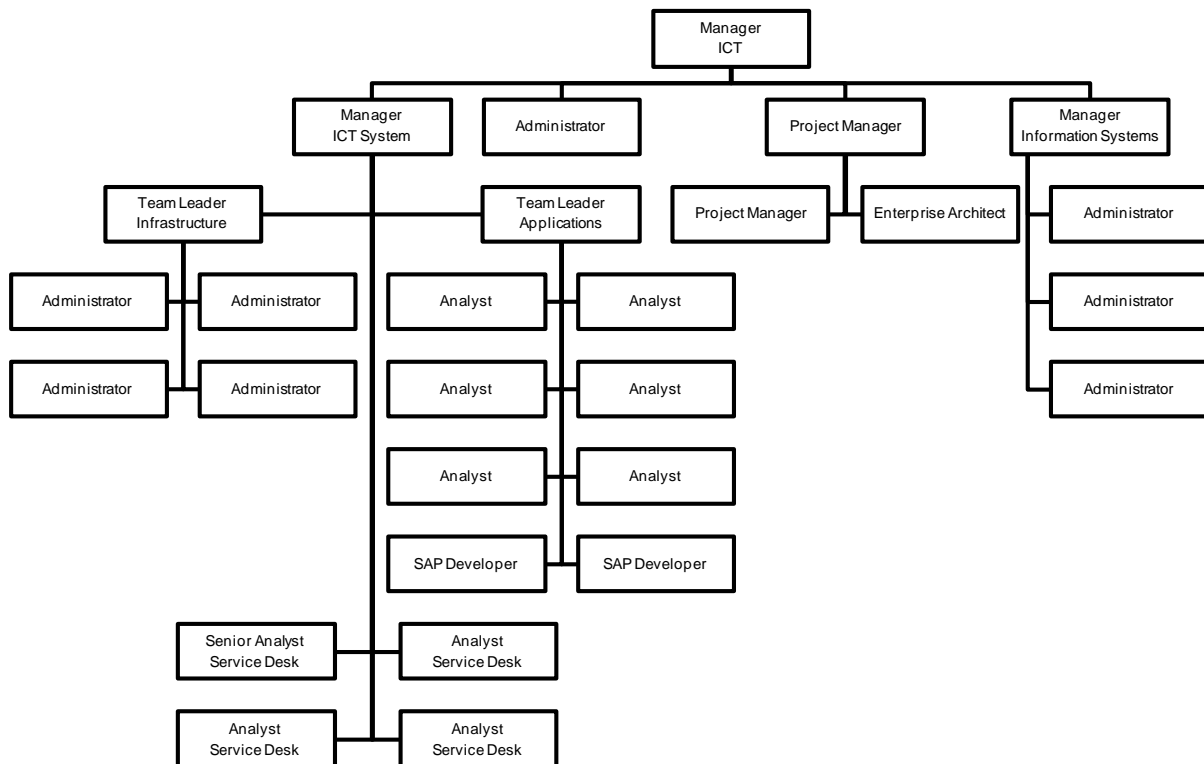
1. Total of all Indirect and Overhead cost centres for 6 months ending 30 June 2010
2. Highlighted red pie slice presented in waterfall chart

The main activities undertaken by the ICT function include:

- Management of IT platforms, infrastructure and the overall network
- Management of phone system
- Document record management (Hummingbird system);
- Library function and hard copy file storage;
- Service desk function; and
- Application support including some support for SAP, SWIMS, Hummingbird, Intranet/Internet, WMS.

Total FTE's at 30 June 2010 was 29.7. Targeted FTE's on completion of SLFI is a decrease to 27 FTE's<sup>18</sup>. The structure of ICT post SLFI is as follows:

**Figure 6-14 Corp - ICT Structure post SLFI<sup>19</sup>**



The ICT group supports most of the systems used by SunWater however it makes extensive use of external contractors where required. Most of the application development for SAP is outsourced, as is development for SWIMS however there is capability in-house to provide support to the business.

ICT has implemented a number of cost saving initiatives over the past 2 years including a move to replace the WAN (contracted CITEC to replace Telstra at significant cost reduction) and made a move to a virtual environment to reduce operating costs. This has not been independently verified.

The SWIMS system is currently under review and there is a proposal to replace it going forward, as it is costly to maintain. It currently manages relatively complex rules to record customer WAE's and manages transfers and trades between customers. This capability can be undertaken by SAP however would require a significant and costly investment. ICT is currently looking at solutions to move to another system to manage customer WAE's and use SAP to handle customer data.

Based on the IT support for a range of companies including IT software businesses (requiring software development capability and significant customer management) the ICT function is a high cost operation with significant head count for the services provided. Our conclusion takes into account the use of SAP, the



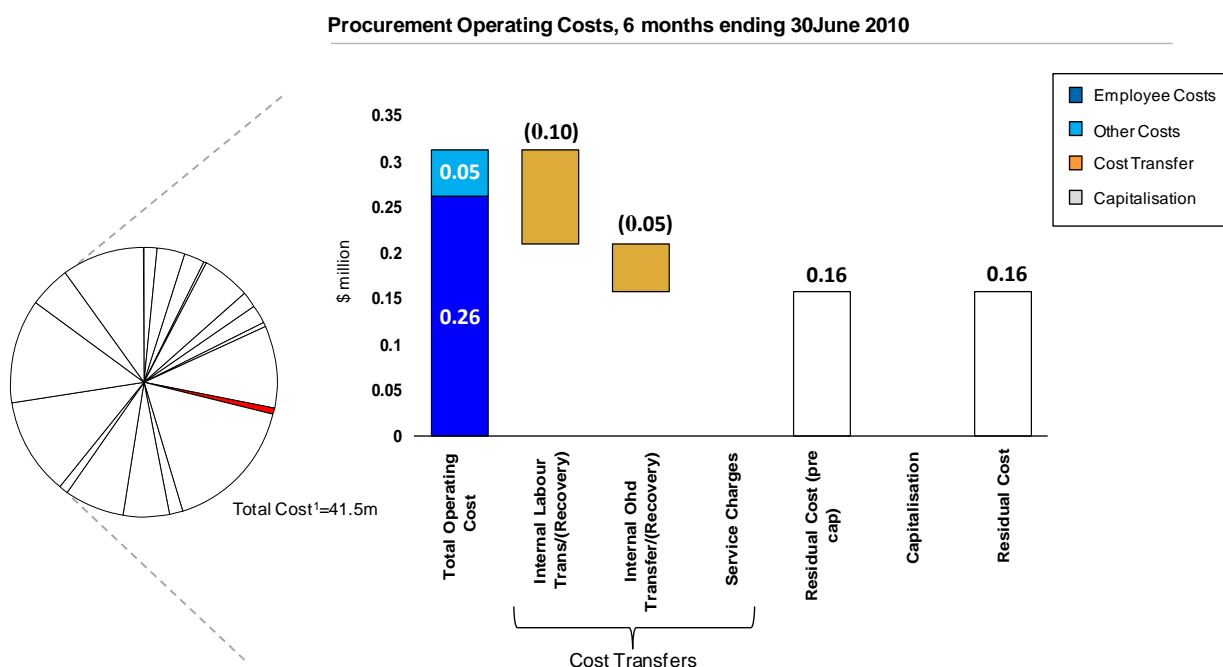
SWIMS system and other internal ICT needs of SunWater's business. Relative to our experience there is a potential to reduce the technical support by up to 4 FTEs. This is based on our understanding that a large amount of the development work for both SAP and SWIMS is undertaken externally (which is also reflected in the non labour cost base). We have not assessed the exact roles that could be potentially targeted however the number of systems administrators appears high.

Other major cost items including telecommunication costs, occupancy and software licensing costs appear appropriate (and in cases low) based on our professional judgement and previous experience. We are informed by SunWater that a recent review of telecommunication costs and the tendering of a new provider has significantly reduced total IT cost, however have not verified this.

## 6.8 Corporate – Procurement

The Procurement function includes costs related to the procurement of major engineering infrastructure (including technical goods and services) and procurement of consumables. SunWater’s Procurement Policy and Procedures are based on the Queensland Government Chief Procurement Office (QGCP) State Procurement Policy. The total cost (for the six months ending 30 June 2010, prior to cost transfer) was \$0.312 million of which 84% was attributable to labour. Note the cost of materials procured is directly allocated to the Service Contracts. Procurement is the only cost pool in this function.

**Figure 6-15 Procurement Cost Analysis**



**Notes:**

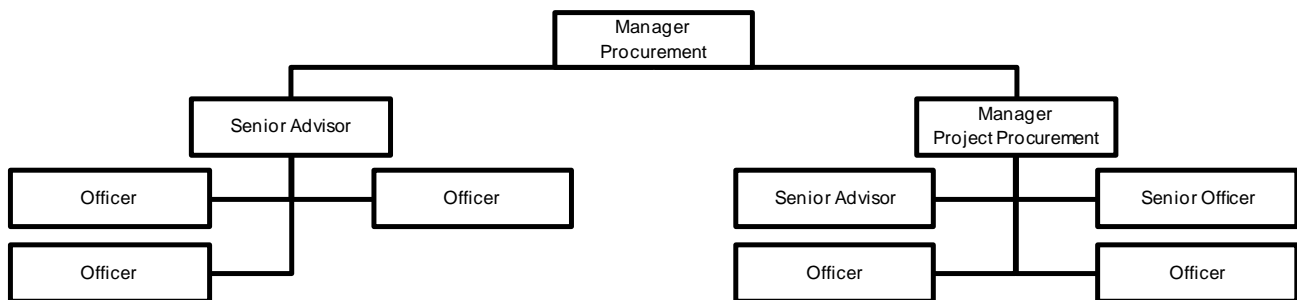
1. Total of all Indirect and Overhead cost centres for 6 months ending 30 June 2010
2. Highlighted red pie slice presented in waterfall chart

The main activities undertaken by the Procurement function include:

- Direct management of all SunWater purchases valued over \$25,000;
- Support to regional offices for purchases valued under \$25,000;
- Management of all general procurement is in accordance with SunWater’s Procurement Policy and QGCP’s State Procurement Policy;
- Advise on procurement for goods and services, including those for water infrastructure and services;
- Manage central stores and the movement of supplies to regional stores; and
- Ensure procurement of supplies meets safety, insurance, sustainability and risk management requirements

Total FTE's at 30 June 2010 was 9. Targeted FTE's on completion of SLFI is an increase to 9.8 FTE's<sup>18</sup>. The structure of Procurement post SLFI is as follows:

**Figure 6-16 Corporate - Procurement Structure post SLFI** <sup>19</sup>



Procurement is largely centralised in Brisbane head office with the purchase of all items greater than \$25,000 undertaken by Corporate Procurement. Purchases under \$25,000 are managed by regional offices with guidance from Corporate Procurement.

SunWater uses its own Standing Offer Arrangements, as well as the whole-of-Government Arrangements, available from the QGCPO and Best Buys, as applicable (examples are travel management, vehicle hire, protective clothing and equipment). Utilisation of such arrangements is designed to achieve the lowest cost, along with ease and reliability of procurement. SunWater's provision of vendor managed stationery supply was procured as a period contract via a competitive select tender process.

The procurement function operates over two levels – one being the procurement of major engineering infrastructure (including technical goods and services) and the other for more general procurement activities.

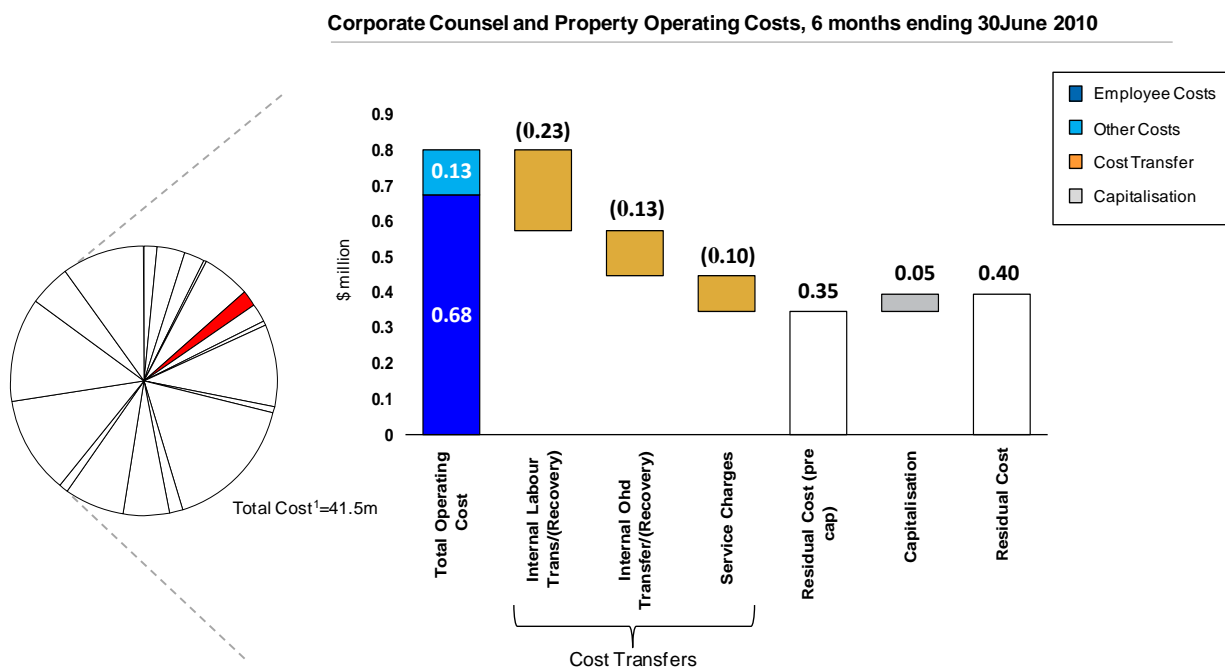
The recent organisational changes led to the centralisation of some procurement functions from the regions into Brisbane head office. Previously each region had procurement officer/s, a situation which no longer exists. Procurement projects that take more than 4 hours and are directly attributable to a Service Contract are costed directly to the Service Contract.

A total of 9.8 FTEs is high for a centralised procurement function, however given the limited regional support and the level of direct labour charged to projects, the overall cost benchmarks are reasonable given our experience of a number of procurement functions in mining and rail operations. We would expect that the procurement function is providing sufficient support to ensure the regions are able to procure timely and cost effective goods and services. The basis for this analysis is procurement functions in other capital intensive businesses that undertake large centralised procurement activities for regionally operated businesses with very large SKU volumes (e.g., rail operators).

## 6.9 Corporate – Legal & Property

The Legal function includes costs related to legislative and regulatory compliance, property management (including public access and staff housing), legal disputes, and contract management. The total cost (for the six months ending 30 June 2010, prior to cost transfer) was \$0.800 million of which 84% was attributable to labour. Legal and Property is the only cost pool in this function.

**Figure 6-17 Legal and Property Analysis**

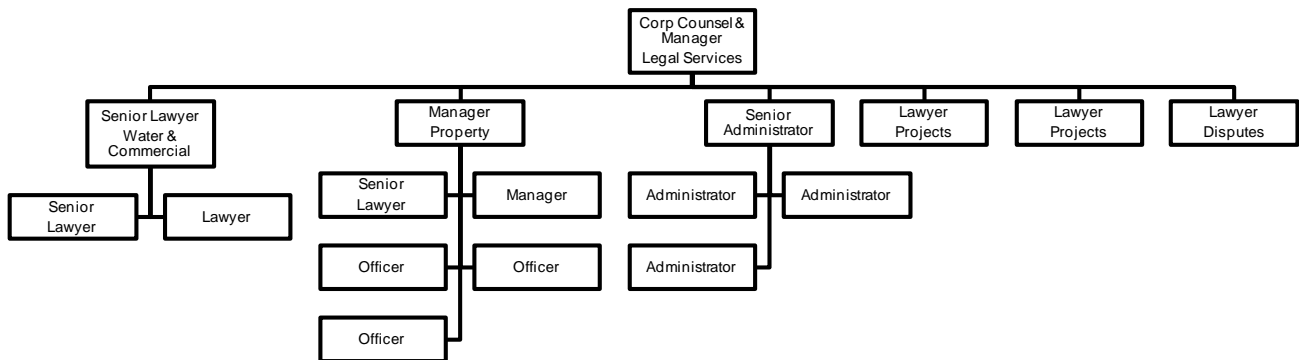


The main activities undertaken by the Legal and Property groups include:

- Legislative compliance (SunWater must comply with 474 different pieces of legislation);
- Regulatory compliance with range of parties including the Water Act 2000;
- Legal matters associated with all assets including perpetual leases, water tenures, access issues, recreational area use, flood licence areas, rental property management, leases;
- Negotiations with third parties associated with assets;
- Legal disputes;
- General contractual advice (including all assets); and
- Project legals including cultural heritage, native title, pipeline and dam legal matters

Total FTE's at 30 June 2010 was 12.6. Targeted FTE's on completion of SLFI is slight increase to 13<sup>18</sup>. The structure Legal post SLFI is as follows:

**Figure 6-18 Corporate - Legal Structure post SLFI** <sup>19</sup>



Headcount in this business unit is significantly higher than the FTE amount because there is a number of part time staff.

The legal department is large for an organisation the size of SunWater compared to other similar businesses. We understand there are a number of compliance requirements placed on the business that are the responsibility of legal group, in addition to monitoring and managing any changes to these requirements. Also due to the public access nature of the business there is a significant requirement to manage access to waterways and recreational facilities around dams and weirs. The legal group currently have a couple of significant ongoing litigation matters requiring resources.

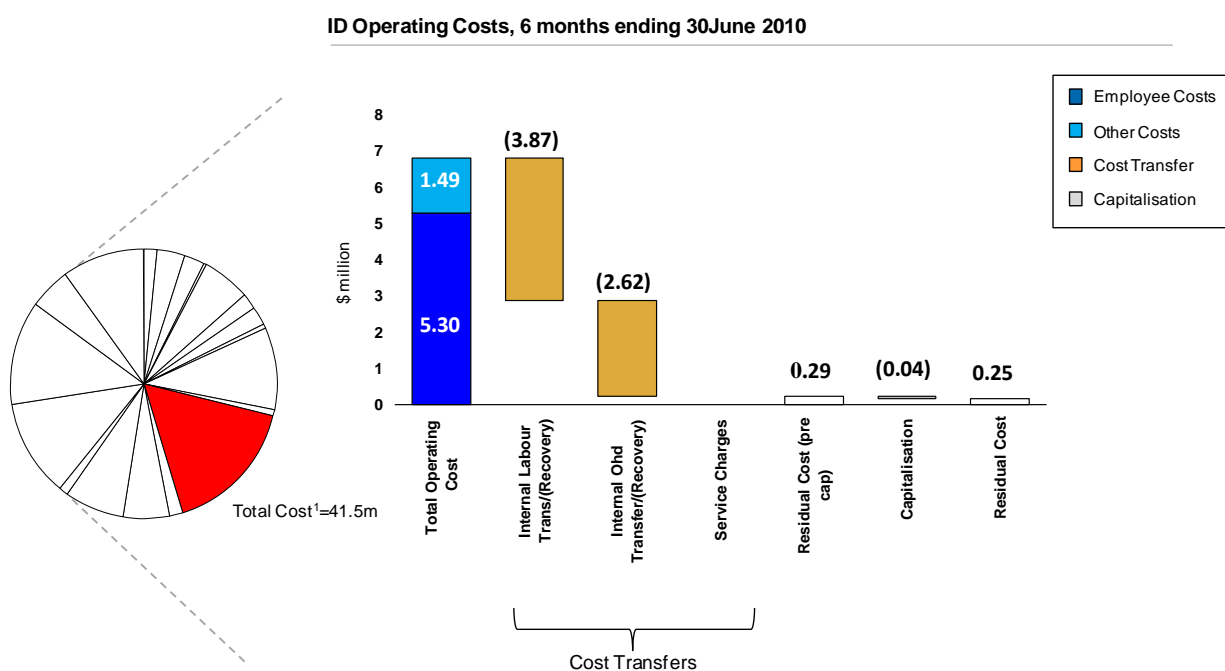
Based on our experience the legal and property groups are at the higher end of the benchmark group. We would recommend a further review of the compliance requirements currently being undertaken by the business and whether these are part of normal business operations or external requirements placed on the business. While this determination is out of scope of this study we believe the work load required of the business is significant and a review should therefore be conducted to assess the appropriate level of cost transfer to customers (including irrigation customers).

When looking at total legal costs it is important to include both internal resources and the cost of briefing externally. SunWater have adopted a policy of keeping legal in-house and reducing the amount of briefing externally. Due to the continuous nature of the work this appears a reasonable strategy (although no judgement of the outcomes of this has been assessed). Based on our experience after adjusting for the limited amount of external briefing undertaken, there is an opportunity to review 1-2 FTEs across the legal and property group. However note that this is subject to a review of compliance and reporting requirements.

## 6.10 Infrastructure Development (ID)

The ID function includes costs related to ID GM's office, northern and southern regions (for ID), project management, project proposals and business development. The total cost (for the six months ending 30 June 2010, prior to cost transfer) was \$6.807 million of which 78% was attributable to labour. ID function has both a Local Overhead cost pools (some of which are Resource Centres) and also an indirect cost pools.

**Figure 6-19 ID Cost Analysis**



**Notes:**

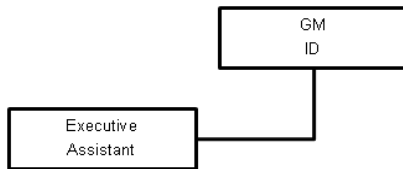
1. Total of all Indirect and Overhead cost centres for 6 months ending 30 June 2010
2. Highlighted red pie slice presented in waterfall chart

The main activities undertaken by the administrative function of the ID group include:

- Engineering design, technical support and hydrology advisory
- Project management support
- Activities that are not recovered from Service Contracts impacting irrigators (including industrial projects)

Total FTE's at 30 June 2010 was 126 (across all ID). Targeted FTE's on completion of SLFI is a decrease to 115.9 FTE's<sup>18</sup>. Note that this includes all FTEs – both direct and overhead. The structure of the ID GM's post SLFI is as follows:

**Figure 6-20 ID GM's Office Structure Post SLFI (including direct reports) <sup>19</sup>**



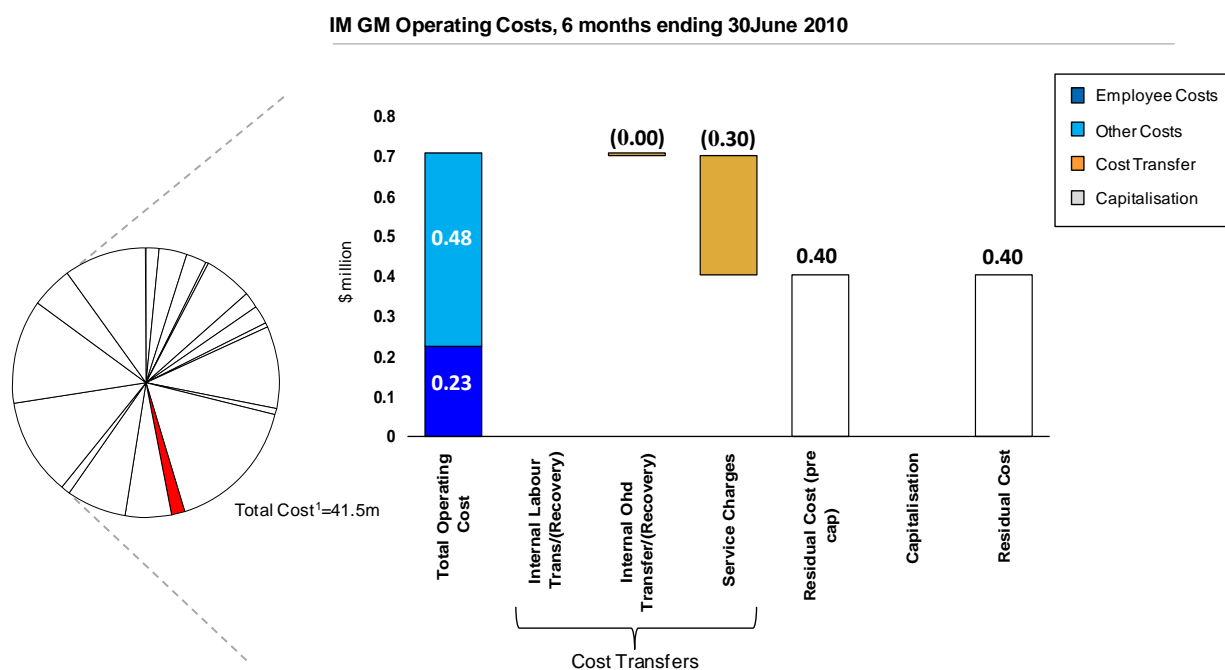
The significant amount of overhead cost in ID reflects the Resource Centre capturing the overhead cost prior to transfer to ID activities and also other projects based on direct labour. Note overhead is approximately 30% of the total ID operating cost.

Historically ID labour has been directly charged to Service Contracts relating ID and consulting activities and not to Service Contracts relating to irrigators. However some ID labour and associated overhead has been charged to IM activities which are attributable to Service Contracts relating to irrigators. These amounts have been minimal over the last 5 years. Due to the immaterial amount of overhead cost allocated to irrigator service contracts we have not undertaken a detailed assessment of the reasonableness of the ID functions overhead costs.

## 6.11 Infrastructure Management - GM Office

The IM function includes costs related to IM GM's office. The total cost (for the six months ending 30 June 2010, prior to cost transfer) was \$0.709 million of which 32% was attributable to labour. GM office is the only cost pool in this function.

**Figure 6-21 IM GM Office Cost Analysis**



**Notes:**

1. Total of all Indirect and Overhead cost centres for 6 months ending 30 June 2010
2. Highlighted red pie slice presented in waterfall chart

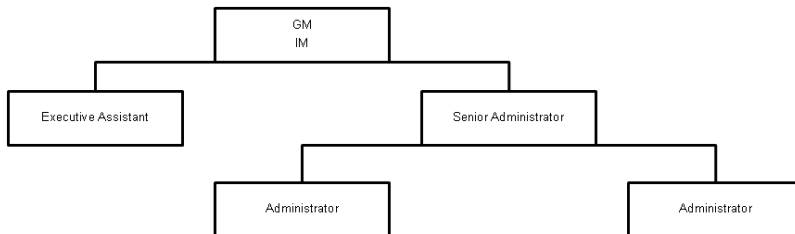
The main activities undertaken by IM GM's office include:

- Responsibility for the day to day performance of the IM group and admin team; and
- Administrative support to the IM Group.

Total FTE's at 30 June 2010 was 5. Targeted FTE's on completion of SLFI is unchanged<sup>18</sup>. The structure of the ID GM's post SLFI is as follows:



**Figure 6-22 IM GM's Office Structure post SLFI (including direct reports) <sup>19</sup>**



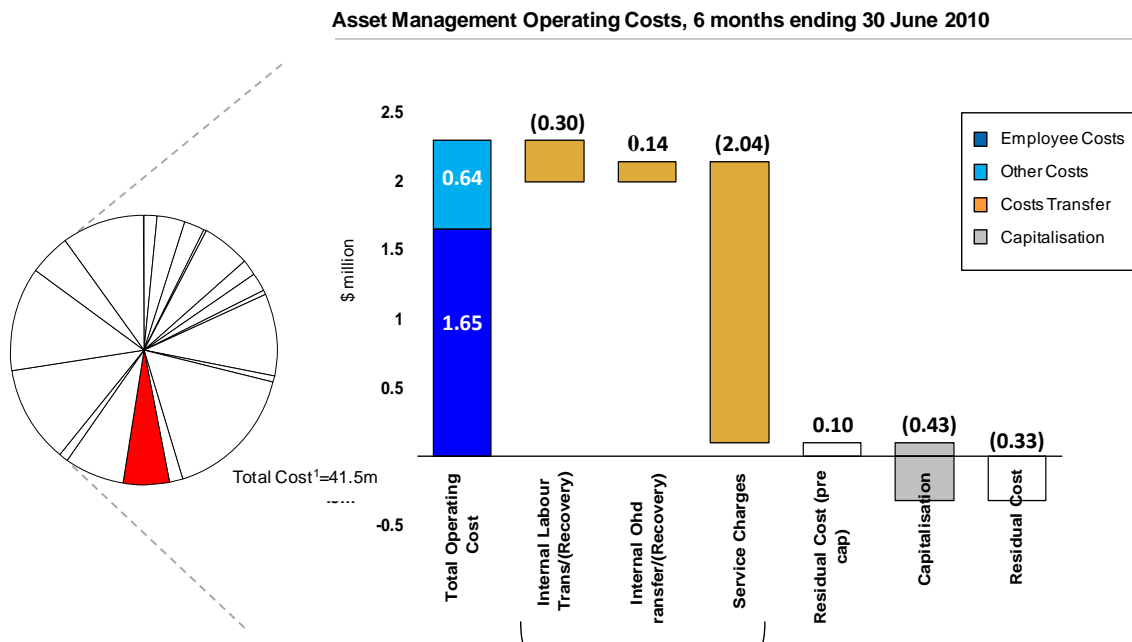
Most activity undertaken by IM business units is direct labour that is time-written to the Service Contracts being worked on. However some costs are captured as overhead costs and are shared across the SunWater business. Based on the size of the IM team the costs look reasonable.

The large non labour cost is due to an inventory adjustment during this period. The basis for this has not been verified however assuming it is a one-off we would not expect such adjustments to appear in SunWater's projected cost base.

## **6.12 Infrastructure Management - Asset Management**

The Asset Management function oversees the 'whole of life' planning for infrastructure assets including costs related to the provision of dam safety, pump stations and pipelines, channels and drainage, water and waste water, headworks and strategy and systems. These costs are largely engineering support costs that sit in the centralised asset management functions to support work being delivered in the regions. The total cost (for the six months ending 30 June 2010, prior to cost transfer) was \$2.297 million of which 72% was attributable to labour. AM function has both a Local Overhead cost pool (which is the Resource Centre) and also indirect cost pools.

**Figure 6-23 Asset Management Cost Analysis**



Source: SunWater Profit Centre P&Ls

Notes:

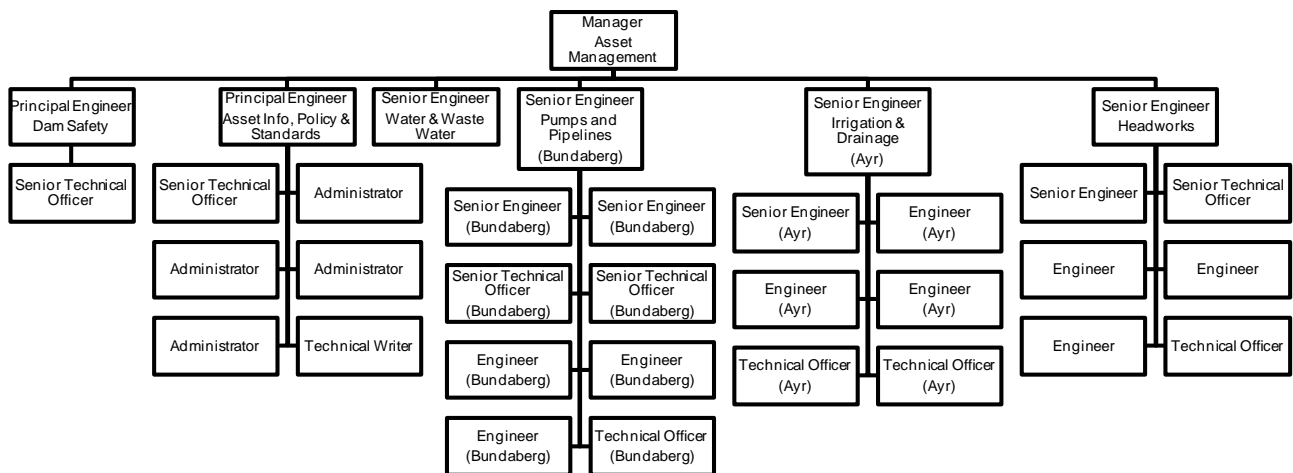
1. Total of all Indirect and Overhead cost centres for 6 months ending 30 June 2010
2. Highlighted red pie slice presented in waterfall chart

The main activities undertaken by the Asset Management function include:

- Asset management strategy - \$7bn assets owned by SunWater;
- Works management system including planning;
- Maintenance including planned maintenance, corrective maintenance, reactive maintenance, refurbishment and replacement;
- Development of Whole of Life (WoL) plans and Network Service Plans (NSP's);
- Infrastructure governance ;
- Dam safety compliance; and
- Engineering support for major assets across the SunWater business.

Total FTE's at 30 June 2010 was 34. Targeted FTE's on completion of SLFI is an increase to 35 FTE's<sup>18</sup>. The structure of Asset Management post SLFI is as follows:

**Figure 6-24 IM – Asset Management Structure post SLFI<sup>19</sup>**



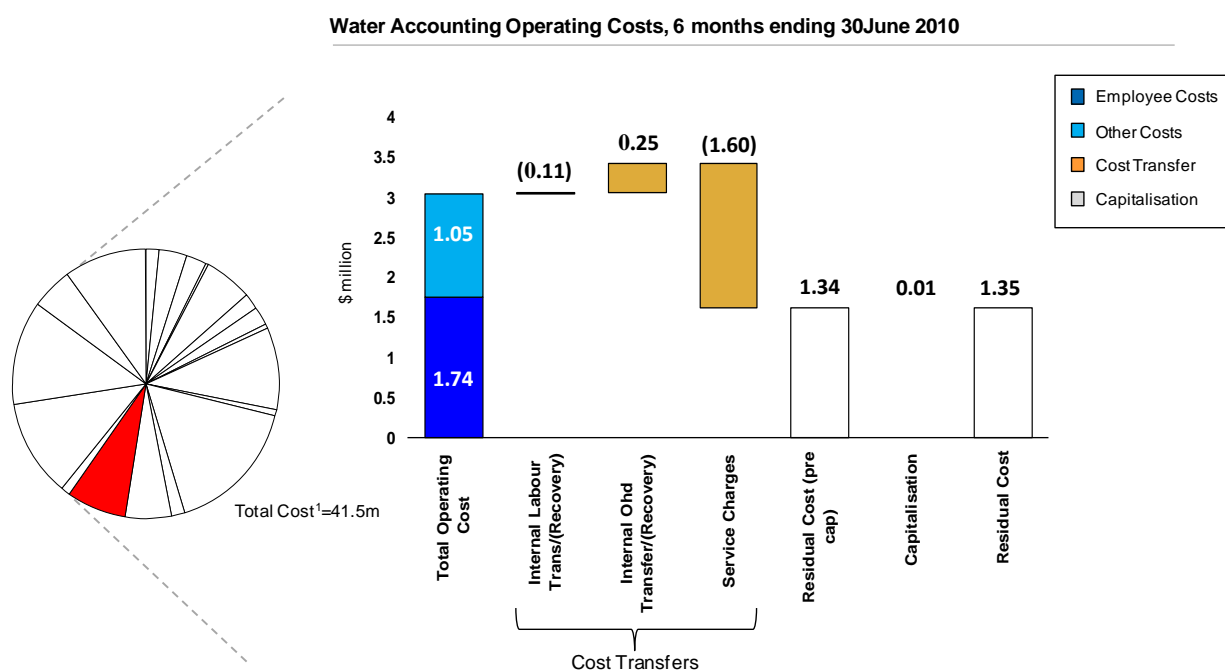
The engineering groups have recently been centralised to provide centres of excellence to service the business. While most groups have been relocated to Brisbane, 7 FTEs reside in Ayr and 9 FTEs reside in Bundaberg. Previously there were numerous asset management experts in each region creating duplication and making management of standards across the business difficult. The creation of centres of excellence has enabled information sharing and consolidation of the number of FTEs required.

The recent centralisation of engineering/asset management services has delivered a significant cost reduction to the business that should be fully reflected in 2011 numbers. We have only undertaken a very high level review of this function and a final assessment of requirements will be subject to the capital and O&M business assessments. We suggest a final recommendation on the efficiency of the asset management function be undertaken once all information is available.

## 6.13 Infrastructure Management - Water Accounts

The Water Accounts function includes costs related to customer support, hydrographical services and water accounting. The total cost (for the six months ending 30 June 2010, prior to cost transfer) was \$3.037 million of which 57% was attributable to labour. Water Accounts has both a Local Overhead cost pool (which is the Resource Centre) and also indirect cost pools.

**Figure 6-25 Water Accounts Cost Analysis**

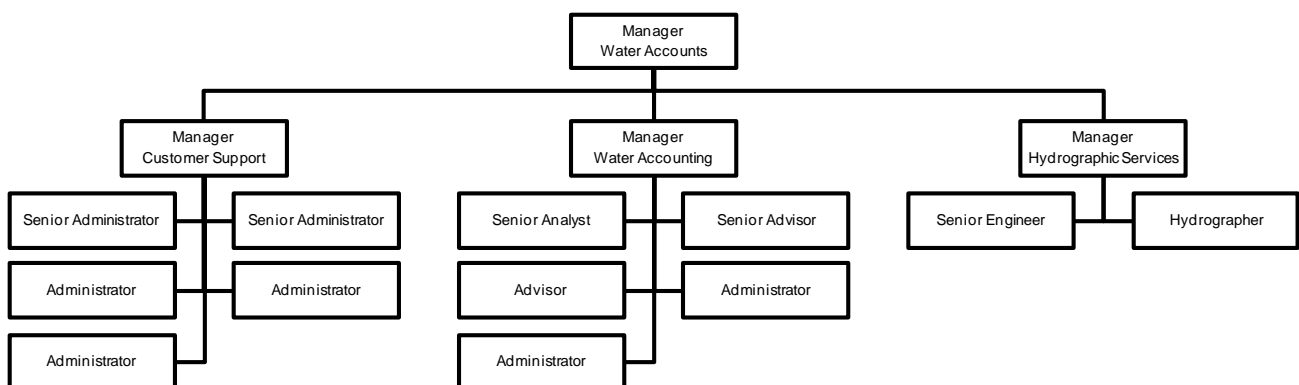


The main activities undertaken by the Water Accounts function include:

- Customer support (call centre);
- Customer data management, billing, water balance tracking;
- Customer notifications;
- Maintenance of state-wide gauging station network;
- Water accounting compliance and reporting (ROP management);
- Compliance reporting to State and Federal authorities and agencies;
- Processing of customer transactions (e.g. temporary trades, unauthorised usage, water allocations, water sharing rules); and
- Manage transfer and sale of water entitlements.

Total FTE's at 30 June 2010 was 16. Targeted FTE's on completion of SLFI is the same<sup>18</sup>. The structure of Water Accounting post SLFI is as follows:

**Figure 6-26 IM – Water Accounting Structure post SLFI<sup>19</sup>**



The Water Accounts group manages all customer contracts and must record and update the personal, billing and WAE records for each customer. This includes using information to handle customer requests for water releases as per the ROP. As the regions have developed independently of each other in the past, this has added to the workload of the Water Accounting team as there are often complex and varied water accounting rules to be applied to different scenarios.

This size of the team in place appears appropriate for the role undertaken given our previous experience; however note the unique nature of the work undertaken. In the subsequent review we would recommend undertaking a more detailed assessment of activities undertaken by the group. The highly regionalised nature of the business means significant coverage is required by the team. This requires understanding the specific nature of different arrangements in each region that in many cases have evolved organically and independent of each other.

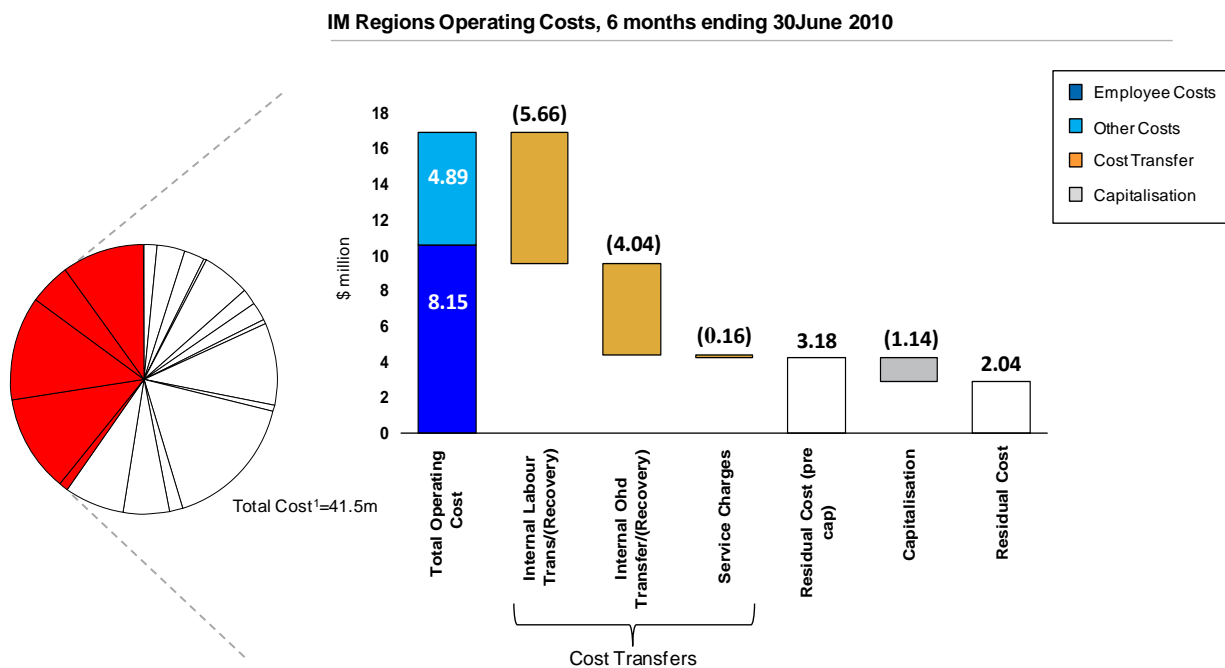
Non labour costs include system (SWIMS) amortisation and contractor costs of around \$1 million per annum. This is a significant cost and if associated with the IT system it would be expected to be already captured within the ICT function. This should be assessed in parallel with a review of the ICT cost function and the labour, contractors and materials required to maintain the SWIMS system. Potential opportunities exist to improve system costs going forward, should other systems be more suitable.

## 6.14 Infrastructure Management - Service Delivery (including Regional Offices)

The IM Service Delivery administrative functions include costs related to the provision of administrative labour, housing and regional office and depot management. In the period being addressed some regional asset management and customer service costs remained in these profit centres, as the effect of the recent organisation changes only took place in the first 3 months of 2010, prior to finalisation of the new centralised structure. IM function has both a Local Overhead cost pool (which is the Resource Centre) and also an indirect cost pool.

The total cost for IM Service Delivery and Regional Offices (for the six months ending 30 June 2010, prior to cost transfer) was \$13.04 million of which 62% was attributable to labour.

**Figure 6-27 IM Service Delivery and Regional Offices**



Source: SunWater Profit Centre P&Ls

**Notes:**

1. Total of Indirect and Overhead cost centres for 6 months ending 30 June 2010
2. Highlighted red pie slices presented in waterfall chart
3. Includes IM Regions – South, Central, North, Far North and Service Delivery Cost Centre

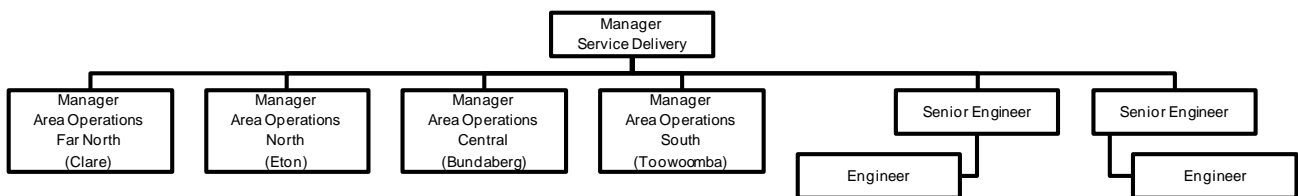
The main administrative activities undertaken within the regional offices include:

- Management of staff housing;
- Management of commercial, office and depot space;
- Flood room operations;
- General admin the regional office and depot level including purchasing (under \$25,000 in value) and asset documentation;
- Work scheduling and work order
- Customer service (centralised during period); and

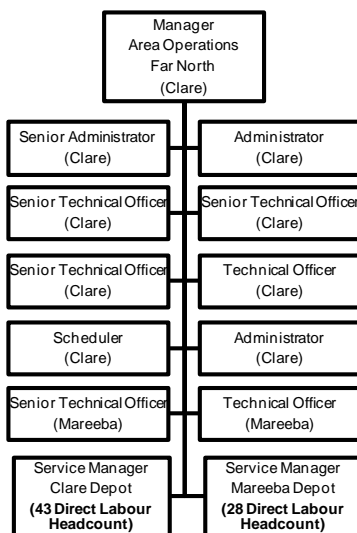
- Asset management (centralised during period).

Total FTE's (including field FTEs) at 30 June 2010 for Far North, North, Central and South (and Brisbane Service Delivery Staff) was 229.5. Targeted FTE's on completion of SLFI is an increase to 246 FTE's<sup>18</sup>, including administrative staff of 10 FTE's. The structure of the Service Delivery Group shown below includes regional office managers and administrative staff. The organisational structure of the Far North regional office at Clare (called IM – North by SunWater) is also included as an example of the level of administrative staff in the regions post SLFI. Administrative headcount of Service Delivery and the regional offices post SLFI is as follows:<sup>18</sup>

**Figure 6-28 IM – Service Delivery Structure post SLFI<sup>19</sup>**



**Figure 6-29 IM – Far North Structure post SLFI<sup>19</sup>**



Similar to the cost structure in ID, much of the cost within the regional overhead cost centres reflects Resource Centres that capture all labour cost paid. This is then transferred cost to direct cost centres based on the direct labour hours per the time sheeting process. Once this cost is removed the remainder is treated as a local overhead and transferred to the relevant Service Contracts.

Most of the administrative functions undertaken by the regional offices have been centralised with the recent organisational review. This includes customer service, asset management, procurement, finance and HR functions that were all previously undertaken at the regional level. Removal of duplication with head office will bring savings of 45.1FTE's.

In summary, the costs presented above for SunWater's overhead and indirect business units include a significant proportion of direct cost transferred to the Service Contracts. Of the remaining costs, SunWater have indicated the centralisation of the regional functions and other SLFI initiatives have identified some \$10m in savings, of which around 75% relates to labour costs. In aggregate we would expect to see approximately \$8m in cost reductions come through in 2011 compared to the cost under the previous organisation structure, to reflect the labour cost savings.

The post SLFI regional service structure is close to best practice on the basis that where centralisation of services could be achieved it has. In particular the centralisation of the finance and HR functions, as well as the creation of centres of excellence within asset management, is strongly supported. We do however note the risks facing SunWater of operating a centralised service model and the need to ensure customer service standards are maintained.

## **6.15 Summary of Opportunities**

Table 6-1 provides a summary of potential efficiency opportunities and one-off costs that have been identified and should be investigated or noted when SunWater's NSP's are reviewed by QCA. We note that these have been identified based on a high-level assessment and based on our understanding of normal business operations. We have used our experience and expertise in assessing performance and productivity improvement opportunities across a wide range of businesses and industries. We are therefore relying on our judgement combined with the information provided by SunWater to identify the efficiency opportunities within the business.



**Table 6-1 Opportunities for Efficiencies and one-off costs identified**

Admin function	Opportunity Description	FTEs	Estimated Value (\$'000 p.a.)	Percentage of 2009*10 costs <sup>21</sup>
CEO Office	NA	NA	NA	NA
SSR	Consultant spend related to regulatory submission should be noted on review of projected cost base (\$260,000 expected once every 5 years)	NA	260 (one-off) For consideration on review of projected cost base	NA
HSEQ	Consolidate headcount	2	210	9.8%
Corp GM	NA	NA	NA	NA
Finance	Potential for future headcount consolidation in Business Accounting Function	For ongoing review	For ongoing review	NA
HR	NA	NA	NA	NA
ICT	Headcount reduction SWIMS replacement (see Water Accounts)	4 NA	460 See Water Accounts	5.7%
Procurement	Potential for future headcount consolidation	For ongoing review	For ongoing review	NA
Legal & Property	Headcount reduction	1-2	110 – 220	6.9% to 13.8%
ID	NA	NA	NA	NA
IM – GM	Effect of inventory adjustment during 2010 should be noted on review of projected cost base (\$320,000 impact on 2010 costs)	For ongoing review	320 (one –off) For ongoing review	1.9% to 2.1%
IM – Asset Management	NA (to be reviewed once capital and O&M data available)	NA	NA	NA
IM – Water Accounts	SWIM System replacement / optimisation	NA	To be verified	NA
	Efficiency gains identified by SunWater in recent SLFI process		10,000	
<b>TOTAL EFFICIENCIES (excluding SLFI)</b>			<b>780 - 890</b> (excl. SLFI)	
<b>TOTAL ONE-OFF COSTS</b>			<b>580</b>	

<sup>21</sup> Total operating costs by function before administration cost transfer. Note that an annualised operating cost amount based on costs for January to June 2010 has been used as the total operating cost amount.. The reason is explained in section 4 3.1 above.

## 7. CONCLUSIONS AND NEXT STEPS

This review has identified potential cost savings of some \$780,000 - \$890,000, based on a high level review and interviews with personal across SunWater's business. It also identified \$580,000 of one off costs in the period reviewed (six months to 30 June 2010) that should be taken into consideration when reviewing forecast costs over the next pricing period.

Cost savings opportunities have been identified using a range of data points however should not be interpreted as guaranteed savings. They are indicative only and it is up to SunWater to provide a basis for why they are necessary to support SunWater's ongoing operations and delivery of services. These costs are in addition to the expected cost savings from SunWater's SLFI review.

### Next Steps

We understand the QCA is planning to undertake a subsequent review of SunWater's projected administrative costs once NSP's have been submitted. This will form part of the overall assessment of the prudence and efficiency of SunWater's 2011-2016 irrigation prices. The cost and efficiency savings identified as part of this review should inform the basis for the subsequent review of projected administrative costs. Given the analysis undertaken to date we would recommend the following assessments to provide the required insight into SunWater's projected administrative costs:

1. **Output Based Assessment:** A bottom-up approach to assess the true need for resources (labour and other) to deliver the activities and subsequent output, by function. This analysis takes into account the specific nature of the environment in which a business function operates
2. **Comparison against Actuals:** SunWater cost projections should be assessed with reference to current actual costs and known efficiency improvements (as documented in this report). SunWater should provide justification for any variations from actual. In addition SunWater should justify a cost structure different to comparable business metrics
3. **Review of Allocation Methodology:** Once efficient administrative costs have been determined, the methodology for allocating administrative costs across customer segments (for the purposes of cost recovery through the price setting mechanism) is required. Specifically, an assessment of the appropriateness of the allocation drivers for irrigators should be undertaken

During the current administrative cost review we identified a number of areas requiring additional focus. Two areas requiring attention have a material impact on the cost of service delivery to SunWater's customers. The first is an assessment of the various compliance and reporting requirements placed on SunWater. These are at times, resource heavy. An assessment should be made as to whether these activities should be compensated for by irrigation customers. In addition the asset management function (classified as an administrative function for the purposes of this review) requires further review once the operational requirements of the business are better understood. We would suggest an assessment of the asset management function is undertaken in parallel with the capital and operational reviews of SunWater's projected expenditure. Each of these analytical reviews can be undertaken as part of the review of SunWater's projected administrative costs for the period 2011 – 2016.

## APPENDIX A – MINISTER’S REFERRAL NOTICE

**QUEENSLAND COMPETITION AUTHORITY ACT 1997**  
**Section 23**

**MINISTERS' REFERRAL NOTICE**

**Referral**

As the Premier and Treasurer of Queensland, pursuant to Section 23 of the *Queensland Competition Authority Act 1997* (the Act), we hereby direct the Queensland Competition Authority (the Authority) to develop irrigation prices to apply to the following SunWater water supply schemes (WSS) from 1 July 2011 to 30 June 2016:

Barker Barambah	Lower Fitzroy
Bowen Broken Rivers	Macintyre Brook
Boyne River and Tarong	Maranoa River
Bundaberg	Mareeba-Dimbulah
Burdekin-Haughton	Nogoa-Mackenzie
Callide Valley	Pioneer River
Chinchilla Weir	Proserpine River
Cunnamulla	St George
Dawson Valley	Three Moon Creek
Eton	Upper Burnett
Lower Mary	Upper Condamine

**1. Matters the Authority must take into consideration**

In referring this investigation, the Ministers direct the QCA under section 24 of the Act as follows:

- 1.1 For water supply schemes, or segments of schemes (except those listed in 1.2 below), bulk water supply and channel prices/tariff structures are to be set to provide a revenue stream that allows SunWater to recover:
- a) its efficient operational, maintenance and administrative costs;
  - b) its expenditure on renewing and rehabilitating existing assets, whether through a renewals annuity or a regulatory depreciation allowance;
  - c) a rate of return on assets valued at 1 July 2011, as specified in 1.4 (below) (the initial regulated asset base (RAB)); and
  - d) after 1 July 2011, a return of, and on, prudent capital expenditure on existing assets or for constructing new assets.

- 1.2 For the following schemes (schemes or segments of schemes identified as unable to meet the full costs of 1.1 a) and 1.1 b) due to hardship):
- a) irrigation prices are to be set to maintain current prices in real terms, and improve the level of cost recovery, where the capacity to do so exists;
  - b) after 1 July 2011, prices are to include a return of, and on, prudent capital expenditure to augment existing assets or construct new assets.
  - c) the Authority may recommend whether to set prices through the use of a renewals annuity or depreciation-based RAB pricing approach.
- These schemes are:
- Redgate Relift in the Barker Barambah WSS
  - Callide Valley WSS
  - Cunnamulla WSS
  - Maranoa River WSS
  - Channel Relift in the Mareeba Dimbulah WSS
  - Three Moon Creek WSS
- 1.3 For 1.1 (d) and 1.2 (b), the Authority is to have regard to the agreed level of service between SunWater and the customers of the water supply scheme, including for capital expenditure on existing assets or for the construction of new assets.
- 1.4 In recommending an initial RAB (1.1 c) for irrigation supply assets (or that part of an asset used for the supply of water for irrigation purpose), the Authority is to:
- a) value the following channel distribution systems assets at zero;
    - Bundaberg channel distribution system
    - Burdekin channel distribution system
    - Dawson Valley channel distribution system
    - Eton channel distribution system
    - Lower Mary channel distribution assets
    - Mareeba Dimbulah channel distribution system
    - Emerald channel distribution system
    - St George channel distribution system
    - Callide Valley channel distribution assets
    - Yarralong Pump Station and associated distribution assets in the Upper Condamine Scheme
    - Youlambie channel distribution assets in the Three Moon Creek Scheme
    - Redgate Relift distribution assets in the Barker Barambah scheme
  - b) For other schemes or segments of schemes, apply a 'line in the sand' approach<sup>1</sup> to value assets for bulk water supply based upon:
    - the level of service attributed to the supply of water for irrigation;
    - the efficient operating cost of meeting the required level of service;
    - water prices reflecting the irrigators' anticipated capacity to pay;

<sup>1</sup> The 'line in the sand' approach can be used to set an initial regulated asset base between:

- at the upper end, a value at which customers would be better off if the asset was scrapped and a new asset installed – which is what a depreciated, optimised replacement cost provides an estimate of; and
- at the lower end, the value that the assets would have in their next best use, which for sunk investments may be very low.



- water prices achieving a commercial return over a period not longer than 15 years.

The 'line-in-the-sand' approach must not adversely affect the operator's ability to recover full commercial prices from urban and industrial customers.

- 1.5 In providing pricing recommendations for each scheme, the Authority is to also consider how to treat existing renewals reserves if it considers it appropriate to transition schemes to a depreciation-based RAB pricing approach.
- 1.6 For relevant schemes, the Authority is to review drainage charges and channel water harvesting charges.
- 1.7 The Authority is to recommend pricing principles to apply for the inclusion of capital expenditure on dam spillway upgrades.

## 2. Consultation

The Authority must undertake an open consultation process with all relevant parties and consider submissions within the timetable for the delivery of the Final Report to Government. All reports and submissions must be made publicly available, including on the Authority's website.

## 3. Timing

The Authority must provide to the responsible Ministers and the Minister for Natural Resources, Mines and Energy and Minister for Trade:

- a Draft Report and draft irrigation prices by no later than 31 January 2011 and;
- a Final Report and recommended price paths by no later than 30 April 2011.

The Final Report will inform the Government's deliberations for price paths to apply to SunWater's irrigation water prices for the five year period commencing 1 July 2011.

## 4. Other matters

The Authority may exercise all the powers under Part 6 of the *Queensland Competition Authority Act 1997*.

**ANNA BLIGH**

**ANDREW FRASER**

The Hon. Anna Bligh MP, Premier

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Queensland 4001 Australia

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## APPENDIX B – LIST OF INTERVIEWEES

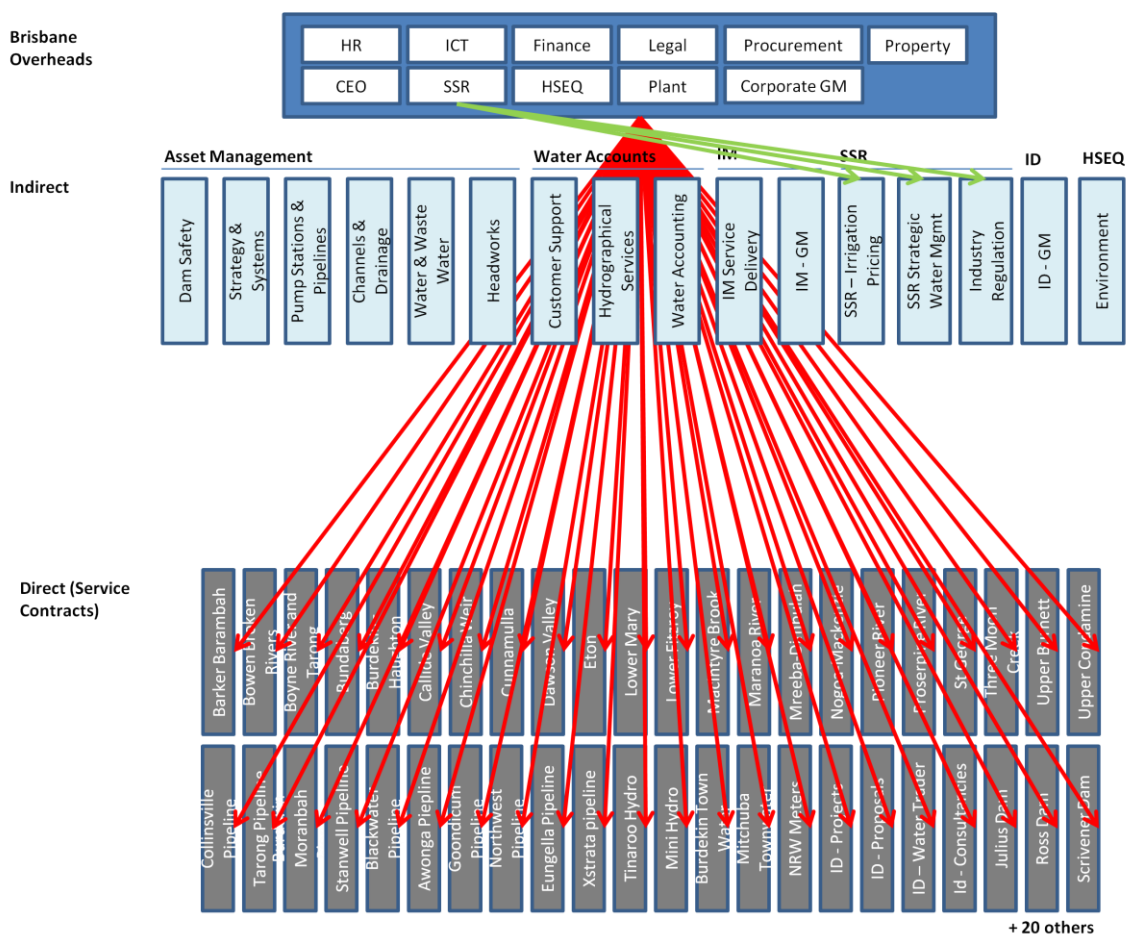
Position	Name
1. Chief Executive Officer	Peter Boettcher
2. General Manager – Corporate and Company Secretary	Geoff White
3. General Manager – Infrastructure Management	Barry Jeppesen
4. General Manager – Infrastructure Development	Mark Browne
5. Manager – Strategy and Stakeholder Relations and	Tom Vanferby
6. Manager – Corporate Finance	Col Nicolson
7. Manager – Corporate Information Communication and Technology	Mike Minter
8. Corporate Counsel and Manager – Corporate Legal Services	Renee Butterfield
9. Manager – Corporate Human Resources	June Dous
10. Manager – Procurement	Janet Porchun
11. Manager – Asset Management	Rob Koegh
12. Manager – Water Accounting	Donna Hodhon
13. Property Manager	Nadia Margets
14. Strategy and Planning Manager	Peter McGahan
15. Business Strategy Analyst	Neva Tran

## APPENDIX C – CONCEPTUAL SCHEMATIC OF COST TRANSFER PROCESS BETWEEN PROFIT AND COST CENTRES/POOLS

Below is a discussion of how overhead and indirect costs are transferred to Service Contracts. This is a conceptual discussion of the transfer of costs to develop an understanding of how costs are transferred in the majority of circumstances.

### Brisbane Overhead Cost Centres

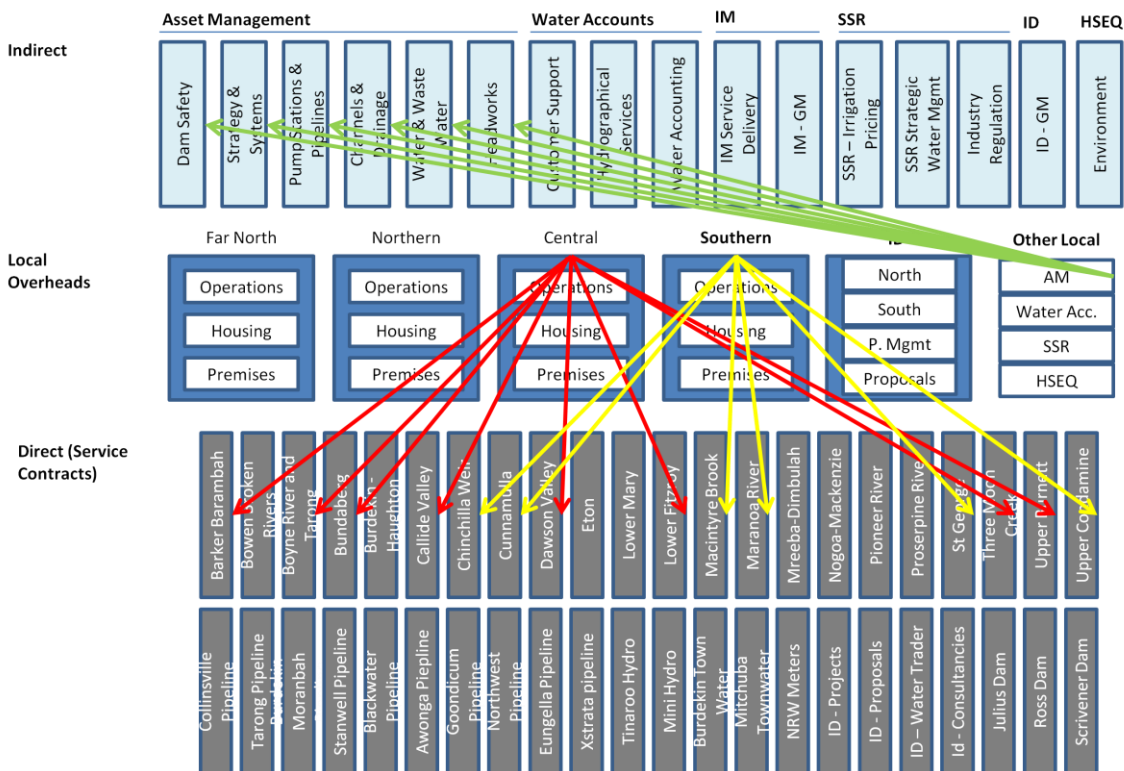
Costs generated in Brisbane overhead cost centres are generally incurred by all Service Contracts and are transferred in proportion to direct labour hours performed in those contracts. Also as discussed in Section 4, for Brisbane overhead cost centres that are Resource Centres, direct labour hours and associated costs are transferred to associated indirect cost pools.





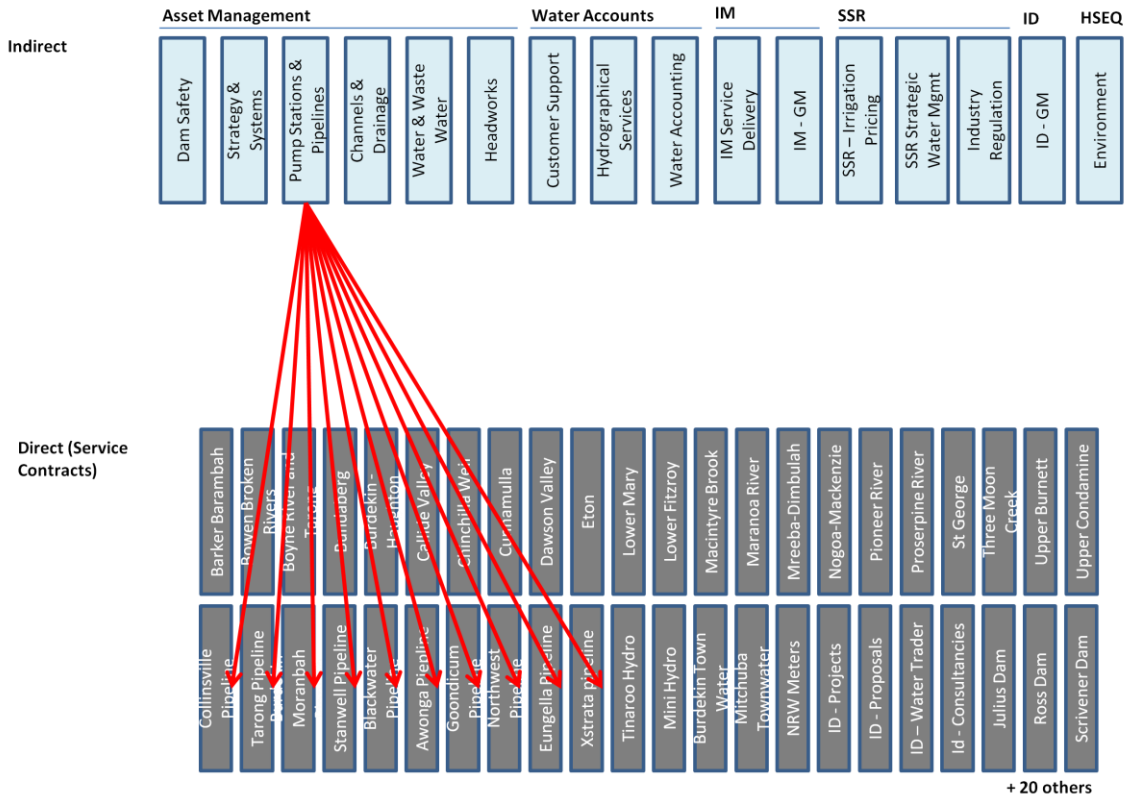
## Local Overhead Cost Centres

Costs generated by local overhead cost centres are generally incurred by select cost centres (e.g. regional overhead costs) and are transferred in proportion to direct labour hours performed in those Service Contracts. For example, Infrastructure Management - Central cost centres generate costs predominately in relation to Service Contracts in their region; therefore overheads are transferred to these Service Contracts accordingly. Also as discussed in Section 4, for local overhead cost centres that are Resource Centres, direct labour hours and associated costs are transferred to associated indirect cost pools.



## Indirect Cost Centres

Costs generated or transferred to indirect cost centres are generally incurred by select cost centres that support specific direct activity relating to certain Service Contracts (e.g. pump station and pipeline indirect costs only related to Service Contracts that manage pipelines).



## APPENDIX D – WORKED EXAMPLES OF COST TRANSFER

This section provides three worked examples of the cost transfer process. For simplicity all examples will assume the same staff salary is paid and the same direct labour hours and standard labour cost rate apply. The first example will demonstrate the transfer of Brisbane overhead to a Service Contract. The second will demonstrate the transfer of local overhead from a Resource Centre to an associated indirect cost pool and then on to a Service Contract. The third will demonstrate the transfer of local overhead from a regional Resource Centre to a regional Service Contract.

In the following examples, a Brisbane Overhead rate of 30% of direct labour cost is assumed and a local overhead rate of 70% of direct labour cost is assumed.

### Example 1 – Legal working on the Three Moon Creek Service Contract (example of Brisbane overhead transfer)

Step 1 – Legal wages and oncosts are paid out of the Legal cost centre

Account	Legal	Three Moon Creek	Profit Centre 202
Salaries	85		
Statutory On Cost	19		
Direct Labour			
Brisbane Overhead			
Local Overhead			
Indirect Costs			
<b>Total</b>	<b>104</b>	-	-

Step 2 – Legal staff perform work on the Three Moon Creek Service Contract (direct labour costs are transferred)

Account	Legal	Three Moon Creek	Profit Centre 202
Salaries	85		
Statutory On Cost	19		
Direct Labour	(20)	20	
Brisbane Overhead			
Local Overhead			
Indirect Costs			
<b>Total</b>	<b>84</b>	<b>20</b>	<b>-</b>

Direct labour costs are transferred to Three Moon Creek Service Contract by the Legal Cost Centre. The Legal cost centre is credited and the Three Moon Creek Service Contract is debited (with an amount representing hours x standard labour cost rate).

Step 3 - Legal staff perform work on the Three Moon Creek Service Contract (Brisbane overhead is transferred)

Account	Legal	Three Moon Creek	Profit Centre 202
Salaries	85		
Statutory On Cost	19		
Direct Labour	(20)	20	
Brisbane Overhead		6	(6)
Local Overhead			
Indirect Costs			
<b>Total</b>	<b>84</b>	<b>26</b>	<b>(6)</b>

Brisbane overhead is transferred to Three Moon Creek Service Contract. The Three Moon Creek Service Contract is debited, however a separate Corporate Profit Centre (number 202) is credited instead of the Legal cost centre. This practice happens with all Corporate Cost Centres and is done so that costs reported in the corporate cost centres transparent and not distorted by internal revenue amounts. The Brisbane overhead cost represents direct labour cost x Brisbane Overhead rate.

**Example 2 – Asset Management Dam Safety Work Performed (example of local overhead transfer and indirect cost transfer)**

Step 1 – Asset Management (AM) Dam Safety wages and oncosts are paid out of the Asset Management Resource Centre

Account	Asset Mgmt Resource Centre	Asset Mgmt Barker Dam Safety Barambah	
Salaries	85		
Statutory On Cost	19		
Direct Labour			
Brisbane Overhead			
Local Overhead			
Indirect Costs			
<b>Total</b>	<b>104</b>	-	-

AM Dam Safety wages are paid from the Resource Centre (not the indirect cost centre).

Step 2 – AM Dam Safety staff time-sheet their chargeable hours to the AM Dam Safety indirect cost centre (direct labour costs are transferred)

Account	Asset Mgmt Resource Centre	Asset Mgmt Barker Dam Safety Barambah	
Salaries	85		
Statutory On Cost	19		
Direct Labour	(20)	20	
Brisbane Overhead			
Local Overhead			
Indirect Costs			
<b>Total</b>	<b>84</b>	<b>20</b>	-

Direct labour costs are charged to the AM Dam Safety from the AM Resource Centre. The AM Resource Centre is credited and the AM Dam Safety cost centre is debited (with an amount representing hours x standard labour cost rate).

Step 3 - AM Dam Safety staff time-sheet their chargeable hours to the AM Dam Safety indirect cost centre (Local overhead is transferred)

Account	Asset Mgmt Resource Centre	Asset Mgmt Dam Safety	Barker Barambah
Salaries	85		
Statutory On Cost	19		
Direct Labour	(20)	20	
Brisbane Overhead			
Local Overhead	(14)	14	
Indirect Costs			
<b>Total</b>	<b>70</b>	<b>34</b>	<b>-</b>

Local overhead is transferred from the AM Resource Centre to the AM Dam Safety cost centre. The AM Resource Centre is credited and the AM Dam Safety cost centre is debited. The local overhead cost represents direct labour cost x local overhead rate.

Step 4 – AM Dam Safety Cost applied to Barker Barambah Service Contract (indirect cost is transferred)

Account	Asset Mgmt Resource Centre	Asset Mgmt Dam Safety	Barker Barambah
Salaries	85		
Statutory On Cost	19		
Direct Labour	(20)	20	
Brisbane Overhead			
Local Overhead	(14)	14	
Indirect Costs		(4)	4
<b>Total</b>	<b>70</b>	<b>30</b>	<b>4</b>

Because Barker Barambah Service Contract has a dam, it must be allocated a share of the AM Dam Safety cost. The AM Dam Safety cost centre is credited and the Barker Barambah Service Contract is debited.

**Example 3 – Infrastructure Management – Central Operations work performed within region (example of local overhead transfer in the regions)**

Step 1 – Infrastructure Management (IM) Central Operations wages and oncosts are paid out of the IM Central Operations Resource Centre

Account	IM Central	Three Moon Creek
Salaries	85	
Statutory On Cost	19	
Direct Labour		
Brisbane Overhead		
Local Overhead		
Indirect Costs		
<b>Total</b>	<b>104</b>	<b>-</b>

Step 2 – IM Central Operations staff time-sheet their chargeable hours to the Three Moon Creek Service Contract (direct labour costs are transferred)

Account	IM Central	Three Moon Creek
Salaries	85	
Statutory On Cost	19	
<b>Direct Labour</b>	<b>(20)</b>	<b>20</b>
Brisbane Overhead		
Local Overhead		
Indirect Costs		
<b>Total</b>	<b>84</b>	<b>20</b>

Direct labour costs are charged to the Three Moon Creek Service Contract from IM Central Operations. The IM Central Operations is credited and the Three Moon Creek Service Contract is debited (with an amount representing hours x standard labour cost rate).

Step 3 – IM Central Operations staff time-sheet their chargeable hours to Three Moon Creek Service Contract (Local overhead is transferred)

Account	IM Central	Three Moon Creek
Salaries	85	
Statutory On Cost	19	
Direct Labour	(20)	20
Brisbane Overhead		
Local Overhead	(14)	14
Indirect Costs		
<b>Total</b>	<b>70</b>	<b>34</b>

Local overhead is transferred from the IM Central Operations Resource Centre to the Three Moon Creek Service Contract. The IM Central Operations Resource Centre is credited and the Three Moon Creek Service Contract is debited. The local overhead cost represents direct labour cost x local overhead rate.