

CANEGROWERS submission to QCA Sunwater review April 2011

Below are preliminary comments on 6 overhead, operations and capital expenditure efficiency reviews undertaken by consultants for the QCA. Given the extremely short timeframes for submissions a thorough analysis has not been possible and I will seek to give more detailed feedback in the near future.

Operational and capital expenditure

Pioneer and Eton

- All costs associated with the palm tree creek valve should be worn by SunWater due to the valve failures as a result of inadequate design, wrong valve selection, faulty valves or a combination of all.
- No fabri dams in NSP so conversion factors should make the same assumption
- All eton dam safety inspections and studies over last 5 years should be taken out of renewals costs since related to spillway upgrade
- Water treatment costs are not recreation costs but water service delivery so should be taken out of bulk costs. Recreation costs are the bare minimum of costs to service bulk water needs only. If Sunwater wants to do more and be good corporate citizen then this should be funded from Sunwater profits not growers
- Eton direct labour (and consequently overheads) doubles in 2011 and stays there. Why? Arup report for Eton states that an additional "New tech man" is to be employed for weed control at a cost of \$80k/a.

Proserpine

- Kelsey creek tariff compared to river tariff needs to be explored. Metering, billing, water ordering and other functions are undertaken by water board for their customers which would justify a cost difference

Burdekin

- Direct costs decrease but overheads increase
- Need to ensure that costs of each item including its overhead allocation is competitive with private rates
- Revenue offset in bulk NSP for profits from bulk customers will eliminate free water distortion
- NQ water is channel customer so must pay channel charge

Mareeba

- Cost increase in overheads only due to change in overhead allocation methodology
- Must compare to efficient Indec costs
- Starting renewals balance of -\$2m must be reviewed
- Most weirs have been moved from bulk to distribution

Maryborough

- \$70/ML is renewals cost half of which is interest on starting negative balance of -\$1.4m. Growers very concerned re starting negative balance and past expenditure and believe negative balances should be zeroed.
- Many future big expenditures are not prudent and around half of the future spending. Reconfiguration of the scheme is required to ensure that the renewals program reflects the most efficient cost of delivering the water demanded in the scheme.
- Overhead allocation too high at around 50% of costs. Consequently renewals of around \$15-20/ML is more realistic
- If capital expenditures are undertaken there should be a decrease in operating costs but the opposite is happening.
- Need a lot more detail on cost items to allow more detailed comments by customers. Also there was insufficient time to have a proper discussion re costs of lower Mary scheme at the round 2 consultation and there must be more detailed discussions in the future to resolve concerns. This will need to focus on scheme overdesign issue.
- Cost of upgrades is higher than it should be because of overkill on Sunwater processes.
- This is a draft report which shows lots of holes which requires a lot more work to be undertaken by Aerecon
- The nsp costs and type of works are not efficient for the lower Mary scheme? They are more reflective of costs appropriate for larger irrigation schemes and industrial schemes.
- Is revenue offset from leasing out Sunwater offices included in nsp's
- Tariff issues need to be resolved between 3 existing tariff groups. High priority customers using channels should pay the same channel charge as all other customers
- Do not like 100% part A tariff. Costs to growers will go up if prices can't go down which is a big concern for growers
- Distribution loss allocations much lower than allocations at around 15 times higher. Also if 2 weirs are in channel so why are channel losses all deemed to be in Mary river barrage when most would be in other 2 weirs. Should not have distribution losses in Maryborough as a result or adjust historical losses to reflect the fact that only a portion of historical losses are from bulk and most are from storages in channel scheme.
- Tariff issues need a major review.
- Given that there it is not prudent to replace many of the assets in this scheme, replacement of all items should be deferred as long as possible. Also, for items such as switchboard replacement, old parts from switchboards replaced prudently in other regions could be used to keep the switchboard in Maryborough going for many decades

Bundaberg

- Very concerned re the level of overheads. For example 61.3% of costs for preventative maintenance bulk are indirect and overheads so in reality it is not preventative maintenance but just indirect and overheads. Indirect, overheads and other for operations bulk is 70% which is not operations costs but overheads
- Very concerned re increases in electricity costs
- Concerned direct in field labour staff decreasing but total staff unchanged. Want focus to be on majority of staff in field doing work not overhead staff in Brisbane which doesn't increase service

- Centralisation has moved staff from Bundaberg to Brisbane. Higher labour costs in Brisbane means costs have increased
- Growers concerned re declining levels of service delivery re not maintaining assets properly.
- Bucca weir is in bulk not distribution
- There is no scheduling in Bundaberg so should not be a cost for this. The scheme is down stream controlled so releases occur automatically to fill channels and pipes rather than requiring water ordering
- Have costs been allocated to paradise water for use of channels? Growers had 15 % of flow rate in channel for new water and have taken a lower standard of service. Consequently 15% of channel costs including distribution losses. Also, off peak water has been sold so how will this be accounted for? Also for bulk, paradise has caused credit water to be removed so what cost re allocation will occur for this lower standard of service and water reliability? Finally there is 1 colour water now so Burnett water uses Sunwater assets and should pay part A.
- Are items such as water meter reading for groundwater attracting overhead costs? are they included as revenue offset?
- Renewals expenditure over the past 2 years for the bulk scheme need to be investigated further
- Has a full cost benefit analysis been done on all expenditure or are assets just being replaced at set times without a thorough analysis?
- Has the labour mix of full time, casual and contract appropriate? If there is spare labour then should be more casuals and contractors? An analysis of direct cost allocation % of IM staff. If there is spare time then a portion of this is likely to be inefficient
- Are costs attributed accurately to projects or are costs of people sitting around doing nothing attributed directly to schemes to make time sheets look good? Analysis of % of costs being direct for each item to see if they are appropriate needs to be done
- Very concerned re conversion factors since some growers are likely to convert from medium to high priority over the next 5 years. Will cause remaining MP growers to be imposed with extra costs. Conversion factors should be calculated by converting all MP to HP and use this for both bulk and channel so there is no incentive or cost impacts on remaining growers if some growers decide to convert.
- Service standards imposed by Sunwater are all the same throughout state when this may not be appropriate. Big issue for renewals

Overheads

Level

- Need more reflective definition and reporting of major cost item being direct and overheads. Much of direct costs is overhead costs attributed to schemes direct not direct costs of operating a scheme and fixing assets
- Change in allocation methodology in 2011 creates big increase in costs for many schemes
- 60% overheads and indirect is not acceptable despite consultants views
- Sunwater runs 2 businesses.

- An industrial development company that sells water to a group of customers who are price insensitive, high profit, high priority for Sunwater and low risk takers re their water supply
- An irrigation company that sells water to a group of customers who are very price sensitive, low profit, low priority for Sunwater and high risk takers re their water supply and businesses
- The level of costs and structure of Sunwater to service these 2 very different customer groups has not been considered when setting efficient costs.
- Infact the costs have been determined to service the needs of the industrial development customers not the irrigation customers which is a focus for this review
- The costs must be set to reflect efficient costs for irrigation customers. Review against Pioneer valley would be a good start in this process.
- Must undertake a review of Sunwater structure and business model recognising this is a review of efficient costs for the irrigation side of Sunwaters business. You can't force Sunwater to change structure but you can set efficient costs based on this.
- 34% of costs are not indirect and overheads since overheads are also attributed as direct cost when activities are for one scheme only
- Benchmarking analysis implies that Sunwater has around 20 FTE's more than required. This analysis was done by comparing Sunwaters performance to the 25th percentile for each item. For sunwater items significantly great than the 25th percentile, the difference in FTE's would be considered inefficient. If the total inefficiencies and multiplied by 5 (to reflect 500 FTE's in Sunwater not 100) this gives the total of around 21 FTE's too many.
- Have the efficiency savings identified by indec 5 years ago been implemented? That has not been looked at but should be by Indec in the coming months
- Want details of cost items including cost per bill, cost per transaction, etc to compare to similar costs incurred by water users in their business.
- Are overheads shown in pie charts and 178 staff total overheads and indirect costs or just costs and staff for items for items not directly attributed to schemes?
- Is it really efficient and prudent when faced with 3 potential expenditure items being overheads in Brisbane, spending \$14.4m on safety and spending \$50,000 on replacing a pump about to break that the first 2 are approved and the last is not? The last is the only one that increases growers level of service while the others are non core items that do not relate to service?

Allocation

- Spare time for staff member eg IM should go back to schemes they service only in proportion to time spent on them as direct cost. If items below 80% direct cost allocation for IM for example does this indicate inefficient costs? Is it efficient for companies to have such a high proportion of costs not attributed to projects directly?
- Economies of scale have not been considered when allocating overhead costs to large schemes
- Need major review of cost allocation methodologies. Many of the items including IM regions would be better to allocations to regions in proportion to the way their direct costs were apportioned to regions as suggested by Deloitte. This could be done for any items where

direct and indirect costs are great than say 60% of an items cost. This analysis should be done for each of the 12 overheads items mentioned

- Other allocation methodologies could be looked at include direct and indirect FTE's, Direct and indirect labour costs, direct non labour cost and profit. If profit was the driver, given that there should be zero profits in irrigation schemes then the allocation to the 30 NSP's in this review would be zero.
- For HR, either FTE's or direct labour cost are suitable
- For finance, transactions seems to be the best driver and I don't see how customer numbers is a direct driver. However if most of the finance cost is in undertaking reports, budgets and trying to make a profit rather than paying bills then transactions is not a good driver
- For strategy, service contracts is a reasonable driver. However, it is not appropriate to charge channel NSP's for this service since it implies that this service is done twice for channel schemes which is not appropriate
- HSEQ should be either FTE's or direct labour costs. Service contracts is not a good driver.
- Legal is probably best by using service contracts but I do not believe that it is appropriate to charge channel schemes twice in the bulk and channel NSP's. I do not believe either customers or asset value are good drivers. I would expect that the majority of legal costs are directly attributed to schemes so perhaps it is best to allocate the rest of legal costs to schemes in proportion to the way legal direct costs are?
- Procurement is both a function of number and value of transactions though I suspect that the value is the more important driver. Consequently total direct costs minus labour is probably the best driver not transactions.
- ICT is probably best served by FTE's
- IM regions is mostly a direct cost and there would only be a small residual of non direct costs. Therefore these residual costs should be attributed back to the schemes that use their services only in the same proportion as their individual IM regions direct costs are attributed to schemes
- IM asset management should be mostly a direct cost and there would only be a small residual of non direct costs. Therefore these residual costs should be attributed back to the schemes that use their services only in the same proportion as their individual IM asset management direct costs are attributed to schemes
- IM water accounts is probably best served by customer numbers. However, if the majority of these costs are indirectly and directly attributed to the schemes then perhaps the residual can be attributed to the schemes in the same proportion
- IM GM is probably best driven by profits or direct costs
- ID would mostly be a direct cost so the residual should be attributed back to each scheme in proportion to how direct costs are apportioned on this specific item.
- In summary for allocation methodologies
 - An analysis needs to be done of the 12 items to see what proportion of costs are direct, indirect and other
 - The items with at least say 60% direct and indirect costs should be attributed to each scheme in proportion to how the direct and indirect costs are attributed to schemes. This is likely to be the case for IM regions, IM asset management and ID but perhaps others including IM water accounts and legal

- Of the remaining overheads
 - Direct labour costs or FTE's best for HR, HSEQ and ICT
 - Contracts (excluding channel ones) for legal and SSR
 - Transactions for finance
 - Direct non labour costs for procurement
 - Profit or direct costs for IM GM
 - Customers for IM water accounts
- This are too many so it may be more appropriate to use allocating directly for items with more than 60% direct and indirects, direct labour, contracts and direct non labour costs
- Why is customer support included in channel costs? This is a duplication with bulk many indirect and overhead costs are duplicated between bulk and channel when they should only occur once for a scheme. Many of the allocations of indirect and overheads should only be to bulk for 8 channel schemes

Overhead implications for schemes

- The level of overheads allocated to schemes needs to be reviewed on a scheme by scheme basis. This will require a thorough analysis of the overhead costs attributed to individual activities within schemes to see if these are efficient. At this stage neither the overhead or op/cap x consultants have looked at this critical issue and this is the most critical element of the efficiency review.

QCA issues

- Prices can't go down is not feasible given costs likely to be recovered on average over 5 years not in last year so price above lower bound in year 5. Split of bulk and channel means bulk charge in channel has to be at bulk price last time as minimum which is often above lower bound. Also change to 100% part A is a problem. Tariff groups are different so prices should be able to go down
- Must be revenue offset in next price path from part A and B charges from sales of water during this price path. New water should receive same charges as existing growers. If not, Sunwater can double dip and charge twice for same water. If charges for new water reflect variable costs only, value of water will increase so this is not a solution. The investment in channel lining may reflect marginal costs but once this investment is undertake it should be reflected in a lower average cost to all users not just the new water
- If Sunwater pays for its losses it loses money unless it saves and sells water. This is a much bigger incentive than if it doesn't pay for them so they break even, even it is extremely inefficient re losses. Also, if it doesn't pay for losses and it can only sell them if it shows that they have been saved there is a big incentive for Sunwaters actual losses to match loss allocation. The time for this manipulation to occur is when new meters are introduced. Also if Sunwater sells channel loss water into the bulk system then it should pay an exit fee like all other customers
- Impact of change in conversion factor and overhead allocation methodology on renewals balances needs to be reviewed

- Unless there is a conversion factor for prices reflective of conversion in ROP's for channel schemes there will be a strong incentive for some water users to convert their allocation. This is the case for fruit and vegi growers in Mareeba and Bundaberg who have excess water for dry years who would be better suited to HP water anyway. This will have significant implications for remaining MP users
- Are HP charges above MP charges for emerald irrigation a revenue offset?
- If water use lower than forecast then renewals under recover is reflected in renewals balance. How is this done though if efficient renewals costs from last review are not known and the subsequent % of renewals of total costs and revenues?
- QCA's variable cost analysis of historical data may not show much due to uncertainty re data and change in methodologies over time. Advice from experts on what is variable and fixed is best approach including advice from the 4 direct cost efficiency consultants and the Pioneer Valley Water Board
- Definition of renewals by Sunwater is all items not undertaken at least once a year and operations as costs incurred at least yearly. This does not relate to maintaining and asset and operating a scheme. Also overhead and indirects are allocated to both renewals and operating. Consequently it is not appropriate to have 2 allocation methodologies in bulk and is also questionable how a different conversion factor can be used for both bulk and channels?
- Complication of 6 tariffs in Mareeba will be difficult to sort out especially since 1 tariff group has been moved from bulk to channel. Also should supplemented stream losses be included in their water use. For example if 3ML in released into stream to deliver 1 at farm gate what ML do you charge for?
- If channel customers pay more for bulk water than bulk customers because of distribution losses, should the bulk costs not used by channel customers be only charged to bulk water users?
- There is a negative incentive for Sunwater to deliver water in sections of channel schemes where the part B charge is lower than variable cost
- If water use reflects historical average then customers wear all water use risk regardless of tariff structures
- If new prices start on 1 January or 1 July 2012, is our 5 year forecast of costs now 2012/13-2016/17?
- If costs for bulk are determined to be all fixed then whether you deliver 0 or 100% of the water in a year then the costs are unchanged. Consequently if you do not operate the dam (and delivery 0%) or you do operate the dam (and deliver 100%) your costs stay unchanged. This appears to suggest that the actual operating costs are 0. Consequently by sunwater HUF's proposal, all bulk costs would be converted using the HUF.