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## QCA Pricing Practices Recommendations

### SunWater Implementation Plan

#### Item 3.3.1 – Process and Systems Changes for Separate Identification of Drainage Costs

December 2012

## Introduction

SunWater provides drainage services to remove water from irrigation properties (both from farm run-off and stormwater) in the Burdekin-Haughton, Emerald, St George, Dawson Valley and Mareeba distribution networks. Separate charges amounting to around \$1.2m per year are levied for drainage for the first four of the channel systems listed. In Mareeba, the drainage system charges are incorporated into the fixed distribution charge.

In the pricing review concluded in April 2012, SunWater submitted that the existing drainage prices should be retained for the 2013-17 period, subject to an annual CPI adjustment. However, SunWater's preference from 2018 is for drainage costs to be combined into the fixed charge for the distribution system, thereby appropriately reflecting the interrelationship between the drainage and water supply network infrastructure. The QCA agreed to maintain the current drainage charges in real terms for the 2013-17 pricing period; however, they disagreed with SunWater's position post-2018 and decided there was a strong case to maintain separate drainage fees beyond the current price path.

To support the determination of cost-reflective drainage tariffs in the future, the Authority recommended that SunWater put in place (from 1 July 2012) processes to accurately identify drainage costs in preparation for the next price review. Consequently, SunWater's implementation plan has identified the steps required for improved identification of drainage charges. The plan aims to identify and implement the required process and systems changes by 30 Sept 2013. This paper addresses the first step in this plan (item 3.3.1) which is to identify process and systems changes required by SunWater to separately identify drainage costs. As outlined in the implementation plan, any changes in this area will be subject to the outcomes of the local user management process.

## Implementation Plan Item 3.3.1 – Required Process and System Changes

### Current Status of Drainage Cost Identification

While the separation of drainage costs has not been a priority for SunWater, most of the costs associated with drainage assets have been historically captured due to the existence of dedicated drainage profit centres in SunWater's SAP financial system. So the ability already exists to separately identify asset based costs, such as maintenance and renewals, against the drainage service. The accuracy of the current asset-driven cost allocation will be confirmed as part of this process.

While drainage asset costs are being captured, drainage operational costs are currently not captured accurately. This is because it simply hasn't been a priority to have operators separately costing their time and other direct costs between drainage and other channel activities. In the past, this has not been an issue because the costs have ultimately all ended up against the relevant distribution service contracts, as have the drainage revenues (as revenue offsets).

Apart from the costing perspective, the physical similarities between channels and drains and the geographical proximity of the two systems has meant that the operators have tended to view this infrastructure as a single entity, rather than two distinct entities. For example, if an operator performs a channel inspection, he is likely to also perform a drain inspection at the same time and in his mind these assets are one and the same thing, consequently his time will typically be recorded against the channel system.

### Changes Required to Accurately Identify Drainage Operating Costs

In order to accurately identify the operating cost of the drainage systems, there needs to be a lower level allocation of these costs both when allocating labour and when allocating direct operating costs. This can be achieved by either having operators separately apportion their time and other costs between the channels and drains, or by SunWater introducing standard allocations of operating costs between the channels and drains. SunWater's experience with unbundling the Bulk and Distribution system costs was that there was a significant amount of effort expended in getting operators to accurately cost their time between the two systems. Given that drains represent a much smaller part of the infrastructure than the channels and that the two systems are physically and geographically so similar, SunWater believes the most efficient way to separate drainage and channel operating costs is via a standard allocation methodology<sup>1</sup>.

Given that SunWater has decided to apply a standard allocation approach to separating out drainage costs there is little point in implementing this change in SAP when the allocators can simply be applied in a spreadsheet to reports from SAP to achieve the same ends at much lower cost. What needs to be developed and documented is the methodology for determining each allocator and the spreadsheet tool for applying the allocator to the distribution costs. These allocators will be developed in consultation with the QCA.

The proposed approach to separately identify drainage costs will allow SunWater to provide these costs to the QCA prior to the next pricing review so that the QCA can determine cost-reflective drainage prices. The revenue from drainage services will continue to be applied in SAP as a revenue offset against the relevant channel service contract.

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<sup>1</sup> There will be CSO implications of treating drainage revenue as a separate service from distribution services. SunWater needs the drainage revenue and costs to be recognised in the CSO to ensure that this new approach is revenue-neutral for SunWater.

SunWater needs to investigate the best method for setting and maintaining standard allocators for the various operating activities such as condition monitoring and weed control. Similarly, allocators need to be determined for direct costs such as insurance, rates and other service contract based costs. SunWater suggests that the allocators should only be reviewed every five years in the first year of each price period with approval by the QCA.

**Estimated Cost for Investigation:** \$5,500

**Estimated Cost for Required Changes:** \$8,500

In total, there are clearly some significant costs associated with the separate identification, reporting and budgeting of drainage costs. Before committing any costs beyond the investigation phase, SunWater will liaise with Government and the QCA to ensure the extra costs are prudent and efficient given the relative costs and revenue associated with the drainage systems. Also, the final implementation of system and process changes for drainage cost identification will not occur until a decision on the progression of Local User Management of the channel systems has been made.

### **Confirmation that Asset Driven Drainage Cost Allocation is Accurate**

As mentioned earlier, SunWater already separately captures asset driven drainage costs. Given the elevated importance of these costs under the proposed cost-reflective drainage tariffs, the allocation of these costs will be reviewed for accuracy and corrective action taken where costs are being incorrectly allocated to the channel system.

**Estimated Cost for Investigation:** part of normal business

**Estimated Cost for Required Changes:** n/a

## **Conclusion**

SunWater believes the most efficient way to separate drainage and channel operating costs is via the standard allocation method performed on cost figures extracted from SAP each year. This standard allocation will not form part of the general ledger accounts but will be maintained off-line in a spreadsheet tool designed for the purpose.

SunWater will determine the best method for achieving an accurate outcome for each of the major cost categories affecting operating costs. SunWater believes that asset-based costs are currently being captured accurately but will review these costs to confirm this assertion.

SunWater will liaise with Government and the QCA to ensure the extra costs associated with are prudent and efficient given the relative costs and revenue associated with the drainage systems. Also, the final implementation of system and process changes for drainage cost identification will not occur until a decision on the progression of Local User Management of the channel systems has been made.