From: McGahan, Peter [mailto:Peter.Mcgahan@sunwater.com.au]
Sent: Monday, 5 March 2012 9:10 AM
To: Angus MacDonald
Cc: Les Godfrey; Matthew Bradbury
Subject: Recommended changes to CAM

Angus,

After doing some analysis we have some concerns with the Authority's draft recommendation about changing the distribution of local overheads as presented on p237 of the draft report. Attached is a brief paper outlining out concerns.

I hope the paper provides enough information to have the Authority reconsider this recommendation, but please contact me if further information is required.

As the paper explains, if the Authority does not change the draft recommendation then changes must be made in the Authority's pricing model before prices are set.

Regards
Peter

Response on the Authority's Draft Recommendation to Change SunWater's CAM

In the QCA's Draft Report the following recommendation was made:

The Authority recommends non-direct costs be allocated to service contracts using DLCs (as proposed by SunWater with two exceptions:

a) the overhead component of Infrastructure Management (Regions) should be allocated to the service contracts serviced by each relevant resource centre (South, Central, North and Far North), on the basis of DLC from each respective resource centre; and

b) the overhead component of Infrastructure Development should be allocated to service contracts on the basis of DLC from that respective resource centre.

SunWater has reviewed the implications of this recommendation and has found that it introduces unnecessary complexity to SunWater's Cost Allocation Methodology (CAM), will introduce increased administrative costs and will generally result in increased non-direct costs to irrigation service contracts.

SunWater currently operates with two overhead cost pools: Brisbane overheads and Local overheads. Both of these pools are allocated to service contracts using average rates applied to direct labour; there is one rate for Brisbane overheads and one for Local overheads. The QCA's recommendation effectively removes many of the Local overhead resource centres from the average rate methodology and this will mean that SunWater will have to maintain around 18 average overhead rates rather than the two currently in place.

While implementing the QCA's recommendation will arguably create a more cost-reflective distribution of local overheads the impacts need to be assessed in totality to confirm that the benefits outweigh the costs. Analysis by SunWater indicates that the rebalancing of overheads will result in most irrigation service contracts being worse off under the proposed methodology. The overall increase in non-direct costs to irrigation service contracts is estimated to be around $600k p.a.; for individual contracts the maximum saving is about 1%, while the maximum increase is about 5%. These estimates are based on allocations without considering the additional costs of maintaining a more complex CAM. There will also be additional complexity in job costing which will flow to increased administration costs.

Additionally, given that the Local overhead cost pool would be moving away from an average rate approach, it would be difficult to rationalise how this cost pool could continue to run at a net under-recovery.

The table following shows SunWater's estimate of the average annual impact of the recommended changes on each irrigation service contract showing the impact of unwinding the average rate allocation method and of also removing the current under-recovery of Local overheads.

Service Contract	Estimated Annual Increase due to Multiple Local Overhead Rates	% Increase	Total Increase Including the Impact of Full Local Overhead recovery	% Increase
Barker Barambah Bulk	(0)	0.0%	7	0.8%
Bowen Broken Bulk	38	3.1%	48	3.9%
Boyne Bulk	(1)	-0.3%	3	0.6%
Bundaberg Bulk	4	0.3%	18	1.1%
Burdekin Bulk	3	0.1%	38	1.0%
Callide Bulk	2	0.1%	13	0.8%
Chinchilla Weir Bulk	2	2.1%	3	3.0%
Cunnamulla Weir Bulk	1	1.5%	1	2.4%
Dawson Bulk	1	0.1%	13	1.1%
Eton Bulk	55	2.9%	69	3.6%
Lower Fitzroy Bulk	(3)	-1.0%	(0)	-0.1%
Lower Mary Bulk	(0)	-0.1%	3	1.0%
Macintyre Brook Bulk	21	1.9%	34	3.1%
Maranoa Bulk	1	2.2%	1	3.0%
Mareeba Bulk	0	0.0%	10	1.0%
Nogoa Bulk	112	4.2%	136	5.1%
Pioneer Bulk	25	2.2%	41	3.6%
Proserpine Bulk	(1)	-0.1%	6	0.7%
St George Bulk	37	2.3%	49	3.1%
Three Moon Bulk	(2)	-0.4%	2	0.5%
Upper Burnett Bulk	(7)	-0.7%	4	0.4%
Upper Condamine Bulk	34	2.2%	46	3.0%
Bundaberg Distribution	7	0.1%	66	0.7%
Burdekin Distribution	26	0.2%	119	0.8%
Dawson Distribution	(1)	-0.1%	14	1.0%
Emerald Distribution	82	4.5%	101	5.6%
Eton Distribution	93	3.3%	114	4.0%
Lower Mary Distribution	(5)	-0.5%	3	0.3%
Mareeba Distribution	15	0.3%	62	1.2%
St George Distribution	49	3.8%	67	5.2%
Total ($2011 k real)	**$587**		**$1,089**	

Under full cost recovery, only one irrigation service contract will see a reduction in non-directs. This is before the additional costs of implementation and maintenance are included.

SunWater estimates that the additional costs associated with these recommendations are:

Implementation in SAP	$60k
Implementation in the SFM	$40k
Implementation in the job costing system	$75k
Ongoing maintenance of additional overhead rates	$45k p.a. (0.5 FTE)

SunWater notes that if the QCA were to proceed with these recommendations then the Authority's pricing model would have to be modified to reflect the recommendations and the cost base would have to be increased to reflect the additional costs. These changes would need to occur before prices are established.