



OUT16/14293

Mr Hugo Harmstorf  
Chief Executive Officer  
Independent Pricing and Regulatory Tribunal  
PO Box K35  
Haymarket Post Shop NSW 1240

Dear Mr Harmstorf

### **2016 WAMC Draft Price Determination**

Thank you for your letter of 8 March 2016, advising of the release of the Draft Price Determination and associated explanatory report for prices for water management, water licence consent transactions, meter service and reading and ancillary services commencing on 1 July 2016 for the Water Administration Ministerial Corporation (WAMC).

Please find attached the DPI Water response to Draft Price Determination.

I would welcome the opportunity to talk you through the implications of our submission and the IPART proposals to date.

Yours sincerely

A black rectangular redaction box covering the signature of Gavin Hanlon.

**Gavin Hanlon**  
**Deputy Director General, DPI Water**  
4 April 2016

Encl.



Department of  
Primary Industries  
Water

## **DPI Water Response to IPART**

Draft Determination for prices from 1 July 2016  
on behalf of the  
Water Administration Ministerial Corporation

Published by the NSW Department of Primary Industries, Water

*DPI Water response to the IPART Draft Determination*

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**More information**

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## Introduction

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The Independent Pricing and Regulatory Tribunal (IPART) price determination process includes seeking public comment on a Draft Price Determination prior to a Final Price Determination being issued. The Draft Price Determination and associated explanatory report for prices for water management, water licence consent transactions, meter service and reading and ancillary services commencing on 1 July 2016 for the Water Administration Ministerial Corporation (WAMC) was released by IPART on 8 March 2016.

This document presents the DPI Water response to the Draft Price Determination.

The Final Price Determination is scheduled to be issued on 7 June 2016.

### Summary of DPI Water's response:

- DPI Water accepts the proposed pricing structure for water management services, consent transactions and meter service and reading services.
- DPI Water requests the removal of the reduction in allowed costs of water management planning. Synergies' assessment of the unit costs of water management planning is inaccurate. DPI Water's proposed forecast costs reflect a reduction in unit costs and are favourably benchmarked against Synergies information.
- DPI Water contends that all of the activities associated with the Metropolitan Water Plan fall within the ambit of the Water Services Order and therefore all such costs should be allowed for within the price.
- DPI Water has proposed an efficient level of costs for Systems Operation and Water Availability Management that reflects historical levels and hence the proposed reduction in costs allowed should be removed.
- DPI Water is concerned that, in proposing an increase of 5 per cent in efficiency savings across all operating costs, the level of efficiency already included by DPI Water in its cost forecasts has not been understood. The outcome of the proposed change is that DPI Water is expected to make an average 9.2% per annum reduction in operating costs in addition to the \$4.7m already included in the baseline costs. DPI Water contends that the existing cost savings outlined in the Price Submission are appropriate and that there is no basis for the proposed additional efficiency discount.
- However, if an efficiency discount was to be applied, DPI Water considers that the existing efficiency dividend commitment should be taken into account and that the discount should be phased in to allow time for the business to adjust.

### Overview

DPI Water is committed to providing prudent, efficient and effective water management and associated monopoly services to its customers and to the NSW community. It has worked to improve all of its activities during the current determination period and will continue to seek efficiencies and advancements to its services in the future.

DPI Water welcomes the fact that the Draft Price Determination reflects acceptance by IPART of the key structural elements of Price Submission made by DPI Water in September 2015, namely:

#### *Water management services*

- a price determination period of four years - 2016/17 to 2019/20;
- retention of the existing water source definitions;
- 70:30 fixed:variable prices. except for North Coast Regulated which is 92:8;
- the proposed cost allocators used to attribute revenue needs to water sources;
- the proposed government and user cost shares;

- 2016/17 water management prices being set so that a typical bill does not increase when compared to 2015/16 prices;
- for water sources where the users' share of revenue needs is not fully recovered, real prices to increase by 2.5% per annum from 2017/18;
- introducing new prices when floodplain harvesting licences commence;
- proposed demand forecasts, particularly for unregulated and groundwater sources;
- increasing the minimum annual charge to better reflect the baseline cost of managing a water licence;
- the proposed service standards and performance measures.

*Consent transactions*

- the structure of DPI Water's proposed prices has been adopted; and

*Meter service and meter reading charges*

- relating meter service charges to the size of the meter.

Adopting these structural elements will provide a firm basis for DPI Water's future planning and the delivery of essential water management services to licence holders.

The Draft Price Determination proposes two enhancements to DPI Water's price submission for water management services, being:

- (i) introduction of a premium price for WaterNSW to recover the costs of monopoly water management services associated with the Metropolitan Water Plan; and
- (ii) an increase in the minimum annual charge to \$200 (\$2015/16) in 2019/20.

DPI Water accepts these enhancements.

However, consistent with the findings of the Expenditure Review conducted by Synergies Economic Consulting, the Draft Price Determination indicates that IPART believes DPI Water can achieve substantial cost savings beyond the proposals identified in the Price Submission. IPART has, with one relatively minor exception, accepted the Synergies recommendations on revenue needs for operating costs, capital costs and the level to which contributions to the Murray-Darling Basin Joint Venture and Dumaresq-Barwon Border Rivers Commission are to be included. As a consequence, IPART's proposed total revenue needs for service delivery over the 4-year determination period has been set at \$229.94 million, which is \$20.2 million (8.1 per cent) less than the \$250.14 million proposed by DPI Water.

DPI Water, in preparing the revenue needs proposed in the Price Submission, used a robust forecasting framework to establish an efficient level of the costs of providing an appropriate level of service. Therefore, whilst accepting the overall structure of the Draft Price Determination DPI Water does not accept some of the proposed changes to business revenue needs for water management services over the 4-year determination period.

In aggregate the assessed notional revenue requirements that underpin the Draft Price Determination represent a very substantial reduction in DPI Water's funding and would require an increased public contribution to water management costs or the immediate implementation of an aggressive staff reduction strategy and other savings measures that may seriously threaten the delivery of essential water management services. To propose further efficiencies on DPI Water's proposed costs that already reflect a high level of efficiency to commence in just three months time would test nearly every business. It is our view that this would be detrimental to the water planning and management system in NSW and ultimately to water access licence holders.

Set out below are DPI Water's arguments against the proposed reduction in revenue needs.

## Revenue Needs for Water Management Services

### Water Management Planning (W06-01 and W06-02)

Consistent with the Expenditure Review report, the Draft Price Determination proposes a \$1.7 per annum million (approximately 41 per cent) reduction in the revenue needs costs for water sharing planning.

DPI Water is concerned that this proposal appears to be largely founded on arithmetic errors and/or misunderstanding of the information on these activities presented to IPART in the Price Submission and subsequently during the Expenditure Review process.

These errors and misunderstandings include:

- (i) *Miscalculation of the forecast average cost of water sharing plans in the future determination period that has led to the erroneous conclusion that average costs are rising.*

The Draft Price Determination relies upon the Synergies report, which drew upon a number of unit costs in reaching the recommendation for a reduction in the forecast costs of reviewing and re-making water sharing plans as required under the Water Management Act. Synergies observed, for example, DPI Water's average cost of \$575,000 per water plan over the current price period and costs of water planning in Queensland which ranged from \$117,000 for minor changes to \$856,000 for major changes.

The following information, which is entirely consistent with the information presented in the Price Submission and other material provided by DPI Water during the Expenditure Review, clearly demonstrates that on a per plan basis water sharing planning costs are in fact falling and are towards the lower end of the range observed in Queensland.

#### *W06-01 Water plan development (coastal)*

DPI Water's Price Submission (p.147) notes the following output measures to be achieved in the period to 2020:

- 5 water sharing plans will be reviewed and replaced/extended;
- 7 water sharing plans will be reviewed; and
- 1 water sharing plan will be reviewed and merged into another plan.

The per plan average cost of this activity over the next determination period is shown in the table below:

| Activity code | No. of WSPs over the period | 2016/17<br>\$'000<br>15/16 | 2017/18<br>\$'000<br>15/16 | 2018/19<br>\$'000<br>15/16 | 2019/20<br>\$'000<br>15/16 | 4-year total<br>\$'000<br>15/16 | Premium for indigenous work<br>\$'000 15/16 | BAU cost<br>\$'000<br>15/16 | Average cost per WSP -<br>\$'000 15/16 |
|---------------|-----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|---------------------------------|---|-----------------------------|--|
| W06-01        | 13                          | 1,962                      | 1,950                      | 1,944                      | 1,959                      | 7,815                           | 2,000                                       | 5,815                       | 447.32                                 |

The forecast average cost of \$447,000 per plan in the next determination period is 22 per cent below DPI Water's average cost in the current determination period and mid-range in terms of the unit costs that would have been experienced in Queensland

#### *W06-02 Water plan development (inland)*

DPI Water's Price Submission (p.148) notes the following output measures to be achieved in the period to 2020:

- 8 water sharing plans reviewed and replaced/extended;
- 2 water sharing plans reviewed;
- 3 water sharing plans reviewed and merged; and
- 22 water resource plans will be completed (Note: Water sharing plans are

components of water resource plans and in most cases there is than one water sharing plan per water resource plan).

An apparent critical misunderstanding reflected in the findings of the Expenditure Review was that all of the costs of water sharing plan reviews where those plans will form part of a water resource plan, would be covered under Basin Plan arrangements and therefore be funded by the Commonwealth. However, under the terms of the agreement with the Commonwealth funding does not cover work on water sharing plan amendment, review and replacement that is required under NSW legislation, only any additional costs associated with water resource plan requirements.

In practical effect, Commonwealth funding of the Basin Plan reduces but does not eliminate the costs of water sharing plans to be borne by NSW users in the Murray Darling Basin as the scope of work required under the Basin Plan does not fully comply with the requirements of water sharing plans under the NSW *Water Management Act 2000*. DPI Water's several attempts to explain this fundamental point seem to have failed.

The Price Submission(p.148) indicated that there would be 42 water sharing plans that will need to be remade to complete all the water resource plans, but this has since been updated to 44 (see Appendix 1). In addition to these, there are two other non-Basin Plan water sharing plans that will need to be remade in the inland, which brings the total to 46 inland water sharing plans.

When the total number of water sharing plans is considered, the average cost per inland water sharing plan is \$298,000 (see table below), which is very substantially below the current cost benchmark of \$575,000 per plan specified in the Synergies report and near the bottom end of the costs experienced for like activities in Queensland.

| Activity code | No. of WSPs over the period | 2016/17<br>\$'000<br>15/16 | 2017/18<br>\$'000<br>15/16 | 2018/19<br>\$'000<br>15/16 | 2019/20<br>\$'000<br>15/16 | 4-year total<br>\$'000<br>15/16 | BAU cost<br>\$'000<br>15/16 | Average cost per WSP - \$'000<br>15/16 |
|---------------|-----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|---------------------------------|-----------------------------|--|
| W06-02        | 46                          | 3,440                      | 3,435                      | 3,431                      | 3,389                      | 13,695                          | 13,695                      | 297.72                                 |

Even if the cost per plan is calculated on the previous estimate of 42 plans, the cost per plan is still only \$326,000, i.e., well below the \$575,000 per plan benchmark.

- (ii) *Concerns that the costs of water sharing plan reviews that were scheduled for completion by June 2014 but had been delayed may have been shifted into the forthcoming determination period.*

This would obviously involve double counting of these costs for pricing purposes and DPI Water has previously made it clear that this will not occur as these plan reviews will be completed by 30 June 2016. That is, these reviews will be completed during the current determination period and no related costs have been shifted into the next determination period.

- (iii) *A supposed unexplained increase in the forecast resource needs for W06-01 Water plan development (coastal).*

Over the period 2014/15 to 2017/18, the level of FTEs for W06-01 and W06-02 collectively are anticipated to rise from 21.24 to 24.58. DPI Water has previously provided the explanation for this forecast increase in these resource needs, but it seems to have been overlooked.

The objects of the *Water Management Act 2000* require recognition and fostering of social and economic benefits to Aboriginal people and the additional resource needs relate to the introduction of three recurrently funded Aboriginal Water



Initiative (AWI) roles and associated operational expenses. This will occur after the 2016/17 financial year to provide Aboriginal input to the water sharing plan process. These staff will service the Aboriginal consultation and planning inputs for water planning only in coastal NSW as similar AWI roles in inland NSW will be funded through the Commonwealth to meet Basin Plan requirements.

On the basis of the above information, DPI Water contends that there is no basis for the proposed reduction in notional revenue needs for water sharing planning (W06-01 and W06-02). Just as is flagged in the Price Submission, there is a sound basis for the increased resource needs that have been identified and the forecast costs in the Price Submission already demonstrate substantial gains in efficiency. It is strongly recommended that the Final Determination reflect a reconsidered approach to this matter.

### **Regional Planning & Management Strategies (W06-05)**

IPART's draft decision is to exclude 25 per cent of the cost of the Metropolitan Water Directorate's development of the Metropolitan Water Plan (MWP).

#### ***Interpretation of the Water Services Order***

The Draft Price Determination excludes activities related to recycled water and desalination from the cost base for developing the MWP as they are not considered monopoly services and therefore do not meet IPART's interpretation of the Independent Pricing and Regulatory Tribunal (Water Services Order) 2004.

IPART's Expenditure Review consultant (Synergies) noted that the Water Services Order can be interpreted in different ways, as there is no guidance on which water management activities should be included as monopoly services. The Water Services Order is ambiguous regarding what is meant by 'the making available of water', however, IPART and its consultants appear to have interpreted it as relating to activities associated with water resource planning and management.

The Draft Price Determination notes (p39):

*We assess that the Metropolitan Water Plan (MWP) falls within the category of 'localised water plan – plans developed to address specific water resource problems (quantity or quality) at a local level'. As such, these are appropriate water planning activities that should be included in the definition of monopoly services.*

The relevant activity therefore is *water planning* and, in relation to the greater Sydney region, the development and review of the MWP. The MWP aims to secure water via an optimal (highest net benefit to the community) portfolio of water supply and demand management measures and strategies. The component elements of the MWP portfolio work together to secure water for the greater Sydney region in drought and over the long term, and cannot be meaningfully separated by water use.

Further, implementation of the measures and strategies in the MWP is not the responsibility of DPI Water but government water utilities (monopoly providers) and private providers. There is a clear distinction between the development of the MWP (water planning) and the provision of water services consistent with the MWP (water services).

#### ***Basis for calculating the cost base for the MWP***

The costs associated with water planning in greater Sydney reflect:

- the population of the region and growth forecasts: currently there are 4.5 million people in greater Sydney (over 60 per cent of NSW population), increasing to 6 million by 2036;
- the value of the region's economy;
- the complexity of the water supply system including the number and diversity of water sources and number of water service providers; and
- the review cycle for the MWP.

There is no correlation between the costs associated with the development of the MWP and the volume of water potentially able to be provided by (non-monopoly) suppliers of recycled water and desalinated water. The approach taken by IPART in arriving at the Draft Price Determination is therefore not considered to be a robust methodology for calculating the cost base for setting water management charges.

In addition, the Draft Price Determination provides for the exclusion of 25 per cent of the costs of the MWP. However this figure is arrived at by adding together the amount of water that could be supplied by recycled water projects and turning on the desalination plant (*supply capacity*), then calculating the total supply capacity as a percentage of the forecast *demand for water*.

This calculation needs to be done on a consistent basis that does not conflate supply capacity with water demand (or volumes supplied). DPI Water can provide accurate data on volumes supplied (to meet projected demand) by water source or estimated supply capacity using data from modelling undertaken as part of the MWP Review. Using volumes supplied (to meet forecast demand to 2064), the contribution of non WaterNSW sourced water for greater Sydney is around nine per cent.

| <i>Forecast demand<br/>(volumes supplied by source)</i> | <i>GL/a</i> | <i>% total</i> |
|---|-------------|----------------|
| Dam water   | 568.7       | 91             |
| Desalinated water                                       | 4.7         | 1              |
| SWC recycling   | 43          | 7              |
| Private recycling                                       | 6           | 1              |
| Total   | 622.4       | 100            |

On the basis of the above, it is recommended that IPART:

1. reconsider the interpretation of the Water Services Order in relation to the water planning costs for the MWP that are allowed to be recovered from users; and/or
2. review the approach to calculating the costs to be excluded from the cost base to ensure principles are being applied on a consistent basis.

In summary, DPI Water questions the basis for the proposed reduction in the revenue needs identified in the Price Submission.

### **Systems Operation and Water Availability Management (W05-01)**

The Draft Price Determination proposes a \$1.3 per annum million reduction in the allowed costs for Systems operation and water availability management, largely due to concerns arising from an acknowledged weakness in cost reporting in the early years of the current determination. This particular problem was a key driver for the DPI Water's proposal to refine the activity definitions for the next determination period.

The historical costing error relates to operations-level misinterpretation and resulting misallocation of resources between current activities C06-01, C06-02 and C06-03. A summary of the historical costs for these activities is as follows:

|                                       | 2012<br>(\$2015/16) |        |        |       | 2013<br>(\$2015/16) |        |        |       |
|---------------------------------------|---------------------|--------|--------|-------|---------------------|--------|--------|-------|
|                                       | C06-01              | C06-02 | C06-03 | Total | C06-01              | C06-02 | C06-03 | Total |
| <b>Actual operating costs</b>         | 962                 | 70     | 3,497  | 4,529 | 943                 | 279    | 2,848  | 4,070 |
| <b>Costs allowed for in the price</b> | 1,557               | 1,537  | 4,502  | 7,595 | 1,268               | 1,523  | 4,546  | 7,338 |

|                                       | 2014<br>(\$2015/16) |        |        |       |
|---------------------------------------|---------------------|--------|--------|-------|
|                                       | C06-01              | C06-02 | C06-03 | Total |
| <b>Actual operating costs</b>         | 2,801               | 142    | 2,242  | 5,185 |
| <b>Costs allowed for in the price</b> | 1,273               | 1,510  | 4,948  | 7,731 |

What this time series shows is that the *total* costs for these activities are actually consistent and reliable and within that which IPART allowed for in its last determination.

The lack of operational clarity in the activity definitions was exacerbated in the period 2011/12 and 2012/13 as DPI Water (then the NSW Office of Water) was being integrated into a new agency and was undergoing a significantly disruptive change management process. This problem was rectified in 2013/14, which is reflected in the \$2.9 million spend in C06-01 and C06-02 and the budget for 2014/15 being \$3.4 million, a 17 per cent increase.

In regard to the forecast increase in service delivery costs in the next determination period, water management generally, and the service expected by customers, is widely known to be changing rapidly and manifesting in increasing costs to maintain required services. Demand for water through water markets is forcing the market value of water upward, creating an expectation from water users of more service – to protect their investment water users are demanding more accurate allocations, more detailed explanations, more responsiveness to conditions and individual needs, and more sophisticated systems for water regulation, accounting and operations.

Despite continuing to introduce efficiencies and savings, for example, eliminating paper records and relying on electronic document transfer and storage systems, streamlining statutory approvals processes and creating templates to efficiently collate and dispense standardised information across NSW valleys, customer expectations and demands on water resource management resources continue to grow.

Water management is continuing to be more complex and onerous and is anticipated to become more so, particularly with a significant probability of NSW descending further into drought. DPI Water's forecast operating costs for the period 2016/17 to 2019/20 as specified in the Price Submission are considered realistic to properly service water users and protect the environment.

DPI Water contends that the conclusion reached by Synergies in the Expenditure Review is inaccurate and consequently the proposed reduction in costs for these activities is not justified.

### **General efficiency discount**

The Draft Price Determination adopts the Synergies recommendation to impose a five per cent efficiency discount to the forecast delivery costs for all monopoly service activities other than those for which individual discounts were recommended. This efficiency discount totals \$7.9 million (\$2015/16) over the proposed 4-year price path.

The Synergies Expenditure Review report identifies the reasons for the proposed discount as including:

- (i) DPI Water has reduced total and/or unit costs however we (Synergies) are unconvinced that further savings are not possible.
- (ii) It is Synergies view that DPI Water has failed to meet the standard set for it by IPART in the last review.
- (iii) Benchmarking revealed that DPI Water's corporate costs appear high, though there is not sufficient information at a granular level to make conclusions about specific dollar savings that should be applied.

- (iv) Absent a detailed analysis of all DPI Water's activities, the level of adjustments typical for first-time regulated businesses is a reasonable proxy for extrapolation. The adjustment should be at the top end of this range.

The reasoning for the quantum of the efficiency adjustment is very nebulous. DPI Water makes the following observations in relation to Synergies reasoning for the reduction.

***DPI Water has reduced total and/or unit costs however we are unconvinced that further savings are not possible:***

DPI Water has achieved reductions in operating costs for water management services during the current price path (based on the 2011 price determination) A significant reduction of operating costs in 2013/14 resulted from the full assimilation of DPI Water into the Department of Trade and Investment and was followed by an increase in 2014/15 reflecting restructuring to provide the appropriate levels of service.

DPI Water's forecast water management services operating costs for 2016/17 are 12.6 per cent (\$7.6 million) lower than the 2014/15 level, representing further cost efficiencies that are already being realised. In addition to this, as noted in its Price Submission, DPI Water has included efficiency savings of savings of 1.5 per cent per annum (i.e., cumulative) into total forecast operating costs on the 2016/17 baseline costs plus the CPI from 2015/16 to 2016/17 which would normally be applied to revenue operating costs to set the prices in \$2016/17.

In summary DPI Water has included the following efficiency savings on total operating costs inclusive of overheads:

| 2016/17 | 2017/18 | 2018/19 | 2019/20 |
|---------|---------|---------|---------|
| 1.5%    | 3.0%    | 4.6%    | 7.7%    |

In practical effect, the Draft Price Determination proposes that DPI Water's operating costs for water management services should reduce from \$60.2 million in 2014/15 to \$50.6 million in 2016/17, a reduction of 16 per cent, of which DPI Water has already included \$.7.6 million. The Draft Price Determination proposes further reductions for each subsequent year of the price path.

DPI Water contends that the service delivery revenue needs in the Price Submission, which were arrived at through a very thorough and stringent review and robust budgetary process, already represent an efficient level of costs. While one of IPART's key roles is to drive monopoly service providers to an efficient level of costs, arbitrarily seeking savings where costs are already at an efficient level must inevitably impact on service standards.

***It is Synergies view that DPI Water has failed to meet the standard set for it by IPART in the last review:***

There is no explanation as to which of IPART's standards DPI Water has failed to meet. DPI Water has lodged all information required by IPART in a timely manner, has in an overall sense contained cost within the expenditure envelope proposed in the last Price Determination and has not received any advice from IPART indicating a failure to meet their standards.

Not only is there is no explicit evidence presented of DPI Water failing to meet IPART's standards, there is also no nexus demonstrated between any such purported failure and a lack of cost efficiency.

***Benchmarking revealed that DPI Water's corporate costs appear high, though there is not sufficient information at a granular level to make conclusions about specific dollar savings that should be applied:***

DPI Water is at a loss to understand the comment about a lack of information to make a fully informed assessment of the efficiency of its overhead costs. DPI Water has no record of a request from Synergies for more information or comment that there was insufficient information available or provided.

Corporate services are provided to DPI Water by the overarching Department of Industry, Skills and Regional Development, which developed a transparent model to calculate the overhead factors and was ready to respond to any requests for information.

DPI Water also notes that the conclusion that its corporate costs are relatively high is a selective interpretation of Synergies' own findings in that it relates only to a comparison between DPI Water and some other government agencies. The Expenditure Review report also observes that "in comparison to other regulated water businesses, DPI Water performs favourably."

***Absent a detailed analysis of all DPI Water's activities, the level of adjustments typical for first-time regulated businesses is a reasonable proxy for extrapolation. The adjustment should be at the top end of this range:***

The Expenditure Review strategy adopted by Synergies was their own choice and should have been appropriately designed to allow a fully informed assessment. DPI Water did not restrict Synergies in their review and cooperated fully with every request for information and explanation.

Due to the importance of the regulated prices in providing a revenue stream to fund service delivery and also in providing water users with appropriate economic signals, simply assuming that DPI Water is similar to "first-time regulated businesses" is an extremely arbitrary and weak basis upon which to justify a substantial reduction in forecast revenue needs.

Moreover, Synergies' apparent assumption that DPI Water is a first time regulated business and has not previously been subject to stringency measures is incorrect. DPI Water's charges have in fact been subject to price regulation for more than ten years and in 2011 IPART imposed a 3.8 per cent efficiency discount on the adjusted operating costs. Further, DPI Water's regulated prices have been frozen in nominal terms since 1 July 2013, which has further reduced its cost-recovery revenue in real terms over the subsequent period.

DPI Water has successfully met these budget stringencies. Over the period 2011/12 to 2014/15 (the last complete financial year in the current determination period), DPI Water's allowed costs were \$302.637 million and actual expenditure was \$302.949 million (Table 4.2, p53, of the Price Submission). That is, over the period as a whole, DPI Water costs are clearly tracking very closely with the costs allowed by IPART.

Furthermore, DPI Water has volunteered additional reductions in service delivery costs in the next determination period:

- The proposed user share of MDBA costs increases by \$3.7 million from \$1.8 million to \$5.5 million from 2015/16 to 2016/17, but the identified revenue needs do not increase accordingly. The revenue needs identified in the Price Submission in fact decline by \$1 million from 2015/16 to 2016/17. This means that DPI Water has already committed to deliver a \$4.7 million cost saving across the rest of the business in the first year of the new determination period.
- In addition, the forecast service delivery costs in the DPI Water Price Submission already include a further, annual and hence cumulative, 1.5 per cent efficiency dividend and discounting out of the normal CPI escalation of costs from 2015/16 to 2016/17.

### **Summary Position**

DPI Water is of the view that there is no robust foundation to the arbitrary judgment that its forecast costs are inefficient and that it can continue to deliver its defined water management services to the expected standards within the cost envelope that the Draft Price Determination represents.

As shown in the following table, if IPART's proposed five per cent general efficiency discount flows through to the Final Determination, the combination of DPI Water's own existing cost saving commitments and this discount would be a requirement for DPI Water to find savings of an average of 9.2 per cent every year.

|  | 2016/17        | 2017/18        | 2018/19        | 2019/20        | Total          |
|--|----------------|----------------|----------------|----------------|----------------|
|  | \$'000 (15/16) | \$'000 (15/16) | \$'000 (15/16) | \$'000 (15/16) | \$'000 (15/16) |
| Operating costs subject to efficiencies                | 43,263         | 43,981         | 43,914         | 43,278         | 174,436        |
| DPI Water's proposed efficiency savings                | -790           | -1,598         | -2,386         | -3,103         | -7,877         |
| Additional efficiency as per Draft Price Determination | -2,128         | -2,109         | -2,048         | -1,971         | -8,256         |
| Total efficiency savings                               | -2,918         | -3,707         | -4,434         | -5,074         | -16,133        |
| DPI Water's proposed efficiency levels                 | 1.8%           | 3.6%           | 5.4%           | 7.2%           | 4.5%           |
| Draft Pricing Determination efficiency levels          | 6.7%           | 8.4%           | 10.1%          | 11.7%          | 9.2%           |

DPI Water requests, at worst, that if IPART remains of the view that a general efficiency discount would be appropriate, DPI Water's standing commitment to a cumulative 1.5 per cent per annum efficiency dividend should be taken into account. DPI Water further considers that any such efficiency imposition should be phased in so as to allow the business time to achieve the required level of efficiency savings.

## External Funding of Water Management Services

DPI Water would also like to take this opportunity to respond to explicit and implied concerns about its accounting for external funds and the potential for DPI Water to have also sought recovery through water management prices of the costs of activities that have been or will be paid for by those funds.

For example, concerns were expressed in the Expenditure Review report that some of the service delivery costs reported in the Price Submission could involve DPI Water seeking funding from water access licence holders for costs that are covered by other external funding sources, such as Commonwealth programs.

In response DPI Water notes that in the 2011 price determination IPART did not identify any concerns relating to the division between DPI Water's 3<sup>rd</sup>-party funded water planning and management activities and those whose costs were included in the revenue recovered from water access licence holders. And DPI Water has made further improvements to its control processes since that time, including:

- Budgeting – Budgets are prepared on a net cost of service basis; as part of this for each activity funded by 3<sup>rd</sup>-parties a separate budget is prepared identifying the level of internal resources required (generally identifying the individual resourcing the work) plus other associated costs. The Department of Industries finance group review these budgets to ensure that the total resources used by DPI Water fit into the Department's overall resourcing framework and financial management requirements are being complied with.
- Costing – The costing system records information for each project and provides the facility to use tasks under each project to further categorise the work. The recorded data identifies via a "Source of Funds" code those projects that are subject to 3<sup>rd</sup>-party funding (by means of a grant or fee for service). This source of funds code is used as a mechanism either to bill, fee for service, or to account to the funder for grant monies.
- Under-recovery of fee for service work is identified by means of a negative net cost of service on the project which is then subject to management analysis.
- In the case of grants, DPI Water is in virtually all circumstances required to account to the funder for the expenditure to demonstrate that the funds have

been appropriately expended. A significant proportion of these accounts are subject to external audit.

- In most cases budgets for resource inputs are set at an individual officer level and therefore the allocation of costs to a project/task can be easily reviewed for accuracy.

Whilst these mechanisms and approaches may differ from a commercially focused business, they follow standard Department of Industry, Skills & Regional Development processes and clearly demonstrate that DPI Water's ring-fencing of both actual and forecast costs is robust and there is no risk of double counting.

DPI Water categorically refutes that the costs of any water management services are being recovered twice and is particularly concerned that the proposed general five per cent efficiency discount may have in part been based on unsubstantiated suspicions in that regard.

## Appendix 1

### Water Sharing Plans Under Each Water Resource Plan

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| <b>SW 8 – WRP for the New South Wales Murray and Lower Darling</b>                             |  |
| WSP for New South Wales Murray and Lower Darling Regulated Rivers Water Source 2003            |  |
| WSP for the Lower Murray-Darling Unregulated and Alluvial Water Sources 2012                   |  |
| WSP for the Murray Unregulated and Alluvial Water Sources 2012                                 |  |
| <b>SW9 – WRP for the Murrumbidgee</b>  |  |
| WSP for the Murrumbidgee Regulated Rivers Water Source 2003                                    |  |
| WSP for the Murrumbidgee Unregulated and Alluvial Water Sources 2012                           |  |
| <b>SW10 – WRP for the Lachlan</b>  |  |
| WSP for the Belubula Regulated River Water Source 2012   |  |
| WSP for the Lachlan Regulated River Water Source 2003  |  |
| WSP for the Lachlan Unregulated and Alluvial Water Sources 2012                                |  |
| <b>SW11 – WRP for the Macquarie-Castlereagh</b>  |  |
| WSP for Castlereagh Unregulated River Water Source (2016)                                      |  |
| WSP for the Macquarie and Cudgegong Regulated Rivers Water Source 2003                         |  |
| WSP for the Macquarie Bogan Unregulated and Alluvial Water Sources 2012                        |  |
| <b>SW12 – WRP for the Barwon-Darling Watercourse</b>   |  |
| WSP for the Barwon Darling Unregulated and Alluvial Water Sources 2012                         |  |
| <b>SW13 – WRP for the Intersecting Streams</b>   |  |
| WSP for the Intersecting Streams Unregulated and Alluvial Water Sources 2011                   |  |
| <b>SW14 – WRP for the Namoi</b>  |  |
| WSP for the Peel Valley Regulated, Unregulated, Alluvium and Fractured Rock Water Sources 2010 |  |
| WSP for the Namoi Unregulated and Alluvial Water Sources 2012                                  |  |
| WSP for the Upper Namoi and Lower Namoi Regulated Rivers Water Source 2003                     |  |
| <b>SW15 – WRP for the Gwydir</b>   |  |
| WSP for the Gwydir Regulated River Water Source 2002   |  |
| WSP for the Gwydir Unregulated and Alluvial Water Sources 2012                                 |  |
| <b>SW16 – WRP for the NSW Border Rivers</b>  |  |
| WSP for the NSW Border Rivers Regulated River Water Source 2009                                |  |
| WSP for the NSW Border Rivers Unregulated and Alluvial Water Sources 2012                      |  |
| <b>GW 6 – WRP for the Western Porous Rock</b>  |  |
| WSP for the NSW Murray-Darling Basin Porous Rock Groundwater Sources 2012                      |  |
| <b>GW 7 – WRP for the Darling Alluvium</b>   |  |
| WSP for the Intersecting Streams Unregulated and Alluvial Water Sources 2011                   |  |
| WSP for the Lower Murray-Darling Unregulated and Alluvial Water Sources 2012                   |  |
| WSP for the Barwon-Darling Unregulated and Alluvial Water Sources 2012                         |  |
| <b>GW 8 – WRP for the Murray Alluvium</b>  |  |
| WSP for Lower Murray Groundwater Source 2006   |  |
| WSP for the Lower Murray Shallow Groundwater Source 2012                                       |  |
| WSP for the Murray Unregulated and Alluvial Water Sources 2012                                 |  |
| <b>GW 9 – WRP for the Murrumbidgee Alluvium</b>  |  |
| WSP for the Lower Murrumbidgee Groundwater Source 2003   |  |
| WSP for the Murrumbidgee Unregulated and Alluvial Water Sources 2012                           |  |
| <b>GW 10 – WRP for the Lachlan Alluvium</b>  |  |
| WSP for the Lachlan Unregulated and Alluvial 2012  |  |
| WSP for Lower Lachlan Groundwater Source 2003  |  |



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| <b>GW 11 – WRP for the Lachlan and South Western Fractured Rock</b>              |
| WSP for the NSW Murray-Darling Basin Fractured Rock Groundwater Sources 2012     |
| <b>GW 12 – WRP for the Macquarie-Castlereagh Alluvium</b>                        |
| WSP for the Lower Macquarie Groundwater Source 2003                              |
| WSP for the Macquarie Bogan Unregulated and Alluvial Water Sources 2012          |
| WSP for the Castlereagh River (Below Binnaway) Unregulated and Alluvial 2011     |
| <b>GW 13 – WRP for the New South Wales GAB Shallow</b>                           |
| WSP for the NSW Great Artesian Basin Shallow Groundwater 2011                    |
| <b>GW 14 – WRP for the Namoi Alluvium</b>  |
| WSP for the Namoi Unregulated and Alluvial Water Sources 2012                    |
| WSP for the Upper and Lower Namoi Groundwater Sources 2003                       |
| WSP for the Peel Valley Regulated, Unregulated, Alluvium and Fractured Rock 2010 |
| <b>GW 15 – WRP for the Gwydir Alluvium</b>                                       |
| WSP for the Gwydir Unregulated and Alluvial Water Sources 2012                   |
| WSP for the Lower Gwydir Groundwater Source 2003                                 |
| <b>GW 16 – WRP for the Eastern Porous Rock</b>                                   |
| WSP for NSW Murray-Darling Basin Porous Rock Groundwater Sources 2012            |
| <b>GW 17 – WRP for the New England Fractured Rock and Northern Basalts</b>       |
| WSP for the NSW Murray-Darling Basin Fractured Rock Groundwater Sources 2012     |
| <b>GW 18 – WRP for the New South Wales Border Rivers Alluvium</b>                |
| WSP for the NSW Border Rivers and Unregulated and Alluvial Water Sources 2012    |