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21 July 2010

Dear Amanda

Addendum to Final Report – Adjustment to Corporate Overheads

Following the completion of the Final Report *Review of NSW Office of Water’s water management expenditure* an error was identified in the recommended adjustments to NSW Office of Water’s (NOW’s) operating expenditure, specifically relating to corporate overheads. This letter provides for a corrected analysis and identifies areas of our Final Report which should be read in conjunction with this letter.

The changes to the Final Report relate to the efficiency of overheads component of section 7.4 (Overhead expenditure) starting on page 117, and the corresponding section of the executive summary (third bullet point on page 12). The analysis in our Final Report inadvertently excluded a component of NOW’s operating costs (water consent transactions), which biased the calculated size of corporate overheads as a percentage of total operating cost.

After correcting our analysis, we determined that NOW’s corporate overheads (after other adjustments recommended in the Final Report) falls within the target range of 10-12 per cent, as referenced from the NSW Government’s *Council on the Cost and Quality of Government* analysis. The corrected percentages of overheads to total operating costs for each year of the analysis appear in bold font in the table below:

	2010/11	2011/12	2012/13	2013/14	2014/15
Corporate overheads as percentage of operating expenditure – incorrect figures used for in the analysis for the Final Report	14.0%	13.2%	13.2%	13.3%	13.3%
Corporate overheads as percentage of operating expenditure - Corrected	11.9%	11.1%	10.9%	10.9%	10.9%

Based on this corrected analysis, we recommend that **no further adjustment** should be made to NOW’s operating expenditure for the corporate overheads component.

The following table provides the correct adjustments that are recommended for NOW’s operating expenditure. This table replaces both tables 1.3 and 7.9 in the Final Report.

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	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Proposed operating expenditure ('000s)	48,809	50,180	53,913	56,807	59,036	59,797
Reduction due to inconsistencies in calculating overhead unit rate ('000s)	-245	-245	-250	-267	-280	-285
Reduction due to business administration	-176	-175	-173	-173	-173	-173
Reduction due to Metro Water	-475	-470	-465	-465	-465	-465
Reduction of unallocated FTEs	-2,481	-2,458	-2,433	-2,433	-2,433	-2,433
Reduction due to 20% reduction in new FTEs ('000s)		-295	-758	-1,263	-1,675	-1,808
Reduction due to fixed overhead costs for additional FTEs ('000s)		-92	-228	-380	-503	-543
Total reduction in operating expenditure ('000s)	-3,377	-3,735	-4,306	-4,980	-5,530	-5,707
<i>Adjusted operating expenditure</i>	<i>45,432</i>	<i>46,445</i>	<i>49,607</i>	<i>51,827</i>	<i>53,507</i>	<i>54,090</i>
Reduction due to efficiency adjustment of 0.5% p.a. for forecast period ('000s)		-232	-495	-774	-1,062	-1,339
Recommended operating expenditure	45,432	46,213	49,112	51,054	52,445	52,752
Percentage reduction in total operating expenditure ('000s)	-6.9%	-7.9%	-8.9%	-10.1%	-11.2%	-11.8%

We apologise for any inconvenience this error has caused.

Yours sincerely



Craig Fenton
Partner
Advisory