

**Review of Network Service  
Plan 2012-2017**

**Coleambally Irrigation Co-  
operative Limited (CICL)**

**Report to the ACCC and  
Coleambally Irrigation Co-operative  
Limited under Part 5 of the Water  
Charge (Infrastructure) Rules 2010**

**Summary paper**



## Introduction

Coleambally Irrigation Co-operative Limited (CICL) has prepared a Network Service Plan (NSP) which provides details of its plans for water service infrastructure over the forthcoming five year period (2012-13 to 2016-17). The NSP includes details of customer service levels, operating and capital expenditure and how CICL intends to recover its costs through prices and finance future capital expenditure.

We have undertaken an independent review into the prudence and efficiency of CICL's NSP as per the requirement in the Water Charge (Infrastructure) Rules 2010 (WCIR). This report provides the findings of our review and recommendations.

## Overview of the NSP

Key features of CICL's NSP include:

- Operating costs are expected to increase in real terms, however a proportion of these costs will be capitalised and recovered under the Private Irrigation Infrastructure Operators Program (PIIOP) program.
- Forecast capital expenditure reflects PIIOP Round 1 and Round 2 projects. Round 1 projects include; clay relining at the main canal; and installation of Total Channel Control (TCC) infrastructure on the West Coleambally Canal. Round 2 projects include; the replacement of 100 non flume gate meters with flume gates; and construction of a balancing storage. PIIOP Round 2 was still under negotiation when the NSP was finalised however this has now been approved.
- CICL identified that its water access charges in recent years have been either at, or below, the cost of providing its services. This has been the result of conscious decisions taken by CICL's Board having regard to its customers' ability to pay during and immediately post the drought. However, CICL has also identified that this is unsustainable and, as a result, CICL proposes to increase its tariffs (with the exception of Coleambally Irrigation Mutual Co-operative Limited (CIMCL) levy) by 1.5% in real terms per annum for the NSP period.
- CICL has committed to establish and maintain a 'service delivery efficiency' database and 'emergency response' database and to report this information in future annual reports.

## Statement of prudence and efficiency

We consider that CICL's capital and operating expenditure is generally prudent and efficient based on our review of information provided by CICL. However (in addition to some minor matters) we consider the NSP document lacks detail and is unclear on a number of matters including:

- The assumptions that underpin forecast costs and the reasons for fluctuations in costs in any particular year. We suggest that CICL provide clearer information to its customers in its NSP for the key factors that are influencing its cost base
- CICL's historical operating costs, presented in the NSP, are heavily influenced by the current PIIOP program because a proportion of costs for each cost category (e.g. labour, vehicles and administration) has been capitalised and therefore 'recovered' under PIIOP. CICL, however, has not set out in its NSP what proportion of its operating costs will be capitalised under PIIOP for the forecast period. We suggest that CICL provide a forecast for capitalised costs under PIIOP in its NSP (CICL has provided this information to Deloitte as part of this review).

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## Adequacy and clarity of information in the NSP

Firstly, we were asked to assess whether the NSP provides sufficient details and is communicated in a way that would be clear to a customer audience. We consider that customers would benefit, and the requirements of the WCIR would be better met, if additional information was included on matters including the following:

- Details of customers affected and financial schedules supporting maintenance and PIIOP programs and further detail supporting the reasons for undertaking modernisation works

CICL advised that it had consulted with its customers prior to entering into its PIIOP agreements with the Commonwealth and provided them with the opportunity to vote on the merits of each of the seven modernisation sub-projects. However for the purposes of completeness of the NSP it is suggested that further detail of the rationale for projects be placed on CICL's website and be referenced in the NSP.

- Details of the renewals annuity including (but not limited to) annuity term and expected annuity and interest payments

We note that, as CIMCL and CICL are two distinctly separate legal entities, CICL provided limited detail on the renewals annuity due to uncertainty around scope of the NSP. CICL advised that customers have access to CIMCL's method for calculating annuity payments and expenditure in its Annual Report. We suggest, therefore, that CICL provide this information, or at a minimum references to where the information can be found, in the NSP.

- Details of how operating and administration costs are capitalised and recovered under PIIOP.
- A breakdown of revenue by tariff category, as well as commentary or forecasts on Government charges.

## Customer service standards

We note that CICL has not reported historical customer service levels for metrics other than delivery efficiency and water losses. It is therefore difficult to assess whether service standards have improved or declined over time and how this has impacted on the business and its customers.

We support CICL's commitment to establish and maintain a 'service delivery efficiency' database and an 'emergency response' database and report a historical time series of these data in future annual reports. We also suggest these performance metrics are published regularly (i.e. monthly or quarterly depending on frequency of data collection) on CICL's website or in regular customer publications.

## Demand for services

CICL has not provided a forecast of likely water sales over the NSP period as revenue is not based on sales. Nor has it estimated the level of delivery entitlements (which is declining) as the annual loss of revenue from reducing delivery entitlements is offset by the payment of termination fees.

While we note that water sales are unrelated to revenue, we consider that having a broad view on potential sales is likely to:

- Allow CICL to form a view on whether capacity issues or delivery constraints are likely to exist (we note that a key justification for the balancing storage is to better enable CICL to meet spikes in demand) and to form plans to address them.
- Assist with the planning of maintenance requirements.
- Forecast expenditure required to cover bulk costs associated with conveyance losses.

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We agree with CICL that there will come a time when the termination of delivery entitlements will have a bearing on charges, and that delivery system rationalisation or price increases will occur as a result. Therefore we also suggest that it would be prudent for CICL to forecast the level of delivery entitlements in order to provide a view of the time at which this will occur.

## Operating costs

The table below shows CICL's forecast expenditure by major cost item over the course of the NSP.

**Table E1 CICL forecast operating expenditure, 2010-11 to 2016-17 (\$'000s, nominal dollars)**

Operating expenditure item	Actual	Actual	Network Service Plan forecast				
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Operations	2381	2755	3098	2668	2915	3002	3092
Salary and wages	2676	2464	2595	3057	3443	3547	3653
Plant and vehicle	185	79	233	255	288	297	306
Administration	317	338	349	353	372	384	395
Depreciation	1636	1607	1739	2010	2173	2144	2155
Other expenses	86	92	100	92	95	98	101
Sale conveyance water*		1608					
<b>Total operating expenditure</b>	<b>7281</b>	<b>8942</b>	<b>8114</b>	<b>8432</b>	<b>9286</b>	<b>9471</b>	<b>9701</b>

Source: CICL NSP 2012 and financial model

\*This cost item represents a write down of inventory as a result of sale of conveyance water to the Government and is based on market value. This value was not included in the NSP.

We reviewed each item of operating expenditure through analysis of historical costs, benchmarking (industry escalation rates, other regulatory decisions, and other rural water providers) and our experience in other similar reviews.

We note there is a relatively large increase in total operating expenditure over the life of the NSP. This is mainly attributable to the inconsistent accounting of the PIIOP program between historical and forecast costs. For instance, a proportion of operating costs (from 2007-08 to 2012-13) has been dedicated to delivering the PIIOP program. Therefore these costs have been 'capitalised' and removed from operating costs. However, when it comes to forecast costs (2013-14 to 2016-17) there has been no estimate made for the proportion of operating costs that would be dedicated to delivering the PIIOP program. Therefore historical costs cannot be compared with forecasts. The major cost items affected by this issue include 'salary and wages', 'plant and vehicle' and 'administration' expenses. CICL advised that they have not forecast the proportion of 'capitalised' operating costs due to uncertainty around what the proportion might be.

We suggest that CICL estimate the amount of capitalisation from PIIOP in the forecast costs and present these costs separately. This will improve transparency for customers and enable a like for like comparison between historical and forecast costs. We consider the current presentation of operating costs has the potential to be misinterpreted.

A summary of our view on forecast changes in key expenditure items is as follows:

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## **Operations, maintenance and administration costs**

With regard to assumptions around OMA forecast costs, CICL advised that it applied a 3% inflation assumption to its OMA costs for the years of the NSP.

We note, however, that CICL has not factored in any productivity gains for any of its cost categories. We consider it would not be unreasonable to expect that ongoing real reductions in costs the order of 0.5% to 1% per annum are achievable across total operations, maintenance and administration costs.

## **Salary and wage costs**

The assumptions underpinning salary and wage costs with regard to inflation appear reasonable. While CICL has forecast no productivity savings, it has also forecast low wages growth. In combination, the outcome of these two assumptions appears reasonable.

## **Plant and vehicle costs**

CICL plant and vehicle cost forecasts appear reasonable, if the average of historical PIIOP recoveries are excluded from the forecasts.

## **Depreciation**

While it is forecast for depreciation expenditure to increase, the majority of this increase is from PIIOP-funded assets which are not recovered through regulated charges. The non-infrastructure depreciation component appears to be reasonable.

## **Other expenses**

While the forecast for general insurance does not appear overly high, we suggest that CICL include the forecasting assumptions. CICL advised that its general insurance costs are expected to increase, however the figures currently show insurance expenditure decreasing or remaining static in real terms.

## **Capital costs**

### **Prudence**

Although not specifically detailed in the NSP, there is adequate evidence in supporting documentation and Annual Reports that historical and forecast capital expenditure is supported by a strategic planning focus that integrates asset management planning, incorporates risk mitigation measures and is consistent with CICL's key drivers. In addition, CICL has demonstrated that this planning framework has been appropriately applied in relation to PIIOP funded capital projects.

The fact that MI's PIIOP funding applications have been successful effectively reflects the Commonwealth Government's conclusions that the proposed works were in alignment with the strategic objectives of both the Government and the applicant, and the risks associated with construction and operation were understood and clearly articulated.

On the basis of the information provided, we consider that CICL has acted prudently in respect of its historical capital expenditure and also planned expenditure utilising approved PIIOP funds.

### **Efficiency**

Capital projects which were the subject of PIIOP funding applications had to undergo rigorous assessment before funding was granted. Technical feasibility and a sound project management capability, including a realistic budget and implementation program were key components of the assessment process. This was necessary to ensure that service enhancement options selected for future implementation had been subjected to rigorous technical and financial assessment and that water savings could be transferred to the Commonwealth without risking the viability of the company.

On the basis of the information provided in the NSP and supporting documents, we consider that forecast capital expenditure shown in the NSP is efficient.

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## Tariffs

As a result of the drought, CACL advised that it has deliberately under recovered its costs in recognition of customer's financial hardship. CACL is proposing to increase tariffs by 1.5% in real terms over the course of the NSP. This increase appears reasonable.

We suggest that CACL, as part of its upcoming business review, examine its cost base to confirm whether its cost base is effectively 100% fixed. If it is, then we consider that CACL's current pricing structure (of only fixed charges) is appropriate. However if there is a component of costs that varies with water delivered then CACL should investigate the option of introducing a usage based charge.

## Financing

CIMCL's levy of \$1.3m, and the decision to hold it constant, appears reasonable in light of the Mercer report and the absence of a need to spend funds during the NSP period.

# Limitation of our work

## General use restriction

This report is prepared for the ACCC for the purposes of reviewing the prudence and efficiency of CICL's NSP in accordance with the *Water Charge Infrastructure Rules 2010* and accompanying Guide. We note that this report will be made publicly available to CICL's customers in accordance with the *Water Charge Infrastructure Rules 2010*.

In preparing this report we have relied on the accuracy and completeness of the information provided to us by the ACCC, CICL and from publicly available sources. We have not audited or otherwise verified the accuracy or completeness of the information. We have not contemplated the requirements or circumstances of anyone other than the ACCC.

Our name or the report should not be used for any other purpose and we accept no duty of care to any other person or entity.

Events may have occurred since we prepared this report which may impact on it and its conclusions.

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