PRODUCTIVITY COMMISSION

Financial Performance of Government Trading Enterprises 1996-97 to 2000-01

Performance Monitoring

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The Productivity Commission

The Productivity Commission, an independent Commonwealth agency, is the Government's principal review and advisory body on microeconomic policy and regulation. It conducts public inquiries and research into a broad range of economic and social issues affecting the welfare of Australians.

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Foreword

This report is the third in a series initiated by the Productivity Commission to provide comparable information on financial performance of government trading enterprises (GTEs). It follows the earlier series of broader 'Red Book' reports by the Steering Committee on National Performance Monitoring of Government Trading Enterprises, to whom the Commission served as secretariat.

The study forms part of a continuing program of research by the Productivity Commission into the performance of economic infrastructure industries and the impact of microeconomic reforms. While not covering all aspects of GTE performance, the data recorded in this series provide a useful overview of financial trends which have a bearing on the contribution of these firms to the Australian economy. As such, the Commission proposes to continue to report the financial performance of GTEs. Such reporting will be complemented by benchmarking studies and other related work, including further reviews of price and service quality.

Future reports in this series will also include information on the governance arrangements for GTEs. While there have been significant improvements over the past decade, many GTEs are yet to achieve a fully commercial performance under existing approaches. An examination of key elements of current governance arrangements may help illuminate areas requiring review.

Research for the study was undertaken in the Economic Infrastructure Branch under the guidance of Commissioner Michael Woods. State and Territory governments cooperated by furnishing data collected for the Australian Bureau of Statistics Government Finance Statistics collection. The Commission is very grateful for this continuing support.

Gary Banks
Chairman

June 2002

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Abbreviations

AASB	Australian Accounting Standards Board
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
AIE	Australian Inland Energy
AIEW	Australian Inland Energy and Water
AMSA	Australian Maritime Safety Authority
ARG	Australian Railroad Group
ASA	Airservices Australia
AUSTA Electric	Queensland Generation Corporation
BACL	Brisbane Airport Corporation Limited
BPA	Bunbury Port Authority
BPC	Burnie Port Corporation
COAG	Council of Australian Governments
CPI	Consumer Price Index
CSO	Community Service Obligation
DAC	Depreciated Actual Cost
DDO	Digital Data Obligation
DNR	Department of Natural Resources (QLD)
DORC	Depreciated Optimised Replacement Cost
DPC	Darwin Port Corporation

DUS	Department of Urban Services (ACT)
EBIT	Earning Before Interest and Tax
ESC Act	*Energy Services Corporations Act 1995*
ETEF	Electricity Tariff Equalisation Fund
FPA	Fremantle Port Authority
FreightCorp	Freight Rail Corporation
GBE	Government Business Enterprise
GHz	Giga (10^9) Hertz
GOC	Government Owned Corporation
GPA	Gladstone Port Authority
GPFR	General Purpose Financial Reports
GSE	Great Southern Energy
GTE	Government Trading Enterprise
GWh	Giga (10^9) watt hours
HEC	Hydro-Electric Corporation
HPC	Hobart Port Corporation
HWC	Hunter Water Corporation
IPART	Independent Pricing and Regulatory Tribunal
ISDN	Integrated Service Data Network
kbps	kilo bits per second
Kilolitres	1000 litres
kV	Kilo Volt
kWh	Kilo (10^3) watt hours

ML	Mega (10^6) litres
MPC	Melbourne Port Corporation
MTT	Metropolitan Transport Trust
MW	Mega (10^6) watts
MWC	Melbourne Water Corporation
MWh	Mega (10^6) watt hours
NAU	Network Access Unit
NCP	National Competition Policy
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
NPC	Newcastle Port Corporation
NPV	Net Present Value
NRC	National Rail Corporation
NRV	Net Realisable Value
NWRWA	North West Regional Water Authority
NWWA	North West Water Authority
ORG	Office of the Regulator-General
PBC	Port of Brisbane Corporation
PDC	Port of Devonport Corporation
PKPC	Port Kembla Port Corporation
PSA	Ports Services Act 1995
PTB	Passenger Transport Board
QPTC	Queensland Power and Trading Corporation

QR	Queensland Rail
QTSC	Queensland Transmission and Supply Corporation
RAC	Rail Access Corporation
RAT	Recoverable Amounts Test
RSA	Rail Services Australia
SA Water	South Australian Water Corporation
SAPC	South Australia Ports Corporation
SAR	Search and Rescue
SCA	Sydney Catchment Authority
SECWA	State Energy Commission of Western Australia
SEQEB	South East Queensland Electricity Board
SEQEC	South East Queensland Electricity Corporation
SERC	Southern Electricity Retail Corporation
SEW	South East Water
SHTPL	Snowy Hydro Trading Pty Ltd
SMHEA	Snowy Mountains Hydro-Electric Authority
SOC Act	*State Owned Corporations Act 1989*
SPC	Sydney Ports Corporation
SRA	State Rail Authority
STA	State Transit Authority
SWC	Sydney Water Corporation
SWP	State Water Projects
Tascorp	Tasmanian Public Finance Corporation

TCV	Treasury Corporation of Victoria
UIG	Urgent Issues Group
USO	Universal Service Obligation
VCA	Victorian Channels Authority
WAGRC	Western Australia Government Railways Commission
YVW	Yarra Valley Water

Box 1 **Key messages**

- Government trading enterprises (GTEs) have an important place in the Australian economy. In 2000-01, the GTEs monitored in this report generated just over $55 billion in revenue.
- At 30 June 2001, those GTEs controlled assets valued at more than $145 billion in key areas of infrastructure, including electricity, water, railways, urban transport and ports. The asset base grew by over $11 billion from the level in the in the preceding year.
- During 2000-01, there was a decline in performance for all profitability measures in most sectors.
- Despite the intent of governments to operate GTEs on a fully commercial basis, 50 per cent of monitored GTEs earned less than the long-term bond rate in 2000-01. An even greater number of GTEs failed to earn a commercial rate of return, which would include a margin for risk.
- Failure to ensure that GTEs operate on a fully commercial basis, that they are fully funded for CSOs and that their assets are valued appropriately, affects the transparency of their performance, and therefore, their accountability.
- An examination of key elements of current governance arrangements may help illuminate areas requiring review.

1 Introduction

This report contains a consistent set of financial performance indicators for 64 government trading enterprises (GTEs) for the period 1996-97 to 2000-01. By the end of 2000-01, the GTEs monitored in this report (listed in appendix A), controlled over $145 billion in assets and, during the year, generated almost $55 billion in total revenue — accounting for around two thirds of the assets and 90 per cent of the revenue generated by Australian government-owned businesses (ABS 2002).

This financial performance monitoring study forms part of the Commission's research into the performance of Australian industries and the progress of microeconomic reform. Performance monitoring increases transparency and hence, accountability. It also facilitates yardstick competition — which is important in industries where businesses do not face vigorous competition.

The information was compiled for the purpose of making a general assessment of financial performance within and across sectors.[1] The assessment focuses on the effectiveness of reform measures aimed at giving the Boards of GTEs clear financial objectives, replicating financial market disciplines and ensuring competitive neutrality.

In undertaking the assessment, the influence of factors, both within and outside the control of GTEs, that affect their performance are discussed. These factors include structural reform, changes in the market environment, financial arrangements, comparability of data and changes in accounting procedures.

For this report, the factors examined in detail are the valuation of assets, debt management and debt guarantee fee policies and community service obligation (CSO) policies.

[1] It does not provide information suitable for a detailed analysis of the performance of individual GTEs — a thorough examination of their financial statements is required for that purpose.

1.1 Background

In 1991, Australian Governments agreed that a system of national performance monitoring of GTEs should be established. The prime objective was to assist governments in their efforts to achieve and sustain performance improvement. Performance monitoring was seen as a way of promoting accountability through transparency, and performance improvement through yardstick competition.

A steering committee — The Steering Committee on National Performance Monitoring of Government Trading Enterprises (referred to hereafter as the Steering Committee) — was established to oversee the monitoring process. It was chaired and serviced by the Industry Commission, a predecessor of the Productivity Commission. The Steering Committee was responsible for the development of nationally consistent performance indicators and their publication on an annual basis.

With the achievement of substantial GTE reform and the privatisation of a number of enterprises, the Steering Committee recommended in 1997 that it should be disbanded.

At the time that formal agreement for disbandment was sought, the Commission indicated that it would continue to monitor GTEs under its general research program. This report is the third released by the Commission.

The Commission is currently reviewing its ongoing involvement in performance monitoring. In recent reports an increasing emphasis has been placed on issues which affect GTE financial performance and the comparability of results. Any future reports are likely continue this trend, with an increased emphasis on governance issues in particular.

1.2 Report structure

Following this chapter, is a sector level overview of the financial performance among GTEs and over time. The remainder of the report is then divided into two parts.

In part A, issues that affect GTE performance and the comparability of results, are examined. Specifically, the influence of the valuation of assets, debt management and debt guarantee fee policies and community service obligation (CSO) policies are assessed.

In part B, GTE performance reports are presented on a sector basis. The sectors are electricity; water, sewerage, drainage and irrigation (referred to hereafter as the water sector); urban transport; railways; and ports. The Commonwealth Government GTEs — Airservices Australia, Australia Post and Telstra Corporation — that do not have peers in other jurisdictions — are reported separately.

For consistency, the Commission selected GTEs monitored by the Steering Committee for inclusion in this study. However, State and Territory governments were given the opportunity to nominate GTEs. Several GTEs were added as a consequence and a number were eliminated because they had been privatised.[2]

The sector chapters in part B of this report include a summary which draws on the information in the performance reports to comment on the influence of structural reform, market environment and performance. State and Territory governments were given the opportunity to review the GTE performance reports.

[2] GTEs that are no longer monitored include: ETSA Power, ETSA Transmission and Optima Energy (SA); Power and Water Authority (NT); ACTEW Corporation (ACT); Public Transport Corporation and the State Electricity Commission of Victoria (Victoria); AlintaGas and MetroBus (WA); and ANL Limited and the Federal Airports Corporation (Commonwealth).

2 Financial performance overview

The financial performance of 64 government trading enterprises (GTEs), from 1996-97 to 2000-01, is reported in part B. Their financial performance was examined using a consistent set of financial indicators and ratios which cover the GTEs operating performance, financial management and transactions with government.

An overview of performance at a sector level is presented in this chapter. Information relating to the data and measures used in assessing performance — both at a sector level and for individual GTEs — is presented in chapter 3.

2.1 Profitability

Profits (or surpluses) add value to shareholders' equity. If profits are insufficient to generate the returns which could be available from alternative investments, having regard for differences in the level of risk, the capital embodied in the assets could be put to more productive use.

An adequate return would be the risk free return on capital plus an amount reflecting the non-diversifiable market risk inherent in the investment. The 10 year Commonwealth Government bond rate is widely used as the risk free return benchmark.

The average rate of return on 10 year Commonwealth Government bonds in 2000-01 was 5.8 per cent.[1] In 2000-01, only 45 per cent of monitored GTEs were earning nominal pre-tax returns above this level. Given the non-diversifiable risk inherent in any business activity, it is reasonable to expect that provided their assets are correctly valued, almost all GTEs should be generating returns above this rate.[2]

On average, profitability performance deteriorated across all sectors in 2000-01, compared to 1999-00 (see figure 2.1). Profitability among GTEs varied considerably by sector, with ports and electricity generating the highest returns. The significant variation around the sector averages suggests that this apparent reduced performance may be due in part to financial and business restructuring in some GTEs (see table 2.1).

Table 2.1 **Selected profitability measures across sectors (per cent)**
2000-01

Sector	*Cost recovery*		*Return on assets*		*Return on equity*	
Electricity	121.7	(31.8)	6.7	(25.9)	5.5	(27.5)
Water	165.5	(32.7)	5.0	(4.1)	3.4	(6.2)
Urban transport	99.0	(3.8)	1.1	(0.3)	-1.4	(1.3)
Railways	99.5	(22.8)	3.2	(4.2)	0.4	(58.0)
Ports	151.0	(31.4)	6.5	(5.3)	4.4	(9.4)

Note Indicators are the sector-wide weighted means. Standard deviations are shown in brackets. The large standard deviations recorded for indicators in some sectors may reflect the influence of GTE restructuring or other factors, such as asset revaluations.

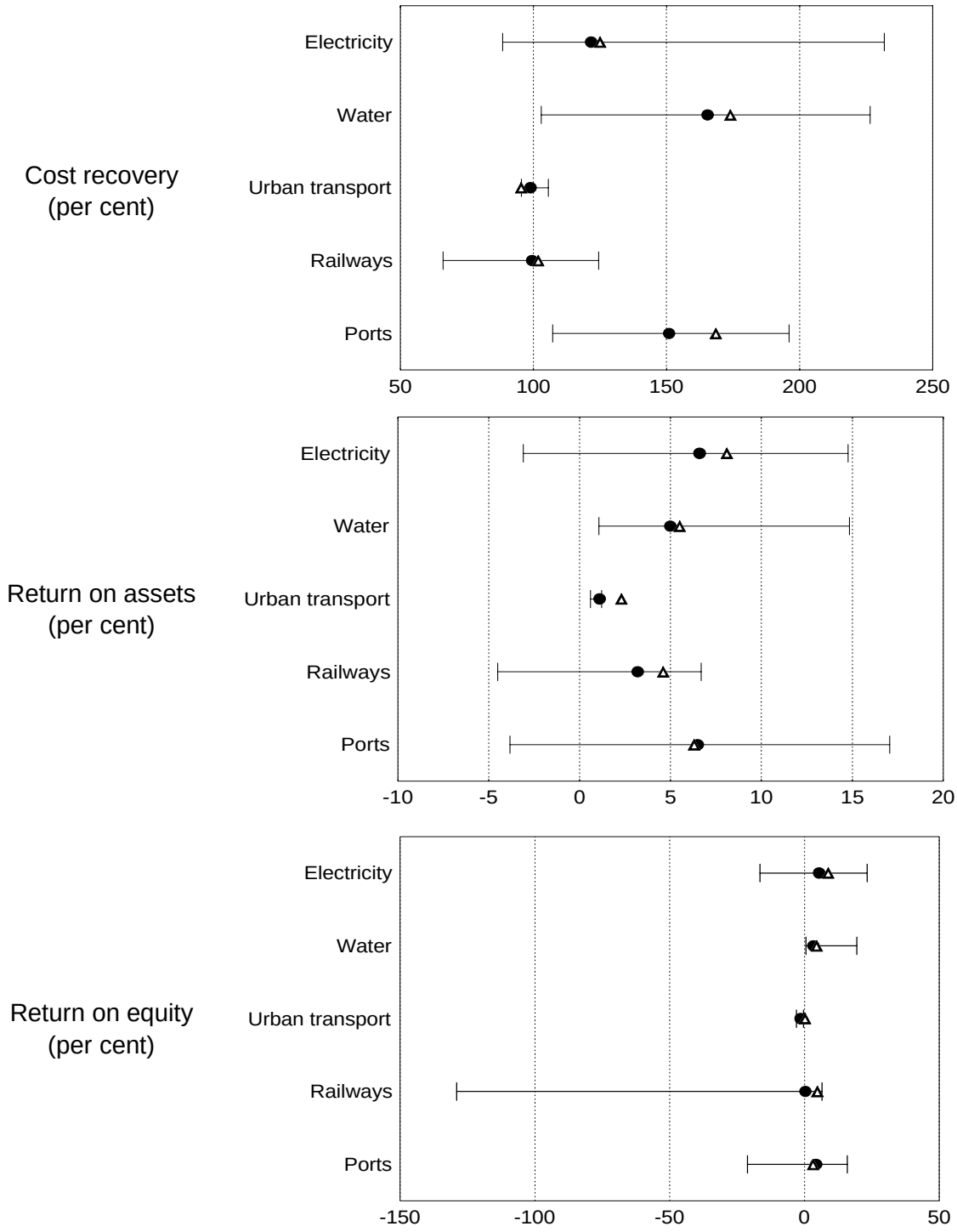
Source: PC estimates.

Poor returns may raise competitive neutrality issues. If GTEs are not earning a commercial rate of return on appropriately valued assets, this may indicate that they are charging prices lower than private sector competitors, which must fully recover costs to remain viable over the longer term.

1 Based on the average daily rate over the 12 months to June 2001. The rate is usually based on the average bond rate over a specified period rather than an 'on the day' rate in order to minimise short-term impacts. However, the averaging period used by regulators varies. For example, IPART (1999a) used the average of the 20 business days prior to a determination. The ACCC (1999) used an average of the rate over 12 months.

2 Typical values estimated by regulators as an approximate overall rate of return (including an allowance for non-diversifiable risk) are significantly higher. For example, regulators expect a nominal post-tax return of between 10.5 per cent and 13.5 per cent for electricity distributors in NSW over the period February 2000 to June 2004 (IPART 1999a) and nominal pre-tax returns of between 8.2 per cent and 10.8 per cent for the NSW rail access regime (IPART 1999b).

Figure 2.1 **Selected profitability measures by sector (per cent)**
2000-01



Note The dot represents the weighted mean value and the 'whiskers' represent the range of values, in 2000-01, for a given performance indicator by sector. The triangle represents the mean value for 1999-00. For example, in 2000-01 the minimum cost recovery ratio in the electricity sector was 89 per cent, and the maximum value was 227 per cent. The mean cost recovery ratio was 122 per cent (125 per cent in 1999-00).

Source: PC estimates.

There are, however, a variety of reasons why GTEs may consistently generate returns below a commercial rate. For example, prices may be too low, inherited costs may be too high, assets may be overvalued, community service obligation (CSO) payments may be inadequate or there may be some combination of these factors at play.

Governments may accept lower rates of return when some of the services provided by GTEs benefit the community more generally as well as their direct customers, such as the reduction in traffic congestion arising from the use of urban public transport. Governments may also consider that pricing above the current level would have adverse social outcomes. For example, an increase in the price of public transport may affect access, for some members of the community, to essential services, although such concerns should be reflected in CSO payments.

Profitability and prices

The profitability and operating performance of GTEs will be affected by changes in the prices a GTE charges for its goods and services. The GTEs monitored in this report generally operate in regulated industries, where prices are largely determined by independent price regulators or require ministerial approval.

Regulators have encouraged GTEs to implement more cost-reflective pricing, as part of broader GTE reforms. Prices, for household and business customers, are set in line with the cost to the GTE of providing the service to each group of customers.[3]

Historically, trends in business prices have often diverged markedly from those for households, with governments seeking to cross-subsidise the household sector by keeping their prices low, relative to business prices, even when the unit cost of supplying household customers was considerably higher.

The Commission has studied the price trends for goods and services provided by GTEs (see Productivity Commission 2002). The results for households (see table 2.2) and businesses from 1996-97 to 2000-01 indicate a rebalancing of prices. Generally, business prices fell relative to household prices over the period.[4]

3 Regulators may also take into account demand factors to ensure efficient levels of consumption are not distorted in setting price above marginal cost.

4 Tariff 'rebalancing', to reduce business prices relative to household prices, is likely to have benefited household customers indirectly. For example, business input cost savings from lower infrastructure prices flow through, to some extent, as lower prices for consumer products and services. Also, substantial falls in real rail and port charges would have assisted exports (such as grain and minerals) from regional Australia. These broader changes in prices and the

For example, household prices for electricity, water and urban transport have risen across most of Australia between 1996-97 and 2000-01. In contrast, electricity and water prices for most business customers have fallen over the reporting period.[5]

Table 2.2 **Change in real infrastructure prices, metropolitan households (per cent)**
1996-97 to 2000-01

Sector	*Sydney*	*Melbourne*	*Brisbane*	*Adelaide*	*Perth*	*Hobart*	*Darwin*	*Canberra*
Electricity	-1	-10	3	8	4	11	7	12
Water	3	-22	26	1	2	-15	16	2
Urban transport	11	4	7	7	6	-3	13	-2

Note. Figures show the percentage change in an index of real prices over the period 1996-97 to 2000-01. Negative numbers indicate a fall in the real price index for the good or service. Price changes partly reflect the introduction of the Goods and Services Tax in 2000-01, other than for water.

Source: Productivity Commission 2002.

Prices for certain services provided by GTEs to business customers in the railways and ports sectors also declined throughout Australia. Between 1996-97 and 2000-01, average rail freight charges for the transport of wheat from the silo to the port have fallen in real terms in NSW, Victoria, Queensland, SA and WA. Port prices (based on the price per twenty foot equivalent unit exchanged) have fallen throughout Australia since 1996-97 (Productivity Commission 2002).

The influence of regulators' decisions on prices means that their decisions will also have a significant influence on the profitability of GTEs. The possibility of regulatory error should be taken into account when assessing the operating performance of GTEs. For example, a poor operating result may reflect regulated prices being set too low, rather than indicate poor management on the part of the GTE.

Changes in GTE performance 1996-97 to 2000-01

Comparison of GTE financial performance over the reporting period is one indicator of the effectiveness of GTE reforms that have occurred during the past decade (see Productivity Commission 2002).

distributional consequences will be examined in a forthcoming Productivity Commission research study.

5 Changes in infrastructure prices, other than for water, in part reflect the introduction of the Goods and Services Tax (GST) in 2000-01. The real price series for water does not include the GST cost component.

Reforms have generally required GTEs to operate at arms length from government on a commercial basis. Commercialisation subjects GTEs to factor market disciplines, requiring them to earn a normal rate of return, charge prices for their goods and services which are reflective of cost and to operate in competitive environments.

In examining the current reporting period, the financial performance of several GTEs improved, but rates of return remain low and, in the majority of sectors, the mean return is lower in 2000-01 than in 1996-97.

Over the five-year period since 1996-97, profitability has improved in the railways and water sectors, remained stable in the electricity sector and declined in the urban transport and ports sectors (see table 2.3). The average return on assets has increased from 6.5 per cent in 1996-97 to 9.4 per cent in 2000-01, whilst return on equity has increased from 4.6 to 8.9 per cent over the same period.[6] Financial performance, as measured by cost recovery, has remained steady over the reporting period at just under 130 per cent.

Many GTEs are not producing a commercial rate of return and several GTEs are showing no signs of improvement in this respect.

In 1996-97, only 51 of the 64 GTEs monitored in 2000-01, were operating. Of those 51, 21 reported clearly inferior operating results in 2000-01. A GTE's financial performance was determined to have deteriorated over the reporting period if its level of cost recovery, its return on assets and return on equity were all lower in 2000-01 than in 1996-97.

Of the 51 GTEs, 21 reported return on assets less than the long-term Commonwealth bond rate (5.8 per cent) in 2000-01. Of the 21 GTEs earning returns less than the risk-free rate, 17 reported returns in 2000-01 that were less than reported in 1996-97.

Some GTEs are not meeting their recurrent costs and are consequently earning negative returns on assets and equity — notably in the urban transport and rail sectors (see part B, chapters 9 and 10).

6 The overall averages are heavily impacted by Telstra's operating results (In 2000-01, Telstra accounted for over 25 per cent of assets and almost 50 per cent of revenues for the group of monitored GTEs). When Telstra is excluded, the average return on assets has increased from 5.6 per cent in 1996-97 to 5.7 per cent in 2000-01, whilst return on equity has increased from 2.7 to 4.2 per cent over the same period.

Table 2.3 **Average GTE profitability performance, (per cent)**
1996-97 and 2000-01

Sector	*Year*	*Cost recovery*		*Return on assets*		*Return on equity*	
Electricity	2000-01	121.7	(31.8)	6.6	(25.9)	5.5	(27.5)
	1996-97	121.6	(31.8)	6.9	(3.6)	3.7	(5.2)
Water	2000-01	165.4	(32.7)	5.0	(4.1)	3.4	(6.2)
	1996-97	161.4	(51.8)	5.0	(5.3)	2.5	(9.4)
Urban transport	2000-01	98.9	(3.8)	1.1	(0.3)	-1.4	(1.3)
	1996-97	102.1	(24.5)	2.2	(4.8)	-1.1	(9.0)
Railways	2000-01	99.5	(22.8)	3.2	(4.2)	0.4	(58.0)
	1996-97	106.7	(26.8)	2.6	(6.7)	-1.0	(7.8)
Ports	2000-01	151.0	(31.4)	6.5	(5.3)	4.4	(9.4)
	1996-97	170.8	(50.0)	9.0	(14.8)	6.7	(20.5)

Note Excludes GTEs that were monitored in 1996-97 that were subsequently privatised or are no longer monitored by the Commission. Standard deviations are in brackets.

Source: PC estimates

Over the reporting period, the variability in performance — as measured by the standard deviation — decreased in most sectors among GTEs (see table 2.3). A notable exception is the electricity sector, where the range of performance around the average increased. This may be due in part to adjustments required by some GTEs to compete in the National Electricity Market.

2.2 Financial management

Across sectors there is significant variation in the financial management performance indicators presented in this report (see table 2.4 and figure 2.2). The variability in these indicators may be in part due to financial restructuring of GTEs or may simply be the normal variability among businesses. In this respect the financial performance of GTEs appears more stable and consistent within sectors than companies listed on the Australian Stock Exchange (see box 2.1).

Table 2.4 **Selected financial management performance measures across industries (per cent)**

2000-01

Sector	*Debt to equity*		*Current ratio*		*Interest cover*	
Electricity	88.5	(97.9)	80.0	(57.8)	2.3	(26.4)
Water	21.9	(30.7)	58.8	(69.5)	4.4	(3.4)
Urban transport	35.6	(29.4)	59.5	(30.1)	0.7	(0.2)
Railways	74.7	(1335.1)	89.2	(36.8)	1.3	(1.1)
Ports	32.0	(45.5)	125.0	(34.3)	3.8	(8.5)

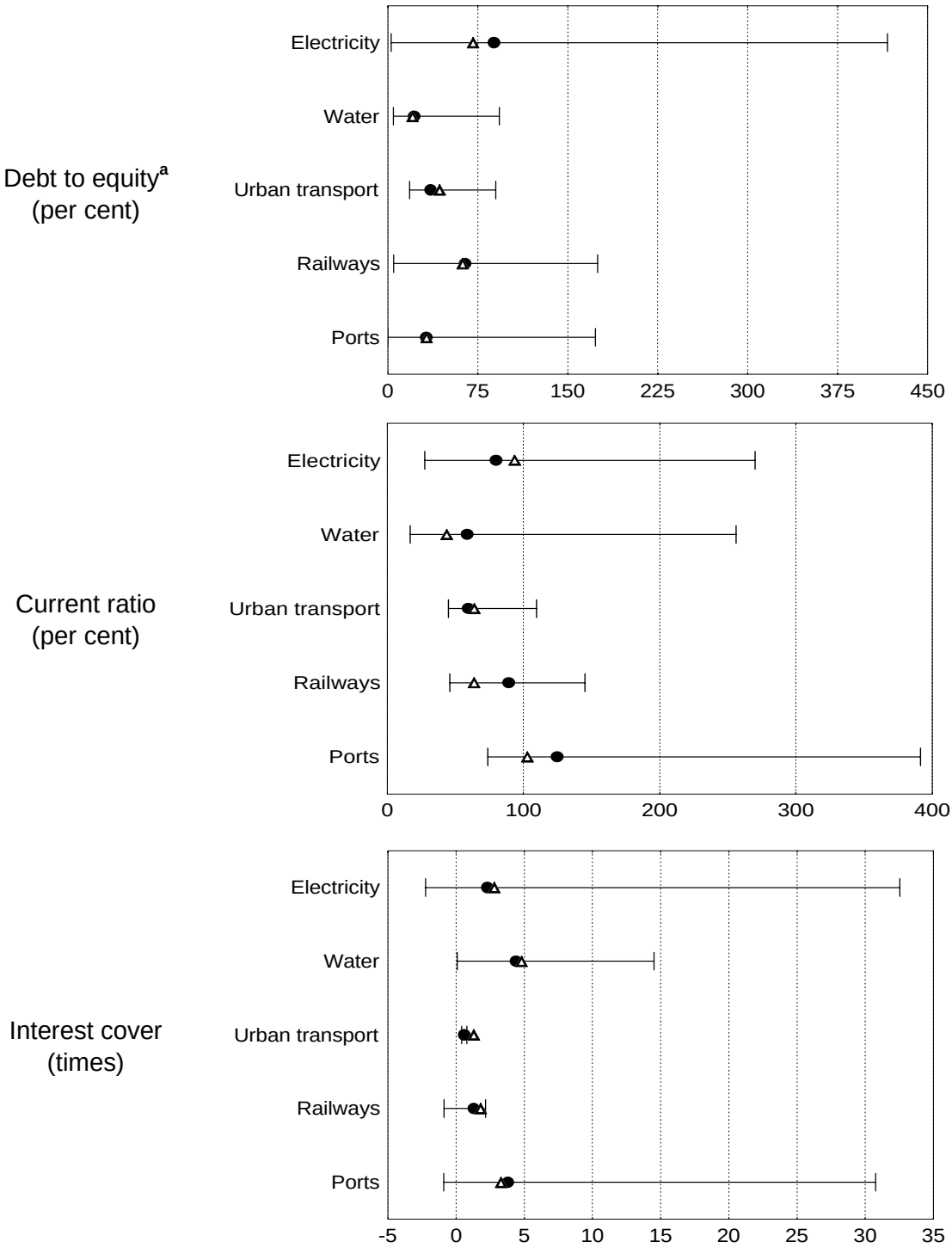
Note Indicators are the sector-wide weighted means. Standard deviations are shown in brackets. The large standard deviations recorded for indicators in some sectors may reflect the influence of abnormal items or other factors, such as asset revaluations.

Source: PC estimates.

Debt levels for many GTEs have fallen over the reporting period. The decline in debt levels can be attributed to a number of factors including debt reduction programs, debt for equity swaps with shareholder governments, the introduction of debt guarantee fees, reduced capital expenditure and the privatisation of parts of GTEs' businesses.

In 2000-01, 35 per cent of the monitored GTEs had an interest cover of less than two times. Around 10 per cent of monitored GTEs had an interest cover less than zero, indicating that funds other than current operating earnings are required to meet financial commitments.

Figure 2.2 **Selected financial management indicators, by sector**
2000-01



Note The dot represents the weighted mean value and the 'whiskers' represent the range of values, in 2000-01, for a given performance indicator by sector. The triangle represents the mean value for 1999-00. For example, in 2000-01 the minimum debt to equity ratio achieved in the electricity sector was 3 per cent, while the maximum value was 417 per cent. The mean was 88 per cent in 2000-01 and 71 per cent in 1999-00. **a** The debt to equity figures for the railways sector exclude data for Western Australian Government Railways.

Source: PC estimates.

Box 2.1 **Financial management indicators for listed Australian companies**

Financial performance indicators for GTEs were compared to those for Australian listed companies. A survey of the top 500 Australian companies (in terms of market capitalisation) listed on the Australian Stock Exchange revealed that financial management indicators varied as much, if not more, than those for monitored GTEs. The companies were divided into 25 sectors based on business type (for example, diversified industrials, energy and retail) as well as two composite groups capturing the top 50 and top 100 companies, in terms of market capitalisation.

Mean interest cover among GTEs ranged from 0.7 times, in the urban transport sector, to 4.4 times in the water sector. The highest deviation around the mean was 26.4 in the electricity sector (see table 2.3). In comparison, mean interest cover for listed companies ranged from –573 times for miscellaneous industrials to 1261 times among energy companies. Standard deviation in the 25 sectors ranged from just over 1 for paper and packaging to over 6500 for energy companies.

Hogget and Edwards (2000) suggest a minimum of two times as a 'rule of thumb' for adequate interest cover. In 2000-01, almost 38 per cent of listed companies had an interest cover of less than two times (GTEs, 35 per cent) and of these companies, 98 had negative interest cover (GTEs, 10 per cent).

Assessment of financial management should have regard to the unique circumstances affecting each entity. Examination of financial management *over time* (such as the movement in a GTE's level of debt) may provide a more meaningful indication of relative performance than stochastic comparisons or rules of thumb.

Source: Listed company data supplied by Aspect Financial.

2.3 Government transactions

In 1995, the Council of Australian Governments agreed to a series of reforms designed to improve the performance of GTEs and encourage them to operate on a commercial basis. These reforms reinforced a range of initiatives, including the application of competitive neutrality principles to GTEs operating in all of the sectors covered in this report.

These policies are designed to expose GTEs to greater competition and the same regulations faced by private sector businesses. They include, among other things, the introduction of tax-equivalent regimes, dividend payments, debt guarantee payments and the identification and explicit funding of CSOs.

Tax equivalent payments

Tax-equivalent regimes require GTEs to pay tax on their operating profit at the same company tax rate as private businesses.

The income tax expense incurred is reported. However, the adoption of tax-effect accounting may result in the income tax expense for any year differing from the actual amount paid to State and Territory governments for that year because of timing differences.[7]

Where a GTE is not subject to a tax-equivalent regime, it potentially possesses a significant advantage over its competitors. This is because, all other things being equal, the GTE can earn the same after-tax commercial rate of return as its competitors at lower prices.

In 2000-01, monitored GTEs paid over $3.5 billion in tax-equivalent payments to governments, compared to $1.9 billion in 1996-97. During 2000-01, tax-equivalent payments increased by almost $1 billion (37 per cent), while overall profits for monitored GTEs rose by only $134 million (1 per cent). The divergence in the growth of tax-equivalent payments and profits was due predominantly to unusually low tax-equivalent payments being made in 1999-00.[8]

Debt guarantee fees

Debt guarantee fees are payments by GTEs to government to ensure that GTEs face the same cost of capital as private businesses by exposing them to the real risk premium of their activities. Given that GTEs' borrowings can be either explicitly or implicitly guaranteed by shareholder governments — they otherwise face relatively low borrowing costs, even if the business or investment project is itself quite risky.

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7 Tax-effect accounting in accordance with AASB 1020 *Accounting for income tax* leads to differences in how tax applies to income and the timing of tax payments. Permanent differences between taxable income and accounting income arise when disparities between tax law and accounting standards occur. For example, depreciation on buildings is charged as an expense under accounting profit but may not be allowable as a tax deduction in the calculation of taxable income. Timing differences may arise, for example, because of different depreciation schedules adopted by the GTE and the tax office.

8 Future tax benefits and liabilities were adjusted in 1999-00 by most GTEs, following the announcement by the Commonwealth Government in 1999 of a reduction in the company tax rate from 36 per cent in 1999-00, to 34 per cent for 2000-01 and then to 30 per cent from 2001-02. The total value of the reduction in future tax payable in 1999-00 was around $1.1 billion.

In 2000-01, the debt guarantee fees paid by 36 monitored GTEs (for which information was available) totalled over $132 million and added between 17 and 167 basis points to the GTE's effective interest rate.

Debt guarantee fees are examined in greater detail in chapter 5.

Dividend payment policies

Dividend payment policies are justified as a return on the funds that government owners, who act as shareholders on behalf of the community, have invested in GTEs. Dividend payment policies are designed to bring GTEs into line with private sector businesses, which usually distribute some of their profits to shareholders, while retaining the remainder for the internal funding of investment.

For each monitored GTE, the total dividends paid are reported, along with the dividend to equity and dividend payout ratios. The dividend to equity ratio indicates the return to shareholders as a percentage of their equity in the GTE. The dividend payout ratio indicates the percentage of profit that is returned to the government shareholder in the form of dividends.

In 2000-01, the level of dividends paid or provided for was $4.8 billion, a rise of $146 million compared to 1999-00. The average dividend to equity ratio was stable at around 7 per cent, while the dividend payout ratio increased from 63 per cent in 1999-00 to 73 per cent in 2000-01.

GTEs' dividend polices were examined in more detail in last year's report (Productivity Commission 2001).

Community service obligations

GTEs often provide economic and social benefits to the community over and above the direct benefits purchased by users of their goods and services. For example, rail GTEs provide explicit community benefits such as greater mobility and access for disadvantaged groups, as well as other positive externalities such as reduced motor vehicle pollution and urban road congestion.

Historically, governments have recognised these benefits through the funding of operating deficits of the relevant GTEs. However, most governments now make specific payments for the provision of certain CSOs, such as pensioner concession fares. This is in line with the adoption of National Competition Policy.

The explicit CSO payments received by each of the monitored GTEs and disclosed in their annual reports are recorded. In 2000-01, governments paid monitored GTEs around $2.3 billion in CSO payments (an increase of $59 million compared to 1999-00).[9] Rail GTEs received around 58 per cent of CSO funding, with the water sector receiving 18 per cent and the electricity sector 14 per cent.

The CSO policies of the States and Territories are examined in greater detail in chapter 6.

2.4 Summary of findings

The poor performance of some GTEs over the period may be due to increased competition, compared to earlier in the decade when many were likely to be earning monopoly profits. The failure of governments to fully compensate GTEs for the provision of CSOs is another reason why they are continuing to poor financial results — especially in the urban transport and rail sectors.

The inadequate levels of return exhibited by some GTEs have implications for both distribution and efficiency. The most obvious distributional impact is that dividend payments to government (the general community) are lower than they would be if rates of return were commensurate with those earned elsewhere in the economy, while payments by users of these services are lower than they would otherwise be, given the current cost structures.

If rates of return are too low either due to regulation or through the incentive framework established in the corporate governance regime, capital may not be efficiently allocated across competing investments.

The steering committee on national performance monitoring of GTEs found strong improvement in the financial performance of GTEs during the early to mid 1990s (SCNPMGTE 1997). The Commission (2002) found that the financial performance of GTEs also improved over the 10 year period 1990-91 to 2000-01. That said, it appears that over the past five years improvements have been small and, in some cases, performance has deteriorated. Despite the stated intent of governments to operate GTEs on a fully commercial basis, many still fail to earn commercial returns and show no signs of improvement. It may be appropriate for a fundamental examination of key elements of current GTE governance arrangements.

9 This includes all CSO payments disclosed by GTEs. In some instances, GTEs did not disclose CSO funding. There also appear to instances where GTEs provide CSOs without reimbursement (see chapter 6).

3 Interpretation of performance measures

The assessment of the financial performance of government trading enterprises (GTEs) monitored in this report is based on a set of performance indicators derived from a data set that is largely consistent over time and across jurisdictions. The data sources, the construction of the performance indicators and particular issues relevant to the interpretation of the results are discussed in this chapter.

3.1 Data

The financial data for 1996-97 were brought forward from the Steering Committee on National Performance Monitoring of GTEs (Steering Committee) publication — *Government trading enterprises performance indicators 1992-93 to 1996-97* (SCNPMGTE 1998).

The data used in calculating the financial performance indicators for 1997-98 to 2000-01 were taken from two sources: The Government Finance Statistics (GFS) collection — audited data collected by State and Territory Treasuries for the Australian Bureau of Statistics (ABS), which was used for most indicators, and General Purpose Financial Report (GPFR) data extracted from audited GTE financial statements.

The ABS has demonstrated a concordance between the definitions used for the GFS collection and those used for previous Steering Committee publications.

There is a small number of discrepancies between GFS data, financial statement data and the data collected for the Steering Committee report (see table 3.1). These differences do not significantly affect performance indicators at a broad level. For an analysis of the differences see chapter 1, section 1.2 of last year's report (Productivity Commission 2001).

Table 3.1 **Differences between GFS and GPFR data**

Items	*GFS*	*GPFR*
Gains and losses on assets	Treated as revaluations and as such are excluded from the net operating balance.	Can be treated as either revenue or expenses and may therefore be included in the net operating balance.
Distributions to owners	Distributions to owners in the form of dividends are treated as operating expenses.	Distributions are disclosed after operating results and therefore do not form part of the operating statement.
Prior-period adjustments	Operating results reflect only items that represent revenue and expense transactions relevant to the current period.	Operating results may include prior-period adjustments.

Source: South Australian Department of Treasury and Finance (2001).

3.2 Performance indicators

The government trading enterprises (GTEs) monitored in this report are analysed using a consistent set of financial performance indicators. These indicators are presented under three broad headings — profitability, financial management and financial transactions

Comparisons of indicators provides an overall picture of how a GTE is performing over time and relative to other GTEs. Generally, it is appropriate to make comparisons across GTEs in the same sector in Australia. Comparisons with privately-owned businesses operating in similar sectors in Australia and overseas may also provide useful information to evaluate the performance of GTEs.

Profitability

Profitability indicators provide a concise and consistent way of presenting financial information. In the absence of stock market valuation, they are an important guide to the performance of a GTE.[1] Profitability indicators provide governments and the community with a means to evaluate the efficiency with which GTEs are using the assets vested in them.

1 If a company is listed on the stock exchange, the value of its equity will generally be expressed through the price of its shares. Hence, expected returns are capitalised into the value of the company through movements in its share price, consistent with the cost of capital. At any particular time, the price of an enterprise's shares encapsulates investors' views of its current and prospective financial performance.·

Profitability can be affected by factors largely outside the control of GTEs. For example, the weather impacts on the revenue of many GTEs in the water sector. This can significantly affect profitability, particularly given that many GTEs have relatively high fixed costs.

For derivations of the profitability indicators, see attachment A.

Operating profit before tax — is an indicator of the operational performance of GTEs, before income tax is paid. It measures the difference between total revenue and total expenses.

Operating sales margin — is earnings from operations (earnings before interest and tax less investment income) over total revenue less investment income.

Cost recovery — is an indicator of the ability of a GTE to generate adequate revenue to meet operating expenses. Investment income, receipts from government to cover operating deficits and gross interest expense are excluded. From 1996-97 to 1999-00, 'abnormal' revenues and expenses were also excluded from the cost recovery ratio. In 2000-01, abnormal items were replaced, in accounting standards, by 'significant items'. Significant items were not to excluded from the cost recovery ratio in 2000-01. A cost recovery ratio of 100 per cent indicates that a GTE is able to meet its operating expenses from its operating revenue, excluding the cost of servicing debt.

Return on assets — is an indicator of the rate of return earned from all assets. The ratio provides a measure of the efficiency with which a GTE uses the assets vested in it to produce operating profit before tax and interest. It is a useful indicator for comparing the profitability of GTEs and businesses in similar industries against a benchmark rate of return equal to the risk adjusted weighted average cost of capital.

The return on assets will be affected by changes in asset values arising from asset revaluations, asset transfers or sales. Some GTEs use different asset valuation methodologies, depending on the type of assets. Reported asset values may vary significantly for a given GTE over time. This can reduce comparability (see chapter 4). If assets are overvalued, GTEs will not appear to earn sufficient returns. Further, inappropriate asset valuations have implications for the efficiency of prices — because it is unlikely that they will reflect the actual cost of capital and depreciation.

Return on equity — is an indicator of the rate of return GTEs are providing to shareholders. The ratio allows the rate of return achieved by a GTE to be contrasted with that expected from alternative investments with a similar level of risk.

Changes in accounting standards and profitability

Changes in accounting standards, which determine what items GTEs disclose in their annual reports and how this is to be done, can impact considerably on the reported operating performance of the GTE.

In October 1999, the Australian Accounting Standards Board's (AASB) 1018 *Statement of Financial Performance* was issued. Under the revised standard, the concept of abnormal items was replaced by 'significant items' for financial years ending on or after 30 June 2001.

Prior to 2000-01, Australian accounting standards required the separate disclosure of abnormal items in financial statements. Their disclosure was intended to allow users of an entity's financial statements to distinguish between what constitutes 'ordinary' operating profit or loss and what the entity regarded as 'abnormal'.

Abnormal items were defined in accounting standards as revenues or expenses of a 'recurring' nature, which are considered abnormal by reason of their size and effect on financial performance.

Under the revised standard, when;

> [A] revenue or an expense from ordinary activities is of such a size nature or incidence that its disclosure is relevant in explaining the financial performance of the entity for the reporting period, its nature and amount must be disclosed separately in the notes in the financial report (AASB 1999).

The value of abnormal and significant items disclosed over the past three years has declined (see table 3.2). This partly reflects a reduction in the extent of restructuring being undertaken by GTEs. However, the magnitude of the decline in 2000-01 may also reflect decisions that 'significant items' comprise a narrower set of items than those categorised as abnormal under the previous standard.

Inconsistency in the disclosure of significant items in 2000-01 annual reports has raised concerns in the wider accounting and auditing profession (see box 3.1). However, of the financial performance indicators used in previous reports, only the cost recovery ratio is affected by the change in accounting standards. Prior to 2000-01, abnormal items were excluded from the calculation of the cost recovery ratio.

Table 3.2 **Significant items and abnormal items disclosed by GTEs**
1998-99 to 2000-01

	Units	*1998-99*	*1999-00*	*2000-01*
Total disclosures		Abnormals	Abnormals	Significant Items
Total item value	$M	2 471	1 344	405
Revenue items	%	10	52	50
Expense items	%	90	48	50
GTEs disclosing items	%	56	66	31
Type of item				
Asset consolidation and disposal	%	49	1	6
Asset revaluations	%	40	8	0
Financial restructuring	%	0	6	51
Redundancy costs	%	6	5	4
Superannuation adjustments	%	0	6	23
Other[a]	%	5	74	16

Note: abnormal and significant items disclosed by Telstra have been excluded from the analysis due to their relative size. [a] Includes items that do not readily fall under any of the preceding categories. These include year 2000 compliance cost, legal costs and GST implementation costs.

Source: PC estimates based on GTE annual reports.

Box 1.1 **Disclosure of significant items by Australian companies**

The disclosure of significant items in 2000-01 annual reports of Australian companies has been inconsistent. The Australian accounting and auditing profession has raised several concerns relating the labels used to identify them, their location within financial statements and the manner in which the amounts are disclosed.

Unlike the previous standard for the disclosure of abnormal items, the new standard provides no specific term under which items described in paragraph 5.4 of AASB 1018 should be listed (although 'significant items' is the widely-used term). CPA Australia, in a submission to the Australian Accounting Standards Board (AASB) stated:

> As a result a number of terms have been used by entities such as 'significant items', 'unusual items', irregular items and,… 'abnormal items'! The use of some of these terms may be misleading (e.g. the items may not be so 'unusual') and results in confusion when comparing across entities (CPA Australia, 2002).

Under the revised standard, significant items are treated as ordinary revenues and expenses in the financial report — unlike abnormal items, which were highlighted separately in the statement of financial performance. Significant items were intended to be disclosed only in the notes to the financial report. This change decreased the subjectivity as to what constituted ordinary revenues and expenses.

When Ernst and Young (2001) reviewed the financial statements from 100 of Australia's top 200 listed entities, they found that over 30 per cent of the entities that had disclosed significant items had reported them on the face of the statement of financial performance, *as well* as in the notes.

AASB 1018 requires that disclosed significant items be reported as gross revenues and gross expenses. However, Ernst and Young (2001) also found that of the entities that disclosed significant items, over half reported the figures in net terms, a practice allowable under the previous treatment for abnormal items.

These apparent difficulties in the implementation of significant items should be taken into account when comparing the financial performance of GTEs where significant items are disclosed.

Source: Ernst and Young 2001; CPA Australia 2002.

When calculating the cost recovery ratio for the 2000-01 reporting year, the Commission has not excluded significant items. This change was made to avoid problems arising from the inconsistent disclosure of significant items.

Financial management

Debt is a major source of funds from which GTEs finance their activities. The capital structure of a GTE is partly determined by the financial risk associated with the use of debt finance. This risk stems from the commitment to pay interest and

repay principal, irrespective of earnings. For example, a decline in operating revenue or an increase in the cost of servicing debt can result in liquidity problems if a GTE's debt is not well managed. Issues relating to the debt structure of GTEs are considered in more detail in chapter 5.

Financial management indicators provide information on the extent of debt used to finance a GTE's assets, the ability to meet periodical interest payments and to meet short-term liabilities. There are various factors — the impact of government directives, changes in asset values and financial restructuring — that have to be taken into account when assessing financial management performance, particularly over time.

For derivations of the financial management indicators, see attachment A.

Debt to total assets ratio — is an indicator of the proportion of assets that are acquired with the use of borrowed capital. It gives an indication of the level of creditor-interest in the GTE.

Debt to equity ratio — is an indicator of the risk of the entity's capital structure in terms of the amount of capital sourced from borrowing and the amount from shareholders (governments in the case of GTEs). The greater the debt to equity ratio, the more geared the GTE.

Total liabilities to equity ratio — is an indicator of the exposure to claims over the assets of the GTE by creditors, in the event that the business ceases operations. An acceptable level for these debt ratios is likely to vary over time and between industries.

Current ratio — is an indicator of an entity's ability to meet short-term liabilities by realising short-term assets. A current ratio greater than 100 per cent indicates that current assets exceed current liabilities and, if realised, their disposal would meet short-term obligations.

Interest cover — is an indicator of an entity's ability to meet periodic interest payments from current profit (before interest expense). The level of interest cover gives an indication of how much room there is for interest payments to be maintained in the face of interest rate increases or reduced profitability.

Apart from the effect of changes in the value of assets, most financial management ratios will also be affected by changes in liabilities. The debt to equity ratio is affected, as equity is a residual measure obtained by deducting total liabilities from total assets. Any change in the level of liabilities will affect the level of equity. For example, an adjustment to provisions for employee entitlements will, if it leads to

an increase total liabilities, will decrease the value of equity (and vice versa), other things being equal.

The debt to equity and debt to total assets ratios are also affected by financial restructuring. Debt for equity swaps, debt transfers to governments and retirement of debt and debt revaluations will influence these ratios either directly through their impact on debt levels or indirectly through their impact on the value of equity.

Attachment A — Definitions of financial performance indicators

Table A.1 **Published financial performance indicators**

Code	*Ratio*	*Definition*
B.01	Operating sales margin B.17 / (B.14 - B.33)	$\frac{\text{EBIT - investment income}}{\text{Total revenue - investment income}}$
B.02	Cost recovery ratio B.24 / B.36	$\frac{\text{Revenue from operations}}{\text{Expenses from operations}}$
B.03	Return on assets B.16 / B.19	$\frac{\text{Earnings before interest \& tax and after abnormals (EBIT)}}{\text{Average total assets}}$
B.04	Return on equity (B.15 - B.31) / B.34	$\frac{\text{Operating profit after income tax}}{\text{Average total equity}}$
B.05	Debt to equity B.27 / B.13	$\frac{\text{Debt}}{\text{Total equity}}$
B.06	Debt to total assets B.27 / B.19	$\frac{\text{Debt}}{\text{Average total assets}}$
B.07	Total liabilities to equity B.22 / B.26	$\frac{\text{Total liabilities}}{\text{Total equity}}$
B.08	Interest cover B.16 / B.28	$\frac{\text{EBIT}}{\text{Gross interest expense}}$
B.09	Current ratio B.21 / B.23	$\frac{\text{Current assets}}{\text{Current liabilities}}$
B.10	Leverage ratio B.13 / B.26	$\frac{\text{Total assets}}{\text{Total equity}}$
B.11	Dividend to equity ratio B.18 / B.34	$\frac{\text{Dividends paid or provided for}}{\text{Average total equity}}$
B.12	Dividend payout ratio B.18 / (B.15 - B.31)	$\frac{\text{Dividends paid or provided for}}{\text{Operating profit after tax}}$

Table A.2 **Non-published financial performance indicators ($'000)**

Code	*Ratio*	*GFS code*	*Definition*
B.13	Total Assets	ETF 81	The service potential or future economic benefits, controlled by the entity as a result of past transactions or other events (measured at the end of the reporting period).
B.14	Total Revenue	ETF 11	Includes revenue from sales and levies, revenue from asset sales, investment income, receipts from governments for specific agreed services (eg community service obligations), other revenue from operations, receipts from governments to cover deficits on operations and abnormal revenue. Excludes equity contributions from governments. GFS has a separate group for abnormals and extraordinary items, ETF 19. Adjustments are made to include abnormal revenues.
B.15	Operating profit before income tax B.14 - B.25		Total revenue less total expenses. Includes abnormal items.
B.16	Earnings before interest and tax (EBIT) B.15 + B.28		Operating profit before income tax plus gross interest expense.
B.17	EBIT from operations B.16 - B.33		Operating profit before income tax plus gross interest expense less investment income.
B.18	Dividends paid or provided for		The amount included in the profit and loss statement for dividends. Includes normal and special dividends and statutory levies on profits and revenues. Excludes returns of capital.
B.19	Average total assets		Average of the value of assets at the beginning and end of the reporting period.
B.21	Current assets	Not classified[a]	Cash and other assets that would, in the ordinary course of operations, be available for conversion into cash within 12 months after the end of the reporting period.
B.22	Total liabilities	ETF 82	The future sacrifice of service potential or future economic benefits that the entity is obliged to make to other entities as a result of past transactions or other events (measured as at the end of the reporting period). Includes provisions for employee entitlements, creditors, deferred revenue, all repayable borrowings and interest bearing non- repayable borrowings.
B.23	Current liabilities	Not classified[a]	Liabilities that would, in the ordinary course of operations, be due and payable within 12 months after the end of the reporting period.

a The Economic Type Framework (ETF) does not differentiate between current and non-current assets.

(Continued next page)

Table A.2 (continued)

Code	*Ratio*	*GFS code*	*Definition*
B.24	Revenue from operations B.14 - B.29 - B.33 - B.35		Total revenue less abnormal revenue, investment income and receipts from governments to cover deficits on operations.
B.25	Total Expenses	ETF 12	Includes salaries and wages, purchases, interest, bad and doubtful debts, material losses from the sale of non-current assets, charges for depreciation, amortisation or diminution in the value of assets and abnormal expenses. GFS has a separate group for abnormals and extraordinary items, ETF 19. Adjustments are made to include abnormal revenues.
B.26	Total equity B13 - B.22		Total assets less total liabilities.
B.27	Debt		Includes all repayable borrowings (both interest bearing and non-interest bearing), interest bearing non-repayable borrowings, and finance leases. Excludes creditors and provisions (but not offsetting assets such as contributions to sinking funds).
B.28	Gross interest expense	ETF 1262	Amount charged to the profit and loss account. Includes finance charges on finance leases and all debt related financial expenses.
B.29	Abnormal revenue		Revenues included in operating profit (or loss) after income tax, which are considered abnormal by reason of their size and effect on the operating result. Abnormal revenue differs from extraordinary revenue in that extraordinary revenue is attributable to events or transactions of a type that are outside the ordinary operations of the entity and are not of a recurring nature.
B.30	Abnormal expenses		Same as description for B.29, except for expenses.
B.31	Income tax	ETF 1264	Income tax expense, or income tax-equivalent expense, on operating profit before tax (including abnormal items) calculated using tax effect accounting (AAS3).
B.33	Investment income	ETF 1131, ETF 1132	Income received and receivable on financial assets.
B.34	Average total equity		Average of total equity at the beginning and end of the reporting period.
B.35	Receipts from Government to cover deficits on operation		Receipts from Government to cover deficits on operations, but excludes receipts from governments for specific agreed services (for example, community service obligations).
B.36	Expenses from operations B.25 - B.30 - B.28		Total expenses less abnormal expenses and gross interest expense.

PART A

4 Asset valuation

Asset values and related expenses affect almost all financial indicators presented in this report. This can be gauged by examining chapter 3, attachment A, which contains a list of the indicators.

Given the pervasiveness of asset values in performance indicators, accurate asset valuation is essential to reliable performance measurement. This is particularly so for government trading enterprises (GTEs). They generally operate in capital intensive industries and have substantial fixed assets. For example, 60 to 70 per cent of all costs of NSW electricity transmission and distribution companies are capital-related (IPART 1999a).

Accurate and consistent valuation is also required if performance is to be compared over time or between GTE's in the one industry sector. However, asset valuations can vary significantly. There are a number of methods that can be legitimately used and many assumptions are required to arrive at an estimate.

With this in mind, asset valuations for GTEs and privately-owned utilities subject to industry regulation were examined to:

- identify the extent of differences in asset values that can arise with the use of different methods and assumptions; and to
- test how these differences affect the comparability of the performance indicators.

Specifically, asset values reported in GTE financial statements were compared with those calculated by regulators for customer and access price (or revenue) determinations.[1]

4.1 Asset valuation in regulated industries

Accounting standards and guidelines provide for significant discretion in asset valuation.[2] Many assumptions are required, given uncertainty about costs and the future (including the future economic benefits to be generated by assets).[3]

1 Individual asset values were not examined to assess their accuracy or the robustness of the method employed because the various methods employed by GTEs are acceptable under current Australian accounting standards and government guidelines.

Accounting standards and guidelines

In the latest reporting year, GTEs and privately-owned utilities were subject to the following accounting standards:

- general purpose accounting standards for entities subject to the *Corporations Act 2001*, such as AASB 1010 *Recoverable amount of Non-Current Assets*, and AASB 1041 *Revaluation of Non-Current Assets*;
- general purpose government accounting standards for entities not subject to the *Corporations Act 2001*, such as AAS 10 *Recoverable Amount of Non-Current Assets* and AAS 38 *Revaluation of Non-Current Assets*;
- general purpose government accounting standards for government-wide reporting, AAS 31 *Financial Reporting by Governments*; and
- State and Territory government reporting standards, which are based on the *Guidelines on Accounting Policy for Valuation of Assets of Government Trading Enterprises* (SCNPMGTE 1994a) published by the Steering Committee for Performance Monitoring of Government Trading Enterprises (Steering Committee).

In broad terms, these standards have the common objectives of improving the efficiency of managing resources, assisting managers discharge their accountability responsibilities and disclosure requirements, and assisting performance monitoring (SCNPMGTE 1994a, p. 16). The accounting standards and guidelines currently followed by GTEs in relation to asset valuation are outlined in box 4.1.

All existing standards and guidelines require the current value or current cost of an asset to be measured (see box 4.2 for current cost and value concepts). The term 'current' refers to the value or cost in 'today's' markets, having regard to changes in technology, factor price relativities and consumer demand. The alternative is to use the historical cost of the depreciated asset in current dollars.

The Steering Committee provided guidance under the recommended deprival method on whether current value or cost methods would be appropriate (SCNPMGTE 1994a). The choice depends in part on the nature of the assets and whether markets exist for the asset.

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2 This is not a criticism of accounting standards. Some discretion is universally accepted.

3 The Commission argued in its last report of this series that accounting standards applying to asset revaluations can yield potentially inconsistent and in some cases inappropriate asset values. Further, this inconsistency has reduced the comparability of financial performance over time and between GTEs (Productivity Commission 2001).

The salient differences distinguishing the Steering Committee's guidelines from the general accounting standards are:

- Existing standards do not provide separate valuation guidelines for assets that are surplus to requirements. Under the deprival method recommended by the Steering Committee, it must be assessed whether an asset would be replaced if they were deprived of the asset (that is, the asset is not surplus to the GTE's needs). Assets that are surplus to requirements are valued at their market value (selling price).
- General purpose standards make no requirement for an entity to value assets at the lower of the recoverable or the fair value amounts.
- Although entities are required to write-down their valuations to the recoverable amount under accounting standards, they cannot do so for assets that have been valued using the fair value method (AASB 1010, s2.2).
- The recoverable amount test does not require future net earnings to be discounted — this is a matter at the discretion of the valuer.

That said, although the deprival method of valuation recommended by the Steering Committee is more prescriptive, many assumptions are still required.

Each of these differences has the potential to lead to differences between revaluations using the deprival value method and those based on general accounting standards. In particular, it will lead to differences between the valuation of assets by GTEs and private sector providers of similar services.

Box 4.1 **Asset valuation guidelines and standards**

Deprival method of the Steering Committee on National Performance Monitoring of Government Trading Enterprises

The objective of the optimal deprival method of asset valuation, endorsed by the Steering Committee on National Performance Monitoring of Government Trading Enterprises (Steering Committee) is to recognise the service potential of assets used by a government trading enterprise (GTE) in pursuing its activities. It measures the value to the entity of the future economic benefits that the entity would forego if deprived of the asset.

In applying the deprival value method the basic principles are:

- where the asset would be replaced or reproduced if a GTE were deprived of its service potential, the value of the asset is measured using current cost — the lowest cost at which the gross service potential of the asset could currently be obtained in the normal course of business.
- where an asset would not be replaced or reproduced if a GTE were deprived of its service potential, value should be measured at the greater of its market value and the present value of any future incomes that it may generate.
- where the asset is surplus to requirements it should be measured at its market value (selling price).

In the case of a specialised non-current asset that would be replaced if the entity was deprived of it, the optimised deprival value would be equal to:

ODV = minimum{DORC, maximum [NPV, NRV]}

where,

ODV = optimal deprival value;

DORC = depreciated optimal replacement or reproduction cost — that is, the depreciated cost of replacing (or reproducing) the asset using the optimum technology (usually the most modern) to achieve current demand plus expected growth over a specified period;

NPV = net present value of future earnings foregone; and

NRV = net realisable value from the sale of the asset.

(Continued next page)

Box 4.1 (continued)

Fair value under AASB 1041 and AAS 38

According to AAS 38, fair value is defined as 'the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction' (s11.1). For general assets this usually would be either the market buying or selling price. For specialised assets, such as those typically owned by GTEs, this would include the 'replacement cost of the asset's remaining future economic benefits' (AAS 38, s5.1.8).

Recoverable amount under AASB 1010 and AAS 10

Both AASB 1010 and AAS 10 require that '…a *non-current asset* must be written-down to its *recoverable amount* when its *carrying amount* is greater than its recoverable amount' (AASB 1010, s5.1, italics in original).

In these standards, the recoverable amount is defined as '…the net amount that is expected to be recovered through the net cash inflows arising from its continued use and subsequent disposal' (AASB 1010, s9.1).

An exception applies to non-profit entities or entities delivering community service obligations, where the recoverable amount would not reflect the service potential of the asset.

Under either standard, managers have discretion on whether to discount future net earnings to present value.

General government valuations under AAS 31

Under AAS 31 government entities are required to apply the standards set out in AAS 10. However, it is acceptable for non-current assets to be valued at their '…written-down current cost, which is determined by reference to the current market buying price of the remaining service potential embodied in the asset. Where a market buying price is not available, the lower of replacement or reproduction cost may be used as a surrogate' (AAS 31, s11.3).

Source: SCNPMGTE (1994a); Johnstone and Gaffikin (1995).

Box 4.2 **Current valuation methods**

Current cost methodologies

- Current market buying price — measures the current market buying price of a *similar asset*, where a similar asset can be purchased. This method is dependant on the existence of readily observable secondary or primary markets to give a reliable indication of value. As a result, it is not easily applied to many highly specialised and capital intensive infrastructure assets.
- Replacement cost — measures the current cost of replacing the same service potential of the existing asset, where a *differing asset* having a similar purpose can be purchased. It is most applicable in situations where more efficient and technologically advanced assets have superseded existing assets. Depreciated Optimised Replacement Cost is commonly used by utilities and regulators to estimate the replacement cost of assets.
- Reproduction cost — measures the cost of replicating the asset's future economic benefits based on a *similar asset* with the same level of technology and scale. It is most suitable to situations where a similar asset exists and the existing asset is not technologically outdated.

Current value methodologies

- Net market selling price — measures the amount which the government trading enterprise (GTE) would expect to receive if the asset were sold at the reporting date less any costs incurred in obtaining the proceeds of the sale. This method depends on the existence of a mature and readily observable market to indicate value. Problems could arise in regard to GTEs as infrastructure assets are not often traded and the resale value of specialised assets can differ markedly from purchase prices.
- Net present value — measures the present value of the net cash inflows that the entity expects to receive from the use of the asset over its remaining life. This approach may be more suitable to GTEs as it addresses the circumstance where the value to the GTE of highly specialised durable assets exceeds their market value.

Source: Queensland Treasury (1997).

Asset valuation by industry regulators

In Australia, revenue and price regulation and third-party access regimes apply to many electricity, gas, water and sewerage, rail, port, urban transport, airport and telecommunications service providers. Regulation is deemed necessary because either they exhibit natural monopoly characteristics (such as occur in transmission networks), or because competition is generally weak (such as with ports).

Regulators generally rely on current cost methodology. The Depreciated Optimised Replacement Cost (DORC) is widely calculated by regulators.[4] In some cases it is used as the main basis of valuation; in others it is a component of the Optimised Deprival Value method.

The alternatives are to use a net present value methodology or a historical cost approach, such as the Depreciated Actual Cost (DAC) method, which equates asset values with the original purchase price less accumulated depreciation. However, the use of a present value methodology introduces an element of circularity into performance assessment (CCNCO 2001). This circularity means that changes in prices determine asset values and asset values determine the revenue required to recover the cost of capital, and hence regulated prices. In the absence of effective price regulation, cost inefficiencies may also feed through to asset values.

Historical cost can produce misleading results due to the impact of changing market environments, technical obsolescence and inflation, particularly given the relative longevity of some assets controlled by GTEs.

Regulators are required to have regard to their statutory objectives when determining the 'regulatory asset base' — the scope and value of a GTE's assets to be regulated.[5] For example, the Independent Pricing and Regulatory Tribunal (IPART) of NSW must give consideration to section 15 of the *IPART Act 1992*, that is to the '…appropriate rate of return on public sector assets' while ensuring 'the protection of consumers from abuses of monopoly power.'

Regulators must also have regard to the industry codes that they are enforcing. For example, the *National Electricity Code* (Electricity Code) and the *National Third Party Access Code for Natural Gas Pipeline Systems* (Gas Code), and the *Report of the Expert Group on Asset Valuation Methods and Cost-Recovery Definitions for the Australian Water Industry* each contain standards or guidelines for the valuation and revaluation of assets.

According to the Electricity Code, transmission assets in existence prior to 1 July 1999 must be revalued after 1 July 1999 using the deprival method (s6.2.3). In contrast, the Electricity Code does not prescribe a valuation methodology for distribution assets, but it does recommend the deprival method (s6.10.3).

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4 The DORC equates asset values to the cost of replicating the required service potential of the asset in the most efficient way possible while allowing for the age of the existing asset through depreciation.

5 This is most notable with regulatory approaches using the 'building block' method to determining price or revenue caps.

Under the Gas Code, regulators have greater scope for selecting the relevant asset value. For example, the initial regulatory asset base for regulated pipelines in existence before the commencement of the Gas Code should not normally fall outside the range of values determined by the DAC and the DORC (s8.11). However, the regulator, in determining asset values, is required to have regard to a range of factors including the international competitiveness of energy consuming industries, the efficient utilisation of gas resources, and '…other factors the Relevant Regulator considers relevant' (s8.10(k)).

The *Expert Group on Asset Valuation Methods and Cost-Recovery Definitions for the Australian Water Industry* recommended that the deprival value method be used to value metropolitan and non-metropolitan water assets. It was argued that this would provide a real (economic) cost of service provision (Expert Group 1995).

4.2 Implications for performance indicators

Data were collected for some electricity, gas, and water utilities. This information is reported in attachment A. The utilities were included on the basis that data were publicly available (this is not the case for urban transport and many water GTEs) and they were subject to price, revenue or access regulation (this is not the case for electricity generators). Some industries were excluded because of insufficient coverage across jurisdictions (as in the case of rail GTEs).

The main findings of this examination are discussed below.

Utility practice

There is a noticeable variation across utilities in the valuation methods used (see attachment A). The majority of electricity and water utilities use a current cost or current value technique, although several utilities employed DAC.

Among those using current value or current cost methods, over one-half valued assets based on replacement (or reproduction) cost and the remainder used the net present value (or net recoverable amount). This is consistent with an earlier finding that a majority of reported GTE asset valuations (55 per cent) are based on current cost or current value (Productivity Commission 2001). For example, 50 per cent of electricity utilities examined are using replacement cost to value assets.

Regulator practice

There was little variation in the valuation methods used by regulators for the electricity sector. However, some variation was evident in the gas and water sectors.

Regulators used the optimal deprival method, as required by the Electricity Code for valuing existing electricity assets. Under this method, DORC was used in most cases. The NPV method and an average of DAC and DORC was used in three circumstances.[6]

All regulators report a DORC valuation for assets in their gas determinations and assessments of access arrangements. However, only in about two-thirds of cases is DORC accepted as the final valuation method. In other cases, the final valuation is either an average of the DAC and the DORC or a current valuation based on the NPV. The DAC valuation for the Goldfields Pipeline (WA) can be considered a DORC valuation as the asset was relatively new at the time of the regulator's assessment (OffGar 2001b).

Water regulators applied the optimal deprival value method in assessing the value of water and sewerage assets in a minority of cases. In about 70 per cent of cases, regulators applied NPV valuations to water assets. DORC was applied in only 30 per cent of cases, and then only in Tasmania.

Valuations implicit in regulators' price determinations

Among utilities examined, the total value of assets under the regulators' initial DORC valuation was higher than the total value of assets under their final regulatory valuation. In some cases, regulators revised asset valuations to balance the interests of the utility owners and their customers.

These differences are significant. For example, the final DORC valuation by IPART of Sydney Water Corporation's assets was around 43 per cent of its initial valuation (IPART 2000c). For the utilities examined, the differences amounted to:

- $3 billion in electricity;
- almost $1 billion in gas; and
- almost $10 billion in water and sewerage.

6 Despite the apparent uniformity in approach, industry regulators did not apply DORC consistently to every assessable item. For example, easements were frequently valued using DAC as were many assets such as movable plant and equipment, while other land under buildings was valued at its market value. Some difference existed between regulators in whether the investments were measured as greenfields or brownfields.

The extent of this effective write-down between the regulators' initial and final valuation is revealed by the regulator's final value expressed as a percentage of their initial DORC valuation.[7] For example:

- the final valuation of electricity utilities was approximately 89 per cent of their initial DORC valuation;
- the final valuation of gas pipeline assets was between 87 and 91 per cent of the proposed or initial DORC valuations; and
- the final valuation of water and sewerage assets was approximately 45 per cent of the proposed DORC valuations.

Electricity

The most common reason given by regulators for a downward revaluation of assets was to provide low prices to consumers, or to reach a 'balance' between the interests of the utility owners and their customers. For example, IPART's valuation of Australian Inland Energy's (NSW — now Australian Inland Energy and Water) assets took into account '…pre-existing policies of governments which are distribution network owners regarding asset values, revenue paths and prices' (IPART 1999a, p. 68), and that IPART was concerned that a DORC valuation would lead to real increases in distribution prices. The proposed asset valuation was intended to avoid real price increases (IPART 1999a, p. 69).

Some regulators also adjusted their DORC valuations to account for differences in prices across regions or to prevent sharp increases in electricity prices. In Victoria, the Office of the Regulator-General (ORG) identified measures that lowered the differential between rural and urban prices:

> One is the downward revaluation of the assets of rural distributors relative to the assets of the metropolitan distributors, made at the time of privatisation. These adjusted asset values are embedded in the initial distribution prices determined under the Tariff Order.
>
> The second measure is the equalisation adjustment applied to transmission charges, under which Eastern Energy and Powercor currently receive a lump sum subsidy from the three urban distributors to reduce their transmission tariffs. The equalisation adjustment continues until 2020. These measures will continue to restrain the differential between rural and urban prices during the 2001-05 regulatory period, and beyond (ORG 2000a).

7 This ratio is conceptually similar to Tobin's q — the value of a firm's market capitalisation divided by the value of the replacement cost of the firm's assets. A ratio of greater than 100 per cent suggests the presence of (expected) profits, and a ratio of less than 100 per cent suggests the presence of (expected) losses.

Gas

In the case of natural gas pipelines, regulators have in some cases adjusted asset valuations to take into account other interests. The approaches used in these cases were to adjust the DORC valuation, take an average of the DAC and DORC valuation or use the NPV, given the price determination.

In NSW, IPART had regard to the requirements of the Gas Code and balanced the interests between the service provider and users. IPART stated that:

> This determination reflects our assessment of and, most importantly, our judgement about the revenue and price outcomes that best balance the competing interests of the owner and the different groups of customers of the AGLGN distribution network, as required by the Code (IPART 2000a, p. i).

In Victoria, the ORG adjusted the DORC method to ensure that certain classes of customers in certain geographic areas did not experience price increases when valuing the natural gas distribution network (ORG 1998a).

In Queensland, the price determinations arising from adopted asset valuations tended to reflect the underlying prices facing pipeline users. The Queensland Competition Authority (QCA) also balanced the interests of service providers and users. The QCA stated that:

> In particular, the Authority is cognisant of the need for service providers to have the opportunity to achieve a reasonable return on their investment while retaining sufficient flexibility to meet the changing needs of the market. At the same time, the Authority recognises that consumers will be seeking to pay no more than the efficient costs of operating the gas distribution networks (QCA 2001b).

Water and sewerage

Similarly, industry regulators in NSW and the ACT were generally mindful of the previously regulated water prices and of the needs of consumers. Consequently, industry regulators valued water and sewerage assets at almost $8 billion, compared to a DORC value of $17.9 billion.

In the ACT, the regulatory asset base determined by the Independent Pricing and Regulatory Commission (IPARC) for ACTEW stated that the determination:

> …. balances ACTEW's revenue needs with social impacts and the interests of other stakeholders (IPARC 1999).

These social impacts also included concerns about the appropriate support for low income earners adversely affected by proposed price increases (IPARC 1999).

4.3 In summary

Asset valuation has a direct effect on reported performance, as many measures — notably, return on assets — are derived using an estimate of the value of assets. Asset valuations by regulators have the potential to affect reported performance indirectly if GTEs do not adjust their valuations to reflect the valuation implicit in the regulators' price determinations.

In the long-run, actual performance can be affected by inefficient prices that do not provide for a normal rate of return on the resource tied up in assets. This will affect the usefulness of performance measures as indicators of a GTEs underlying efficiency as they will in part reflect the performance of the regulator.

Performance monitoring and accountability

The evidence that the valuation methods used by GTEs vary does not imply that the asset valuations are inappropriate for financial reporting. However, as noted in Productivity Commission (2001), differences in valuation methods complicate the comparability of financial performance indicators both among GTEs and over time where GTEs change the method used.

Regulators' DORC valuations were used as a benchmark to examine the effect that differences in utility valuation methodology and assumptions have on performance measurement. This choice of benchmark is not intended to imply that the regulators' estimates are better than the utility valuations or that they are a 'best practice' benchmark. Many assumptions are required and there is uncertainty about future market conditions and choice of best technology and even of current best practice unit costs.

Among the utilities examined, the differences between the regulators' DORC valuations and the utilities' own valuations result in appreciable differences in the implicit rate of return on assets among the utilities examined. For example, the effect of using DORC valuations rather than GTE valuations reduces the electricity sector's rate of return on assets by 5.5 per cent (around 0.4 percentage points), and increases the water sector's rate of return on assets by 3.2 per cent (around 0.2 percentage points).

That said, there is considerable difference between the regulator's DORC valuation and the utility's own DORC valuation. For example, if the regulator's DORC valuation was used in the financial statements instead of the utility's valuation, the rate of return on assets would increase by 22.2 per cent (around 3 percentage points)

for Great Southern Energy and decrease by 55.5 per cent (around 5 percentage points) for the Sydney Catchment Authority.

It is not possible to generalise the results of the review beyond the utilities included in the examination. However, this evidence suggests that the valuation practices of utilities has the potential to have an appreciable affect on reported performance.

Regulators' valuations

Appropriate asset valuations are central to the formation of efficient policies regarding both capital investment and pricing regimes. This is particularly so for GTEs, which have no share price to reflect market assessments of how the business is managing its resources.

Significant differences between the reported and the true economic value of assets diminishes accountability for performance, sound asset management and efficient investment. Consequently, regulators have a responsibility to ensure that the value of assets implicit in their price determinations are robust.

Consideration of social objectives by regulators in their price determinations can potentially lead to a downward valuation of assets. This is likely to reduce the comparability of performance measures further. For example, asset values in water utilities' financial statements are over twice those implicit in the final price determinations by regulators.

There may be significant longer term implications for performance and performance comparability if assets are over or under valued in relation to their true economic value. Under valuation of assets could discourage new investment, with the consequence of increasing costs or reduced service levels over time. Over valuation is likely t to reduce consumption to below efficient levels. In turn, this may result in the inefficient allocation of resources and provide scope for GTE managers to be inefficient.

Attachment A — Valuation practices and asset values for selected electricity, gas and water and sewerage utilities and industry regulators

Utility	*Period*	*utility's valuation method*	*Utility's valuation*	*Regulator's initial DORC valuation*	*Regulator's final valuation method*	*Regulator's final valuation*	*Difference between regulator's initial DORC and final valuations*	*Regulator's final valuation as a proportion of their DORC valuation* [a]	*Change to GTE's return on assets if regulator's initial DORC valuation used* [b]
			($ million)	($ million)		($ million)	($ million)	(%)	(%)
Electricity									
ACTEW	June 1998	value	410	437	DORC	437	0	100	-6.2
Advance Energy	June 1998	cost	367	303	DORC	303	0	100	21.1
AGL Electricity	July 1994	n.r	n.r	422	DORC	361	61	86	n.a
Aurora Energy	June 1999	value	762	615	DORC	550	65	89	23.9
Australian Inland Energy	June 1998	DAC	58	72	NPV	50	22	69	-19.4
CitiPower	July 1994	n.r	n.r	611	DORC	482	129	79	n.a
Energex	June 2000	cost	3 237	2 813	DORC	2 715	98	97	15.1
EnergyAustralia	June 1998	cost	3 746	3 767	DORC	3 767	0	100	-0.6
EnergyAustralia (interstate)	June 1999	n.a	n.a	864	DAC-DORC	457	407	53	n.a
Ergon Energy	June 2000	DAC	2 786	2 524	DORC	2 493	31	99	10.4
Great Southern Energy	June 1998	value	628	514	DORC	514	0	100	22.2
Hydro-Elec. Corp.	June 1999	value	3 199	4 498	NPV	2 987	1 511	66	-28.9
Integral Energy	June 1998	cost	1 828	1 732	DORC	1 732	0	100	5.5
NorthPower	June 1998	cost	831	858	DORC	858	0	100	-3.1
PAWA Dist.[c]	June 2001	n.a	n.a	n.a	ODV	319	n.a	n.a	n.a
PAWA Trans.[c]	June 2002	n.a	n.a	n.a	ODV	39	n.a	n.a	n.a

Attachment A (Continued)

Utility	*Period*	*utility's valuation method*	*Utility's valuation*	*Regulator's initial DORC valuation*	*Regulator's final valuation method*	*Regulator's final valuation*	*Difference between regulator's initial DORC and final valuations*	*Regulator's final valuation as a proportion of their DORC valuation* [a]	*Change to GTE's return on assets if regulator's initial DORC valuation used* [b]
			($ million)	($ million)		($ million)	($ million)	(%)	(%)
Powercor	July 1994	n.r	n.r	1 066	DORC	1 227	-161	115	n.a
Powerlink Qld	June 1999	cost	1 737	2 827	DORC	1 842	985	65	-38.6
SMHEA (trans.)	June 1999	n.a	n.a	62	DORC	62	0	100	n.a
Transend	June 1999	cost	406	322	DORC	333	-11	103	26.1
TransGrid	June 1998	cost	2 095	2 104	DORC	1 935	169	92	-0.4
TXU	July 1994	n.r	n.r	828	DORC	1 046	-218	126	n.a
United Energy	July 1994	n.r	n.r	743	DORC	743	0	100	n.a
Western Power	Dec. 1998	n.r	4 038	n.a	ODV	2 767	n.a	n.a	n.a
Total			**26 128**	**27 982**		**28 020**	**3,088**	**89**	**-5.5**
Natural Gas Pipelines									
ActewAGL	June 1999	DAC	92[d]	255	NPV	175	80	69	n.r
AGL - CW Pipeline	June 1999	n.r	n.r	26	NPV	28	-3	112	n.r
AGL Gas Netw'ks	June 1999	n.r	n.r	2 060-2 101	DAC-DORC	1 550	551	75-74	n.r
Albury Gas Coy.	Jan. 1999	n.r	n.r	23	DORC	22	1	94	n.r
AlintaGas D'bn Sys.	Dec. 1998	n.r	n.r	707	NPV	536	171	76	n.r
Allgas	June 1999	n.r	n.r	143-196	NPV	181	15	126-92	n.r
Amadaeus Basin-Darwin Pipeline	Jul. 1999	n.r	n.r	199.0	DORC	176.2	23	89	n.r
Angaston-Berri Pipeline	July 1999	n.r	n.r	15.3	DORC	15.3	0	100	n.r

Attachment A (Continued)

Utility	*Period*	*utility's valuation method*	*Utility's valuation*	*Regulator's initial DORC valuation*	*Regulator's final valuation method*	*Regulator's final valuation*	*Difference between regulator's initial DORC and final valuations*	*Regulator's final valuation as a proportion of their DORC valuation* [a]	*Change to GTE's return on assets if regulator's initial DORC valuation used* [b]
			($ million)	($ million)		($ million)	($ million)	(%)	(%)
Natural Gas Pipelines (cont.)									
Dampier to Bunbury Pipeline	Dec. 1998	n.r	n.r	1 234	DORC	1 234	0	100	n.r
Envestra Qld	June 1999	n.r	n.r	125-197	NPV	162	35	130-82	n.r
Envestra SA	June 1998	n.r	n.r	632	DORC	632	0	100	n.r
Goldfields Gas Pipeline	Dec. 1998	n.r	n.r	407	DAC	438	-31	108	n.r
Great Sthn Energy	June 1998	n.r	n.r	32.7-34.0	DAC-DORC	28	6	86	n.r
Moomba-Adelaide (Epic Energy)	Dec. 1998	n.r	n.r	387-405	DORC	353.3	Na	91-87	n.r
Moomba-Sydney & Canberra (EAPL)	July 2000	n.r	n.r	539.5	DORC	502.1	37	93	n.r
Multinet	June 1998	n.r	n.r	762	DORC	740	22	97	n.r
Parmelia Pipelines	Dec. 1998	n.r	n.r	66	DORC	63	3	95	n.r
Stratus	June 1998	n.r	n.r	590	DORC	580	10	98	n.r
TPA & VENCorp	Dec. 1998	n.r	n.r	373.5	DORC	363.7	10	97	n.r
Tubridgi Pipeline System	Dec. 1998	n.r	n.r	24	DORC	17	7	71	n.r
Westar	June 1998	n.r	n.r	669	DORC	632	37	94	n.r
Total				**9269 - 9455**		**8429**	**974**	**91-89**	**n.r**

Attachment A (Continued)

Utility	*Period*	*utility's valuation method*	*Utility's valuation*	*Regulator's initial DORC valuation*	*Regulator's final valuation method*	*Regulator's final valuation*	*Difference between regulator's initial DORC and final valuations*	*Regulator's final valuation as a proportion of their DORC valuation* [a]	*Change to GTE's return on assets if regulator's initial DORC valuation used* [b]
			($ million)	($ million)		($ million)	($ million)	(%)	(%)
Water and sewerage									
ACTEW (sewer.)	June 1998	NPV	381	391	NPV	367	24	94	-2.6
ACTEW (water)	June 1998	NPV	436	440	NPV	330	110	75	-0.9
Cradle Coast (NWWA)	June 2000	DRC	59	58	DORC	58	0	100	1.7
Esk Water Auth.	June 2000	DORC	100	97	DORC	97	0	100	3.1
Gosford City Council	June 2000	n.r	n.r	525	NPV	227	298	43	n.a
Hobart Water	June 2000	DORC	171	135	DORC	135	0	100	26.7
Hunter Water Corp.	June 2000	cost	1970	1 900	NPV	810	1 090	43	3.7
SA Water (sewer.)	n.a	DRC	1900	n.a	n.a	n.a	n.a	n.a	n.a
Sydney Catchment Auth.	June 2000	DAC	736	1 653	NPV	668	985	40	-55.5
Sydney Water Corp.	June 2000	cost	13 053	12 600	NPV	5394	7 206	43	3.6
Wyong Shire Council	June 2000	n.r	n.r	428	NPV	186	242	43	n.a
Total			**18 806**	**18 227**		**8272**	**9955**	**45**	**3.2**

Note Value is net present value or net recoverable amount. Cost is depreciated replacement, depreciated optimised replacement or depreciated reproduction cost. DORC is depreciated optimised replacement/reproduction cost. DRC is depreciated replacement cost. NPV is net present value. DAC is depreciated actual cost. DAC-DORC is an average of DAC and DORC. **n.r** not reported in Productivity Commission (2001). **n.a** not available. [a] (Regulator's final valuation divided by Regulator's DORC valuation)*100. [b] (Utility's valuation – Regulator's DORC valuation) / Regulator's DORC valuation. [c] Power and Water Authority electricity transmission and distribution assets.

Source: ACCC (1998, 2000a–g); Cap Gemini Ernst & Young (2001a, 2001b); EAPL (1999); Envestra Ltd (2000); Epic Energy (2000); IPARC (1999, 2000); IPART (1999a–f); GPOC (2001); ICRC (2000); ORG (1998a, 1998b, 1999, 2000a, 2000b); OffGar (2000a–c, 2001a, 2001b); OTTER (1999); QCA (2001a, 2001b); SA Water (2000); SAIPAR (2000); UC (2000, 2001).

5 Debt management

Decisions by governments and government trading enterprise (GTE) managers about capital structure — the mix of debt and equity — affect the type and level of borrowings entered into to manage short-term cashflows, and to purchase, maintain and invest in assets. The degree to which GTEs rely on debt financing is also partly related to the business conditions in which they operate and as a result, varies between GTEs.

In 2000-01, the debt to equity ratio for GTEs that held debt ranged between 3 per cent (Australian Inland Energy and Water) and 3058 per cent (Western Australian Government Railways Commission).[1] Across all sectors, government ownership interest (equity) in monitored GTEs represented around 70 per cent of the value of assets employed by GTEs. The remaining 30 per cent of assets were funded by borrowings.

The level and structure of outstanding debt affects operating costs and a GTEs exposure to financial risks.

GTE debt management and the cost of debt is also affected by government policies designed to ensure competitive neutrality. The variations in policies between jurisdictions should be taken into account when examining the debt management of particular GTEs.

5.1 Government trading enterprise debt

GTE debt comprises borrowings made under a number of different instrument classes, differentiated by the timing of interest payments and the maturity of borrowings. Finance leases, where the risks under the lease are effectively transferred to the lessee, are also classified as debt.[2]

1 The Victorian Channels Authority did not have any debt in 2000-01.

2 Under Australian Accounting Standards, the assets and future obligations relating to finance leases are treated as an asset and a liability upon commencement, and amortised over the term of the lease (AASB 1008). The amortised amount is treated as an interest expense (AASB 1036).

At the end of June 2001, monitored GTEs had accumulated borrowings of around $45 billion. The outstanding level of debt has increased in each year over the reporting period, rising from $32 billion in 1996-97. Interest payments on outstanding debt rose from $2.9 billion in 1996-97 to $3 billion in 2000-01, representing around 6.6 per cent of total expenses incurred by GTEs by the end of the reporting period.

The management of borrowings has implications for profitability. Overall, a 1 percentage point change to the average interest rate on debt in 2000-01 would change interest expenses by around $452 million, leading to a change in pre-tax operating profit of 5 per cent and return on equity of 0.3 percentage points.[3]

However, the imperative to minimise the cost of debt varies between GTEs. In 2000-01, interest expenses as a share of total expenses for monitored GTEs ranged from zero (Victorian Channels Authority) to 37 per cent (Powerlink, Queensland). The share was less than 10 per cent for 39 of the 64 monitored GTEs and greater than 20 per cent for eight monitored GTEs.

Characteristics of GTE debt instruments

Currently, monitored Commowealth GTEs raise funds directly from financial markets. Most monitored State and Territory GTEs are required by governments to borrow through central borrowing authorities. Borrowing through central authorities typically provides GTE managers with access to a range of debt instruments, advisory services and short-term deposit facilities. It also gives greater flexibility of choice between debt instruments.

GTEs that borrow through central borrowing authorities can have lower debt costs where there are economies of scale involved in managing a larger pool of debt. Without the imposition of a debt guarantee fee, they may also face a lower cost of debt than their private sector counterparts because lenders would perceive that there is negligible risk of default by virtue of government ownership.

GTE managers may be able to choose from a range of debt instruments offered by a central borrowing authority. Interest payments on borrowings may be subject to fixed interest rates or based on a variable rate that may increase or decrease over the term of the loan. GTE managers may also have a choice about the maturity date of loans. The term of a loan may be overnight or for a period exceeding 10 years.

3 In 2000-01, the median interest rate cost that applied to monitored GTE debt was 6.8 per cent. The standard deviation of interest costs was 1.3 percentage points and ranged between 5.1 per cent and 12.4 per cent (see figure 5.4).

Typically, GTE borrowings are made on an interest-only basis, with borrowings redeemed or refinanced at maturity. Some borrowing terms and conditions may require a repayment of principal as well as interest. Smaller authorities typically choose this approach.

The debt structure of a business is the product of the history of borrowings together with decisions made to manage that debt. This profile determines the GTE's exposure which arises from floating interest rate debt and when fixed interest debt is due to be redeemed or refinanced.

Standard yield curves show that long-term debt is generally more costly than short-term debt for borrowers. This may reflect a number of factors including investors demanding an additional premium for uncertainty, which is greater over a longer time period (Brealey and Myers 1991).

Over the reporting period, interest rates, as measured by trends in the yields for Commonwealth Government securities over different maturities, have varied. The difference ('spread') between the interest cost of securities with different maturities have also varied (see figure 5.1).

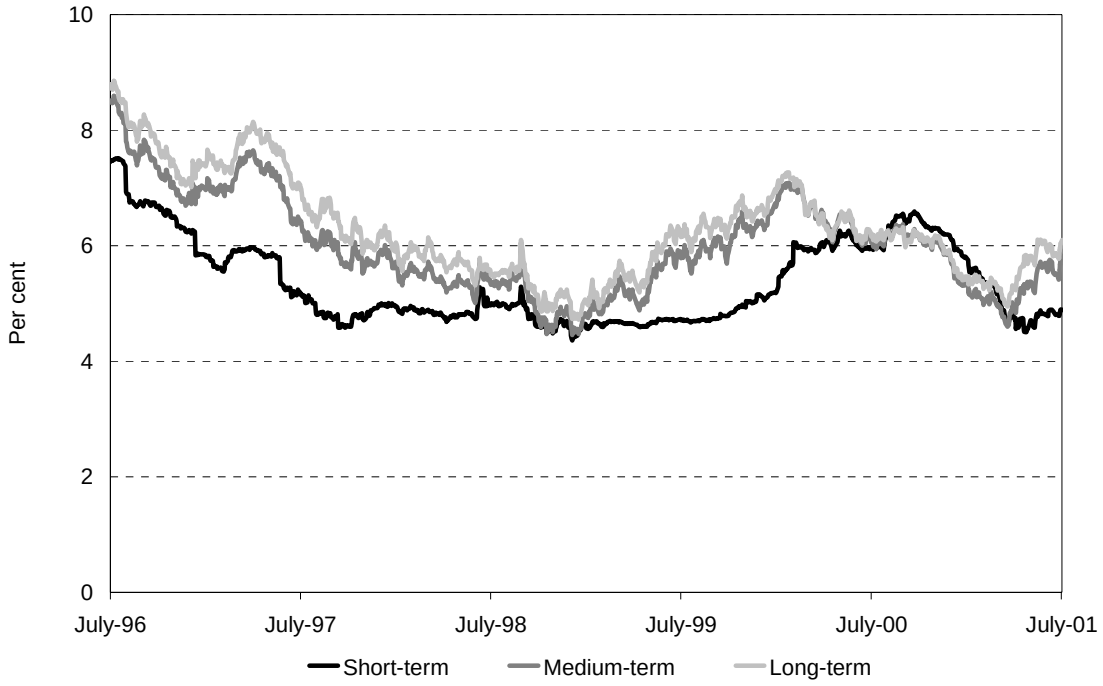
Securities issued by State and Territory government central borrowing authorities generally trade at a margin above those issued by the Commonwealth Government, reflecting the Commonwealth Government's lower risk of default. In 2000-01, the margin above an equivalent seven year security issued by the Commonwealth Government and those issued by State governments ranged from between 36 and 24 basis points for NSW, 42 and 28 basis points for Victoria and 42 and 28 basis points for Queensland (TCV 2001).[4]

For Commonwealth Government securities, the cost of short-term debt has generally been lower than longer term debt in recent years, except for several months after July 2000, when longer term debt was cheaper, thus leading to an inverse yield curve.[5]

4 One percentage point equals 100 basis points.

5 The cost of longer term debt may be lower than short-term debt when future short-term interest rates are forecast to be lower than current short-term interest rates.

Figure 5.1 **Commonwealth government bond yields**
1996-97 to 2000-01



Note In this figure, the cost of long-term debt (maturing in greater than five years) is approximated by 10 year bonds, the cost of medium-term debt (between two and five years) is approximated by 5 year bonds and the cost of short-term debt (less than 12 months) is approximated by six month bonds.

Source: RBA (2002, http://www.rba.gov.au/Statistics/OP10_update.xls, accessed 7 May).

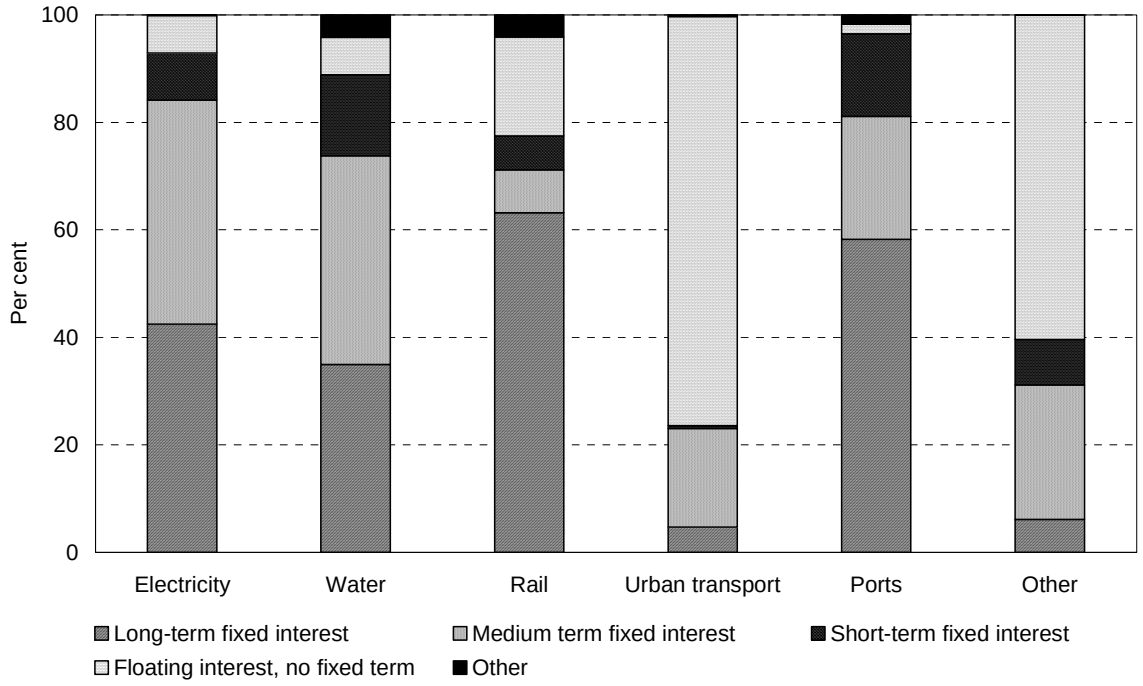
The interest cost of debt instruments with the same maturity varied over the reporting period. Between 1996-97 and 2000-01, the cost of long-term debt moved between 8.9 per cent and 4.7 per cent, medium-term debt between 8.6 per cent and 4.5 per cent and short-term debt between 7.5 per cent and 4.4 per cent. The difference in interest cost between debt of different maturities also varied.

Government trading enterprises debt structure

A GTE's debt structure reflects its short-term and long-term financing needs along with the degree of risk that managers and governments are prepared to accept. These risks include:

- liquidity risk — the risk that it is unable to obtain additional borrowings;
- cashflow risk — the risk that future cash flows associated with a monetary financial instrument will fluctuate in amount; and
- interest rate risk — the risk that a financial instrument's value will fluctuate as a result of changes in market interest rates (NSW Treasury 1997).

Figure 5.2 **GTE debt structure, by class of instrument and sector**
30 June 2001



Note Long-term debt matures in more than five years, medium-term debt matures in one to five years and short-term debt matures in less than 12 months. Fixed interest debt requires a government trading enterprise (GTE) to pay a fixed interest rate over the term of the loan. Floating interest debt with no fixed term to maturity requires a GTE to pay an interest rate which may change until the debt is repaid. Other debt mainly comprises floating interest rate debt that has a fixed term and non-interest bearing debt.

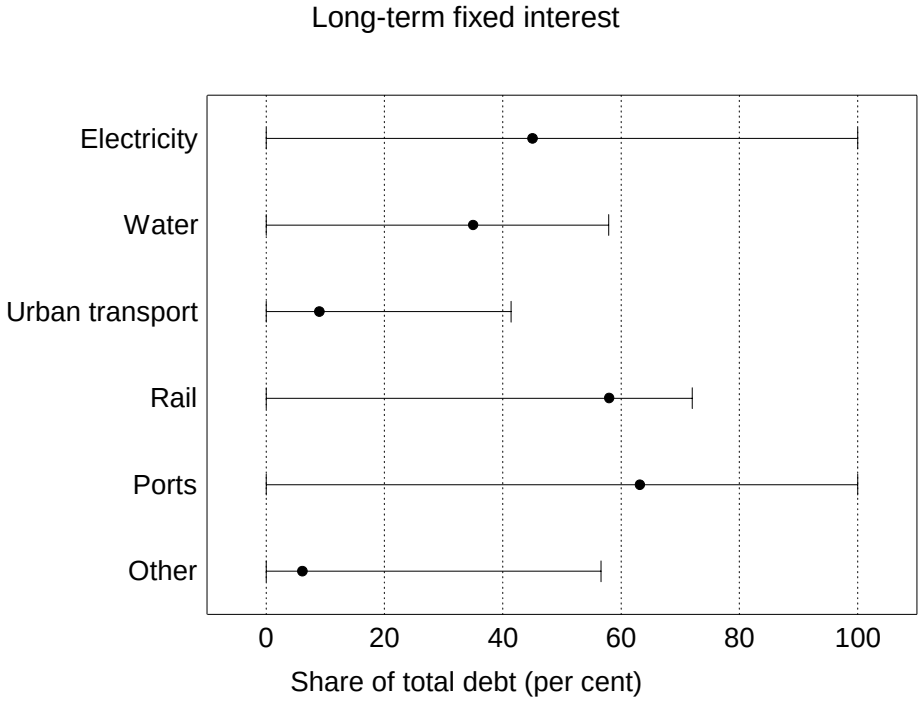
Data source: PC estimates based on GTE annual reports.

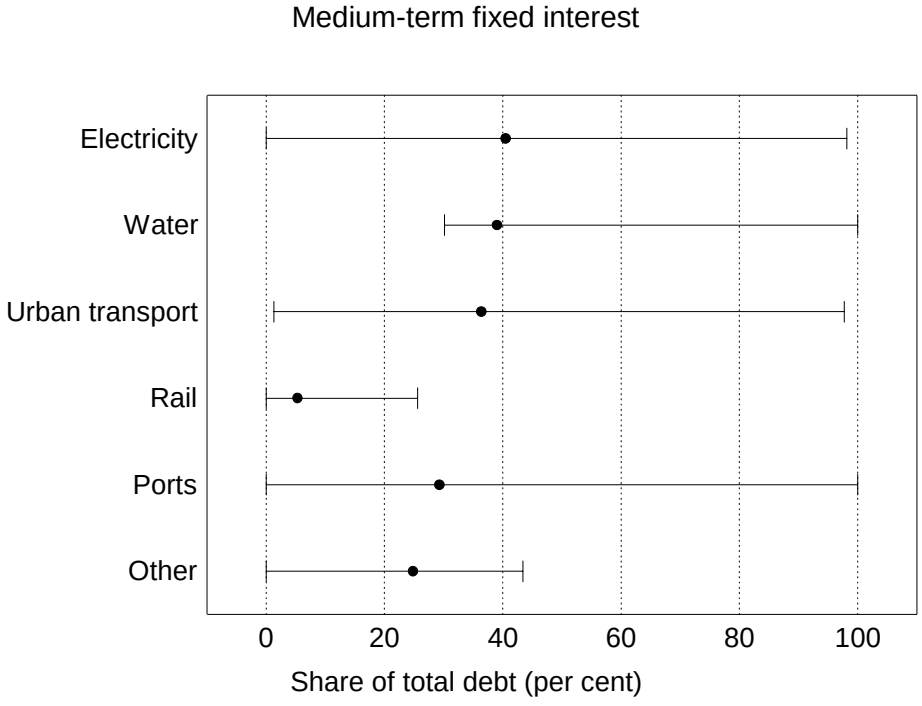
The mix and maturity of debt varies across sectors (see figure 5.2). However, overall, long-term fixed interest debt (due to be repaid in more than five years) accounted for the largest share (32 per cent) of GTE borrowings in 2000-01. Medium-term fixed interest debt (due to be repaid between one and five years) accounted for 31 per cent. Debt that was subject to floating interest rates represented around 27 per cent of outstanding debt and short-term fixed interest debt (due to be repaid in less than 12 months) accounted for most of the remainder.

Most GTEs use several debt instruments that offer a range of different maturities and a mix of fixed interest and floating interest rates (see table 5.1). For example, two-thirds of GTEs use 3 or more classes of debt instruments.

The extent to which different classes of instruments are used by GTEs, measured as a proportion of each GTE's total debt, also varies across sectors (see figure 5.3). The characterisation of instruments in figure 5.3 does not have regard for the change in interest rate exposures that result from the use of derivatives.

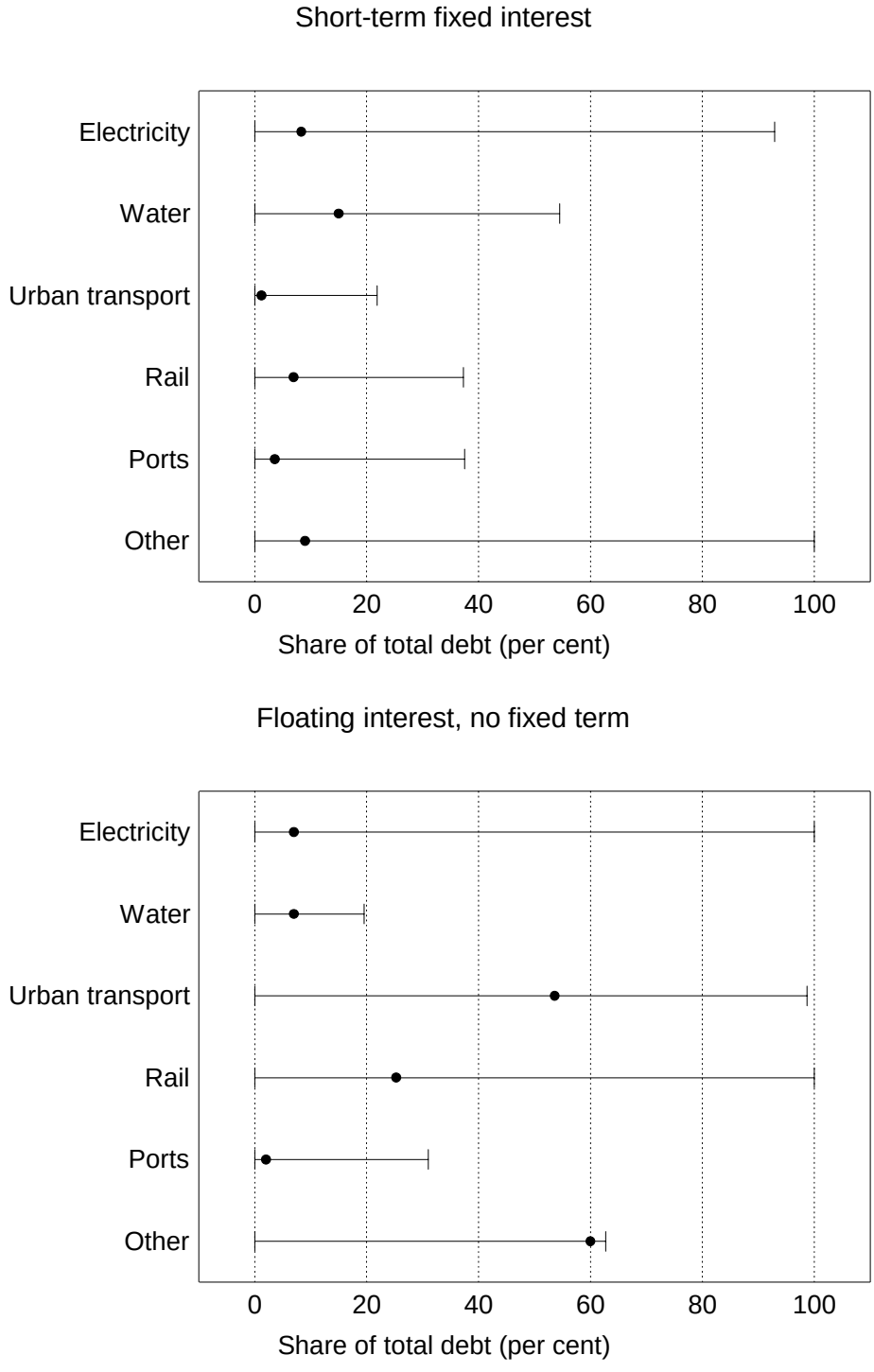
Figure 5.3 **GTE debt maturity profile, by class of instrument and sector**
30 June 2001





(Continued)

Figure 5.3 (continued)



Note Long-term debt matures in more than five years, medium-term debt matures in one to five years and short-term debt matures in less than 12 months. Fixed interest debt requires a government trading enterprise (GTE) to pay a fixed interest rate over the term of the loan. Floating interest debt requires a GTE to pay an interest rate which may change over the loan term. 'Other' debt comprises mainly of floating interest rate debt that has a fixed term and non-interest bearing debt. The dot represents the weighted mean value and the 'whiskers' represent the range of values for a given performance indicator by jurisdiction.

Source: PC estimates based on GTE annual reports.

Table 5.1 **Number of debt instrument classes used by GTEs**
30 June 2001

No. of debt instruments used by the GTE	*No. of GTEs*	*No. of GTEs including a floating interest rate debt instrument*
1	7	1
2	12	5
3	20	3
4	21	17
5	3	3

Source: PC estimates based on GTE annual reports.

In 2000-01, around 30 per cent of monitored GTEs used interest rate swaps to manage interest rate risk. This type of derivative instrument allows borrowers to swap floating rate exposures to fixed rate exposures and vice-versa.[6] Other instruments used are forward rate agreements or futures contracts.

Of the 19 GTEs using derivative instruments in 2000-01, over half were GTEs owned by the NSW Government. Most of the remainder were owned by the Tasmanian and Commonwealth governments.

The extent to which derivative instruments are used to manage interest rate risk varies. For example, Western Power (WA) used derivative instruments to reduce its exposure to floating interest rates from 10 per cent of its overall debt portfolio to 6 per cent. In contrast, National Rail Corporation (Commonwealth) made much greater use of derivative instruments, reducing its exposure to floating interest rates from 100 per cent of its overall debt portfolio to 51 per cent.

Commonly, the use of derivative instruments by GTEs is subject to a range of policies and controls administered by each GTE's Board, Treasury department and central borrowing authority. For example, in NSW, the *Treasury Management Policy* sets out several criteria to authorise agencies to enter into derivative contracts including:

- a sound business case, based on the better management of the risks associated with the core business of an agency;
- the existence of a strong internal policy framework within which any transactions take place; and
- a sound operational environment including appropriately qualified staff, adequate systems to evaluate and report on exposures and senior management and Board supervision (NSW Treasury 1997).

6 Under an interest swap contract, each party to the agreement agrees to exchange, at specified intervals, the difference between a specified fixed interest rate and a nominated floating interest rate.

Under these policies, derivative instruments must be used to manage risks, and not for speculative purposes. For example, Sydney Water Corporation:

> [….] uses derivative financial instruments for hedging purposes only and does not enter into or trade them for speculative purposes. Strict internal guidelines exist to control the use of derivative financial instruments (2001, p. 72).

Although often beneficial for the management of financial risks, derivative instruments can give rise to additional risks, namely:

- liquidity risks associated with the possibility of not being able to sell derivative positions or selling at a value which is below their underlying worth;
- control risk associated with mismanagement, fraud or speculative use of derivative instruments; and
- credit risks associated with counterparties being unable to fulfil contractual obligations.

Several monitored NSW GTEs adopt an active approach to debt management by using derivative instruments to manage interest rate risk and the interest cost of debt. In contrast, monitored Victorian GTEs adopt a generally conservative approach by making the majority of borrowings subject to fixed interest rates and not using derivative instruments.

When derivative instruments are used to manage interest rate risk, gains or losses on these transactions are usually included in their financial statements as borrowing expenses. However, the treatment of gains and losses on derivative instruments varies between GTEs.

Some GTEs amortise gains and losses over the term of the underlying physical borrowing instrument. In this way, interest expenses are smoothed from period-to-period as changes in exposures are spread over the remaining term of the borrowings to which the derivative instrument relates. As a result, the use of derivative instruments may reduce the variation in period-to-period borrowing costs compared to a circumstance where a GTE is exposed to significant variations in the cost of borrowing at different times over the interest rate cycle.

Other GTEs recognise the gains and losses on derivative instruments in a single period. This may result in greater variation in borrowing costs compared to a situation where gains and losses are amortised.

Determinants of a GTEs debt structure

Factors that influence the decisions on the appropriate debt structure of a GTE include the type of business (asset lives and cashflows), capital expenditure (investment) plans and the ability of the business to raise debt funds in capital markets.

A general aim of risk management is to match the maturity profile of debt with the revenue stream generated during the asset's expected life. In doing so, a business may avoid potential risks and costs related to refinancing debt if the debt matures early, and minimise risks associated with repaying debt beyond the revenue stream generated during the expected life of an asset (Barclay and Smith 1995).

Borrowing decisions may also reflect a GTE's relationship with its central borrowing authority. For some GTEs, the central borrowing authority only acts as an intermediary. In the case of others, the central borrowing authority acts as an active debt manager for GTEs and provides advice relating to the management of debt. For example, TCorp (the central borrowing authority in NSW) provides debt management services for several NSW GTEs (TCorp 2001).

GTEs with larger debt portfolios may also be able to better tailor debt instruments to their requirements. The use of debt instruments that are specific to the requirements of the business may give these GTEs access to more appropriate debt instruments and, in some cases, reduce the interest costs of debt. For example, in Queensland, the cost of debt arranged through client-specific debt pools in 1999-00 was 43 basis points (7 per cent) lower than GTEs that arranged borrowings through generic debt pools (QTC 2000).

Where a GTE's borrowings are largely sourced from generic debt pools, its borrowing costs or debt structure will be influenced by the central borrowing authority's decisions relating to the management of its entire debt portfolio, including the size and structure of the portfolio.

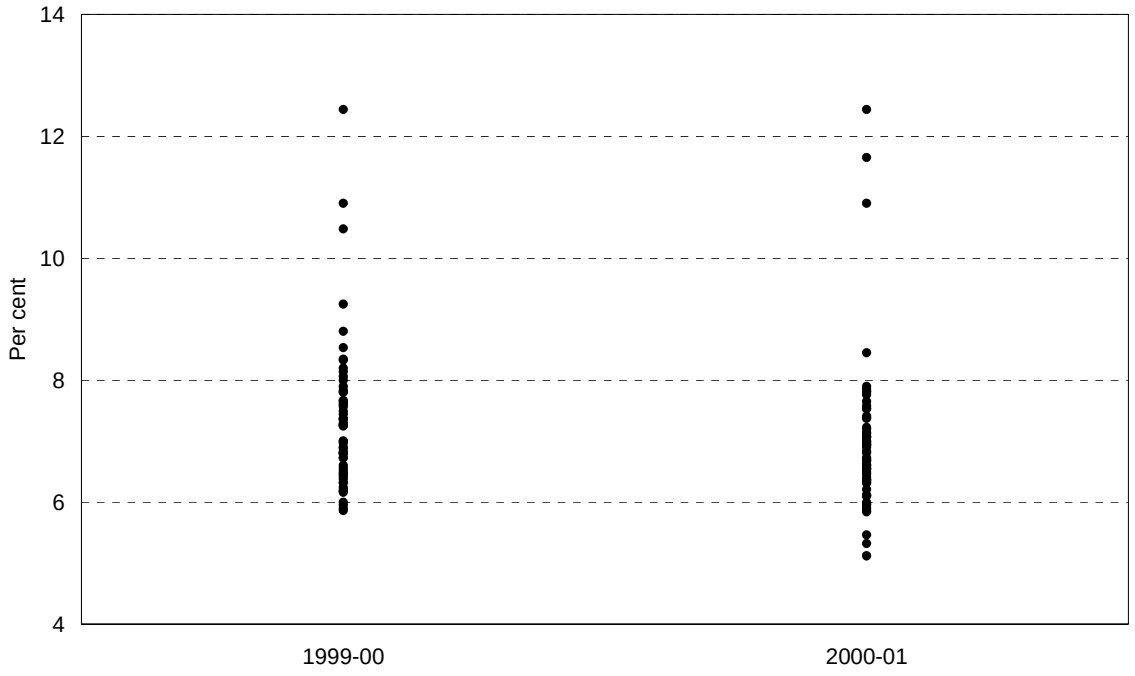
When GTEs borrow through central borrowing authorities, they may not be exposed to risks or transaction costs similar to those faced by private businesses seeking to raise debt finance. For example, a GTE may be less likely to face the liquidity risk associated with refinancing debt compared to a private sector business. In this respect, central borrowing authorities may not withhold finance or impose risk-related interest rate premiums if a business is in financial difficulty. In addition, a GTE may face lower transactions costs in using some types of debt instruments because it may benefit from economies of scale involved in borrowing from the larger debt pool managed by the central borrowing authority.

Interest cost of GTE debt

Differences in the interest cost of debt between GTEs partly reflects decisions by GTE managers and governments about debt structures. However, part of the difference in the interest cost of debt may also be due to the timing of new borrowings or the refinancing of existing borrowings (see figure 5.1). As a result, some changes in the cost of debt are not within the control of GTE management and may reflect the situation within debt markets generally.

In 2000-01, the median effective interest rate applying to debt held by GTEs was 6.8 per cent. However, there was considerable variation in the average cost of debt, with GTEs facing an average cost of between 5.1 per cent (Pacific Power, NSW) and 12.4 per cent (ACTION, ACT) (see figure 5.4).

Figure 5.4 **Average interest cost of debt, monitored GTEs**
1999-00 and 2000-01



Note Excludes the effect of debt guarantee fees and derivative instruments.

Source: PC estimates based on GTE annual reports.

Not all GTEs experience the same changes in interest costs from year-to-year. The median interest rate applying to GTEs in 2000-01 was almost 50 basis points (0.5 percentage points) less than the median rate in 1999-00. However, not all GTEs experienced a decline in interest costs, with around 30 per cent facing a higher effective interest rate in 2000-01 than 1999-00. For example, the interest cost of

debt for National Rail Corporation increased by 0.6 percentage points in 2000-01 compared to the previous year. In contrast, the interest cost of debt for TransGrid (NSW) declined by 4 percentage points.

5.2 Debt guarantee fees

GTEs usually face a lower cost of capital in the marketplace than a comparable private enterprise due to their government-owned status. Over the past decade, governments have introduced debt guarantee fees, which impose a premium on GTEs' borrowings, to ensure competitive neutrality. These fees also aim to ensure that the cost of risk is included in financial reporting.

Government and GTE borrowing

The Commonwealth, State and Territory governments generally source credit more cheaply than the private sector. The low risk of government default is, as Klein (1997) explains, primarily because governments have recourse to taxpayers, who *de facto* provide an open-ended credit insurance to the government. For this reason, the cost of sovereign debt is commonly referred to as 'risk-free'.[7]

A GTE with borrowings that are either explicitly or implicitly guaranteed by its shareholder government will therefore face an interest rate substantially below the market rate, even if the business or investment project is itself quite risky.

The Competition Principles Agreement, signed in 1995, requires each signatory government to impose a debt guarantee fee on its GTEs to offset the competitive advantages provided by government guarantees. The agreement stipulates that the fee should be commensurate with the credit risk the enterprise would face if it had no guarantee — exposing the GTE to the full risk-related cost of its debt.

In practice, debt guarantee fees offset interest rate advantages by virtue of government ownership. They do not generally reflect any benefit derived from

7 Of the eight governments under which GTEs in this report operate, six had a 'AAA' Standard and Poors sovereign credit rating (the highest possible), with the lowest rating being for Tasmania, which has a 'AA' rating. The Northern Territory had a Moodys rating of 'Aa2'. Credit ratings reflect the agencies' confidence in the governments' ability to repay creditors. They provide a guide to the interest rates governments are likely to face in the market.

Governments with the same credit rating will not necessarily borrow at the same interest rate. Other factors, such as the liquidity of government paper and a government's fiscal policy, although in part reflected in credit rating, will also determine the particular interest rate faced by the government.

borrowing through a central government borrowing authority with economies of scale that reduce transactions costs.

State and Territory government debt guarantee fee policies

The financial instruments covered by the debt guarantee fee may also include finance leases, overdrafts and other interest bearing liabilities. Although the guarantee fee coverage and mechanisms vary between jurisdictions, each policy employs a broadly similar methodology.

Assessment of stand-alone credit ratings

The stand-alone credit worthiness of the GTE provides an indication of the interest rate that it would face in the market without government support.

Credit worthiness is usually assessed by an independent credit rating agency which determines the stand-alone credit rating of the GTE (see box 5.1). However, for Tasmania and some small GTEs in other jurisdictions, the treasury department — rather than an external agency — assigns proxy ratings annually. For some other GTEs, they may be permitted to conduct their credit rating internally. For example, the Commonwealth's guarantee fee policy allows its GTEs to conduct an internal rating assessment if its current liabilities do not exceed $10 million for more than 90 days in a given financial year.

The legislative requirements relating to the frequency of rating assessments varies across jurisdictions. GTEs in NSW and Victoria must obtain a stand-alone rating from an independent ratings provider annually, while Queensland GTEs must obtain an independent rating every three years.

Guarantee fee rate

The credit rating determines the guarantee fee rate. The rate is the differential between the average interest rate paid by the government and the estimated rate that the GTE would pay if it were a stand-alone entity. The government's rate is usually proxied by the yield curve of the State's treasury corporation, or by the long-term bond rate.

Box 5.1 **Stand-alone credit ratings**

The definition of 'stand-alone' is generally taken to mean without the assistance of government.

> [T]he one assumption made in determining the stand-alone rating is that the government will not specifically intervene to maintain the solvency or liquidity of the public entity, or in other words that the government will not bail out the enterprise in a crisis (S&P 2001).

Making the assumption that government support would not be extended to a private business may be unrealistic. Governments are sometimes placed under pressure to assist private businesses where a significant number of jobs or an essential service would be at risk if a collapse occurred. For example, the Victorian Government announced that it would spend over $100 million to ensure the viability of Melbourne's private train, tram and bus companies (Batchelor 2002).

Other aspects of the government trading enterprise(GTE)–Government relationship are not taken into account by rating agencies when determining the stand-alone rating. GTEs may occupy monopoly positions in the market or have exclusive government tenders and contracts that are protected by legislative arrangements. These forms of government assistance, as well as the receipt of community service obligation payments, are typically not factored out as they could also be afforded to a private company.

In most jurisdictions, there is a requirement for the GTE to obtain their rating from an external ratings provider (such as Moodys or Standard and Poors). Alternatively, the rating is determined by the treasury of the shareholder government, or in rare cases internally by GTE management. There are several advantages to seeking a rating from an external agency. In NSW, GTEs are required to source their rating externally as,

> This separation is necessary given that the New South Wales Government holds the dual roles of owner and provider of debt finance (NSW Treasury 2001).

Aside from the transparency and legitimacy attached to external ratings, GTEs benefit from the examination of their business by credit rating agencies. When assigning a stand-alone rating, agencies examine market position, past performance and future prospects against objective benchmarks for that type of organisation and in comparison to the GTE's competitors. Standard and Poors note that obtaining a credit rating provides an organisation with 'an independent, external review of management, its strategies and corporate performance' (S&P 2001).

Ideally, the estimate of the yield curve for stand-alone GTEs should be based on the average interest rates paid by similarly rated Australian corporations. Due to a lack of depth in some Australian debt markets, some jurisdictions estimate the curve with reference to the US corporate or utility bond markets.

Jurisdictions typically publish schedules of debt guarantee fee rates for GTEs each financial year (see table 5.2).

Table 5.2 **Guarantee fee rate schedules**
basis points

GTE stand-alone credit rating	*Commonwealth (AAA)*	*New South Wales (AAA)*	*Victoria (AAA)*
	2000-01	2000-01	1999-00
AAA	0	0	0
AA+	2	9	6
AA	5	19	13
AA-	10	29	18
A+	30	39	23
A	50	49	28
A-	70	63	36
BBB+	90	81	46
BBB	100	104	58

Source: State and Territory government debt guarantee fee policies.

Calculation of fee payable

The fee rate is multiplied by the GTE's debt to determine the guarantee fee to be paid. The way the debt is valued is not consistent across jurisdictions. In some, the fee is based on the net present value of debt, while in others the book value of a GTE's debt is used.

The calculation process is generally different for short-term debt (maturing in less than one year) and longer term debt (maturing in more than one year). In most jurisdictions, the fee applying to short-term debt is simply the product of the fee rate and the total outstanding short-term debt of the GTE.

For longer term debt, the GTE's total debt is divided into maturity segments to ensure that an appropriate fee rate is applied. For example, in Queensland, GTE debt is divided into four maturity 'buckets' (less than one year, one to three years, between three and seven years and greater than seven years). The total guarantee fee is calculated by multiplying the average fee rate, applicable to each bucket of debt, by the amount of debt in that bucket. The figures for each bucket are summed to give the total fee.

There are differences between jurisdictions in the range of debt instruments to which debt guarantee fees are applied. For example, in NSW the fee applies only to the loan portfolio of a GTE. In Tasmania and Victoria the fee can apply to other financial liabilities — for instance, finance leases, promissory notes and derivative instruments.

This inconsistent coverage could potentially encourage GTEs to shift their borrowings into instruments that do not attract a charge, but still benefit from an implicit government guarantee. Consequently, in some jurisdictions the policy may not be fully effective in ensuring competitive neutrality.

In some jurisdictions, restrictions are imposed on the calculation methodology. For example, Tasmania's policy sets a regulated limit on the maximum fee rate applicable to GTEs. This rate is currently set at 1 percentage point (100 basis points).

The timing and number of debt guarantee payments made each year varies between jurisdictions. In some jurisdictions the fee is divided into quarterly instalments, whereas in others the fee is paid annually.

Debt guarantee fees generally apply to the balance of all existing debt at the end of the financial year. The amount paid is determined by the cost of debt instruments entered into in previous years, as well as newly issued debt or refinanced debt. As such, the fees do not replicate the conditions faced by private sector managers when deciding whether to take out new debt or refinance existing debt. Specifically, they have the potential to distort price relativities between existing and newly issued fixed-interest debt instruments.

In the private sector, once a business has acquired a long-term fixed rate debt instrument, the cost of repayments will not change (in nominal terms) over the life of that instrument. Repayments on the fixed rate instrument will remain the same, regardless of whether a company's credit rating is downgraded or interest rates rise.

In the case of most GTEs, where guarantee fees apply to the balance of all existing debt, any change which affects the guarantee fee rate — such as the GTE's credit rating or the owner-government's credit rating — will change the cost of fixed rate instruments already held by the GTE.

Debt guarantee payments by monitored GTEs

In 2000-01, over $132 million in debt guarantee fees were paid by the 36 GTEs monitored for which fee data were available (see table 5.3). This compares to over $1.7 billion in total borrowing costs for the same group of GTEs.

Debt guarantee fees are not paid by some GTEs which have low debt levels or are considered to be non-commercial (such as the State Transit Authority in NSW). Further, a majority of the GTEs that are subject to fee regimes do not disclose the amount paid in their annual reports. However, this data is available from alternative sources (such as budget papers or Government Financial Statistics) for some GTEs.

Table 5.3 **Debt guarantee fees**
2000-01

Jurisdiction	*GTEs in sample*[a]	*Total debt guarantee fee payments*	*Debt guarantee fee as a component of borrowing costs*	*Contribution of debt guarantee fee to average effective interest rate*
		$'000	per cent	basis points
NSW	15	64 638	8.63	78
VIC	5	3 901	2.61	20
WA	1	4 005	2.49	17
SA	3	3 164	3.06	26
QLD	4	52 179	12.45	94
TAS	8	4 315	3.40	29
ACT	0	n.a	n.a	n.a
NT	0	n.a	n.a	n.a
C'wealth	0	n.a	n.a	n.a

[a] The number of monitored GTEs in each jurisdiction for which debt guarantee fee data for 2000-01 was available. **n.a.** Not applicable.

Source: PC estimates.

The range of fee amounts paid by individual GTEs reflects the diversity of the GTEs themselves. Queensland Rail ($42.9 million or 14 per cent of total borrowing costs) paid the highest nominal fee, while Metro Tasmania ($20 000 or 8 per cent of total borrowing costs) paid the lowest nominal fee observed. The observed GTEs' fees contributed between 2 and 20 per cent of their total borrowing costs, with the median fee contributing 7 per cent.

5.3 In summary

In 2000-01, monitored GTEs owed over $45 billion. Consequently, debt management and debt guarantee fees may have a significant impact on GTE costs and their financial performance.

In view of the significance of borrowing costs, it is important to consider differences in external factors that influence GTE debt structure and the cost of borrowing, when making comparisons of financial performance. These factors include government debt management policies and the timing of major investments over the interest rate cycle.

Generally, debt guarantee fees are unlikely to add significantly to the overall cost of debt. Therefore, policy differences will not affect performance comparisons greatly. However, debt guarantee fee policies may affect performance by altering the incentives of GTEs in the management of their debt.

6 Community service obligations

Traditionally, Australian governments have imposed special requirements on GTEs which extend beyond the commercial operations of these businesses (SCNPMGTE 1994b). Governments have often required GTEs to produce specific goods or services, to provide concessions to particular users and, to a lesser extent, utilise specific inputs or levels of inputs. These requirements are usually referred to as 'community service obligations' (CSOs).

CSOs generally involve a transfer from the government (and taxpayers) to a specific group of customers of a GTE.[1] As such, an appropriately costed CSO does not represent a subsidy to the GTE — it is a fee for service.

In accordance with inter-governmental agreements related to National Competition Policy, governments reviewed their CSO policy to address concerns about the transparency of their interventions on GTE financial performance. The objective was to improve the consistency of the identification, costing, funding and monitoring of CSOs.

CSOs identified elsewhere in this report are those that are *directly funded* by government and reported by GTEs. The amounts recorded as CSOs were taken from GTEs' annual reports or financial statements. Not included elsewhere in the report, but discussed in this chapter, are non-commercial activities:

- that were directly funded by the government and unreported;
- funded *internally* by the GTE and reported; and
- funded *internally* by the GTE and unreported.

6.1 State and Territory government CSO policies

Governments over the last decade have increased the commercial focus of GTEs. Reforms included the commercialisation and corporatisation of GTEs and the

[1] Not all goods or services sold to customers at below the cost of production are necessarily non-commercial. For example, private businesses may use 'loss leading' products or services — sold at a loss — to attract customers. These losses are then more than offset by gains from economies of scale and on the sale of profitable items.

implementation of competitive neutrality regimes that exposed GTE managers to factor market disciplines. The main aim of the reforms was to improve the operating efficiency and productivity of GTEs and the quality of services delivered to customers.

Where governments direct GTEs to undertake non-commercial activities and services, the payment for a CSO allows the GTE to be managed on a fully commercial basis as the payment is treated as a fee for service.

Direct funding of CSOs improves transparency and makes financial performance easier to assess. This facilitates accountability of GTE management and strengthens incentives to improve financial outcomes. The direct funding of CSOs may also improve GTE cashflows and financial management if the payments match the period over which the services are provided.

All Australian State and Territory governments have adopted policies on the provision of CSOs by GTEs. Each CSO policy generally includes a range of provisions covering identification, costing, funding, contracting and monitoring.

Identification

State and Territory governments have generally adopted the common definition of a CSO that was proposed by the Steering Committee on National Performance Monitoring of GTEs (Steering Committee):

> A Community Service Obligation arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis, and which the government does not require other businesses in the public or private sectors to generally undertake, or which it would only do commercially at higher prices (SCNPMGTE 1994b, p. xi).

A feature of this definition is the requirement for a government to direct a GTE to undertake a specific service or function. This rules out initiation of CSOs by GTEs and prevents other loss-making activities being treated as CSOs. The definition also implies that the service or function would not have been provided had the GTE assessed the proposal purely on commercial grounds (WA Treasury 2000).

Some minor variations in the application of the Steering Committee definition apply between jurisdictions (IC 1997). For example:

- the NSW Government requires the relevant government directive to identify a specific social objective;

- the Victorian Government explicitly acknowledges that both directives to carry out an uncommercial activity and directives to *cease* carrying out a commercial activity are CSOs; and
- the Tasmanian Government explicitly requires the CSO to be a net cost to the GTE.[2]

Some CSO policies specify a range of activities which are not to be included as CSOs. This may resolve some ambiguity relating to whether or not a service or function would have been performed on purely commercial grounds. For example:

- non-commercial activities undertaken by GTEs in WA, such as community projects or sponsorships designed to promote a good corporate image, are not regarded as CSOs in the absence of a government directive or request (WA Treasury 2000); and
- costs incurred in meeting regulatory requirements which are also incurred by private sector businesses are generally not regarded as CSOs (IC 1997).

Costing

In principle, most jurisdictions favour an *avoidable cost* approach to determine the financial value of CSOs (see table 6.1). Under this approach, the cost (net of extra revenue) that would have been avoided if the activity or service was not provided is calculated.

Table 6.1 **Method of costing CSOs advocated by Australian governments**

Jurisdiction	*Costing method advocated*
NSW	Avoidable cost (for subsidised operations)
	Fully distributed cost or forgone revenue (for subsidised price concessions)
Victoria	Avoidable cost (inclusive of capital costs)
Queensland	Long-run avoidable cost
SA	Avoidable cost
WA	Long-run avoidable cost
Tasmania	Avoidable cost
ACT	Avoidable cost
	Fully distributed cost or forgone revenue (for subsidised price concessions)
NT	Avoidable cost
	Fully distributed cost or forgone revenue (for subsidised price concessions)
Commonwealth	Avoidable cost (although this method is only explicitly required in several cases)

Source: IC 1997.

2 Activities and services that are provided at the direction of the Tasmanian Government by GTEs and earn revenues greater than the cost of provision are not classified as CSOs.

In practice, governments use a range of methods, including foregone revenue (the difference between revenue received from each CSO customer and the cost of supply) and fully distributed cost to determine the financial value of CSOs provided by GTEs.[3]

A major difficulty is that governments and GTEs are required to make judgements about what a GTE would do in the absence of a government directive to undertake a CSO. For example, a decision must be made about whether capital assets would be reduced if a CSO was terminated.

The allocation of costs may involve subjective judgements about assigning fixed costs and the time period over which costs should be assessed (CCNCO 1998a). It may also require estimating efficient costs to provide incentives for GTE managers to improve operational efficiency. For example, a CSO provided by the State Transit Authority (NSW) is funded based on the cost of private sector operations (STA 2001).

Funding

In this report, a CSO is reported only when it has been directly funded by government. Most governments state an in-principle preference for direct CSO funding. However, some policies have acknowledged that this is not always practicable, and other measures have been retained (IC 1997). CSOs are also funded using cross-subsidies between users and the acceptance of lower rates of return on capital.

Cross-subsidisation requires GTEs to charge higher prices to some users to recover the losses incurred in supplying the CSO to other users. This usually involves price discrimination — charging different prices for an identical good or service or uniform pricing for a good or service with different costs of production (WA Treasury 2000).[4]

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3 The fully distributed cost method allocates the GTE's total costs to all the activities it undertakes. Those costs that cannot be directly attributed to a particular activity (joint or common costs), are allocated somewhat arbitrarily (often on a pro rata basis) or by taking demand factors into account. Therefore, some proportion of joint costs, such as overheads, must be allocated to CSOs, even though the majority of these costs would still have been incurred had the CSOs not been provided (WA Treasury 2000).

4 Strictly, cross-subsidisation only occurs if the price paid by CSO customers is less than short-run marginal cost, or the price paid by all or some non-CSO customers exceeds the cost of providing the service to them (the 'stand-alone' cost) (Baumol and Sidak 1994).

Cross-subsidies involve a transfer from one group of customers to another. They are only possible when on-selling among customers (arbitrage) is not feasible or worthwhile. When cross-subsidies distort efficient consumption, they affect production efficiencies and may lead to cost padding if the cross-subsidy can be maintained in the absence of effective competition (SCNPMGTE 1994b). Cross-subsidisation also reduces the transparency of CSOs and inhibits performance monitoring. Further, customers meeting the cost of the cross-subsidy may be unaware of the additional costs they face.

The acceptance of a lower rate of return may involve implicit subsidies where revenues do not cover the full cost of providing the activity or service, including the opportunity cost of capital — a transfer from taxpayers to GTE customers. Acceptance of a lower rate of return reduces the transparency of CSOs and may require complex adjustments to a GTE's income and asset base to determine what its commercial return would have been had the CSO been directly funded (WA Treasury 2000).

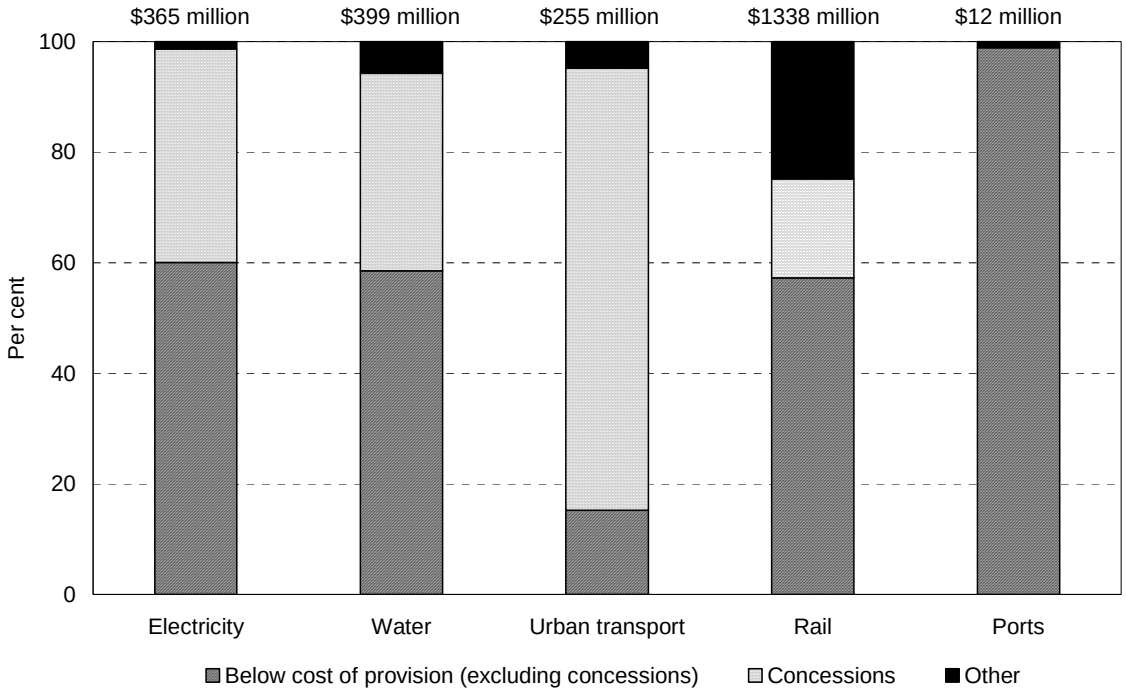
6.2 Disclosure

A survey of GTEs' 2000-01 annual reports revealed that 27 of the 64 monitored GTEs received $2.4 billion in *direct funding* for the provision of CSOs. This amount represents a lower bound estimate of the cost of all non-commercial activity. Some GTEs received CSO funding that was not disclosed in their financial statements, while others were required to perform CSOs without reimbursement.

Funded CSOs

CSO payments to monitored GTEs were mainly for the provision of goods and services at a price less than the cost of supply (other than concessions), and for the provision of pensioner and other concessions. CSOs relating to 'other' activities, such as the Water Corporation's (WA) sewerage infill program and Queensland Rail's network access payments, accounted for the rest. Around 56 per cent of CSO payments were to GTEs in the rail sector, with water (17 per cent) and electricity (15 per cent) accounting for most of the remaining balance. The share of CSO payments differed across sectors according to the nature of the CSO (see figure 6.1).

Figure 6.1 **Community service obligation payments received by monitored GTEs, by sector and type**
2000-01



Note Below cost of provision (excluding concessions) includes payments to government trading enterprises (GTEs) that relate to the provision of an activity or service at a cost that is lower than the cost of providing the activity or service, but excludes specific payments for pensioners and other selected customers, such as charities. The latter two are included in the separate category — Concessions. 'Other' includes payments for community service obligations (CSOs) that do not generally fit into the two previous categories, and include CSO payments such as the Water Corporation's (WA) sewerage infill program and Queensland Rail's network access payments.

Data source: PC Estimates based on GTE annual reports.

The costing of CSOs is an important factor affecting the financial performance of some GTEs because CSO funding accounts for a significant share of their operating revenue. In 2000-01, CSO funding for 13 monitored GTEs accounted for more than 10 per cent of their operating revenue. For three GTEs — ACTION (ACT), Metro Tasmania and the State Transit Authority (NSW), CSO funding was more than 40 per cent of operating revenue.

GTEs in the urban transport and rail sectors were the most dependent on CSO revenue, with CSO payments accounting for 37 and 23 per cent of total sector revenues respectively. CSOs in these sectors included the provision of non-commercial transport services and concessions for specified customers, such as pensioners and school students (see box 6.1).

Most GTEs did not disclose details of how CSOs were costed or arrangements relating to the payment of the CSO by government, such as the timing of payments, which may affect liquidity and short-term borrowing requirements. For example, in some cases it appears that whilst the GTE is reimbursed for providing a CSO, it is not always reimbursed for the cost of its administration.

Box 6.1 **Examples of funded CSOs provided to selected urban transport and rail GTEs, 2000-01**

State Transit Authority (NSW)

The State Transit Authority (STA) received community service obligation (CSO) funding from the NSW Government for the provision of:

- non-commercial ferry services in Newcastle and Sydney and non-commercial bus services in Newcastle ($19 million);
- charging prices at below commercial levels ($38 million); and
- concession fares to pensioners and other eligible passengers ($138 million).

Metro Tasmania

Metro Tasmania received CSO funding from the Tasmanian Government for the provision of concession fares to pensioners and other eligible passengers, charging prices at below commercial levels and servicing non-commercial bus routes ($19 million).

Freightcorp (NSW)

Freightcorp received funding for the provision of non-commercial freight services ($72 million).

ACTION (ACT)

ACTION received CSO funding from the ACT Government for the provision of:

- school transport services and special needs transport ($12 million);
- concession fares to pensioners and other eligible passengers ($4 million);
- non-commercial off-peak bus routes ($10 million); and
- charging prices at below commercial levels ($16 million).

Source: GTE annual reports; GPOC (2000).

There were inconsistencies in the disclosure of direct funding of CSOs. For example, NSW electricity distributors received funding from the NSW Department of Human Services (DHS) for the provision of pensioner and other concessions to

customers.[5] In 2000-01, the amount paid to NSW electricity distributors by the DHS was around $74 million (NSW DHS 2001). However, only three out of the six electricity distributors — Australian Inland Energy and Water, Advance Energy and NorthPower — disclosed the funding in their financial statements.

There are instances where GTEs report the receipt of CSO revenue but do not disclose the nature of the activity to which it relates. For example, Eraring Energy (a NSW electricity generator) disclosed $150 000 it had received as a CSO from NSW Treasury. However, there was no indication in Eraring's annual report about the purpose of this payment.

In some jurisdictions, payments for some non-commercial activities were not recognised as CSOs. For example, in Victoria, water GTEs deliver pensioner concessions on water and sewerage charges and relief grants to eligible customers on behalf of the State Government.[6] These were funded by the Government but not identified as a CSO by the either the Government or the GTEs.[7] In contrast, similar concessions provided in NSW were treated as CSOs.

There are also instances where amounts provided as payment for CSOs may not match the costs incurred. For example, Airservices Australia disclosed a shortfall in the CSO funding received to maintain price capping at general aviation and regional airports in 2000-01. Airservices Australia received $7 million in CSO payments from the Commonwealth Government, however they reported that the cost of provision was 70 per cent higher ($11.9 million). If Airservices Australia received CSO funding for its full cost of CSO provision (that is, it received an additional $4.9 million in CSO payments), pre-tax operating profit would have been 5.8 per cent higher and return on assets would have increased from 15.5 per cent to 16.3 per cent.[8]

5 The payment of this CSO was transferred to the Department of Energy from 2001-02.

6 This is also the case for pensioner and other concessions delivered by SA Water. However, SA Water receives a payment for *administering* the delivery of these concessions.

7 The amounts reimbursed to Victorian GTEs have not been disclosed in annual reports. In 1998-99, City West Water, Yarra Valley Water and South East Water delivered concessions worth $41 million to 387 000 households. In addition, 1105 emergency relief grants of over $380 500 were approved for these metropolitan water customers (Victorian DHS 2001).

8 Where the cost difference is funded using a cross-subsidy, there would be no change in profitability. However, the price differences used to maintain the cross-subsidy may lead to other costs due to their effect on the allocation of resources and incentives.

Internally funded CSOs

An examination of GTE annual reports in 2000-01 revealed that several GTEs provide non-commercial activities and services at the direction of government without direct funding (see box 6.2).

Box 6.2 **Examples of internally funded non-commercial activities provided at the direction of government, 2000-01**

Australia Post

Australia Post was required to provide a letter service to all Australians which reasonably meets their needs on an equitable basis and a domestic standard letter service at a uniform price. In 2000-01, the cost of these requirements was estimated by Australia Post to be $92 million using avoidable cost methodology and was met through transfers from within the reserved letter service.

Western Power

Western Power was required to offer residential and small to medium business customers in remote areas the same tariff as customers in metropolitan areas, despite any differences in the cost of providing the service. The losses incurred in providing uniform tariffs were estimated by Western Power to be about $38 million.

If Western Power had been directly funded for these activities, operating profit in 2000-01 would have been 13 per cent higher and return on assets would have increased from 11 per cent to 11.9 per cent.

Airservices Australia

Airservices Australia performed a range of non-commercial activities to meet specific requirements of the Commonwealth Government that were not directly funded. In 2000-01, Airservices Australia estimated that these activities cost $11 million. This covered several activities including a shortfall in the subsidy used to maintain price capping ($4.9 million), provision of environmental information ($2.9 million), Sydney Olympics ($1.4 million) and noise inquiry lines ($1.4 million). In estimating the cost of providing these activities, Airservices Australia did not include joint costs such as corporate overheads or a margin to cover the cost of capital.

If Airservices Australia was directly funded for these activities, operating profit in 2000-01 would have been at least 13 per cent higher and return on assets would have increased from 15.5 per cent to 17.3 per cent.

Source: PC estimates based on GTE annual reports.

In addition, the absence of some types of CSOs in some jurisdictions suggests that there may be additional internally funded CSOs that have not been recognised by governments and GTEs. For example, SA Water, Australian Inland Energy and Water (NSW), Energex (Queensland) and Water Corporation (WA) receive CSO

funding for the provision of non-commercial services to non-metropolitan customers but their counterparts in some other jurisdictions do not.

Implicit CSOs

Where GTEs are not making commercial returns, customers of a GTE receive an implicit subsidy — the difference between a GTE's return on assets and its risk-adjusted cost of capital. This involves a transfer of capital from taxpayers to customers.

An implicit CSO may arise for reasons such as:

- setting prices that do not recover the full cost of providing an activity or service — including the opportunity cost of capital; or
- inadequate funding for existing CSOs.

The Commonwealth Government 10 year bond rate plus a premium for risk may be used as an approximate estimate of a 'normal' rate of return. Risk premiums will vary over time and across GTEs.[9]

Based on the risk-free rate of return equal to the average of the Commonwealth Government 10 year bond rate in 2000-01, the size of the implicit subsidy for monitored GTEs was around $5.1 billion in 2000-01, assuming that GTEs' assets are correctly valued (see chapter 4).[10]

The implicit subsidy estimate is lower than if it were based on a 'commercial' rate of return, rather than the risk-free rate. The Commonwealth Competitive Neutrality Complaints Office (CCNCO 1998b) has stated that typical rate of return targets for a low risk business should include a nominal pre-tax premium of 3 percentage points on the risk-free rate, and that a high risk business should include a premium of 7 percentage points.

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9 Premiums for risk are generally composed of two parts — the equity premium and the market risk. The equity premium is the market rate of return less the risk-free rate of return, often within a band of 3 to 7 per cent. The market risk is an estimate of the level of risk associated with a specific GTE. The market risk, usually expressed as a 'beta', will vary over time and across industries. Some examples of the betas used in the calculation of risk premiums for Australian industries are 0.6 (energy), 1.0 (transport) and 0.9 (healthcare) (CCNCO 1998b).

10 The implicit subsidy is calculated as the difference in a GTE's actual reported earnings before interest and tax (EBIT), and the EBIT that the GTE would be required to provide a return on its assets equal to the risk-free rate.

6.3 In summary

Appropriate costing and funding of CSOs improves the comparability of financial performance with other GTEs and businesses. Adequate disclosure of CSOs — both funded and unfunded — improves transparency and enhances the accountability of governments and GTEs for the cost and quality of their non-commercial activities and services.

Failure to rigorously apply the policy weakens government accountability for sound governance. It also has the potential to diminish the accountability of managers and may reduce the incentive for managers to improve operational performance and deliver high quality commercial and non-commercial activities and services.

PART B

7 Electricity

The financial performance of 23 electricity government trading enterprises (GTEs) is covered in this chapter. The GTEs vary significantly in their size and the range of generation, transmission and distribution services they provide.

Of the 23 GTEs monitored, ten provided generation services, three were involved in the transmission of electricity and nine distributed electricity and provided retail services. Western Power was the only fully integrated electricity utility monitored.

In 2000-01, these GTEs generated $16.3 billion in revenue and controlled assets valued at $44.6 billion — an increase of 6 and 8 per cent respectively on 1999-00.

For a discussion of the data and the financial indicators used and some of the factors that should be considered when assessing performance, see chapter 3.

7.1 Sector reforms

Governments have introduced reforms aimed at improving the efficiency and financial performance of electricity GTEs. Reform has focused on the governance of GTEs, the efficiency of the production process and the competitiveness of market structures in which the GTEs operate. These sector reforms have implications for the financial performance of GTEs and the consistency of performance measures over time.

The Australian electricity supply industry developed on a state-by-state basis with vertically integrated, government-owned utilities. However, during the 1990s, the industry has been disaggregated into separate generation, transmission and distribution businesses in most jurisdictions (see table 7.1).

Table 7.1 **Monitored electricity GTEs, 1996-97 to 2000-01**

1996-97	*1997-98*	*1998-99*	*1999-00*	*2000-01*
New South Wales				
Generation				
Pacific Power	→	→	→	Pacific Power[a]
				Eraring Energy
Delta Electricity	→	→	→	Delta Electricity
Macquarie Generation	→	→	→	Macquarie Generation
Transmission and System Operation				
TransGrid	→	→	→	TransGrid
Distribution				
EnergyAustralia	→	→	→	EnergyAustralia
Australian Inland Energy	→	→	→	Australian Inland Energy and Water[b]
NorthPower	→	→	→	NorthPower[c]
Advance Energy	→	→	→	Advance Energy[c]
Great Southern Energy	→	→	→	Great Southern Energy[c]
Integral Energy	→	→	→	Integral Energy

a Pacific Power transferred its remaining generation assets to a new entity, Eraring Energy, during 2000. Pacific Power's generation activities ceased on 31 July 2000. **b** Australian Inland Energy merged with the Broken Hill Water Board on 15 December 2000. The merged entity was renamed Australian Inland Energy and Water. **c** On 1 July 2001, the NSW Government merged Great Southern Energy, Advance Energy and NorthPower to form Country Energy.

(Continued next page)

Table 7.1 (continued)

1996-97	*1997-98*	*1998-99*	*1999-00*	*2000-01*
Queensland				
Generation				
AUSTA Electric[d]	CS Energy			CS Energy
	Stanwell Corporation			Stanwell Corporation
	Tarong Energy			Tarong Energy
	Queensland Power Trading Corporation			Enertrade
Transmission and distribution				
Queensland Transmission and Supply Corporation[e]				Powerlink Queensland
Energex				Energex
6 regional distributors	Ergon Energy Pty Ltd[f]		Ergon Energy Corporation[g]	Ergon Energy Corporation

[d] On 1 July 1997, AUSTA Electric was separated into three government-owned generation corporations. Originally, the Queensland Power and Trading Corporation (QPTC) was established on a temporary basis to assist in the transition to a new industry structure, by finalising a range of financial and administrative matters arising from the restructure of the former Queensland Transmission and Supply Corporation. Subsequently, the QPTC began trading electricity generated from several privately-owned power stations and was renamed Enertrade. [e] The Queensland Transmission and Supply Corporation (QTSC) commenced operations on 1 January 1995 as a holding company for eight subsidiary corporations — seven regional distribution corporations and Powerlink Queensland, which managed Queensland's high voltage transmission system. On 1 July 1997, QTSC's subsidiaries were established as independent government-owned corporations. [f] Ergon Energy Pty Ltd was established following a merger between the Northern Electricity Retail Corporation and Central Electricity Retail Corporation. Ergon Energy Pty Ltd remained under the ownership of regional distributors. [g] Ergon Energy Corporation was formed following the amalgamation of the six regional distributors and Ergon Energy Pty Ltd.

(Continued next page)

Table 7.1 (continued)

1996-97	*1997-98*	*1998-99*	*1999-00*	*2000-01*
Western Australia				
Western Power	→	→	→	Western Power
Tasmania				
Hydro-Electric Corporation[h]	→	Hydro-Electric Corporation	→	Hydro-Electric Corporation
		Transend Networks	→	Transend Networks
		Aurora Energy	→	Aurora Energy
Commonwealth				
Snowy Mountains Hydro-Electric Authority	→	→	→	Snowy Mountains Hydro-Electric Authority

h On 1 July 1997, the Hydro-Electric Corporation (HEC) was separated into three businesses. The HEC continues to be responsible for generation, Transend Networks owns and operates Tasmania's transmission network and Aurora Energy is responsible for distribution.

The major driver for structural reform in the electricity industry has been a series of inter-governmental agreements, culminating in the National Competition Policy (NCP) agreements, aimed at establishing the competitive National Electricity Market (NEM).[1] The intention behind structural change within the electricity supply industry was to introduce competition in the generation and retail sectors by separating these contestable elements from the natural monopoly elements of transmission and distribution.[2] Of the jurisdictions monitored, only WA is not party to the NCP agreements on electricity.

In NSW, Pacific Power was restructured on 1 February 1995 into a transmission network and three generator businesses. Pacific Power's transmission activities were transferred to TransGrid and six of Pacific Power's power stations were transferred to two new generators — Delta Electricity and Macquarie Generation. On 2 August 2000, the remaining generation assets of Pacific Power were transferred to a new generation company, Eraring Energy.

In October 1995, NSW's 25 existing electricity distributors were amalgamated to form six new distribution businesses — Integral Energy, Advance Energy, Great Southern Energy, NorthPower, EnergyAustralia and Australian Inland Energy and Water.[3] On 1 July 2001, the NSW Government merged three distributors — Great Southern Energy, North Power and Advance Energy — to form Country Energy.

In Queensland, AUSTA Electric was horizontally separated into three generators — CS Energy, Stanwell Corporation and Tarong Energy — which commenced operating on 1 July 1997. At the same time, the Queensland Transmission and Supply Corporation's (QTSC) eight subsidiaries — seven regional distributors and the Queensland Electricity Transmission Corporation, trading as Powerlink — were established as independent government-owned corporations.

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1 In July 1991, governments agreed to work cooperatively to improve competitiveness in the electricity industry and the National Grid Council was established. In June 1993, six governments (Commonwealth, NSW, Victoria, Queensland, South Australia and ACT) committed to undertake reforms necessary to allow a competitive electricity market to commence from July 1995. At the April 1995 Council of Australian Governments meeting, these reforms were extended and brought within the NCP process.

2 An industry is considered to be a natural monopoly if total costs of production are lower when a single firm produces the entire industry output, than when two or more firms divide the total among themselves. It is generally accepted that electricity transmission and distribution networks exhibit some natural monopoly characteristics.

3 Australian Inland Energy and Water traded as Australian Inland Energy to 15 December 2000.

Three entirely new retail corporations were established and two of these merged to form Ergon Energy Pty Ltd.[4] Ergon Energy Pty Ltd was owned by six of the regional distribution corporations. On 30 June 1999, the six regional distributors amalgamated to form Ergon Energy Corporation, of which Ergon Energy Pty Ltd became a wholly-owned subsidiary.

The Queensland Power Trading Corporation (QPTC) was established to assist in the transition to the new industry structure by finalising a range of financial and administrative matters arising from the restructure of the QTSC. The QPTC was also involved in trading electricity generated by a number of private sector generators. Although originally established as a transitional body, the QPTC became Queensland's fourth generation GTE in June 1999. In July 1999, the QPTC was renamed Enertrade.

In WA, Western Power was established in 1995 as a government-owned corporation following the disaggregation of the State Energy Commission of WA.

In Tasmania, the Hydro-Electric Corporation (HEC) was restructured into three businesses on 1 July 1998. The HEC retained responsibility for generation, while the transmission network was transferred to Transend Networks and the retailing and distribution functions were transferred to Aurora Energy.

7.2 Market environment

Over the reporting period, the market environment in which GTEs operate changed in a number of ways — the most significant change being the continued development of the NEM.

The NEM is a wholesale market for the supply and purchase of electricity combined with an access regime for transmission and distribution networks in NSW, Victoria, Queensland, SA and ACT.[5]

The National Electricity Market Management Company (NEMMCO) was established in May 1996 to manage the NEM, in accordance with the National Electricity Code (the Code). The Code specifies the market arrangements that

4 Ergon Energy Pty Ltd was formed through a merger of the Northern Electricity Retail Corporation (Omega Energy) and Central Electricity Retail Corporation (Ergon Energy) in February 1998. The third electricity retailer was Energex.

5 The Queensland–NSW Interconnector (QNI) commenced operation in February 2001. This officially integrated the Queensland wholesale electricity market into the NEM. The Queensland wholesale electricity market commenced operating on 18 January 1998, based on the NEM operating framework.

govern the operation of the wholesale spot market, such as system security requirements, rules for bids and dispatch of generating capacity, and metering standards. The NEM officially commenced operating in December 1998, although trade between the NSW and Victorian wholesale markets commenced in May 1997.

As part of the development of the NEM, governments have progressively introduced choice of electricity supplier, starting with the largest users of electricity (see table 7.2).

The development of the NEM has a number of implications for GTE performance. Most electricity GTEs now face greater competition than they have in the past — through trade between wholesale electricity markets and the introduction of supplier choice in retail markets. There is also increased scope for competition with most jurisdictions adopting the access provisions of the Code for their distribution and transmission networks. These provisions give retailers and businesses purchasing wholesale electricity a right of access to these networks, facilitating their entry into the market.

With the introduction of the NEM, electricity GTEs and NEMMCO have had to come to terms with operating effectively in this new environment. There have been increases to wholesale electricity prices and significant price volatility in some parts of the NEM. For example, the average monthly spot price in NSW in the six months to June 2001 was around $39 MWh compared to $33 MWh and $25 MWh over the same period in 2000 and 1999 respectively. During 2000-01, the maximum monthly prices recorded in NSW ranged between $29 MWh and $121 MWh (NEMMCO 2001).

Volatility in wholesale electricity prices has resulted in greater exposure to risk for both generators and retailers. Consequently, trade in electricity derivatives has developed as a means of managing the financial risks associated with trading in wholesale markets.[6]

6 Electricity futures contracts based on wholesale market prices in the NSW and Victorian regions of the NEM are traded on the Sydney Futures Exchange.

Table 7.2 **Timetable for retail competition, by jurisdiction**

Jurisdiction	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*
New South Wales	>40 GWh (July)	>4 GWh (April) >750 MWh (July)	>160 MWh (July)			>100 MWh (January) >40 MWh (July)	All customers (January)
Victoria	>750 MWh (July)		>160 MWh (July)				All customers (January)
Queensland		>40 GWh (March)	>4 GWh (October)	>200 MWh (July)			
South Australia				>750 MWh (July)	>160 MWh (January)		
Australian Capital Territory		>20 GWh (October)	>4 GWh (March) >750 MWh (May) >160 MWh (July)			>100 MWh (January) >40 MWh (July)	All customers (January)
Western Australia		>88GWh (July)	>44 GWh (July)		>9 GWh (January)	>2 GWh (July)	
Northern Territory					>4 GWh (April) >3 GWh (October)	>2 GWh (April)	

Note 1000 KWh = 1 MWh, 1000 MWh = 1 GWh. Amounts refer the minimum annual electricity a customer must consume to be eligible to choose their supplier.

Source: GSE 2001; WA Energy 2002.

In January 2000, the NSW Government introduced the Electricity Tariff Equalisation Fund (ETEF) to reduce the market risk faced by retail suppliers of electricity. The ETEF is designed to allow the government to offer regulatory price protection to retail customers whilst ensuring that suppliers — who purchase electricity at the market spot price — are not exposed to unacceptable financial risk (NSW Treasury 2000). Essentially the ETEF operates to insulate NSW retailers and their customers from price movements in the NEM.[7]

Although WA is not party to the NEM, it has introduced choice in electricity supplier for large users of electricity under its commitments to NCP. In addition, the *Electricity Corporation Act 1994* provides for third-party access to Western Power's electricity transmission network.

Most of the monitored electricity GTEs continue to operate under some form of price regulation. For example, in NSW the Independent Pricing and Regulatory Tribunal (IPART) regulates distribution and electricity prices for franchise customers on behalf of the Australian Competition and Consumer Commission (ACCC). Prices to customers who use more than 160 MWh per year, are unregulated. IPART was also responsible for regulating the transmission network until July 1999, when this responsibility was transferred to the ACCC.

In Queensland, prices for franchise customers are set by the Treasurer, in his role as the Minister for Energy. The Treasurer was also responsible for regulating the prices charged for use of the transmission network, until the ACCC took over this responsibility in January 2002. The Queensland Competition Authority has had responsibility for distribution network prices since December 2000.

In Tasmania, the Office of the Tasmanian Electricity Regulator sets maximum charges for the generation, transmission and distribution of electricity, as well as maximum retail tariff prices.

On 8 December 2000, the Federal Parliament passed legislation supporting the implementation of a 2 per cent renewable energy target to increase the contribution of renewable energy sources to electricity supply in Australia (see DISR 2000). From 1 April 2001, energy wholesalers have had to purchase increasing amounts of electricity generated from renewable sources. Most electricity generation GTEs are

[7] The ETEF operates as follows. When the market price is higher than the energy cost component retailers may recover from regulated customers, retailers withdraw the difference from the fund, enabling them to earn a commercial return whilst selling at the regulated tariff. If the market price is lower, then retailers pay the difference into the fund. If the fund slips into deficit, then NSW government-owned generators pay into the fund, ensuring it is always in balance.

pursuing investment opportunities including cogeneration, wind and solar power to meet this target and also satisfy consumer demand for 'green' energy. For example, Pacific Power and Western Power constructed wind farms during 1999-00 and 2000-01 respectively.

7.3 Profitability

Profitability indicators provide information on how GTEs are using the assets vested in them by shareholder governments to generate earnings. For a more detailed discussion of profitability indicators, see chapter 3.

Profitability is influenced by a number of factors including prices, business volumes and expenses. Other factors, such as changes in asset values and capital restructuring, will also influence measures of profitability through the impact of depreciation and restructuring expenses.

Over the reporting period, the total asset base for the electricity GTEs has risen from $38 billion to almost $45 billion. This growth has not been consistent across GTEs. The asset base of distribution GTEs increased by 90 per cent over the reporting period, while generation GTEs' total assets fell by 20 per cent — mainly due to the transfer of functions and assets from integrated generators into new entities.

Asset values have also fallen over the reporting period for some GTEs, owing to asset write-downs. For example, Great Southern Energy has written-down assets each year since 1995-96. In other cases, asset revaluations have increased asset values. For example, Aurora Energy revalued its assets upwards in both 1998-99 and 1999-00.

The treatment of contributed assets can have a material effect on financial performance and asset and liability recognition. Where contributed assets are an issue, most GTEs indicate that they are now following Urgent Issue Group Consensus Views — Abstract 11, *Accounting for contributions of, or contributions for the acquisition of, non-current assets* and Abstract 17, *Developer and customer contributions in price regulated industries* — to recognise contributed assets.

The Productivity Commission's profitability measures have changed over the reporting period (see PC 2000, chapter 1), to nullify the impact of changes to the treatment of contributed assets on profitability ratios after 1997-98.

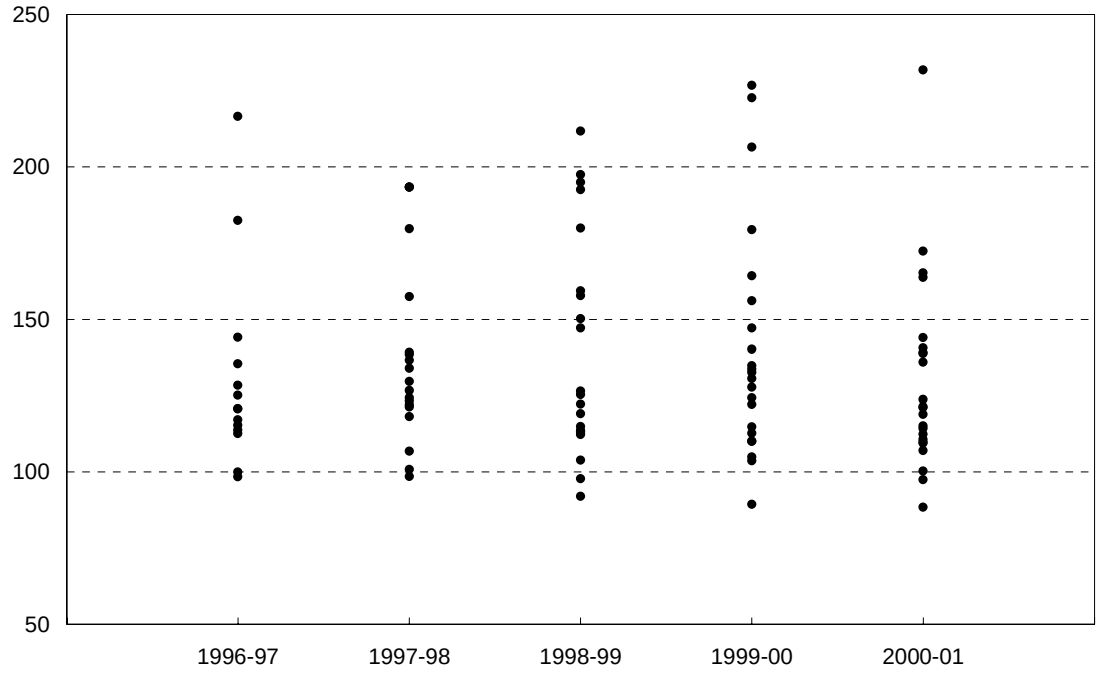
Operating profit (before tax) varied over the reporting period. Most of the electricity GTEs made positive operating profits; however, some incurred operating losses in their first year of operation.

The Snowy Mountains Hydro-Electric Authority (SMHEA) made an operating loss in each year of the reporting period. This largely reflects the way the Authority is funded and the impact of an asset revaluation in 1991.[8]

Over the reporting period, most electricity GTEs have recovered between 100 and 150 per cent of operating costs (see figure 7.1). Cost recovery measures the ability of a GTE to generate adequate revenue to meet expenses. A cost recovery ratio below 100 per cent suggests that a GTE is unable to meet its operating costs even before the cost of servicing debt is taken into account.

In 2000-01, three of the five highest cost recovery ratios were recorded by transmission GTEs, with TransGrid and Powerlink recording cost recovery ratios of over 150 per cent. Distribution GTEs, as a group, recorded the lowest average cost recovery ratio of 114 per cent.

Figure 7.1 **Cost recovery, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the cost recovery ratio for a government trading enterprise in that financial year. Cost recovery is the ratio of revenue from operations to expenses from operations. Revenue from operations is calculated by subtracting investment income and receipts from governments to cover deficits on operations from total revenue. Expenses from operations are calculated by subtracting gross interest expense from total expenses. Prior to 2000-01, abnormal items were also subtracted from operating expenses and revenue.

8 The SMHEA receives funding based on its net cost of production. Under its enabling legislation, additional depreciation charges resulting from the asset revaluation are not taken into account when determining the net cost of production.

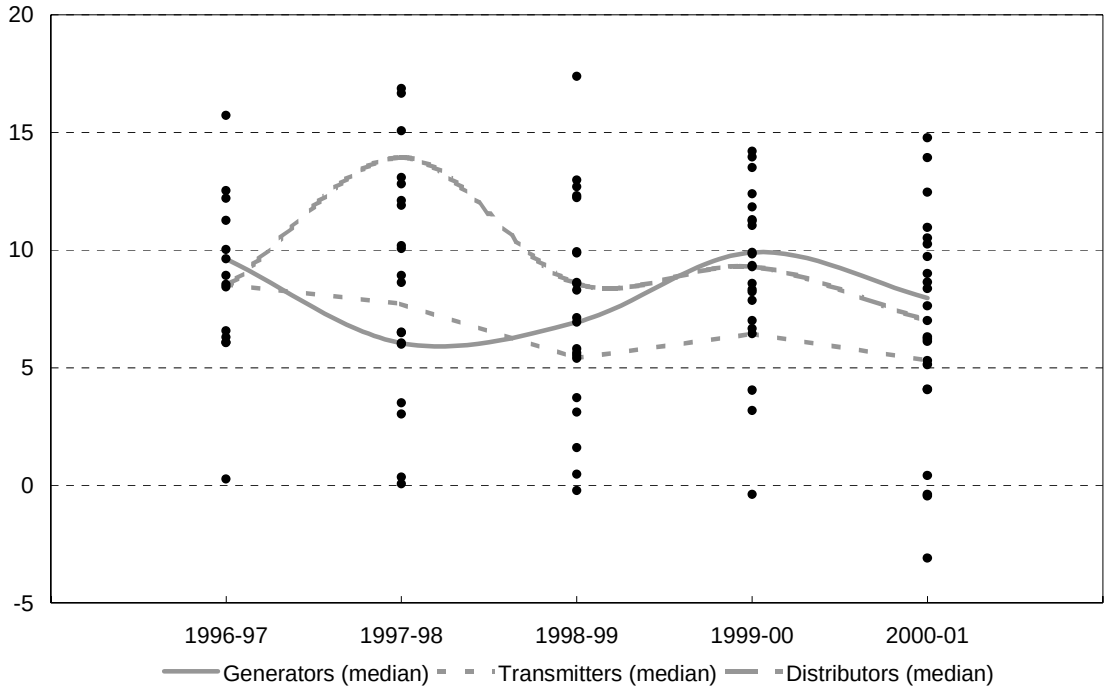
The SMHEA's cost recovery ratio was below 100 per cent throughout the reporting period and below 90 per cent in 1999-00 and 2000-01. Pacific Power's cost recovery ratio fell below 100 per cent in 1998-99 and in 2000-01. Enertrade's cost recovery ratio fell from 104 per cent in 1999-00, to 97 per cent in 2000-01.

While the average return on assets for all electricity GTEs has remained around 7 per cent each year, the performance of individual GTEs and different types of electricity GTEs is quite diverse (see figure 7.2). This variability reflects the influence of restructuring expenses, asset revaluations and the continuing development of the NEM. For example, the opening up of interconnectors and the introduction of retail contestability has affected the operating results of different GTEs at different times during the reporting period.

From 1998-99 to 2000-01, distribution GTEs reported the most consistent returns on assets, with most ranging from 4 to 10 per cent.

The variation in profitability with the sector is also reflected in the return on equity ratio. Most of the monitored electricity GTEs have had unstable return on equity ratios over the reporting period.

Figure 7.2 **Return on assets, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the return on assets ratio for a government trading enterprise (GTE) in that financial year. The trend lines show the median return for each type of electricity GTE over the period. Return on assets is the ratio of earnings before interest and tax (EBIT) to average total assets. EBIT is calculated by subtracting total expenses from total revenue (includes abnormals) and adding back gross interest expense. Average total assets are the average of the value of assets at the beginning and end of each financial year.

Taking into account the risks in the electricity sector, estimates of the weighted average cost of capital for electricity and gas distribution businesses by IPART, the NSW Treasury and others, suggest that a nominal pre-tax return of 8.5 per cent would be sufficient to meet the cost of capital (see IPART 1998). In 2000-01, only nine of the 23 monitored GTEs achieved this level of return on assets.

7.4 Financial management

Financial management indicators provide information about the capital structure of GTEs and their ability to meet the cost of servicing debt and other liabilities as they fall due. For a more detailed discussion of financial management indicators, see chapter 3.

As a part of the reform process, governments have, on occasion, imposed financial restructuring on their electricity GTEs. This has generally involved the transfer of both assets and liabilities to State and Territory governments, and the withdrawal of equity. Financial restructuring makes it difficult to undertake comparisons of financial performance over time.

In Queensland, Powerlink was required by its shareholding Ministers to make interest free loans (valued at $249 million) to the State in 1997-98, as part of a capital restructure. This resulted in a 90 per cent increase in debt. In 1998-99, $249 million of contributed equity was withdrawn, which resulted in an increase in the debt to equity, debt to total assets and total liabilities to equity ratios in 1998-99. Similar restructuring occurred during the last two years of the reporting period. In 1999-00, a non-interest bearing $150 million loan was made to the Queensland Government (funded by an increase in Powerlink debt). In 2000-01, contributed equity was reduced by the same amount, concluding the transaction.[9]

In 1997-98, the Queensland distributor Energex was directed to make interest free loans (valued at $300 million) to the Queensland Government, as part of a capital restructure. These were financed through an increase in Energex's long-term debt.

In 2000-01, over $3.5 billion in equity was returned to the NSW Government from the six NSW distribution GTEs, Delta Electricity, Macquarie Generation and the transmission company TransGrid. The GTEs increased their borrowings by a commensurate amount to pay for this return. This policy initiative affected debt

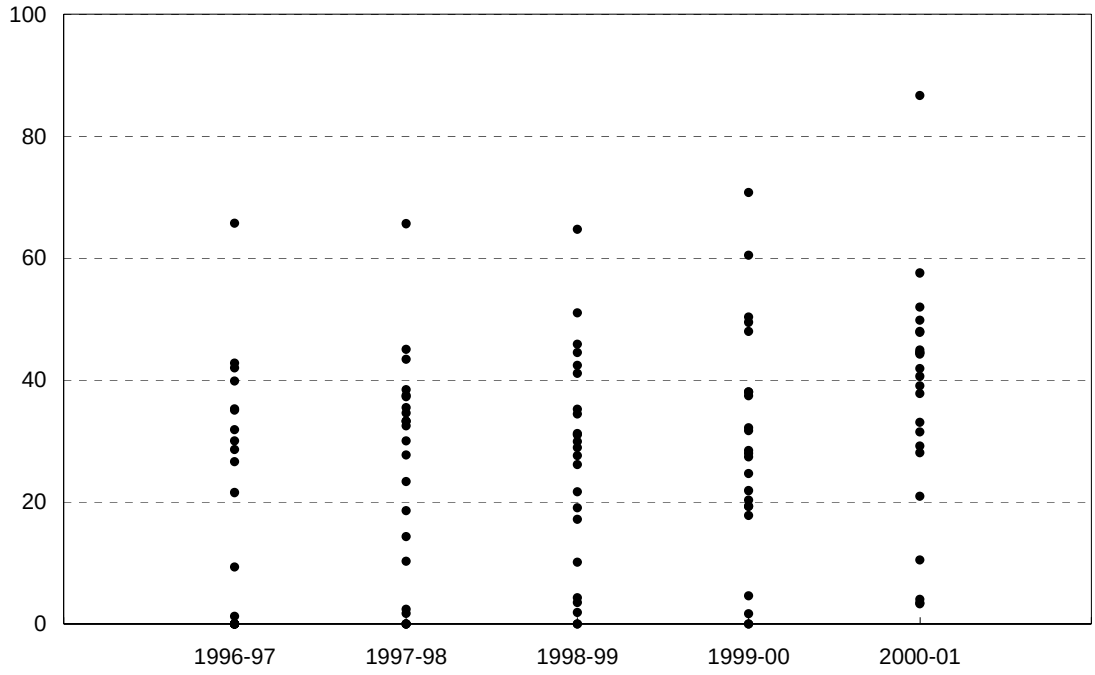
9 These arrangements are analogous to an equity for debt swap (such as those undertaken in 2000-01 between NSW electricity GTEs and the NSW Government). The swaps took place over a two year period, where the government was 'paid' for its return of equity one year prior to actually relinquishing the equity.

levels and borrowing costs, as well as financial management indicators including, debt to equity, debt to total assets, interest cover and leverage ratios.

A number of electricity GTEs have reduced their debt levels through financial restructuring, which has allowed them to reduce repayment periods and to negotiate improved interest terms. For example, during 1999-00 and 2000-01, the HEC terminated loans with a face value of $317 million and interest rate swaps of $898 million prior to maturity — reducing their borrowing costs by 20 per cent from 1998-99 levels.

Most of the electricity GTEs have debt to total asset ratios within the 20 to 50 per cent range (see figure 7.3). In 2000-01, generation GTEs had an average debt to total assets ratio of around 30 per cent, with transmission and distribution GTEs both around 45 per cent.

Figure 7.3 **Debt to total assets, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the debt to total assets ratio for a government trading enterprise in that financial year. Debt is defined to include all repayable borrowings (interest bearing and non-interest bearing), interest bearing non-repayable borrowings and finance leases. Average total assets are the average of the value of assets at the beginning and end of each financial year.

In 2000-01, only five electricity GTEs had an interest cover of over three times — down from 13 in 1999-00. Three GTEs had negative interest cover. Although most of the GTEs had positive interest cover, there does not appear to be a large margin to insulate the GTEs from increases in interest rates or falling revenues. Higher

interest rates or reduced revenues could see the GTEs unable to meet their current interest commitments from current earnings.

7.5 Financial transactions

As part of the reform process, governments have sought to give GTEs a greater commercial focus and facilitate competitive neutrality by exposing them to incentives and regulations similar to those faced by private sector businesses. For a more detailed discussion of competitive neutrality principles, see chapter 3.

The introduction of income tax-equivalent regimes, requirements to pay dividends and debt guarantee fees are examples of how governments have imposed the principles of competitive neutrality on their electricity GTEs.

Over the reporting period, an increasing number of electricity GTEs have been required to make tax-equivalent and dividend payments. Most now make such payments. An exception is the SMHEA which operates on a cost recovery basis and is not required to make dividend or tax-equivalent payments.

Prior to 1999-00, tax-equivalent payments were based on a company tax rate of 36 per cent. Under tax-effect accounting, income tax-equivalent expense for any year may differ from the actual amount of tax paid to the State and Territory governments for that year because of permanent and timing differences. Changes in the company tax rate introduced by the Commonwealth Government in December 1999 led to the restatement of deferred tax liabilities in 1999-00.[10] As a result of this adjustment, tax-equivalent payments by electricity GTEs in 1999-00 were reduced by $240 million (36 per cent).

Dividend payments represent a return on shareholder funds and their size reflects financial performance. There has been significant variation in the level of dividends paid or provided for by GTEs over the reporting period, reflecting annual variations in profitability. In 2000-01, NSW electricity GTEs paid $410 million in dividend payments, Queensland GTEs paid $613 million, whilst Tasmanian and WA GTEs returned $70 million and $94 million respectively.

As part of the reform process, governments moved to identify, cost and fund community service obligations (CSOs) provided by electricity GTEs. Several of the electricity GTEs received CSO funding over the reporting period. Generally, retailers meet these obligations although there are some examples of CSOs being paid to generation GTEs. CSO funding has been received for the provision of

[10] The company tax rate fell to 34 per cent for 2000-01 and then to 30 per cent from 2001-02.

rebates, concessions, the uneconomic supply of electricity to some customers and for electrical inspections.

The total level of CSO payments to electricity GTEs increased up to 1998-99, but declined in the latter part of the reporting period. In 2000-01, CSO payments to electricity GTEs amounted to almost $320 million, the majority going to distribution GTEs.[11]

11 This figure was the amount disclosed by the GTEs in their annual reports. Some GTEs did not separately disclose the value of CSO payments made to them during 2000-01. These undisclosed payments have not been included in the total.

7.6 GTE performance reports

Delta Electricity (NSW)
Macquarie Generation (NSW)
Pacific Power (NSW)
Eraring Energy (NSW)
TransGrid (NSW)
Advance Energy (NSW)
Australian Inland Energy and Water (NSW)
EnergyAustralia (NSW)
Great Southern Energy (NSW)
Integral Energy (NSW)
NorthPower (NSW)
CS Energy (Queensland)
Stanwell Corporation (Queensland)
Tarong Energy (Queensland)
Enertrade (Queensland)
Powerlink (Queensland)
Ergon Energy (Queensland)
Energex (Queensland)
Western Power (WA)
Hydro-Electric Corporation (Tasmania)
Aurora Energy (Tasmania)
Transend Networks (Tasmania)
Snowy Mountains Hydro-Electric Authority (Commonwealth)

DELTA ELECTRICITY — New South Wales

Delta Electricity (Delta) was established as a government-owned corporation in March 1996, following a restructure of the NSW electricity industry. Delta generates electricity for sale into the National Electricity Market (NEM), operating four power stations with a combined generating capacity of 4240 MW. Delta is subject to the provisions of the *Energy Services Corporations Act 1995* and the *State Owned Corporations Act 1989* (SOC Act).

Pre-tax operating profit improved by 19 per cent in 2000-01, with a 12 per cent increase in revenue offsetting a 10 per cent rise in expenditure. Revenues increased mainly due higher wholesale prices — generally attributable to the opening of the Queensland–NSW Interconnector — and greater plant reliability.

In 2000-01, Delta returned $380 million in contributed equity to the NSW Government. The return was paid for with borrowings, increasing the level of Delta's debt by a commensurate amount. Overall, debt increased by almost 110 per cent in 2000-01, the first time debt has increased over the reporting period.

The capital restructure affected several financial performance ratios, notably return on equity, debt to equity, debt to total assets, total liabilities to equity and leverage ratios, all of which increased. If the effects of the restructure are factored out, the debt to equity, debt to total assets and leverage ratios would have been lower than their 1999-00 levels.

Under the provisions of the SOC Act, Delta is required to make tax-equivalent and dividend payments to the NSW Government. In 2000-01, the dividend payment included a $10 million special dividend.

In 1997-98, Delta received $5.4 million in community service obligation (CSO) payments from the NSW Government for subsidised sales contracts assigned to Delta on its establishment. It has received no other CSO income over the reporting period.

DELTA ELECTRICITY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*	*1998-99*	*1999-00*[b]	*2000-01*[c]
Size						
Total assets	$m	1 495	1 337	1 361	1 492	1 555
Total revenue	$m	701	573	574	674	757
Profitability						
Operating profit before tax (includes abnormals)	$'000	131 232	54 636	60 684	158 671	188 072
Operating sales margin	%	25.3	15.3	16.0	28.0	28.9
Cost recovery	%	100.0	118.1	119.0	133.6	140.6
Return on assets	%	12.5	6.5	6.9	13.5	14.8
Return on equity	%	3.1	4.5	5.3	16.1	23.2
Financial management						
Debt to equity	%	73.4	58.8	57.8	46.2	190.3
Debt to total assets	%	35.1	30.0	31.2	24.6	48.0
Total liabilities to equity	%	110.2	85.2	87.0	96.1	304.8
Interest cover	times	3.4	2.5	2.9	5.7	6.1
Current ratio	%	81.5	117.5	96.4	134.3	127.1
Leverage ratio	%	210.2	185.2	187.0	196.1	404.8
Payments to and from government						
Dividends	$'000	180 150	21 402	32 695	86 653	119 740
Dividend to equity ratio	%	26.0	3.0	4.5	11.6	20.9
Dividend payout ratio	%	849.6	67.1	85.0	72.4	90.0
Income tax expense	$'000	11 0029	22 733	22 218	38 966	55 028
CSO funding	$'000	0	5400[d]	0	0	0

a A number of the ratios reflect the impact of three Cross-Border Lease transactions relating to the Mt Piper Power Station, whereby the facility was leased to the State of NSW and sub-leased back to Delta Electricity. **b** Includes an abnormal gain of $25.7 million related to asset surpluses in superannuation funds. A fall in the future company tax rate reduced tax-equivalent payments by $18.4 million. **c** Delta Electricity returned $380 million in contributed equity to the NSW Government. The return was paid for with additional borrowings, increasing the level of debt by a commensurate amount. **d** Delta Electricity received $5.4 million in community service obligation funding for subsidised sales contracts assigned on its establishment.

MACQUARIE GENERATION — New South Wales

Macquarie Generation was established as a government-owned corporation in March 1996, following a restructure of the NSW electricity industry. The company generates electricity for sale into the National Electricity Market (NEM) and currently operates two coal-fired power stations with a combined generating capacity of 4640 MW. Macquarie is subject to the provisions of the *Energy Services Corporations Act 1995* (ESC Act) and the *State Owned Corporations Act 1989* (SOC Act).

In 2000-01, operating profit (before tax) rose by over $78 million, owing to increased revenue from electricity sales and a slight decline in expenditure.[1] Increases in revenue since 1997-98 have been mainly the result of rising wholesale prices for electricity.

Macquarie Generation returned $240 million in contributed equity to the NSW Government in 2000-01. The return was paid for with additional borrowings, increasing the level of Macquarie's debt. Overall, debt increased by 15 per cent in 2000-01 to almost $940 million. This was the first time debt had increased over the reporting period.

The capital restructure affected several financial performance ratios, notably return on equity, debt to equity, debt to total assets, total liabilities to equity and leverage ratios, all of which increased. If the effects of the restructure are factored out, these ratios — except for return on equity — would have been lower in 2000-01 than in 1999-00.

Under the provisions of the SOC Act, Macquarie Generation is required to make tax-equivalent and dividend payments. Dividend payments are made in accordance with the share dividend scheme, which is determined by the voting shareholders and as required by the ESC Act.

Until 1999-00, the NSW Government provided Macquarie Generation with funding for the provision of community service obligations. Macquarie Generation was reimbursed for the full cost of providing rebates and subsidies to certain customers in line with NSW Government policy decisions. Community service obligations (and funding) ceased on 5 December 1999.

1 In 1999-00, Macquarie Generation terminated a long-term coal supply contract. This allowed the company to purchase coal at the prevailing market price. Macquarie Generation estimated this would save it $25 million annually until 2008-09.

MACQUARIE GENERATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*	*1999-00*[a]	*2000-01*[b]
Size						
Total assets	$m	2 260	2 199	2 138	2 158	2 065
Total revenue	$m	866	696	719	733	808
Profitability						
Operating profit before tax, (includes abnormals)	$'000	173 817	53 518	70 141	65 134	143 230
Operating sales margin	%	30.9	19.2	21.3	19.2	26.4
Cost recovery	%	144.2	123.3	126.5	132.5	135.9
Return on assets	%	11.3	6.0	7.1	6.7	10.3
Return on equity	%	12.0	3.7	4.7	6.3	12.7
Financial management						
Debt to equity	%	108.4	107.3	98.6	86.9	135.2
Debt to total assets	%	42.0	45.0	42.4	38.0	44.5
Total liabilities to equity	%	144.4	135.3	129.6	129.5	197.2
Interest cover	times	2.8	1.7	1.8	1.8	3.0
Current ratio	%	43.8	73.4	44.4	81.3	54.3
Leverage ratio	%	244.4	235.3	229.6	229.5	297.2
Payments to and from government						
Dividends	$'000	125 000	35 000	40 000	50 000	100 000
Dividend to equity ratio	%	13.5	3.8	4.3	5.3	12.2
Dividend payout ratio	%	112.4	100.9	91.6	84.4	96.5
Income tax expense	$'000	62 591	18 840	26 468	5 918	39 597
CSO funding	$'000	2 891	20 336	18 153	7 854	0[c]

a Abnormal revenue relating to investment returns on externally managed superannuation funds of $18.8 million was reported. This was offset by an abnormal loss of $53.2 million due to the termination of a long-term coal supply contract. The fall in income tax-equivalent payments reflects a $17.6 million downward adjustment due to a reduction in the future company tax rate. **b** Macquarie returned $240 million in contributed equity to the NSW Government. The return was paid for with additional borrowings, increasing the level of debt by a commensurate amount. **c** Community service obligations (and funding) ceased on 5 December 1999.

PACIFIC POWER — New South Wales

Pacific Power is a statutory authority established by the *Electricity (Pacific Power) Act 1950*. Up to 2000-01, Pacific Power's primary business was power generation, which accounted for almost half of total revenues in 1999-00. Pacific Power's energy generation activities ceased on 31 July 2000.

On 2 August 2000, the generation assets of Pacific Power were transferred to Eraring Energy. Eraring was established on 1 July 2000 through a regulation made under the *Energy Services Corporations Act 1995*. This left Pacific Power with two major businesses, Pacific Power International — an energy services and engineering enterprise — and Powercoal, an underground coal miner.[1]

The transfer of generation assets to Eraring had a significant impact on Pacific Power's financial position. Total assets were reduced by $1.2 billion and liabilities declined by almost $880 million. Debt levels in 2000-01 were just 9 per cent of those in the previous year.

Pacific Power's operating result in 2000-01 reflects the impact of the asset transfer. Operating expenses fell 20 per cent and revenue declined by 35 per cent. Due to the magnitude of Pacific Power's restructure, performance and financial management indicators are largely incomparable to previous years in the reporting period.

Pacific Power is required to make tax-equivalent and dividend payments. Despite making an operating loss in 1998-99, Pacific Power was required to make a special dividend payment. This payment was made under an agreement with the NSW Government. Under this agreement, Pacific Power received a fee to offset any costs associated with managing transitional issues related to the restructure of generation in 1996 and was required to make a special dividend payment equivalent to this fee.[2] No dividend payment was made in 2000-01.

Pacific Power has not been required to perform any community service obligations by the NSW Government over the reporting period.

1 Pacific Power is also a majority shareholder in Pacific Solar — a solar power development company — and Mt Arthur South Coal Pty Ltd. Pacific Power retains revenue entitlements to 58 per cent of the output from the Snowy Hydro generation network.

2 Pacific Power has not paid a dividend based on operating profit since 1996-97.

PACIFIC POWER (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*	*1998-99*	*1999-00*[b]	*2000-01*[c]
Size						
Total assets	$m	2 139	2 148	2 125	2 238	511
Total revenue	$m	937	785	865	1 005	636
Profitability						
Operating profit before tax (includes abnormals)	$'000	152 376	25 767	-39 274	149 603	-37 415
Operating sales margin	%	22.5	9.0	0.9	21.3	-4.8
Cost recovery	%	128.4	106.7	97.7	140.2	95.4
Return on assets	%	9.6	3.5	0.5	9.9	-1.9
Return on equity	%	8.4	0.9	-2.0	13.0	-11.5
Financial management						
Debt to equity	%	65.5	69.7	67.0	56.7	26.8
Debt to total assets	%	28.6	33.3	31.0	27.4	4.0
Total liabilities to equity	%	106.6	110.0	115.0	112.3	146.7
Interest cover	times	3.0	1.5	0.2	3.3	-2.2
Current ratio	%	66.7	90.0	72.2	115.6	183.5
Leverage ratio	%	206.6	210.0	215.0	212.3	246.7
Payments to and from government						
Dividends[d]	$'000	219 937	21 982	27 660	31 573	0
Dividend to equity ratio	%	22.8	2.1	2.8	3.1	0
Dividend payout ratio	%	271.7	232.1	-138.0	23.8	0
Income tax expense	$'000	71 422	16 298	-19 230	16 746	35 151
CSO funding	$'000	0	0	0	0	0

a Includes abnormal revenue of $399 million associated with a reduction in the provision for employee accrued entitlements which were assumed by the Crown. **b** Abnormal expenses related to Powercor prior year loss and legal expenses ($49.4 million), insurance provision for asbestos claims ($40.4 million), write-down of leasehold improvements ($0.9 million), year 2000 costs ($3.4 million) and recognition of deferred hedge losses ($2.2 million). Abnormal revenue related to overfunded superannuation ($128.8 million), legal settlement ($11.2 million) and inter-pool settlement surpluses ($6.6 million). Operating power stations were revalued on 30 June prior to transfer to Eraring Energy. The revaluation resulted in a fall in the value of assets of $89.8 million. **c** On 2 August 2000, the generation assets of Pacific Power were transferred to Eraring Energy. As a result total assets were reduced by $1.2 billion and total liabilities declined by almost $880 million. **d** Pacific Power has not paid a dividend based on operating profit since 1996-97. Dividends paid since 1997-98 are a transfer equivalent to 100 per cent of fees received by Pacific Power to manage transitional issues relating to the restructure of generation. No dividend was paid in 2000-01.

ERARING ENERGY — New South Wales

Eraring Energy (Eraring) was established on 1 July 2000 through the *Energy Services Corporations (Eraring Energy) Regulation 2000*. On 2 August 2000, the company commenced operations following the transfer of generation assets, staff, rights and liabilities from Pacific Power. Eraring operates within the framework of the *Energy Services Act 1995* (ESC Act) and the *State Owned Corporations Act 1989* (SOC Act).

Eraring controls generation assets with a capacity of 3073 MW, from coal, hydro, gas and wind electricity plants — the largest being the Eraring coal-fired power station which provides 86 per cent of the company's output. Eraring has a wholly-owned subsidiary, Pacific Western, which operates the Collie Power Station in Western Australia, under contract to Western Power.

In its first year of operation, Eraring achieved a pre-tax operating profit of $36.8 million. Return on assets was 12.4 per cent, and return on equity was 5.4 per cent, compared to mean returns from the other NSW generators in 2000-01, of 8.9 per cent and 9.7 per cent.

Under the provisions of the SOC Act, Eraring is required to make tax-equivalent and dividend payments. Dividend payments are made in accordance with the share dividend scheme, which is determined by the voting shareholders and as required by the ESC Act. In 2000-01, Eraring returned over $32 million to the NSW government in tax-equivalent and dividend payments.

Eraring received $125 000 in community service obligation payments from the NSW Government in 2000-01.

ERARING ENERGY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*	*1999-00*	*2000-01*
Size						
Total assets	$m	n.r.	n.r.	n.r.	n.r.	1 319
Total revenue	$m	n.r.	n.r.	n.r.	n.r.	463
		n.r.	n.r.	n.r.	n.r.	
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	n.r.	n.r.	36 812
Operating sales margin	%	n.r.	n.r.	n.r.	n.r.	17.6
Cost recovery	%	n.r.	n.r.	n.r.	n.r.	121.3
Return on assets	%	n.r.	n.r.	n.r.	n.r.	12.4
Return on equity	%	n.r.	n.r.	n.r.	n.r.	5.4
		n.r.	n.r.	n.r.	n.r.	
Financial management						
Debt to equity	%	n.r.	n.r.	n.r.	n.r.	28.1
Debt to total assets	%	n.r.	n.r.	n.r.	n.r.	37.8
Total liabilities to equity	%	n.r.	n.r.	n.r.	n.r.	49.0
Interest cover	times	n.r.	n.r.	n.r.	n.r.	1.8
Current ratio	%	n.r.	n.r.	n.r.	n.r.	72.2
Leverage ratio	%	n.r.	n.r.	n.r.	n.r.	149.0
Payments to and from government						
Dividends	$'000	n.r.	n.r.	n.r.	n.r.	19 479
Dividend to equity ratio	%	n.r.	n.r.	n.r.	n.r.	4.4
Dividend payout ratio	%	n.r.	n.r.	n.r.	n.r.	80.8
Income tax expense	$'000	n.r.	n.r.	n.r.	n.r.	12 716
CSO funding	$'000	n.r.	n.r.	n.r.	n.r.	125

n.r. Not relevant.

TRANSGRID — New South Wales

TransGrid was established under the *Electricity Transmission Authority Act 1994* and became a corporatised entity, under the *State Owned Corporations Act 1989* on 14 December 1998. TransGrid is responsible for the management and development of the NSW high voltage electricity transmission network. It transmits power between generators, bulk distributor corporations, some direct customers and to Victoria, South Australia and Queensland through the National Electricity Market (NEM).[1]

In 2000-01, TransGrid returned $260 million of equity to the NSW Government as part of a capital restructure. The return was paid for with borrowings, increasing the level of TransGrid's debt. As part of the restructure, TransGrid incurred an additional expense of $162 million relating to the prepayment of its existing debt portfolio.[2]

The combination of the capital restructure and the restructuring expense significantly affected the corporation's financial performance in 2000-01. Debt to equity, debt to total assets, total liabilities to equity and leverage ratios, all increased as a result of the swap. TransGrid's negative operating result and lower returns on equity and assets were mainly due to the restructuring expense.

Total assets have increased throughout the reporting period due to ongoing capital expenditure to augment the existing transmission network. In 2000-01, TransGrid's asset base grew by 7 per cent compared to the previous year. The completion of the Queensland–NSW Interconnector in December 2000 — which improved Queensland's integration into the NEM — accounted for most of the company's capital expenditure in 2000-01.

TransGrid has made tax-equivalent and dividend payments over the reporting period, however no dividend was required by the shareholder in 2000-01. TransGrid has not been required to provide any community service obligations by the NSW Government over the reporting period.

1 Following the initial establishment of the NEM during 1996-97, TransGrid had the role of market and system operator for NSW, responsible for the development and operation of the NSW wholesale electricity market. This role was subsequently transferred to the National Electricity Market Management Company in December 1998.

2 The prepayment relates to debt inherited from Pacific Power. The loss was non-deductible for income tax purposes.

TRANSGRID (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*	*1998-99*[b]	*1999-00*[c]	*2000-01*[d]
Size						
Total assets	$m	2 115	2 095	2 238	2 392	2 550
Total revenue	$m	386	374	371	354	360
Profitability						
Operating profit before tax (includes abnormals)	$'000	78 309	95 765	90 487	152 763	-84 968
Operating sales margin	%	46.9	50.0	48.1	64.1	-3.3
Cost recovery	%	182.4	193.4	192.5	226.8	172.4
Return on assets	%	8.5	8.9	8.3	9.8	-0.4
Return on equity	%	4.4	5.5	4.9	10.4	-9.6
Financial management						
Debt to equity	%	79.8	71.4	60.8	64.8	121.1
Debt to total assets	%	39.8	37.4	35.2	37.4	52.0
Total liabilities to equity	%	97.9	89.7	78.2	78.9	140.4
Interest cover	times	1.7	2.0	2.0	3.0	-0.1
Current ratio	%	45.1	106.1	49.9	160.4	73.4
Leverage ratio	%	197.9	189.7	178.2	178.9	240.4
Payments to and from government						
Dividends	$'000	54 963	49 616	54 105	54 623	0
Dividend to equity ratio	%	5.1	4.6	4.6	4.2	0
Dividend payout ratio	%	115.7	82.8	92.8	40.6	0
Income tax expense	$'000	30 812	35 848	32 164	18 345	29 567
CSO funding	$'000	0	0	0	0	0

a During 1996-97, TransGrid was the market and system operator responsible for the development and operation of the NSW wholesale electricity market. TransGrid was required to collect and pay monies associated with the market's operation. With the exception of network charges and market fees, these monies are excluded from TransGrid's financial statements. Market and system operation was transferred to the National Electricity Market Management Company in December 1998. **b** TransGrid's grid infrastructure assets were revalued using the optimised depreciated replacement cost methodology. This resulted in an increase in the value of infrastructure assets of $152.8 million. **c** Includes an abnormal gain of $65.7 million due to previous overfunding of superannuation contributions. A change in accounting policy in accordance with accounting standards led to interest on some capital expenditure being capitalised. Income tax-equivalent payments were adjusted downwards by $10.8 million due to a reduction in the future company tax rate. **d** In 2000-01, TransGrid returned $260 million of contributed equity the NSW Government as part of a capital restructure. Debt increased by a commensurate amount. As part of the restructure, TransGrid incurred a loss of $162 million due to prepayment of its existing debt portfolio.

ADVANCE ENERGY — New South Wales

Advance Energy was established as a government-owned electricity distributor and retailer on 1 March 1996. Advance Energy operated under the *Energy Services Act 1995* and the *State Owned Corporations Act 1989*. On 1 July 2001, the NSW Government merged Advance Energy, NorthPower and Great Southern Energy to form Country Energy.

Operating profit (before tax) rose 8 per cent in 2000-01, due mainly to an 11 per cent increase in revenue, compared to 1999-00. Higher revenues were partly due to retail price increases in accordance with determinations from the Independent Pricing and Regulatory Tribunal (IPART).[1]

In 2000-01, Advance Energy returned $190 million in contributed equity to the NSW Government. The return was paid for with borrowings, increasing the level of Advance Energy's debt by a commensurate amount. Overall, debt grew by over 500 per cent while borrowing costs rose by $14.8 million or 565 per cent from the previous year.

Financial indicators were significantly affected by the capital restructure. Debt to equity, debt to total assets, total liabilities to equity and leverage ratios all rose significantly, whilst interest cover and the current ratio fell compared to 1999-00 levels.

Advance Energy is required to make both tax-equivalent and dividend payments. Income tax-equivalent payments were reduced by almost 70 per cent in 2000-01, mainly through deductions due to the prepayment of superannuation contributions.

Advance Energy receives funding for the provision of community service obligations (CSOs) from the NSW Government. These CSOs take the form of rebates and financial assistance to certain groups in the community.[2]

1 Advance Energy operates under a revenue cap determined by the IPART. In December 1999, IPART set revenue caps for the period to June 2004. The determination provides for an average real price decrease of 16 per cent during the period. Prices for customers using above 160 MWh of electricity per annum are unregulated.

2 Advance Energy internally funds losses incurred through installation and inspection services and in supplying electricity to customers connected on uneconomic lines.

ADVANCE ENERGY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*	*1999-00*[b]	*2000-01*
Size						
Total assets	$m	341	367	379	391	419
Total revenue	$m	199	219	230	272	301
Profitability						
Operating profit before tax (includes abnormals)	$'000	24 811	43 897	24 354	20 276	21 896
Operating sales margin	%	13.6	21.0	11.8	8.5	13.1
Cost recovery	%	117.0	124.3	113.4	110.0	115.0
Return on assets	%	8.4	16.7	12.3	9.3	13.9
Return on equity	%	6.3	17.5	7.8	7.8	13.1
Financial management						
Debt to equity	%	13.2	17.7	17.8	19.5	314.0
Debt to total assets	%	9.3	14.3	19.1	19.3	86.6
Total liabilities to equity	%	45.6	62.4	57.8	57.6	429.4
Interest cover	times	9.3	17.3	8.4	7.4	2.2
Current ratio	%	106.8	82.7	89.6	81.9	78.4
Leverage ratio	%	145.6	162.4	157.8	157.6	529.4
Payments to and from government						
Dividends	$'000	17 963	37 568	3 773	11 150	2 223
Dividend to equity ratio	%	7.8	16.3	1.6	4.6	1.4
Dividend payout ratio	%	124.9	93.6	20.7	58.9	10.4
Income tax expense	$'000	10 434	3 766	6 130	1 330	423
CSO funding	$'000	2 318	2 466	2 464	2 495	2 548

a Capital contributions by customers are included in total revenue for the first time. Capital contributions are recognised in the year they become receivable or are received. Contributions received at balance date but for which no work has been undertaken are recorded as a liability. **b** Includes abnormal expense of $1.6 million relating to a backpayment for sales tax. Tax-equivalent payments were reduced by $2.7 million as a result of a fall in the future company tax rate.

AUSTRALIAN INLAND ENERGY AND WATER — New South Wales

Australian Inland Energy and Water (AIEW) was established on 1 March 1996, as a government-owned electricity distributor and retailer, under the *State Owned Corporations Act 1989*. Up to 1999-00, AIEW traded as Australian Inland Energy (AIE), providing energy services in the far west and south-west of NSW. On 15 December 2000, it merged with the Broken Hill Water Board and was renamed AIEW upon receipt of the board's infrastructure and water supply functions.

The *Electricity Supply Act 1995* (and its regulations) and the National Electricity Code govern AIEW's electricity operations.

The December 2000 merger was the most influential factor on AIEW's operations and financial performance in 2000-01, with the workforce doubling and assets increasing by $77.5 million. Total revenues and expenses were also affected, rising by 40 per cent and 75 per cent respectively.

AIEW operates under a revenue cap as determined by the Independent Pricing and Regulatory Tribunal (IPART).[1] Prices for customers using above 160 MWh of electricity per annum are not regulated.

Prior to 2000-01, the predecessor AIE was debt free. Following the merger, borrowings rose to $3.6 million. The level of indebtedness remains very low — in comparison to other electricity distribution GTE's — with debt to equity and debt to total asset ratios both around 3 per cent.

Since 1996-97, AIEW and its predecessors have made tax-equivalent and dividend payments.

AIEW receives community service obligation (CSO) payments from the NSW Government to compensate for the supply of electricity to sparsely populated areas. The value of this CSO has been $5.3 million over the reporting period.

Under the *Water Management Act 2000*, deficiencies in the water segment of AIEW are borne by the Treasurer and the Broken Hill mining companies. In 2000-01, a subsidy of $2.6 million was received — $2 million of which came from the mining companies.

1 In December 1999, IPART set revenue caps for the period to June 2004. The determination provides for an average real price decrease of 16 per cent during the period.

AUSTRALIAN INLAND ENERGY AND WATER (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*[a]	*1999-00*[b]	*2000-01*[c]
Size						
Total assets	$m	53	58	63	67	154
Total revenue	$m	38	38	39	37	52
Profitability						
Operating profit before tax (includes abnormals)	$'000	7 721	11 312	13 174	9 261	4 351
Operating sales margin	%	19.1	28.1	32.0	23.0	6.5
Cost recovery	%	120.6	136.6	147.1	124.2	107.0
Return on assets	%	15.7	20.2	21.7	14.2	4.1
Return on equity	%	11.8	18.7	21.3	13.2	3.5
Financial management						
Debt to equity[d]	%	n.r.	n.r.	n.r.	n.r.	2.8
Debt to total assets[d]	%	n.r.	n.r.	n.r.	n.r.	3.3
Total liabilities to equity	%	31.6	31.0	30.9	29.0	17.4
Interest cover[d]	times	n.r.	n.r.	n.r.	n.r.	32.5
Current ratio	%	231.0	290.1	278.7	184.7	166.4
Leverage ratio	%	131.6	131.0	130.9	129.0	117.4
Payments to and from government						
Dividends	$'000	3 100	3 583	5 721[e]	2 670	1 112
Dividend to equity ratio	%	8.0	8.4	12.3	5.3	1.2
Dividend payout ratio	%	67.6	45.0	57.9	40.4	34.2
Income tax expense	$'000	3 132	3 341	3 296	2 652	1 098
CSO funding[f]	$'000	5 300	5 300	5 300	5 300	5 300

a Dividend payment includes an additional payment of $2.2 million relating to the construction of the Balranald substation. This payment matched the NSW Government's subsidy for the construction of the substation. **b** Includes abnormal revenue of $1.6 million representing a prepayment of employer contributions for superannuation. **c** Australian Inland Energy merged with the Broken Hill Water Board in December 2000 and was renamed Australian Inland Energy and Water (AIEW). Assets increased by $77.5 million as result of the merger. Under the *Water Management Act 2000*, deficiencies in the water segment of AIEW are borne by the Treasurer and the Broken Hill mining companies. In 2000-01, a subsidy of $2.6 million was received by AEIW for these deffeciencies. **d** Australian Inland Energy did not hold any debt. Therefore the indicators could not be calculated up to 1999-00. The new body, AEIW, holds $3.6 million of debt. **e** Includes an additional dividend of $2.2 million relating to the construction of the Balranald substation. **f** AIEW receives community service obligation (CSO) payments from the NSW Government to compensate for the supply of electricity to sparsely populated areas. The value of this CSO has been $5.3 million over the reporting period. **n.r.** Not relevant.

ENERGYAUSTRALIA — New South Wales

EnergyAustralia is a government-owned corporation, which distributes and retails electricity and gas throughout NSW. Its electricity distribution network covers over 22 275 square kilometres. EnergyAustralia operates under the *Energy Services Act 1995* and the *State Owned Corporations Act 1989*. EnergyAustralia owns four subsidiary businesses — Customer Service, Retail and Marketing, Eneserve and Network.

EnergyAustralia's total assets grew by $1.4 billion in 2000-01, primarily due to a revaluation of non-current, physical assets during the year. Depreciation expenses grew as a result of the upward revaluation. Capital expenditure of $254 million also contributed to the asset increase.

Revenue grew 5 per cent in 2000-01, due mainly to a 4 per cent increase in demand for electricity.[1] Despite this improvement, pre-tax operating profit fell by $155 million — 40 per cent lower than 1999-00 — due mainly to higher operating, deprecation and interest expenses.

In 2000-01, EnergyAustralia returned over $1.1 billion in contributed equity to the NSW Government as part of a capital restructure. The return was paid for with borrowings, increasing the level of EnergyAustralia's debt. Overall, debt grew by more than 110 per cent while borrowing costs rose by almost 90 per cent compared to the previous year.

Financial management indicators were significantly affected by the revaluation of assets and the capital restructure that occurred in 2000-01. The debt to equity and debt to total assets ratios both rose, whilst interest cover and the current ratio fell, compared to 1999-00 levels.

EnergyAustralia is required to make tax-equivalent and dividend payments. The NSW Government funds EnergyAustralia for the provision of agreed community service obligations (CSOs). EnergyAustralia receives CSO funding for the provision of rebates to pensioners and low income households, medical rebates for life support systems and the electricity payment assistance scheme. The amounts paid to EnergyAustralia over the reporting period, have not been disclosed in its annual reports.

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1 EnergyAustralia operates under a revenue cap determined by the Independent Pricing and Regulatory Tribunal (IPART). In December 1999, IPART set revenue caps for the period to June 2004. The determination provides for an average real price decrease of 16 per cent during the period. On 25 January 2000, the Australian Competition and Consumer Commission also made a determination in relation to EnergyAustralia's distribution assets.

ENERGYAUSTRALIA (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*[e]
Size						
Total assets	$m	3 609	3 746	3 788	3 732	5 194
Total revenue	$m	2 061	1 839	1 852	2 099	2 196
Profitability						
Operating profit before tax (includes abnormals)	$'000	309 758	360 384	285 022	380 606	224 935
Operating sales margin	%	20.8	25.1	19.5	22.0	17.4
Cost recovery	%	125.1	129.6	125.3	127.7	121.0
Return on assets	%	12.2	12.8	9.9	12.4	8.6
Return on equity	%	13.0	15.0	11.3	19.4	8.9
Financial management						
Debt to equity	%	83.7	82.6	79.9	59.5	110.7
Debt to total assets	%	35.2	35.5	34.4	28.0	49.8
Total liabilities to equity	%	136.6	137.1	133.5	111.2	158.8
Interest cover	times	3.4	4.3	4.2	5.5	2.4
Current ratio	%	67.3	96.7	117.8	73.6	56.3
Leverage ratio	%	236.6	237.1	233.5	211.2	258.8
Payments to and from government						
Dividends	$'000	199 166	177 868	138 800	184 300	92 500
Dividend to equity ratio	%	13.1	11.5	8.7	10.9	4.9
Dividend payout ratio	%	100.4	76.6	76.5	56.0	55.4
Income tax expense	$'000	111 371	128 195	103 664	51 732	57 821
CSO funding[f]	$'000	0	0	0	0	0

a Includes net abnormal revenue of $19.5 million related to prepaid superannuation contributions. **b** Includes net abnormal revenue of $54.3 million related to prepaid superannuation contributions. In line with Urgent Issues Group Abstract 17 issued by the Australian Accounting Research Foundation, EnergyAustralia moved from treating customer and developer capital contributions as revenue to recording them as a liability until the assets are constructed. This change in accounting policy reduced total revenue. **c** Includes abnormal expenses of $13.3 million relating to unfunded superannuation contributions. **d** An abnormal gain of $23.5 million was reported relating to revised superannuation provisions. This was partly offset by abnormal expenses incurred due to year 2000 costs ($11.3 million). Accounting policy changed to treat tax on superannuation and capital contributions as a permanent difference rather than a timing difference. This change reduced the tax-equivalent expense by $39.2 million. A fall in the future company tax rate also reduced tax payable by $12.9 million. **e** EnergyAustralia returned over $1.1 billion in contributed equity to the NSW Government. The return was paid for with borrowings, increasing the level of EnergyAustralia's debt by a commensurate amount. Assets increased by $1.46 billion, largely due to a revaluation of non-current, physical assets. **f** The NSW Government funds EnergyAustralia for the provision of agreed community service obligations, relating to rebates to pensioners and low income households, medical rebates for life support systems and the electricity payment assistance scheme. The amounts paid to EnergyAustralia over the reporting period have not been disclosed in its annual reports.

GREAT SOUTHERN ENERGY — New South Wales

Great Southern Energy (GSE) was established as a government-owned electricity distributor and retailer in 1996, under the framework of the *Energy Services Act 1995* and the *State Owned Corporations Act 1989*. GSE was also involved in the supply of natural gas and a number of ancillary activities, including specialist engineering services, advice on energy efficiency and electrical appliance sales. On 1 July 2001, the NSW Government merged Advance Energy, NorthPower and GSE to form Country Energy.

Profitability fell by 75 per cent in 2000-01, mainly due to operating expenses rising 25 per cent compared to the previous year. The increase in expenses was mainly due to higher wholesale spot prices for electricity and an actuarial assessment of GSE's superannuation liabilities.

In 2000-01, GSE returned $300 million in contributed equity to the NSW Government as part of a capital restructure. The return was paid for with borrowings, increasing the level of GSE's debt by a commensurate amount. Overall, debt grew by over 360 per cent while borrowing costs rose by almost $20 million (300 per cent) compared to the previous year.

Financial management indicators were significantly affected by the capital restructure. Debt to equity, debt to total assets, total liabilities to equity and leverage ratios all rose significantly, whilst interest cover and the current ratio fell compared to 1999-00 levels.

GSE is required to make tax-equivalent and dividend payments. Over the reporting period, GSE has declared dividends in accordance with NSW Treasury financial distribution policy.

GSE receives community service obligation payments from the NSW government for pensioners, customers in caravan parks and to people who rely on life support machines. The amounts paid to GSE over the reporting period, have not been disclosed in its annual reports.

GREAT SOUTHERN ENERGY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*[d]
Size						
Total assets	$m	579	628	626	677	687
Total revenue	$m	315	346	369	407	425
Profitability						
Operating profit before tax (includes abnormals)	$'000	43 581	95 511	74 378	84 328	21 410
Operating sales margin	%	13.5	28.9	21.3	21.6	10.7
Cost recovery	%	115.3	139.2	122.2	130.6	109.4
Return on assets	%	8.9	16.9	13.0	13.9	7.0
Return on equity	%	6.8	16.0	13.0	14.9	4.3
Financial management						
Debt to equity	%	25.0	24.5	23.6	22.1	416.6
Debt to total assets	%	1.2	1.7	1.9	1.7	10.5
Total liabilities to equity	%	57.0	69.1	65.0	68.2	596.9
Interest cover	times	11.0	16.4	11.6	13.9	1.8
Current ratio	%	153.6	154.1	128.2	135.1	113.1
Leverage ratio	%	157.0	169.1	165.0	168.2	696.9
Payments to and from government						
Dividends	$'000	28 171	43 117	41 004	35 335	10 037
Dividend to equity ratio	%	7.8	11.6	10.9	9.0	4.0
Dividend payout ratio	%	115.4	72.8	83.8	60.8	94.2
Income tax expense	$'000	19 165	36 283	25 467	26 258	10 750
CSO funding[e]	$'000	0	0	0	0	0

a GSE incurred abnormal revenue related to a superannuation actuarial assessment ($17.4 million) and an adjustment of transmission charges ($4.9 million). GSE also incurred abnormal expenses related mainly to restructuring and relocation costs ($1.8 million) and an asset valuation adjustment ($8.7 million). Land and buildings were revalued downwards to current market value on 30 June 1998. The downward revaluation was offset by a significant increase in current assets. **b** GSE incurred abnormal expenses related mainly to a superannuation actuarial assessment ($4.2 million) and asset write-offs ($2 million). **c** GSE incurred abnormal expenses related to a loss on sale of buildings ($3.6 million), sales tax back-payment ($1.7 million), restructuring and relocation costs ($1.4 million) and other expenses ($0.5 million). This was offset by an abnormal gain due to a change in superannuation provisions ($9.9 million). **d** GSE returned $300 million in contributed equity to the NSW Government. The return was paid for with borrowings, increasing the level of GSE's debt by a commensurate amount. **e** GSE receives community service obligation payments from the NSW government for pensioners, customers in caravan parks and to people who rely on life support machines. The amounts paid to GSE over the reporting period, have not been disclosed in its annual reports.

INTEGRAL ENERGY — New South Wales

Integral Energy (Integral) is a government-owned corporation — incorporated under the *Energy Services Corporations Act 1995* — which distributes and retails electricity within the framework of the *Electricity Supply Act 1995* and the National Electricity Code. Integral also operates a gas business — Integral Energy Gas Pty Ltd. In 2000-01, Integral had electricity operations in NSW, Victoria, Queensland SA and ACT, through the National Electricity Market.

Pre-tax operating profit increased by over $20 million in 2000-01, largely due to revenues increasing slightly while operating expenses (excluding borrowing costs) fell in comparison to 1999-00 levels. The rise in revenue was largely due to increased capital contributions from developers and a 70 per cent increase in revenue from charges for the use of Integral's distribution system.

Total assets rose by over $640 million, or 33 per cent, in 2000-01, largely due to a revaluation of assets. Integral also increased its levels of cash assets — in the form of term deposits and bank accepted bills — by almost $170 million.

In 2000-01, Integral returned $200 million in contributed equity to the NSW Government as part of a capital restructure. The return was paid for with borrowings, increasing the level of debt by a commensurate amount. Overall, debt grew by over 25 per cent while borrowing costs rose by over 20 per cent on the previous year.

Changes in financial management indicators in 2000-01 reflect the impact of the capital restructure and the increase in Integral's asset base.

Integral Energy is required to make tax-equivalent and dividend payments to the NSW Government. In 1999-00, a change in the accounting treatment for tax purposes of capital and superannuation contributions and a fall in the future company tax rate reduced tax payable by over $40 million — resulting in a negative tax bill for that year. In 2000-01, Integral paid a dividend of almost $53 million to its shareholder government.

Integral Energy receives funding for the provision of community service obligations (CSOs)related primarily to rebates for pensioners. In 2000-01, the amount of CSO payments received by Integral was not disclosed in its annual report.

INTEGRAL ENERGY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*[e]
Size						
Total assets	$m	1 954	1 828	1 844	1 917	2 559
Total revenue	$m	1 047	1 119	1 177	1 122	1 142
Profitability						
Operating profit before tax (includes abnormals)	$'000	51 813	158 599	37 713	83 422	104 242
Operating sales margin	%	11.1	19.7	8.6	13.1	15.5
Cost recovery	%	120.7	121.2	113.3	112.6	118.3
Return on assets	%	6.1	11.9	5.6	7.9	8.2
Return on equity	%	1.7	13.1	2.8	15.6	8.8
Financial management						
Debt to equity	%	123.6	116.3	119.3	93.2	78.3
Debt to total assets	%	42.8	43.4	44.5	38.0	40.6
Total liabilities to equity	%	180.8	159.3	169.3	149.9	120.6
Interest cover	times	1.7	3.4	1.6	2.3	2.3
Current ratio	%	94.1	124.2	94.7	104.0	74.7
Leverage ratio	%	280.8	259.3	269.3	249.9	220.6
Payments to and from customers						
Dividends	$'000	98 460	92 066	45 918	29 743	52 776
Dividend to equity ratio	%	13.1	12.0	6.8	4.1	6.3
Dividend payout ratio	%	768.8	91.7	242.0	26.1	71.8
Income tax expense	$'000	39 006	58 221	18 738	-30 648	30 721
CSO funding	$'000	12 770	12 978	13 069	13 399	0

a Integral Energy incurred abnormal expenses related to a write-down in the value of the street lighting system ($27 million) and some land and buildings ($40 million). Abnormal revenue ($7.6 million) related to prepaid superannuation contributions was also reported. **b** Includes abnormal revenue ($35 million) related to prepaid superannuation contributions and abnormal expenses ($3.9 million) related to a write-down in the value of some buildings. **c** Integral Energy incurred abnormal expenses ($36.5 million). In particular, there were abnormal expenses associated with a debt restructure ($9.4 million), prepaid superannuation contributions ($8 million) and year 2000 compliance costs ($10 million). **d** Includes an abnormal gain of $23.7 million related to superannuation provisions. NSW Treasury changed the basis of dividend payments from available cash to 90 per cent of net profit before tax (excluding abnormals). A change in the accounting treatment for tax purposes of capital and superannuation contributions reduced tax payable by $31.7 million. The fall in the future company tax rate also reduced tax payable by $10.2 million. **e** Integral returned $200 million in contributed equity to the NSW Government. The return was paid for with borrowings, increasing the level of debt by a commensurate amount. Assets were revalued upwards on 1 January 2001. The amount of community service obligation funding received by Integral was not disclosed in its 2000-01 annual report.

NORTHPOWER New South Wales

NorthPower was established as a government-owned electricity distributor and retailer on 1 March 1996. NorthPower operated under the *Energy Services Act 1995* and the *State Owned Corporations Act 1989*. On 1 July 2001, the NSW Government merged Advance Energy, NorthPower and Great Southern Energy to form Country Energy.

Despite an increase in revenues in 2000-01, operating profit (before tax) was almost $50 million less than the previous year. This was partly due to pre-tax profit in 1999-00 benefiting from abnormal revenues of $22.2 million; however, a 30 per cent rise in expenses in 2000-01 also contributed to the fall in profit. NorthPower attributed the rise in expenditure to increased borrowing costs, higher wholesale electricity costs, expenses relating to the accelerated depreciation of computer assets and a funding adjustment to NorthPower's superannuation contribution.

In 2000-01, NorthPower returned $320 million in contributed equity to the NSW Government as part of a capital restructure. The return was paid for with borrowings, increasing the level of debt by a commensurate amount. Overall, debt grew by over 140 per cent while borrowing costs rose by almost 190 per cent on the previous year.

Financial indicators were significantly affected by the capital restructure. Debt to equity, debt to total assets, total liabilities to equity and leverage ratios all rose significantly, whilst interest cover and the current ratio fell compared to 1999-00 levels.

NorthPower is required to make tax-equivalent and dividend payments. Changes in the accounting treatment of capital contributions and an adjustment due to changes in the future company tax rate reduced tax-equivalent payments for 1999-00 by $19.4 million.[1]

NorthPower receives funding for community service obligations from the NSW Government for pensioners, customers in caravan parks and to people who rely on life support machines.

1 Prior to 1999-00, capital contributions were treated as timing differences, they are now treated as permanent differences. This reduced tax-equivalent payments for 1999-00 by $17 million, relating to capital contributions over the period 1997–1999. Changes in the future company tax rate reduced tax-equivalent payments by $2.4 million.

NORTHPOWER (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*[e]
Size						
Total assets	$m	665	831	1 117	1 227	1 245
Total revenue	$m	420	461	478	568	664
Profitability						
Operating profit before tax (includes abnormals)	$'000	30 237	102 387	46 972	88 180	39 221
Operating sales margin	%	9.6	24.1	11.3	17.4	11.0
Cost recovery	%	113.7	126.7	114.9	122.1	112.3
Return on assets	%	6.6	15.1	5.8	8.6	6.1
Return on equity	%	3.8	16.1	4.5	11.1	5.8
Financial management						
Debt to equity	%	35.3	27.2	22.2	27.8	103.1
Debt to total assets	%	21.5	18.6	17.1	19.2	44.2
Total liabilities to equity	%	67.5	62.8	48.6	51.3	134.7
Interest cover	times	3.4	11.0	6.0	8.1	2.1
Current ratio	%	112.2	114.9	77.4	88.0	60.2
Leverage ratio	%	167.5	162.8	148.6	151.3	234.7
Payments to and from government						
Dividends	$'000	17 969	58 080	35 522	31 731	12 000
Dividend to equity ratio	%	4.7	12.8	5.6	4.1	1.8
Dividend payout ratio	%	126.1	79.3	126.2	36.5	30.6
Income tax expense	$'000	15 990	29 134	18 829	-2 918	231
CSO funding	$'000	6 215	7 863	7 996	9 007	10 150

a NorthPower incurred abnormal expenses related to restructuring costs ($2 million) and a change in the provision for employee entitlements ($15.4 million). NorthPower also incurred abnormal revenue of $8.3 million. **b** NorthPower incurred abnormal expenses of $8.1 million. Major items included redundancy payments ($3.9 million) and a loss on the sale of properties ($3 million). NorthPower also received abnormal revenue of $28.2 million related to the recoupment of employer superannuation contributions ($21.5 million) and a change in the provision for employee entitlements ($6.7 million). The carrying amounts of network system assets were revalued upwards. **c** NorthPower incurred abnormal expenses of $8.2 million. Major items include redundancy payments ($2.1 million), an adjustment in the funding of employer superannuation contributions ($2.3 million) and year 2000 compliance costs ($2.5 million). The carrying amounts of network assets were revalued upwards by $247 million. **d** NorthPower reported abnormal revenue of $22.2 million as a result of an adjustment to superannuation contributions. This was partly offset by an abnormal expense of $1.9 million relating to inter-distributor charges for 1998-99. **e** NorthPower returned $320 million in contributed equity to the NSW Government. The return was paid for with borrowings, increasing the level of debt by a commensurate amount.

CS ENERGY — Queensland

CS Energy was established on 1 July 1997, as part of the restructure of the Queensland electricity industry, and is subject to the provisions of the *Government Owned Corporations Act 1993* (GOC Act).[1] CS Energy operate three power stations with a combined generating capacity of 2325 MW. CS Energy generates electricity within the National Electricity Market (NEM).[2]

In 2000-01, operating profit (before tax) was $64 million less than 1999-00, partly due to decreased revenue from electricity sales. Revenue fell 6 per cent in 2000-01, following an 8 per cent fall in the wholesale electricity price. CS Energy attributed this drop in prices to the opening of the Queensland–NSW Interconnector, which improved Queensland's integration into the NEM. Prices were also affected by increased supply as new generation assets came on-line during 2000-01.

Debt to equity and debt to total assets ratios were both higher in 2000-01, mainly attributable to a 50 per cent rise in the level of debt on 1999-00 levels — most of which related to the construction of additional generating capacity. The liquidity of CS Energy, as measured by the current ratio, improved with a reduction in current liabilities.

CS Energy is required to make tax-equivalent and dividend payments. CS Energy's dividend payment is determined in accordance with the provisions of the GOC Act. Under the Act, the Board of Directors makes a recommendation to the shareholding Ministers on its proposed dividend payment. Shareholding Ministers may either approve the recommendation or direct the Board to pay a specified dividend.

CS Energy has not been required to perform any community service obligations by the Queensland Government over the reporting period.

1 Prior to 1997, the assets of CS Energy formed part of Queensland's largest generator AUSTA Electric. On 1 July 1997, AUSTA Electric was separated into three generators — CS Energy, Stanwell Corporation and Tarong Energy. An engineering services corporation was also established through the restructure of AUSTA Electric.

2 The Queensland–NSW Interconnector (QNI) commenced operation in February 2001. This improved the integration of the Queensland wholesale electricity market into the NEM. The NEM connects generation and transmission assets in NSW, Victoria, Queensland and SA.

CS ENERGY (continued)

Performance indicators 1997-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*	*1999-00*	*2000-01*
Size						
Total assets	$m	n.r.	927	1 100	1 323	1 458
Total revenue	$m	n.r.	447	478	480	452
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	98 566	161 826	113 047	48 734
Operating sales margin	%	n.r.	25.3	36.6	28.3	19.2
Cost recovery	%	n.r.	133.9	157.8	134.8	123.7
Return on assets	%	n.r.	13.1	17.4	11.2	6.2
Return on equity	%	n.r.	11.1	17.6	13.9	4.8
Financial management						
Debt to equity	%	n.r.	36.8	44.6	60.4	95.6
Debt to total assets	%	n.r.	23.3	26.1	31.7	41.9
Total liabilities to equity	%	n.r.	63.5	85.4	108.0	139.6
Interest cover	times	n.r.	6.4	12.3	5.9	2.3
Current ratio	%	n.r.	89.0	81.4	79.2	81.3
Leverage ratio	%	n.r.	163.5	185.4	208.0	239.6
Payments to and from government						
Dividends	$'000	n.r.	38 800	75 800	57 111	74 934
Dividend to equity ratio	%	n.r.	6.9	13.1	9.3	12.0
Dividend payout ratio	%	n.r.	62.3	74.3	66.7	251.3
Income tax expense	$'000	n.r.	36 315	59 825	27 381	18 916
CSO funding	$'000	n.r.	0	0	0	0

a CS Energy was established on 1 July 1997. Hence, 1997-98 is the first year where financial data were available. **n.r.** Not relevant.

STANWELL CORPORATION Queensland

Stanwell Corporation (Stanwell) was established on 1 July 1997, as part of the restructure of the Queensland electricity industry, and is subject to the provisions of the *Government Owned Corporations Act 1993* (GOC Act).[1] Stanwell operates six power stations with a combined generating capacity of 1585 MW. Stanwell generates electricity within the National Electricity Market (NEM).[2]

In 2000-01, operating profit (before tax) was less than in 1999-00, due mainly to decreased revenue from electricity sales. The decline in revenue was the combined result of generation assets going off-line to undergo maintenance, a fall in the wholesale electricity spot price due to Queensland's entry into the NEM, and increased generation capacity from competitors.

In 2000-01, Stanwell's asset base decreased slightly compared to 1999-00 levels, due to a depreciation of power plant assets and a reduction in accounts receivable.

The debt to equity and debt to total asset ratios fell in 2000-01, following a reduction in the level of debt held by Stanwell Corporation. Debt levels have declined throughout the reporting period. The fall in the current ratio in 2000-01 reflects a greater fall in current assets than current liabilities. The large fall in the current ratio in 1999-00 was due to provision for an increase in dividend payments that year.

Stanwell is required to make tax-equivalent and dividend payments. Stanwell's dividend payment is determined in accordance with the provisions of the GOC Act. Under the Act, the Board of Directors makes a recommendation to the shareholding Ministers on its proposed dividend payment. Shareholding Ministers may either approve the recommendation or direct the Board to pay a specified dividend.

Stanwell has not been required to perform any community service obligations by the Queensland Government over the reporting period.

1 Prior to 1997, the assets of Stanwell Corporation formed part of Queensland's largest generator AUSTA Electric. On 1 July 1997, AUSTA Electric was separated into three generators — CS Energy, Stanwell and Tarong Energy. An engineering services corporation was also established through the restructure of AUSTA Electric.

2 The Queensland–NSW Interconnector commenced operation in February 2001. This improved the integration of the Queensland wholesale electricity market into the NEM. The NEM connects generation and transmission assets in NSW, Victoria, Queensland and SA.

STANWELL CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*	*1999-00*	*2000-01*
Size						
Total assets	$m	n.r.	1 769	1 715	1 693	1 660
Total revenue	$m	n.r.	384	450	431	416
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	123 171	179 538	162 454	138 608
Operating sales margin	%	n.r.	44.3	48.7	44.3	38.9
Cost recovery	%	n.r.	179.7	194.9	179.4	163.8
Return on assets	%	n.r.	10.1	12.7	11.3	9.7
Return on equity	%	n.r.	7.5	11.6	13.0	9.4
Financial management						
Debt to equity	%	n.r.	62.9	51.0	36.1	34.0
Debt to total assets	%	n.r.	37.2	29.9	21.8	20.9
Total liabilities to equity	%	n.r.	73.8	68.0	64.1	61.0
Interest cover	times	n.r.	3.5	5.3	6.4	6.7
Current ratio	%	n.r.	155.1	204.4	74.2	65.1
Leverage ratio	%	n.r.	173.8	168.0	164.1	161.0
Payments to and from government						
Dividends	$'000	n.r.	40 000	107 808	123 591	98 097
Dividend to equity ratio	%	n.r.	3.8	10.6	12.0	9.5
Dividend payout ratio	%	n.r.	50.8	91.5	92.8	101.4
Income tax expense	$'000	n.r.	44 441	61 752	29 218	41 831
CSO funding	$'000	n.r.	0	0	0	0

a Stanwell Corporation was established on 1 July 1997. Hence, 1997-98 is the first year where financial data were available. **n.r.** Not relevant.

TARONG ENERGY — Queensland

Tarong Energy was established on 1 July 1997, as part of the restructure of the Queensland electricity industry, and is subject to the provisions of the *Government Owned Corporations Act 1993* (GOC Act).[1] Tarong Energy operates two power stations with a combined capacity of 1915 MW, generating electricity within the National Electricity Market (NEM).[2] On 31 October 2000, Tarong Energy purchased the South Australian-based gas supplier, Terra Gas Trader (TGT).

Despite a 30 per cent increase in revenue, operating profit (before tax) fell in 2000-01, due to higher operating costs. The rise in operating costs was largely due to the acquisition of TGT.

The debt to equity and debt to total assets ratios increased in 2000-01, reversing a downward trend evident since 1997-98. Increased capital expenditure — mainly on generation assets — and the purchase of TGT were funded largely from an increase in the level of borrowings.

Tarong Energy is required to make tax-equivalent and dividend payments. Its dividend payment is determined in accordance with the provisions of the GOC Act. Under the Act, the Board of Directors makes a recommendation to the shareholding Ministers on its proposed dividend payment. Shareholding Ministers may either approve the recommendation or direct the Board to pay a specified dividend.

Tarong Energy has not been required to perform any community service obligations by the Queensland Government over the reporting period.

1 Prior to 1997, the assets of Tarong Energy formed part of Queensland's largest generator AUSTA Electric. On 1 July 1997, AUSTA Electric was separated into three generators — CS Energy, Stanwell Corporation and Tarong Energy. An engineering services corporation was also established through the restructure of AUSTA Electric.

2 The Queensland–NSW Interconnector commenced operation in February 2001. This integrated the Queensland wholesale electricity market into the NEM. The NEM connects generation and transmission assets in NSW, Victoria, Queensland and SA.

TARONG ENERGY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*	*1999-00*[b]	*2000-01*[c]
Size						
Total assets	$m	n.r.	1 391	1 263	1 418	1 604
Total revenue	$m	n.r.	439	433	440	562
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	127 310	135 949	142 633	136 186
Operating sales margin	%	n.r.	36.5	37.2	35.9	27.9
Cost recovery	%	n.r.	157.5	159.3	156.1	138.8
Return on assets	%	n.r.	12.1	12.2	11.8	10.5
Return on equity	%	n.r.	10.0	10.7	13.2	10.7
Financial management						
Debt to equity	%	n.r.	54.0	34.2	27.1	48.7
Debt to total assets	%	n.r.	32.5	21.7	17.8	28.1
Total liabilities to equity	%	n.r.	72.8	50.4	61.2	84.3
Interest cover	times	n.r.	4.6	6.2	9.9	7.0
Current ratio	%	n.r.	133.9	92.9	56.6	57.0
Leverage ratio	%	n.r.	172.8	150.4	161.2	184.3
Payments to and from government						
Dividends	$'000	n.r.	73 500	52 582	96 330	102 515
Dividend to equity ratio	%	n.r.	9.0	6.4	11.2	11.7
Dividend payout ratio	%	n.r.	90.0	60.0	84.7	109.7
Income tax expense	$'000	n.r.	45 644	48 313	28 946	42 759
CSO funding	$'000	n.r.	0	0	0	0

a Tarong Energy was established on 1 July 1997. Hence, 1997-98 is the first year where financial data were available. **b** Several classes of non-current assets were revalued downwards by $9.9 million. **c** Tarong Energy acquired South Australian-based Terra Gas Trader on 31 October 2000, increasing Tarong Energy's asset base, revenue and expenditures. **n.r.** Not relevant.

ENERTRADE — Queensland

The Queensland Power Trading Corporation (QPTC) commenced trading as Enertrade in October 2000. The QPTC was established on 1 July 1997, following a restructure of Queensland's electricity supply industry, and is subject to the provisions of the *Government Owned Corporations Act 1993* (GOC Act).[1] Enertrade trades electricity — purchased under fixed contracts from privately-owned power stations — into the National Electricity Market (NEM).[2]

The conditions of Enertrade's purchase contracts (power-purchase agreements) are expected to result in significant future losses for Enertrade. The agreements were entered into prior to the commencement of the NEM and did not anticipate current low prices. The agreements commit Enertrade to the purchase of power at fixed prices over their term, for sale into the NEM at prevailing pool prices. The longest of these contracts is for a term of 35 years and extends to 2029.[3]

A pre-tax operating loss of over $14 million was recorded by Enertrade in 2000-01. Revenue fell by 8 per cent in 2000-01, due to lower average pool prices, fewer sales of derivative contracts and lower proceeds from asset disposal than in 1999-00. The fall in revenues continued the trend evident over the reporting period. Operating expenses in 2000-01 were practically unchanged from the previous year.

Enertrade is required to make tax-equivalent and dividend payments. Its dividend payment is determined in accordance with the provisions of the GOC Act. Over the reporting period a dividend has been paid only in 1999-00.

Enertrade has not been required to perform any community service obligations by the Queensland Government over the reporting period.

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1 QPTC's antecedents were the Queensland Transitional Trading Power Corporation and, before that, the Queensland Transmission and Supply Corporation

2 In February 2001, Queensland entered into the NEM with the opening of the Queensland–NSW Interconnector. Prior to this, Enertrade traded electricity in the Queensland wholesale electricity market which operated from 18 January 1998. Enertrade also has several other functions including the management of assets and liabilities assumed from dissolved or superseded electricity corporations, remediation and disposal of disused power stations and sites and the disposal of surplus assets.

3 In 2000-01, Enertrade arranged for the provision of a working capital funding facility with the Queensland Government extending to 2029, to cover expected losses over the period. It was not necessary to draw down any funds under the facility during 2000-01, however Enertrade is anticipating having to do so by 2002-03.

ENERTRADE (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*
Size						
Total assets	$m	n.r.	3 528	553	310	273
Total revenue	$m	n.r.	921	737	680	625
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	8 159	28 067	30 602	-14 332
Operating sales margin	%	n.r.	1.0	3.8	4.3	-2.7
Cost recovery	%	n.r.	100.7	103.8	103.7	97.4
Return on assets	%	n.r.	0.3	1.6	8.2	-3.1
Return on equity	%	n.r.	0.2	1.1	7.4	-16.5
Financial management						
Debt to equity	%	n.r.	2.6	21.7	88.7	95.1
Debt to total assets	%	n.r.	2.4	4.3	20.3	33.0
Total liabilities to equity	%	n.r.	4.2	37.3	214.2	169.8
Interest cover	times	n.r.	2.8	7.3	7.3	-1.7
Current ratio	%	n.r.	2 467.1	289.8	201.5	269.9
Leverage ratio	%	n.r.	104.2	137.3	137.3	137.3
Payments to and from government						
Dividends	$'000	n.r.	0	0	15 444	0
Dividend to equity ratio	%	n.r.	0	0	6.2	0
Dividend payout ratio	%	n.r.	0	0	83.5	0
Income tax expense	$'000	n.r.	2 345	7 449	12 114	2 123
CSO funding	$'000	n.r.	0	0	0	0

a Enertrade, at the time trading as the Queensland Power Trading Corporation, was established on 1 July 1997. Hence, 1997-98 is the first year where financial data were available. **b** Total assets fell significantly due to the restructuring process. Enertrade was required to transfer its shares in subsidiary corporations to the shareholding Ministers and in return the shareholding Ministers owed a debt (valued at $3.3 billion) to Enertrade in relation to the transferred shares. On 1 April 1999, the net assets of AUSTA Electric were transferred to Enertrade and this debt was reduced by $25 million. On 30 June 1999, 3 billion ordinary shares were cancelled and offset against the loan receivable from the shareholding Ministers. **c** On 29 June 2000, 307 million ordinary shares were cancelled and offset against the loan receivable from the shareholding Ministers. The level of profit (before tax, including abnormals) was increased by an abnormal gain of $5.7 million related to the write-back of provision for settlement of disputes. **n.r.** Not relevant.

POWERLINK Queensland

Powerlink was established on 1 July 1997 and is subject to the provisions of the *Government Owned Corporations Act 1993* (GOC Act). Powerlink owns and controls the Queensland transmission network and operates in the National Electricity Market (NEM).[1] Its transmission grid ranges from far north Queensland to the NSW border.

The improvement in profitability in 2000-01 reflects a $31 million increase in grid sales and contributions from significant items — specifically the proceeds of a Cross-Border Lease of transmission assets and the sale of business units to Ergon Energy.[2] Revenue from non-regulated components of Powerlink's business also grew 8 per cent in 2000-01.[3]

In 2000-01, Powerlink completed the Queensland section of the Queensland–NSW Interconnector (QNI). To finance construction of the QNI, loan debt increased by $114 million in 2000-01, to bring total QNI related borrowings to around $1 billion for the four year construction period. In 1999-00, asset revaluations of $773.8 million to supply system, land and building assets were also recorded.

Financial management indicators over the last two years of the reporting period were affected by capital restructuring undertaken by Powerlink. During 1999-00, a non-interest bearing $150 million loan was made to the Queensland Government, funded by an increase in Powerlink's debt. In 2000-01, the Queensland Government reduced its equity stake by the same amount.[4]

Under the provisions of the GOC Act, Powerlink is required to make tax-equivalent and dividend payments. In 2000-01, an income tax benefit of almost $67 million was recorded — primarily due to the Cross-Border Lease, which reduced tax-equivalent payments by $113 million.

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1 The Queensland-NSW Interconnector commenced operation in February 2001. This officially integrated the Queensland wholesale electricity market into the NEM. The NEM connects generation and transmission assets in NSW, Victoria, Queensland and SA.

2 A Cross-Border Lease involves the leasing of equipment or assets between entities in different countries — in this case where the lessor is from overseas and the lessee is in Australia. The lease is structured so that tax savings may be passed on from the overseas lessor to the local lessee, thereby lowering leasing costs.

3 The majority of Powerlink's revenue comes from sales of electricity at regulated prices. Over the reporting period, Powerlink's transmission prices were regulated by the Office of Energy.

4 These arrangements are analogous to an equity for debt swap. The swap took place over a two year period, where the government was 'paid' for its return of equity one year prior to actually relinquishing the equity.

POWERLINK (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*[d]
Size						
Total assets	$m	n.r.	1 842	1 737	2 554	2 588
Total revenue	$m	n.r.	246	259	300	339
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	68 421	58 515	89 254	112 611
Operating sales margin	%	n.r.	43.6	37.2	46.0	56.9
Cost recovery	%	n.r.	193.4	197.5	222.7	231.8
Return on assets	%	n.r.	6.5	5.4	6.4	7.6
Return on equity	%	n.r.	4.5	4.1	7.1	15.4
Financial management						
Debt to equity	%	n.r.	63.2	95.5	86.1	101.1
Debt to total assets	%	n.r.	38.4	41.1	48.0	44.5
Total liabilities to equity	%	n.r.	83.4	125.7	113.8	128.9
Interest cover	times	n.r.	2.7	2.5	2.8	2.3
Current ratio	%	n.r.	305.5	50.7	142.3	42.0
Leverage ratio	%	n.r.	183.4	225.7	213.8	228.9
Payments to and from government						
Dividends	$'000	n.r.	39 300	27 253	72 441	165 644
Dividend to equity ratio	%	n.r.	4.0	3.1	7.4	14.2
Dividend payout ratio	%	n.r.	88.1	75.0	104.4	92.3
Income tax expense	$'000	n.r.	23 793	22 178	19 846	-66 940
CSO funding[e]	$'000	n.r.	0	0	0	0

a Powerlink Queensland was established as a separate government-owned corporation in 1997-98. Hence, 1997-98 is the first year where financial data were available. Powerlink incurred abnormal expenses of $12.3 million related to a refund of capital contributions to contestable customers and abnormal revenue of $1.3 million related to the provision for a swing load rebate. As part of a capital restructure, Powerlink was required by its shareholding Ministers to make interest free loans (valued at $249 million) to the State of Queensland. This resulted in a 90 per cent increase in debt. **b** Powerlink incurred abnormal expenses of $9.8 million related to the refund of capital contributions to contestable customers and $1.5 million related to year 2000 compliance costs. **c** Includes abnormal expenses of $28.4 million relating to sales tax-equivalent payments ($27 million) and year 2000 compliance costs ($1.4 million). The growth in assets reflects capital expenditure of $244.8 million and an increase in asset values of $773.8 million following a revaluation of supply system assets, freehold land and buildings. Powerlink made a $150 million loan to the Queensland Government. Income tax-equivalent payments were reduced by $17.9 million due to a fall in the future company tax rate. **d** Powerlink received an income tax benefit of almost $67 million. This was primarily due to the Cross-Border Lease entered into during the year, which reduced tax-equivalent payments by $113 million. **e** Powerlink has not been required to perform any community service obligations by the Queensland Government over the reporting period. **n.r.** Not relevant

ERGON ENERGY GROUP — Queensland

The Ergon Energy Group (Ergon Energy) comprises Ergon Energy Corporation Ltd — a regulated electricity distributor, and Ergon Energy Pty Ltd — an energy retailer. The group operates in the National Electricity Market (NEM), and is subject to the provisions of the *Government Owned Corporations Act 1993* (GOC Act). Ergon Energy Corporation was established on 30 June 1999, through the amalgamation of six regional distribution corporations.[1] Ergon Energy Pty Ltd was formed in February 1998, following the merger of Northern Electricity Retail Corporation and Central Electricity Retail Corporation. In 1999, Ergon Energy Pty Ltd became a wholly-owned subsidiary of the newly formed Ergon Energy Corporation Ltd.

The group has over 555 000 customers and manages over 135 000 km^2 of electricity distribution network. Ergon Energy Pty Ltd accounts for about 12 per cent of the group's total assets. However, it accounted for 90 per cent of the Corporation's revenue in 2000-01.

In 2000-01, operating profit (before tax) was over 90 per cent higher than the previous year.[2] The improvement was partly due to increased allowable revenue from regulated electricity sales.

Ergon Energy is required to make tax-equivalent and dividend payments. Its dividend payment is determined in accordance with the provisions of the GOC Act. Under the Act, the Board of Directors makes a recommendation to the shareholding Ministers on its proposed dividend payment. Shareholding Ministers may either approve the recommendation or direct the Board to pay a specified dividend.

The Queensland Government is committed to uniform state-wide retail tariffs for franchise customers, regardless of the cost of supply.[3] Ergon Energy receives community service obligation payments to cover any shortfall incurred in supplying electricity to franchise customers at gazetted tariffs.

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1 The six regional distribution corporations were the Far North Queensland Electricity Corporation, North Queensland Electricity Corporation, Mackay Electricity Corporation, Capricornia Electricity Corporation, Wide Bay-Burnett Electricity Corporation and South West Queensland Electricity Corporation.

2 In 1999-00, pre-tax operating profit was reduced by an abnormal expense of $20.4 million relating to sales tax-equivalent payments.

3 Unlike Victoria and NSW, Queensland does not have full retail contestability. Franchise customers use no more than 200 MWh a year and are not permitted to choose between electricity retailers.

ERGON ENERGY CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*	*1999-00*	*2000-01*
Size						
Total assets	$m	n.r.	n.r.	n.r.	2 786	3 211
Total revenue	$m	n.r.	n.r.	n.r.	1 323	1 418
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	n.r.	45 779	89 262
Operating sales margin	%	n.r.	n.r.	n.r.	7.6	10.5
Cost recovery	%	n.r.	n.r.	n.r.	110.1	110.6
Return on assets	%	n.r.	n.r.	n.r.	7.0	5.1
Return on equity	%	n.r.	n.r.	n.r.	7.4	6.2
Financial management						
Debt to equity	%	n.r.	n.r.	n.r.	100.4	81.6
Debt to total assets	%	n.r.	n.r.	n.r.	70.8	39.0
Total liabilities to equity	%	n.r.	n.r.	n.r.	156.4	124.2
Interest cover	times	n.r.	n.r.	n.r.	1.7	2.4
Current ratio	%	n.r.	n.r.	n.r.	111.3	112.9
Leverage ratio	%	n.r.	n.r.	n.r.	256.4	224.2
Payments to and from government						
Dividends	$'000	n.r.	n.r.	n.r.	38 928	69 305
Dividend to equity ratio	%	n.r.	n.r.	n.r.	6.4	5.5
Dividend payout ratio	%	n.r.	n.r.	n.r.	86.8	89.1
Income tax expense	$'000	n.r.	n.r.	n.r.	917	11 505
CSO funding	$'000	n.r.	n.r.	n.r.	244 768	232 354

n.r. Not relevant.

ENERGEX Queensland

ENERGEX was formed on 1 July 1997, following the incorporation of the South East Queensland Electricity Corporation (SEQEC) and its wholly-owned subsidiary Southern Electricity Retail Corporation (SERC). On 30 October 1997, the company changed its trading name to ENERGEX Ltd. The company includes two wholly-owned subsidiary companies — ENERGEX Retail and, since 1997-98, Allgas Energy. ENERGEX retails and distributes electricity, natural gas and liquefied petroleum gas. The company is subject to the provisions of the *Government Owned Corporations Act 1993* (GOC Act).

Structural and legislative changes have affected the financial performance of ENERGEX, affecting comparability across the reporting period. For example, the incorporation of SEQEC and its subsidiary SERC during 1997-98 makes it difficult to compare financial performance with 1996-97. The phased introduction of customer choice of retail supplier and the acquisition of Allgas in 1997-98 have also significantly influenced the financial performance of ENERGEX.[1]

Operating profit (before tax) rose by almost $75 million in 2000-01. This was mainly due to revenues increasing by 10 per cent on 1999-00 levels, while expenses increased by only 6 per cent. Operating profit in 2000-01 was reduced by significant expenses of $12.4 million, relating to redundancy, restructuring and development costs.

In 2000-01, ENERGEX revalued non-current assets, resulting in the value of total assets increasing by 15 per cent. Debt to total assets and debt to total equity ratios consequently declined. The level of debt in 2000-01, was not materially different from 1999-00.

ENERGEX is required to make tax-equivalent and dividend payments. Its dividend payment is determined in accordance with the provisions of the GOC Act. ENERGEX receives community service obligation funding from the Queensland Government, for the uneconomic supply of electricity to some retail customers, pensioner rebates and the administration of pensioner rebates.

1 Customers using at least 40 GWh per annum were given the choice of retail supplier from 1 March 1998. Customers with sites using at least 4 GWh per annum were given the choice of retail supplier from 1 October 1998. In 2000-01, all customers using at least 200 MWh a year could choose their retail supplier.

ENERGEX (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*[e]
Size						
Total assets	$m	2 334	2 927	2 962	3 237	3 708
Total revenue	$m	1 343	1 424	1 560	1 736	1 908
Profitability						
Operating profit before tax (includes abnormals)	$'000	86 314	186 993	87 171	41 121	116 096
Operating sales margin	%	9.9	17.1	10.0	6.9	11.0
Cost recovery	%	112.6	122.0	112.2	104.9	109.7
Return on assets	%	6.1	8.6	5.5	4.0	6.3
Return on equity	%	4.9	8.4	4.5	3.3	6.8
Financial management						
Debt to equity	%	47.9	67.0	110.0	128.2	97.2
Debt to total assets	%	30.0	34.6	45.9	50.3	44.9
Total liabilities to equity	%	61.7	93.9	141.4	166.1	131.1
Interest cover	times	2.6	3.9	2.2	1.5	2.1
Current ratio	%	161.8	265.1	132.1	197.6	125.8
Leverage ratio	%	161.7	193.9	241.4	266.1	231.1
Payments to and from government						
Dividends	$'000	20 296	105 500	63 607	43 051	102 520
Dividend to equity ratio	%	1.4	7.0	4.6	3.5	7.3
Dividend payout ratio	%	29.4	83.6	104.1	105.2	107.1
Income tax expense	$'000	17 288	60 726	26 073	209	20 381
CSO funding	$'000	22 341	21 734	22 625	23 597	24 626

a ENERGEX incurred abnormal expenses ($12.6 million) related to redundancy payments and a land and building revaluation decrement ($5 million). **b** On 1 July 1997, South East Queensland Electricity Board and a newly formed, wholly-owned subsidiary were registered to become South East Queensland Electricity Corporation and Southern Electricity Retail Corporation. As a consequence, data for this year and previous years is not directly comparable. Includes abnormal expenses related to redundancy payments ($13.4 million). **c** Includes abnormal expenses related to redundancy payments ($5.8 million), year 2000 compliance costs ($4.7 million) and write-off expenses ($3 million). **d** Includes abnormal expenses related to a write-down in the value of land and buildings ($4.7 million), a change in sales tax exemption status ($1.7 million), loss on disposal of assets from a discontinued project ($1.8 million) and year 2000 compliance expenses ($1.8 million). A restatement of deferred tax balances due to a change in the future company tax rate led to an income tax payment of $209 000 for 1999-00. **e** ENERGEX revalued its supply system, upon adoption of AASB 1041, resulting in a revaluation increment of $495 million to non-current assets. Includes expenses of $12.4 million relating to redundancy restructuring and development costs.

WESTERN POWER — Western Australia

Western Power is a government-owned corporation established under the *Electricity Corporation Act 1994*. Western Power operates five major and 26 smaller power stations with a total capacity of 3255 MW — 56 per cent of Western Australia's total generation capacity. Western Power is also involved in the transmission and retailing of electricity.[1] During 2000-01, six business units were established within Western Power — Office of the Managing Director, Commercial Services, Emerging Business, Networks, Retail and Generation. In August 2000, the company engaged in a wind farm joint venture with Enercon Power.

Western Power has improved its profitability over the reporting period, largely through increased revenue from electricity sales, improved funding for the provision of community service obligations (CSOs) and cost management. The 26 per cent improvement in profit (before tax) in 2000-01 was mainly due to lower borrowing costs — coupled with a slight rise in revenue. The cost recovery ratio, which excludes the impact of borrowing costs and abnormal items, fell in 2000-01.

Over the reporting period, Western Power has carried a high level of debt, as reflected in its debt to equity and debt to total assets ratios. Debt restructuring in 1998-99 contributed to a fall in the debt to equity ratio. A further fall in this ratio in 2000-01 was due to refinancing a portion of long-term debt during 1999-00.

Western Power makes dividend and income tax-equivalent payments to the State Government. The dividend payment in 2000-01 comprised a $47.1 million interim dividend, paid on 29 June 2001, and provision for a $47 million dividend, to be paid during December 2001. Western Power receives CSO funding for rebates provided to customers.[2]

1 Western Power's customers are supplied through two major interconnected systems — one in the south-west corner of Western Australia and the other in the Pilbara in the north. Western Power also operates 29 separate systems in remote parts of the State.

2 Western Power is also required to offer residential and small to medium business customers in remote areas the same tariff as customers in metropolitan areas, despite any differences in the cost of providing the service. The losses incurred by Western Power in providing uniform tariffs are met internally.

WESTERN POWER (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*[a]	*1999-00*[b]	*2000-01*[c]
Size						
Total assets	$m	3 684	3 990	4 018	4 038	4 180
Total revenue	$m	1 336	1 398	1 604	1 575	1 597
Profitability						
Operating profit before tax (includes abnormals)	$'000	155 370	227 620	223 369	230 294	289 138
Operating sales margin	%	26.2	27.8	24.4	28.1	28.1
Cost recovery	%	135.4	138.4	150.2	147.2	139.2
Return on assets	%	10.0	10.2	9.9	11.0	11.0
Return on equity	%	14.2	18.0	15.1	12.9	15.3
Financial management						
Debt to equity	%	317.9	299.0	251.2	195.9	188.7
Debt to total assets	%	65.7	65.6	64.7	60.4	57.5
Total liabilities to equity	%	404.3	373.9	289.8	224.9	233.7
Interest cover	times	1.8	2.4	2.3	2.1	2.8
Current ratio	%	154.8	108.1	31.5	41.9	133.5
Leverage ratio	%	504.3	473.9	389.8	324.9	333.7
Payments to and from government						
Dividends	$'000	30 000	30 000	42 332	46 209	94 100
Dividend to equity ratio	%	4.3	3.8	4.5	4.1	7.5
Dividend payout ratio	%	30.4	21.2	30.0	31.5	49.3
Income tax expense	$'000	56 598	85 986	82 273	83 828	98 121
CSO funding	$'000	28 800	31 400	29 300	27 000	28 700

a Includes abnormal revenue relating to fuel back payments following the resolution of the gas price determination ($32.1 million), a reduction in a gas turbine operating lease provision following the purchase of five gas turbines ($38.3 million) and a payment from the WA Government relating to future gas royalties from the North West Shelf ($57.2 million). Western Power also incurred abnormal expenses relating to debt refinancing ($107.5 million) and the write-down of prepaid gas following the agreement reached regarding the North West Shelf gas royalties ($57.2 million). Western Power changed its accounting policy for developer and customer contributions effective from 1 July 1998. Previously, these were treated as deferred income and amortised over the life of the assets that the contribution funded. Contributions are now treated as revenue in the year in which they are received. **b** Includes abnormal revenue relating to adjustments for unread debtors ($28 million). This was offset by abnormal expenses relating to refinancing costs ($47.3 million), redundancy costs ($26.6 million) and decommissioning costs ($8 million). A fall in the future company tax rate reduced income tax-equivalent payments by $7.8 million. **c** The dividend payment in 2000-01 comprised a $47.1 million interim dividend, paid on 29 June 2001 and provision for a $47 million dividend, to be paid during December 2001.

HYDRO-ELECTRIC CORPORATION Tasmania

On 1 July 1998, the Hydro-Electric Corporation (HEC) was disaggregated into three separate businesses — the HEC, Aurora Energy and Transend Networks.[1] The HEC retained responsibility for electricity generation on mainland Tasmania and for generation, distribution and retailing on the Bass Straight Islands.[2] The HEC also provides consulting services. The restructure makes direct comparisons of financial performance with previous years difficult.[3] The corporation operates under the *Hydro-Electric Corporation Act 1995* and is subject to the provisions of the *Government Business Enterprises Act 1995* (GBE Act).

In 2000-01, pre-tax operating profit increased by over $44 million. Revenue grew by 7 per cent in 2000-01, the first increase since disaggregation.

During 1999-00 and 2000-01, the HEC undertook a debt restructuring program. Over the two years, loans with a face value of $317 million ($119 million and $198 million in 2001 and 2000 respectively) and interest rate swaps of $898 million ($596 million and $302 million in 2001 and 2000 respectively) were terminated prior to maturity. The restructuring process cost the HEC around $34 million over the two years, affecting profitability indicators, particularly in 1999-00. The HEC expects these short-term costs to be outweighed by reductions in borrowing costs into the future. During 2000-01, borrowing fell by $13 million.

Under the provisions of the GBE Act, the HEC is required to make tax-equivalent and dividend payments. The HEC also makes payments for debt guarantees ($2.8 million in 2000-01) and pays a levy based on a percentage of retail energy sales to customers on the Bass Straight Islands.[4]

Since 1998-99, community service obligation (CSO) payments have been made to the HEC to compensate for provision of electricity to customers on the Bass Strait Islands. In 2000-01, CSO payments amounted to $4.9 million.

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1 Prior to disaggregation, the HEC had sole responsibility for the generation, transmission and sale of electricity in Tasmania. Transend Networks is now responsible for electricity transmission and Aurora Energy is responsible for electricity distribution and retailing. On 1 July 2000, the responsibility of system controller for the Tasmanian electricity network was transferred to Transend Networks.

2 Delivery of services to the Bass Straight Islands has been contracted to Aurora Energy.

3 The financial impact of the restructure was a reduction in the HEC's equity of $520.1 million.

4 Over the reporting period, the HEC made payments to consolidated revenue under the *Hydro-Electric Corporation (Contributions) Act*. These payments amounted to $0.1 million in 2000-01. Due to legislative changes these payments will not be required from 1 July 2001.

HYDRO-ELECTRIC CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*[e]
Size						
Total assets	$m	4 374	4 041	3 199	3 250	3 342
Total revenue	$m	528	538	323	323	332
Profitability						
Operating profit before tax (includes abnormals)	$'000	85 486	94 693	26 792	1 676	46 284
Operating sales margin	%	53.2	46.8	41.5	31.5	40.2
Cost recovery	%	216.5	193.4	179.9	164.3	165.2
Return on assets	%	6.3	6.0	3.7	3.2	4.1
Return on equity	%	1.3	1.7	0.1	0.4	0.8
Financial management						
Debt to equity	%	59.1	67.7	61.2	57.5	55.0
Debt to total assets	%	31.8	33.2	28.9	32.1	31.5
Total liabilities to equity	%	81.2	95.9	87.0	80.4	77.2
Interest cover	times	1.4	1.6	1.2	1.0	1.5
Current ratio	%	26.1	27.7	17.9	25.2	27.6
Leverage ratio	%	181.2	195.9	187.0	180.4	177.2
Payments to and from government						
Dividends	$'000	27 153	57 709	42 591	45 062	49 230
Dividend to equity ratio	%	1.1	2.6	2.3	2.6	2.7
Dividend payout ratio	%	84.0	148.3	1 643.8	623.9	323.4
Income tax expense	$'000	53 180	55 790	24 201	-5 547	31 060
CSO funding	$'000	0	0	4 390	4 551	4 914

a Includes an asset revaluation decrement of $171 million. **b** The Hydro-Electric Corporation (HEC) incurred abnormal expenses relating to the refurbishment of property assets in villages around power stations in readiness for their disposal. Includes an asset revaluation decrement of $329 million. **c** On 1 July 1998, the HEC was structurally separated into three businesses. This involved the transfer of assets (valued at $1 billion) and liabilities (valued at $472.3 million) relating to transmission, distribution and retailing to Aurora Energy and Transend Networks. The data from 1998-99 relates only to the restructured HEC. The HEC incurred abnormal expenses relating to maintenance on one power station and the refurbishment of another to meet peak demand as a consequence of the maintenance being undertaken on the first. Includes an asset revaluation increase of $209 million. **d** The HEC reported an abnormal expense of $26.8 million related to debt restructuring. Includes an asset valuation increase of $129 million. **e** Includes debt restructuring expenses relating to the repurchase of loans ($6.8 million) and the termination of interest rate swaps ($670 000).

AURORA ENERGY — Tasmania

Aurora Energy Pty Ltd was established on 1 July 1998, following the dissagregation of the Hydro-Electric Corporation (HEC).[1] Aurora Energy is mainland Tasmania's only electricity distribution and retail company. Aurora was formed under the *Electricity Companies Act 1997* and is subject to corporations law. Maximum prices that Aurora can charge are set by the Office of the Tasmanian Electricity Regulator.[2]

In 2000-01, Aurora entered into a telecommunications joint-venture with AAPT and the HEC (TasTel) and formed a subsidiary company — EziKey — to promote its bill paying system.

Aurora's financial performance has improved throughout the reporting period. In 2000-01, operating profit (before tax) improved by 27 per cent — mainly due to a 4 per cent increase in sales revenue while borrowing costs fell by 18 per cent.

Aurora Energy is subject to the income tax-equivalent provisions of the *Government Business Enterprises Act 1995* (GBE Act) and also pays a dividend to the Tasmanian Government. In 2000-01, $10.2 million — or 50 per cent of after-tax profit — was paid as a dividend.

Additional returns to government are paid in the form of a debt guarantee levy ($1.1 million in 2000-01) and a contribution to the consolidated fund related to energy sales ($14 million in 2000-01). Under the provisions of the *Electricity Entities (Contributions Act) 1997*, Aurora Energy paid a levy determined at the rate of 5 per cent of income derived from energy sales to retail customers, other than eligible pensioners in receipt of a discount.[3]

Aurora Energy has a Community Service Activity Agreement with the Tasmanian Government, under which it receives a payment for providing pensioners with discounted electricity. In 2000-01, payments amounted to $9.7 million.

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1 Prior to disaggregation, the HEC had sole responsibility for the generation, transmission and sale of electricity in Tasmania. Transend Networks is now responsible for electricity transmission and Aurora Energy is responsible for electricity distribution and retailing. The HEC is also responsible for generation, distribution and retailing on the Bass Straight Islands, although service delivery has been contracted to Aurora Energy.

2 In November 1999, Aurora Energy was subject to a pricing determination covering the period January 2000 to January 2003. The outcome was a 7 per cent per year average reduction in real prices for high voltage customers, a 1.3 per cent reduction for low voltage customers and a 1 per cent rise for domestic customers (all in real terms).

3 Due to legislative changes these payments will not be required from 1 July 2001.

AURORA ENERGY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*[a]	*1999-00*[b]	*2000-01*
Size						
Total assets	$m	n.r.	n.r.	762	765	792
Total revenue	$m	n.r.	n.r.	543	551	572
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	26 596	29 105	37 002
Operating sales margin	%	n.r.	n.r.	11.9	12.7	12.3
Cost recovery	%	n.r.	n.r.	112.7	114.7	114.0
Return on assets	%	n.r.	n.r.	8.6	9.3	9.0
Return on equity	%	n.r.	n.r.	5.5	8.4	7.7
Financial management						
Debt to equity	%	n.r.	n.r.	171.2	158.8	143.9
Debt to total assets	%	n.r.	n.r.	51.0	49.5	47.8
Total liabilities to equity	%	n.r.	n.r.	235.7	221.2	201.0
Interest cover	times	n.r.	n.r.	1.7	1.7	2.1
Current ratio	%	n.r.	n.r.	72.2	76.7	55.2
Leverage ratio	%	n.r.	n.r.	335.7	321.2	301.0
Payments to and from government						
Dividends	$'000	n.r.	n.r.	6 200	10 052	10 244
Dividend to equity ratio	%	n.r.	n.r.	2.7	4.2	3.9
Dividend payout ratio	%	n.r.	n.r.	50.0	50.0	50.8
Income tax expense	$'000	n.r.	n.r.	14 196	9 002	16 856
CSO funding	$'000	n.r.	n.r.	9 826	9 797	9 727

a Aurora Energy commenced operations on 1 July 1998 following the restructure of the Hydro-Electric Corporation. Aurora Energy is responsible for the low voltage distribution and retailing of electricity and has an exclusive retail licence for all of Tasmania, excluding the Bass Strait Islands. Aurora Energy incurred abnormal expenses ($3.8 million) relating to payments made to staff under redundancy and voluntary advanced retirement programs and rebranding costs. **b** Aurora Energy reported abnormal expenses of $2.9 million relating to redundancy and retirement payments, rebranding costs, costs associated with year 2000 preparation and Goods and Services Tax implementation. This was offset by abnormal revenue of $2.3 million for a reversal of superannuation provisions. **n.r.** Not relevant.

TRANSEND NETWORKS Tasmania

Transend Networks (Transend) was established on 1 July 1998, following the dissaggregation of the Hydro-Electric Corporation (HEC).[1] Transend owns and operates the high voltage electricity transmission system in Tasmania, which includes almost 3 500 km of overhead transmission lines, 45 substations and 10 switching stations. Transend was formed under the *Electricity Companies Act 1997* and is subject to corporations law.

On 1 July 2000, Transend assumed the role of system controller for the Tasmanian electricity network from the HEC, making it responsible for maintaining power system security and assisting with power system planning. Maximum transmission prices that Transend can charge are set by the Office of the Tasmanian Electricity Regulator.[2]

In 2000-01, operating profit (before tax) fell by 35 per cent — despite a 15 per cent increase in revenue — mainly due to rises in operating and depreciation expenses. The increases in revenue and expenses in 2000-01 can be largely attributed to Transend's assumption of system controller responsibilities.

Debt decreased by 37 per cent in 2000-01, leading to lower debt to equity and debt to total asset ratios and reduced interest payments. In comparison to most other transmission GTEs, Transend's relative debt levels are very low — with Powerlink and Transgrid both having debt to total assets ratios above 100 per cent, compared to Transend's ratio of 3.4 per cent.

Transend is subject to the income tax-equivalent provisions of the *Government Business Enterprises Act 1995*. In 2000-01, the Board recommended that a dividend of $10.1 million be paid to the shareholder government. Transend has not been required to perform any community service obligations by the Tasmanian Government over the reporting period.

1 Prior to disaggregation, the HEC had sole responsibility for the generation, transmission and sale of electricity in Tasmania. Transend Networks is now responsible for electricity transmission and Aurora Energy is responsible for electricity distribution and retailing.

2 In November 1999, Transend was subject to a pricing determination by the Tasmanian Electricity Regulator covering the period January 2000 to January 2003. The outcome was that the revenue cap was increased by 4.3 per cent in real terms for Transend's regulated activities.

TRANSEND NETWORKS (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*	*1999-00*	*2000-01*
Size						
Total assets	$m	n.r.	n.r.	406	437	464
Total revenue	$m	n.r.	n.r.	66	68	78
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	34 656	34 220	22 407
Operating sales margin	%	n.r.	n.r.	52.8	51.6	30.6
Cost recovery	%	n.r.	n.r.	211.7	206.5	144.0
Return on assets	%	n.r.	n.r.	8.6	8.3	5.3
Return on equity	%	n.r.	n.r.	5.7	6.2	2.6
Financial management						
Debt to equity	%	n.r.	n.r.	4.0	5.2	3.9
Debt to total assets	%	n.r.	n.r.	3.5	4.6	3.5
Total liabilities to equity	%	n.r.	n.r.	15.7	16.8	17.4
Interest cover	times	n.r.	n.r.	91.7	41.4	16.4
Current ratio	%	n.r.	n.r.	27.1	27.3	35.8
Leverage ratio	%	n.r.	n.r.	115.7	116.8	117.4
Payments to and from government						
Dividends	$'000	n.r.	n.r.	9 994	11 199	10 091
Dividend to equity ratio	%	n.r.	n.r.	2.8	3.1	2.6
Dividend payout ratio	%	n.r.	n.r.	50.0	50.0	100.2
Income tax expense	$'000	n.r.	n.r.	14 668	11 821	12 341
CSO funding	$'000	n.r.	n.r.	0	0	0

n.r. Not relevant.

SNOWY MOUNTAINS HYDRO-ELECTRIC AUTHORITY Commonwealth

The Snowy Mountains Hydro-Electric Authority (SMHEA) controls the Snowy Mountains Scheme — a dual-purpose hydro-electric and irrigation development. The SMHEA operates under the *Snowy Mountains Hydro-Electric Power Act 1949* (SMHEP Act) and is responsible for the collection, storage, diversion and release of water for irrigation and the generation and transmission of electricity. The Commonwealth, NSW and Victoria are joint shareholder governments of the SMHEA.

Although the SMHEA remains a statutory authority, it is prescribed by regulation to be a government business enterprise for the purposes of the *Commonwealth Authorities and Companies Act 1997*. This requires, amongst other things, that the SMHEA prepares a corporate plan which is agreed to by the responsible minister. Over the latter half of the reporting period, the authority has been preparing for transition to a fully corporatised government trading enterprise.[1]

The SMHEA generates its revenue through contributions from the recipients of the Scheme's energy production. Under the SMHEP Act, contributions are made to the Authority's revenue on the basis of the net cost of production.[2] Net cost of production has fallen by 19 per cent over the reporting period. The Authority does not generate any revenue from its water operations.

Over the reporting period, the SMHEA has maintained a cost recovery ratio of around 90 per cent and earned a relatively low return on assets. The operating losses incurred over the period largely stem from an asset revaluation in 1991, which led to depreciation charges.[3] The inability of the SMHEA to recover the full cost of its operations has prevented the authority from achieving higher returns.

The Authority is not subject to any explicit community service obligations, nor is it required to make dividend payments, pay tax or make tax-equivalent payments.

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1 In 1997, Snowy Hydro Trading Pty Ltd (SHTPL) was established to trade electricity generated by the Snowy scheme in the National Electricity Market (NEM). On 27 June 2001, SHTPL was incorporated as Snowy Hydro Ltd. It is expected that Snowy Hydro Ltd will merge with the SMHEA in 2001-02. The company will be incorporated and subject to national competition laws as well as the overall regulatory framework applying to all participants in the NEM.

2 For any given year the net cost of production includes annual interest, an instalment for accumulated interest, depreciation, maintenance charges and operational costs less miscellaneous credits of a current nature.

3 Under the SMHEP Act, the additional depreciation charge resulting from the asset revaluation cannot be included in determining the net cost of production.

SNOWY MOUNTAINS HYDRO-ELECTRIC AUTHORITY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*	*1999-00*	*2000-01*
Size						
Total assets	$m	3 423	3 346	3 241	3 161	3 100
Total revenue	$m	171	156	138	141	156
Profitability						
Operating profit before tax (includes abnormals)	$'000	-79 402	-80 138	-78 783	-79 728	-76 820
Operating sales margin	%	-1.7	-1.6	-8.7	-12.0	-13.1
Cost recovery	%	98.3	98.4	92.0	89.3	88.4
Return on assets	%	0.3	0.1	-0.2	-0.4	-0.5
Return on equity	%	-3.2	-3.3	-3.4	-3.5	-3.5
Financial management						
Debt to equity	%	38.2	39.6	39.7	41.2	42.9
Debt to total assets	%	26.6	27.7	27.6	28.4	29.2
Total liabilities to equity	%	39.9	41.4	41.7	43.2	45.5
Interest cover	times	0.1	0.0	-0.1	-0.2	-0.2
Current ratio	%	43.0	19.7	36.5	63.8	59.8
Leverage ratio	%	139.9	141.4	141.7	141.7	141.7
Payments to and from government						
Dividends	$'000	0	0	0	0	0
Dividend to equity ratio	%	0	0	0	0	0
Dividend payout ratio	%	0	0	0	0	0
Income tax expense	$'000	0	0	0	0	0
CSO funding	$'000	0	0	0	0	0

8 Water, sewerage, drainage and irrigation

The financial performance of 14 water, sewerage, drainage and irrigation (referred to hereafter as water) government trading enterprises (GTEs) is discussed in this chapter. At the end of 2000-01, these enterprises generated over $4.9 billion in revenue and controlled assets valued at $39 billion. They undertake a variety of activities, including water treatment, bulk water supply, reticulation and retail supply, sewerage collection and treatment, drainage and irrigation.

The study covers mostly GTEs that service major urban areas. Non-metropolitan urban water authorities, regional water authorities and local governments are, with some exceptions, not covered.

For a discussion of the data and the performance indicators used and some of the factors that should be considered when assessing performance, see chapter 3.

8.1 Sector reforms

Reforms within the water industry have been aimed at improving efficiency and financial performance by making the GTEs more commercially focused.

In February 1994, the Council of Australian Governments (COAG) agreed to develop a 'strategic framework' for water reform. Governments decided to bring this framework within the ambit of the National Competition Policy (NCP) process in April 1995. Under the framework, governments agreed to introduce:

- consumption-based two-part tariffs, full cost recovery, and to remove or make transparent subsidies and cross-subsidies;
- explicit identification and funding of community service obligations (CSOs);
- structural separation of water resource management, standard setting and regulatory enforcement from water provision;
- trading in rural water entitlements; and
- the allocation of water for the environment.

Almost all jurisdictions have implemented two-part tariffs for water and sewerage services in urban areas and removed many cross-subsidies between customer classes. However, WA, SA and Tasmania mostly retain property-based charges for sewerage services (Productivity Commission 2002).

Around 50 per cent of the monitored GTEs received funding for CSOs over the reporting period, mainly relating to the provision of water to country areas and pensioner concessions. Most of these GTEs received CSOs over the entire reporting period. The exception was in Queensland, where State Water Projects (now Sunwater) received CSO funding for the first time in 1998-99. This improved the transparency of existing non-commercial activities undertaken by State Water Projects following its commercialisation in July 1997.

Regulatory, standard setting and resource management functions have been removed from service providers in most jurisdictions. The establishment of the Sydney Catchment Authority, which began operations in 1999, is an example of the separation of resource management from water provision.

The Sydney Catchment Authority arose out of the review of the 1998 Sydney incidents concerning the detection of the parasites *Cryptosporidium* and *Giardia* in drinking water. It was made responsible for the management and protection of Sydney's water supply catchments, dams, raw water transfer pipelines and canals, and associated infrastructure. These assets, valued at $647 million, were transferred from the Sydney Water Corporation to the Authority.

The COAG water industry reform is not the only path taken to improve the efficiency and financial performance of water GTEs. There have also been changes in governance arrangements and the structure of some GTEs.

Some activities have been privatised. For example, the SA Government contracted out the management and operation of the water supply for the Adelaide metropolitan area to a private company in 1996. In contrast, Sydney Water and Hunter Water, changed their status from company to statutory government-owned corporations on 1 January 1999 — to give the responsible Minister greater power to access information and issue directions to the corporations (see table 8.1).

Table 8.1 **Monitored water GTEs, 1996-97 to 2000-01**

1996-97	*1997-98*	*1998-99*	*1999-00*	*2000-01*
New South Wales				
Hunter Water Corporation	→	→	→	Hunter Water Corporation[a]
Sydney Water Corporation	→	Sydney Water Corporation[a]	→	Sydney Catchment Authority
			→	Sydney Water Corporation
Victoria				
Melbourne Water	→	→	→	Melbourne Water
City West Water	→	→	→	City West Water
South East Water	→	→	→	South East Water
Yarra Valley Water	→	→	→	Yarra Valley Water
Barwon Water	→	→	→	Barwon Water
Queensland				
Department of Primary Industries and Water Resources	→	Department of Natural Resources, State Water Projects[b]	→	Sunwater[c]

a Changed from a company to a statutory government-owned corporation in January 1999. **b** Fully commercialised on 1 July 1997. **c** Established as a government-owned corporation in October 2000.

(Continued next page)

Table 8.1 (continued)

1996-97	*1997-98*	*1998-99*	*1999-00*	*2000-01*
Western Australia				
The Water Corporation[d]	→	→	→	The Water Corporation
South Australia				
SA Water Corporation	→	→	→	SA Water Corporation
Tasmania				
Hobart Regional Water Board	→	→	→	Hobart Regional Water Authority
Rivers and Water Supply Commission, North Esk	Esk Water Authority[e]	→	→	Esk Water Authority
North West Regional Water Authority	→	→	→	North West Water Authority[f]

d Previously the Water Authority of Western Australia. **e** Control and ownership transferred to local governments' joint venture. Assets from the North Esk Scheme, West Tamar Scheme and Launceston City Council were amalgamated to form the Esk Water Authority. **f** North West Regional Water Authority established on 10 August 1999 as a local government joint authority, North West Water Authority. In July 2000, the North West Water Authority adopted the trading name Cradle Coast Water.

Some GTEs have been disaggregated into separate businesses. For example, the Melbourne Water Corporation was disaggregated into four separate government-owned enterprises on 1 January 1995 — a bulk water wholesaler and three water retail companies.

8.2 Market environment

A number of factors influence the market environment that water GTEs operate in. In particular, the demand and supply for water and the consequent revenue for GTEs is affected by weather conditions. For example, following a dry summer, Sydney Water supplied 2404 million litres per day in March 1998 compared to 1700 million litres per day at the same time in 1997. In addition, water restrictions may have to be imposed in unusually dry weather, to the detriment of revenue.

The introduction of two-part tariffs has increased revenue volatility. When revenue was raised through property-based charges, the revenue stream was more stable and predictable unless there was a major change in property values. With the recent increased reliance on user-based charges, revenue depends on the level of demand and is therefore less stable. However, usage charges provide an incentive to consumers to manage their demand.

Revenue volatility is also affected by the inclusion of developer and customer contributions as revenue.[1] During 1999-00, the building sector experienced considerable growth, with the value of work done on new residential buildings increasing by 20 per cent compared to the previous year (ABS 2001). As a result of this increased activity, contributions to monitored water GTEs grew by over 32 per cent.

Changes in developer and customer contributions affect some water GTEs more than others. For example, Melbourne Water developer charges and contributions accounted for nearly 10 per cent of total revenue in 1999-00 compared to just over 4 per cent of total revenue in 1998-99.

Water GTEs are usually required to strike a balance between consumptive and environmental needs in generating an acceptable return to shareholder governments. The amount of water that GTEs can draw from their surface and groundwater sources is usually limited for environmental reasons. For example, the Water

1 Developer and customer contributions entail the transfer of monetary or non-monetary assets to GTEs. GTEs may require customers and developers to contribute capital to finance new infrastructure. Alternatively, GTEs may require developers to construct or install infrastructure assets. Ownership of such assets is transferred to the responsible GTE at no cost.

Corporation of Western Australia holds a water allocation licence, issued by the Water and Rivers Commission, which specifies the amount of water the Corporation can draw from its surface and ground water sources.

Economic regulation of prices can also influence the market environment in which water GTEs operate. In most jurisdictions, the government or an independent pricing body regulates water prices. For example, in NSW the Independent Pricing and Regulatory Tribunal (IPART) is responsible for determining prices for major urban centres and for rural bulk water provision. In September 2000, the tribunal issued the medium term price path for the Sydney Catchment Authority, to extend from 2000-01 to 2004-05.[2]

8.3 Profitability

Profitability indicators provide information on how GTEs are using the assets vested in them by shareholder governments to generate earnings. For a more detailed discussion of profitability indicators, see chapter 3.

The water industry is diverse. Some GTEs undertake a range of activities like bulk water provision, reticulation, sewerage and drainage (for example Hunter Water). Others, such as Sunwater, undertake only one activity (primarily focused on the provision of bulk and raw water). Comparisons need to take this diversity into account.

Operating profit is influenced by the combination of prices, business volumes and expenses. The impact of these factors varied among GTEs. The operating profit of most water GTEs has improved over the reporting period. Total industry operating profit before tax increased from $1.1 billion in 1996-97 to $1.5 billion in 2000-01.[3]

The improvement in operating profit over this period was comparable to the growth in the value of assets. As a result, the return on assets for the sector overall remained stable at 5 per cent. In 2000-01, most water GTEs had a rate of return on assets less than 6 per cent (see figure 8.1), which is below the long-term bond rate.[4]

Part of the decline in profitability in 2000-01 — which was contrary to the five year trend — was due to a slowdown in the level of building activity which resulted in a

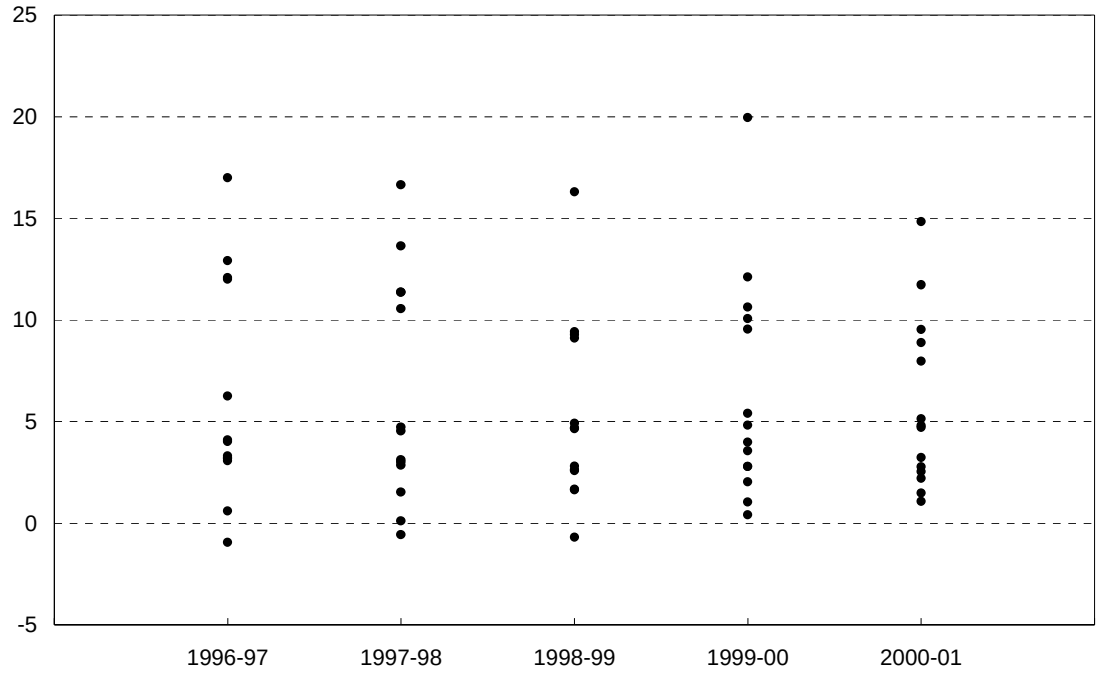
2 IPART determined that the Sydney Catchment Authority's charges to Sydney Water will be maintained in real terms at the 1999-00 level.

3 The treatment of contributed assets has changed over the reporting period in response to changes in the implementation of accounting standards since 1997-98. In 1996-97, contributed assets were excluded from revenue and assets.

4 The rate of return for 10 year bonds at June 2001 was 6.0 per cent, declining from 7.1 per cent in June 1997 (RBA 2002).

fall in revenue from contributed assets. For example, the value of assets contributed to Melbourne Water declined from $46.6 million in 1999-00 to $27.6 million, accounting for most of the $36 million decline in operating profit.

Figure 8.1 **Return on assets, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the return on assets ratio for a government trading enterprise in that financial year. Return on assets is the ratio of earnings before interest and tax (EBIT) to average total assets. EBIT is calculated by subtracting total expenses from total revenue (includes abnormals) and adding back gross interest expense. Average total assets are the average of the value of assets at the beginning and end of each financial year.

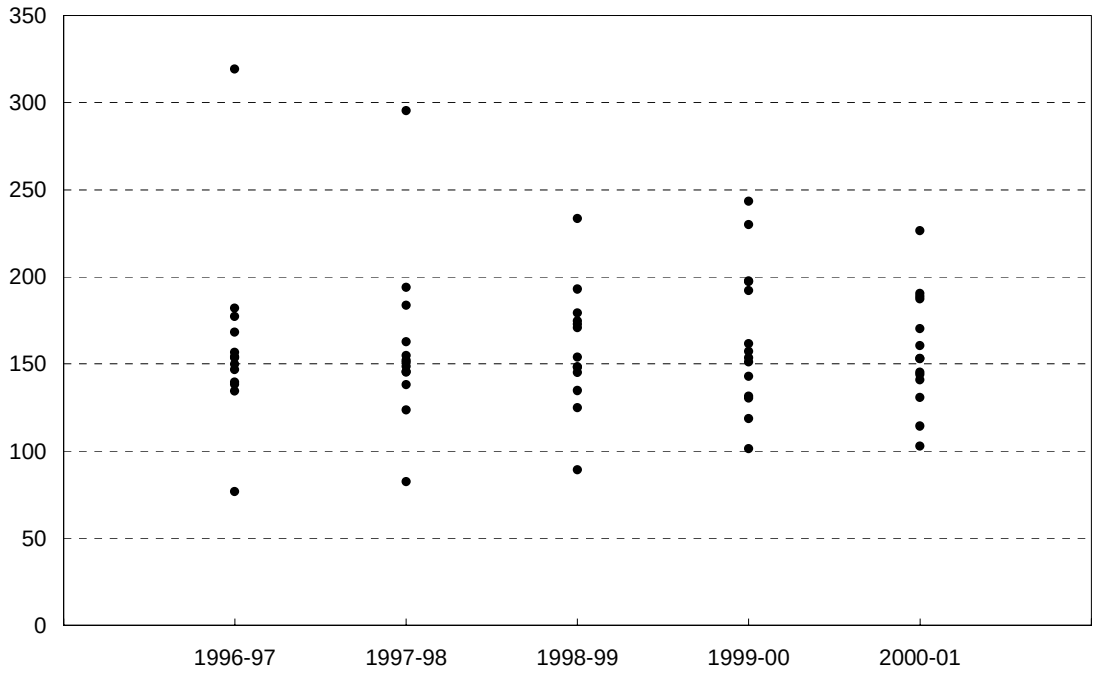
The return on assets is also affected by asset valuations. For example, the value of Sunwater's assets decreased by almost 90 per cent in 1999-00, as a result of the revaluation of non-current physical assets and a move from deprival valuation methodology to fair value methodology. Subsequently, return on assets and return on equity improved.

Another ratio used to measure profitability is return on equity — the rate of earnings on capital provided by shareholder governments. Over the reporting period the return on equity for most water GTEs improved. Return on equity is affected by debt restructuring and operating profits. For example, return on equity for the North West Water Authority increased from -5.4 per cent in 1997-98 to 3.7 per cent in 2000-01, as interest expenses declined, following debt restructuring, and operating profit improved.

The cost recovery ratio indicates a GTE's ability to generate adequate revenue to cover expenses. Most water GTEs achieved cost recovery ratios between 100 and

250 per cent over the reporting period. Prior to 1999-00, Sunwater was unable to achieve a cost recovery ratio of over 100 per cent, despite receiving CSO payments to cover the costs of operation, maintenance and administration (see figure 8.2). On the other hand, Melbourne Water has maintained a cost recovery ratio over 200 per cent.

Figure 8.2 **Cost recovery, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the cost recovery ratio for a government trading enterprise in that financial year. Cost recovery is the ratio of revenue from operations to expenses from operations. Revenue from operations is calculated by subtracting investment income and receipts from governments to cover deficits on operations from total revenue. Expenses from operations are calculated by subtracting gross interest expense from total expenses. Prior to 2000-01, abnormal items were also subtracted from operating expenses and revenue.

8.4 Financial management

Financial management indicators provide information about the capital structure of GTEs and their ability to meet the cost of servicing debt and other liabilities as they fall due. For a more detailed discussion of financial management indicators, see chapter 3.

Many water GTEs have undergone financial restructuring as part of the reform process. This has largely involved debt for equity swaps, debt repayments and debt novation.[5]

The magnitude of debt restructuring has typically depended on the GTE's initial capital structure. For example, Barwon Water's capital structure was changed in 1998-99 to lower borrowing costs and reduce exposure to interest rate fluctuations. The Authority undertook novation of its debt portfolio to the Treasury Corporation of Victoria (TCV).

Debt levels for monitored water GTEs have declined by 1.1 per cent over the reporting period and as a result, financial management ratios have improved. At the end of 2000-01 most water GTEs have debt to total assets ratios of below 30 per cent (see figure 8.3).

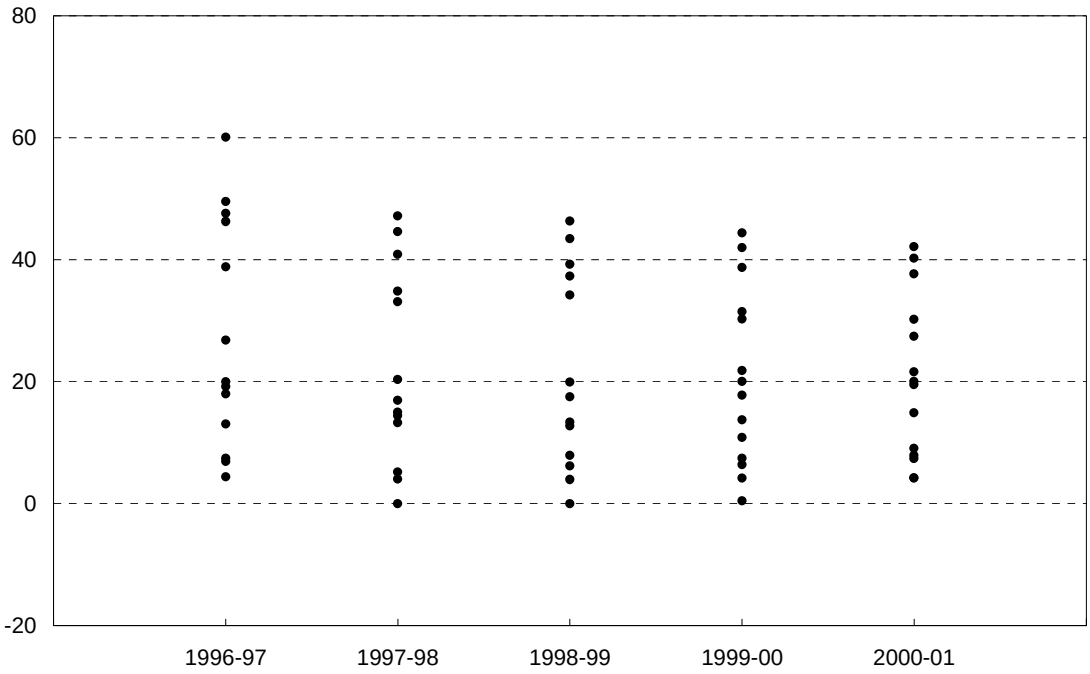
In 1996-97, there were four GTEs with debt to total assets ratios above 45 per cent. These included Melbourne Water and the three retail water GTEs in Victoria. From 1997-98, their debt to total asset ratios fell as a result of capital restructuring introduced by the Victorian Government as part of a $850 million financial reform package, which included a debt for equity swap. However, they continue to have debt to total asset ratios above the other monitored water GTEs.

Asset revaluations have affected the debt to total assets ratios of some water GTEs over the reporting period. For example, the value of the North West Water Authority's assets declined by $26.7 million in 1997-98 due to an asset revaluation. As a result, the debt to total assets ratio increased from 26.8 per cent in 1996-97 to 33.1 per cent in 1997-98, with no significant change in the level of debt.

With the exception of the Victorian GTEs, the debt to equity ratio for most GTEs has been less than 50 per cent. The Melbourne Water Corporation had the highest debt to equity ratio — 235.5 per cent in 1996-97. This has declined over the reporting period to 93.0 per cent, following a debt for equity swap in 1997-98 and a declining level of debt.

5 Novation is the substitution of a new obligation for an old one. Usually it involves the substitution of a new debtor or a new creditor.

Figure 8.3 **Debt to total assets, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the debt to total assets ratio for a government trading enterprise in that financial year. Debt is defined to include all repayable borrowings (interest bearing and non-interest bearing), interest bearing non-repayable borrowings and finance leases. Average total assets are the average of the value of assets at the beginning and end of each financial year.

Another indicator of financial management is interest cover, which measures the capacity of the GTE to meet periodic interest payments out of current earnings. The sector average for interest cover in 2000-01 was 4.4 times, which was lower than the previous year (4.8 times), but higher than the average at the beginning of the reporting period (2.6 times). For most GTEs, increases in interest cover have resulted from lower interest costs due to debt restructuring or lower debt levels.

The ability of water GTEs to meet short-term liabilities, as measured by the current ratio, has remained largely unchanged over the reporting period. Although most water GTEs have had current ratios below 100 per cent for most of the reporting period, the generally stable cash flows that are a feature of the water sector suggest that low current ratios can be sustained.

8.5 Financial transactions

As a part of the reform process, governments have sought to give GTEs a greater commercial focus and facilitate competitive neutrality by exposing them to

incentives and regulations similar to those faced by private sector businesses. For a more detailed discussion of competitive neutrality principles, see chapter 3.

The timing of the introduction of tax-equivalent regimes has varied across jurisdictions. However, by the end of the reporting period all water GTEs, with the exception of Barwon Water, were required to make tax-equivalent payments.

Income tax expense decreased in 1999-00 as a result of a reduction in the future company tax rate.[6] Across the sector, this led to a downward adjustment in tax-equivalent payments by around $150 million.

Dividends represent a return to shareholder government equity. Almost all the monitored water GTEs are required to make dividend payments, with the amount dependent on the dividend policy of its owner government (PC 2001). In 2000-01, three water GTEs had dividend payout ratios — the proportion of operating profit that is paid or provided for as dividend — above 100 per cent. Two water GTEs did not pay a dividend in 2000-01.

A requirement of the COAG reforms is disclosure of the amount by which services are provided at prices which do not fully recover costs.[7] Governments are required to fund any deficiency through CSO payments. This achieves transparency in CSO funding and removes the conflict between non-commercial objectives and cost recovery. CSOs provided by some water GTEs include concessions, the supply of services below the cost of provision and upgrading sewerage infrastructure.

6 The company tax rate fell from 36 per cent in 1999-00 to 34 per cent for 2000-01. It will fall to 30 per cent from 2001-02.

7 Under the COAG water reform framework covering full cost recovery, prices should be set to cover a range of costs such as operational, maintenance and administrative costs, externalities, taxes or tax-equivalent payments, provisions for the cost of asset consumption, interest costs on debt and dividends (NCC 2002).

8.6 GTE performance reports

Sydney Catchment Authority (NSW)
Sydney Water Corporation (NSW)
Hunter Water Corporation (NSW)
Melbourne Water Corporation (Victoria)
City West Water (Victoria)
South East Water (Victoria)
Yarra Valley Water (Victoria)
Barwon Regional Water Authority (Victoria)
Sunwater (Queensland)
SA Water Corporation (SA)
Water Corporation (WA)
Hobart Regional Water Authority (Tasmania)
North West Water Authority (Tasmania)
Esk Water Authority (Tasmania)

SYDNEY CATCHMENT AUTHORITY — New South Wales

The Sydney Catchment Authority (SCA) is a statutory body set up by the NSW Government to manage and protect Sydney's water supply catchments, dams, raw water transfer pipelines and canals, and associated infrastructure. In addition, the SCA supplies bulk water to Sydney Water Corporation (SWC) and local government areas outside the Sydney distribution system. The *Sydney Water Catchment Management Act 1998* and the *Sydney Catchment Authority Operating Licence* govern the SCA's activities. The SCA began operations in July 1999.

Responsibility for managing catchments, dams and their associated infrastructure was transferred from SWC to the SCA. There was a transfer of $492 million in net assets, comprising mainly $619 million in system assets, property and equipment and $162 million of debt.

Prices for bulk water and services provided by the SCA are determined by the Independent Pricing and Regulatory Tribunal (IPART). Under a determination issued by IPART in September 2000, prices in 2000-01 declined by 2 per cent in real terms compared to 1999-00.[1]

Profitability declined in 2000-01 compared to the previous year, due mainly to a 20 per cent increase in expenses. The increase was mainly related to rises in contractor payments, wages, salaries and superannuation.

Capital expenditure by the SCA in 2000-01 was around $33 million. This was largely funded from retained earnings because the level of borrowings was largely unchanged compared to the previous year.

The SCA's taxation liability is assessed according to the tax-equivalent regime of the NSW Treasury and payments are directed to the NSW Government. The SCA is also required to make dividend payments.

The SCA undertakes non-commercial activities. However, the provision and funding of community service obligations are not explicitly reported in the financial statements.[2]

1 Under the determination, prices will remain fixed in real terms over the period 2000-01 to 2004-05, subject to a review by IPART in 2002-03.

2 Examples of non-commercial activities include the provision of monetary or in-kind grants to groups such as the National Trust and Landcare for catchment protection and improvement projects.

SYDNEY CATCHMENT AUTHORITY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*	*1999-00*[a]	*2000-01*
Size						
Total assets	$m	n.r	n.r	n.r	736	746
Total revenue	$m	n.r	n.r	n.r	123	124
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r	n.r	n.r	59 880	47 436
Operating sales margin	%	n.r	n.r	n.r	56.5	46.6
Cost recovery	%	n.r	n.r	n.r	230.0	187.3
Return on assets	%	n.r	n.r	n.r	9.5	8.0
Return on equity	%	n.r	n.r	n.r	7.5	5.9
Financial management						
Debt to equity	%	n.r	n.r	n.r	30.9	30.1
Debt to total assets	%	n.r	n.r	n.r	21.8	21.6
Total liabilities to equity	%	n.r	n.r	n.r	41.5	40.0
Interest cover	times	n.r	n.r	n.r	7.2	5.1
Current ratio	%	n.r	n.r	n.r	92.7	70.4
Leverage ratio	%	n.r	n.r	n.r	141.5	140.0
Payments to and from government						
Dividends	$'000	n.r	n.r	n.r	10 600	17 600
Dividend to equity ratio	%	n.r	n.r	n.r	2.0	3.3
Dividend payout ratio	%	n.r	n.r	n.r	27.3	56.5
Income tax expense	$'000	n.r	n.r	n.r	21 100	16 278
CSO funding	$'000	n.r	n.r	n.r	0	0

a The *Sydney Water Catchment Management Act 1998* received assent on 14 December 1998. On 2 July 1999 the Sydney Catchment Authority (SCA) commenced operations. On this date $491.6 million in net assets where transferred from Sydney Water Corporation to the SCA. **n.r**. not relevant.

SYDNEY WATER CORPORATION — New South Wales

Sydney Water Corporation (SWC) was corporatised on 1 January 1999 following the enactment of the *Water Legislation Amendment (Drinking Water and Corporate Structure) Act 1998*. SWC supplies drinking water and provides wastewater services and some stormwater services to Sydney, the Blue Mountains and the Illawarra. It serves more than 3.9 million customers.

About 90 per cent of SWC's revenue is regulated by the NSW Independent Pricing and Regulatory Tribunal (IPART).[1]

Profitability declined in 2000-01 compared to the previous year due to an increase in expenses and a reduction in the value of contributed assets as developer activity fell. Expenses included $56.2 million of superannuation adjustments, $8.1 million of redundancy payments and $36.3 million for the repayment of excess government contributions for sewerage backlog projects paid to SWC as capital contributions in previous years.

The decline in assets in 1999-00 was partly due to a transfer of staff, assets, rights and liabilities relating to catchment management to the Sydney Catchment Authority in July 1999. The assets included catchments, dams and bulk water pipelines, resulting in a transfer of net assets worth $492 million.

Capital expenditure of $432.1 million and a revaluation increment of $167.8 million to system assets in 2000-01 resulted in a 3 per cent increase in assets compared to the previous year. Capital expenditure was partly funded by a $164.7 million increase in the level of borrowings.

SWC is required to make tax-equivalent and dividend payments. It receives funding for the provision of community service obligations.[2]

1 IPART's determination covering the period October 2000 to June 2003 set specific prices for all services in 2000-01. Prices in subsequent years are to be adjusted using a CPI-X formula. In November 2001, IPART also assumed responsibility for urban water licensing arrangements.

2 In 2000-01, funding related to rebates for pensioners and low income households ($63.2 million), exempt properties such as charitable and religious organisations ($9.4 million), and the Blue Mountains septic pumpout service ($0.7 million).

SYDNEY WATER CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*[a]	*1999-00*[b]	*2000-01*[c]
Size						
Total assets	$m	13 416	14 061	13 278	13 053	13 471
Total revenue	$m	1 283	1 372	1 377	1 467	1 431
Profitability						
Operating profit before tax (includes abnormals)	$'000	237 133	369 634	233 737	385 296	283 510
Operating sales margin	%	30.3	37.7	28.5	35.3	29.4
Cost recovery	%	138.3	138.1	145.1	153.4	145.3
Return on assets	%	3.2	4.0	3.0	4.0	3.2
Return on equity	%	1.3	2.2	1.4	3.0	1.5
Financial management						
Debt to equity	%	16.0	15.8	16.9	17.0	18.1
Debt to total assets	%	13.1	13.3	13.3	13.8	14.9
Total liabilities to equity	%	23.0	21.7	22.8	22.6	23.2
Interest cover	times	2.3	3.1	2.3	3.8	3.0
Current ratio	%	55.6	60.2	24.5	41.0	59.5
Leverage ratio	%	123.0	121.7	122.8	122.6	123.2
Payments to and from government						
Dividends	$'000	77 646	209 000	91 683	129 271	53 353
Dividend to equity ratio	%	0.7	1.9	0.8	1.2	0.5
Dividend payout ratio	%	56.2	86.0	60.1	40.3	32.7
Income tax expense	$'000	98 966	126 533	81 160	64 253[d]	120 292
CSO funding	$'000	93 800	89 700	105 200	87 686	73 300

a Sydney Water Corporation (SWC) recorded an abnormal expense of $55.4 million due to the water contamination incidents that occurred in July, August and September 1998. SWC was established as a statutory government-owned corporation on 1 January 1999. The Sydney Catchment Authority (SCA) was established in December 1998 following the enactment of the *Sydney Water Catchment Management Act 1998* and commenced operations in July 1999. The SCA was formed to improve the catchment management process and thereby drinking water quality. SWC was required over a three year period commencing 1997-98, to pay 100 per cent of its profit after tax and developer contributions as a dividend to the NSW Government. In 1998-99, the dividend declared excludes capital contributions in respect of the Rouse Hill Development and social program sewer backlog projects. **b** Includes abnormal revenue of $132.8 million relating to superannuation adjustments and an abnormal expense of $80.3 million for redundancy payments. Includes a revaluation increment of $134 million relating to system and property assets. Responsibility for managing catchments, dams and their associated infrastructure were transferred from SWC to the SCA. There was a transfer of $492 million in net assets, comprising mainly of $619 million in system assets, property and equipment and $162 million of debt. **c** Includes expenses of $56.2 million relating to superannuation adjustments, $8.1 million relating to redundancy and $36.3 million relating to the repayment of excess government contributions for sewerage backlog projects paid to the SWC as capital contributions in previous years. Includes a revaluation increment of $167.8 million relating to system and property assets. **d** Income tax expense was adjusted down by $5.9 million resulting from a reduction in the company tax rate from 36 per cent up to 1999-00, to 34 per cent for 2000-01 and then to 30 per cent from 2001-02.

HUNTER WATER CORPORATION — New South Wales

Hunter Water Corporation (HWC) was corporatised on 1 January 1999 following the enactment of the *Water Legislation Amendment (Drinking Water and Corporate Structure) Act 1998.*[1] HWC provides water, wastewater and drainage services to almost half a million people, living in the Newcastle, Lake Macquarie, Maitland, Cessnock and Port Stephens council areas. In November 1997, HWC created a wholly-owned and controlled entity known as Hunter Water Australia Pty Ltd.[2]

Revenue earned by HWC has decreased in each year over the reporting period. Factors contributing to the decline include the application of a CPI-X pricing regime by the Independent Pricing and Regulatory Tribunal (IPART) and a fall in average domestic water consumption.[3]

Part of the revenue decline in 2000-01 was due to a fall in the value of contributed assets. Operating profit was also affected by a 9 per cent increase in expenses, which included a $1.6 million adjustment to superannuation liabilities.

The value of assets was written down over a range of asset classes by $105.4 million in 1999-00 following a recoverable amounts test.[4] A revaluation carried out in 2000-01 resulted in an increment of $54.3 million, mainly related to water and sewerage assets.

Capital expenditure of $42.7 million in 2000-01 was largely funded from retained earnings as debt levels remained the same as the previous year. The level of borrowing has remained relatively unchanged over the reporting period.

HWC is required to make tax-equivalent and dividend payments. Community service obligations provided by HWC are funded by the NSW Government to cover tariff rebates to pensioners and exempt properties such as churches.

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1 This amendment changed the status of the HWC from a company to a statutory government-owned corporation, and gives the Minister responsible for Hunter Water greater power to access information, among other things.

2 Hunter Water Australia Pty Ltd's core services comprise water treatment, engineering, surveying, laboratory services and selling their expertise to the external market. Hunter Water Australia's financial results are consolidated with those of the HWC.

3 Under the price determination by IPART covering the period 1996-97 to 1999-00, average real prices fell by 2 per cent per year. Average prices will fall by 1.5 per cent in real terms per year under a price determination covering the period 2000-01 to 2002-03.

4 A recoverable amounts test is undertaken under accounting standards to ensure that the carrying value of non-current assets does not exceed the net amount expected to be recovered through the cash inflows and outflows from their continued use and subsequent disposal (AASB 1010).

HUNTER WATER CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*[d]
Size						
Total assets	$m	2 027	2 038	2 064	1 970	2 017
Total revenue	$m	154	148	139	136	131
Profitability						
Operating profit before tax (includes abnormals)	$'000	54 207	56 205	50 548	50 123	36 420
Operating sales margin	%	37.3	40.5	39.0	39.5	32.4
Cost recovery	%	139.6	154.9	153.9	142.9	140.9
Return on assets	%	3.1	3.1	2.8	2.8	2.2
Return on equity	%	2.3	2.6	1.7	1.9	1.3
Financial management						
Debt to equity	%	4.8	4.4	4.3	4.6	4.5
Debt to total assets	%	4.4	4.0	4.0	4.1	4.2
Total liabilities to equity	%	10.4	9.5	9.9	8.9	9.0
Interest cover	times	8.5	8.8	8.2	9.0	5.8
Current ratio	%	187.4	151.1	91.5	107.7	116.5
Leverage ratio	%	110.4	109.5	109.9	108.9	109.0
Payments to and from government						
Dividends	$'000	35 500	39 000	45 000	28 000	30 000
Dividend to equity ratio	%	2.0	2.1	2.4	1.5	1.6
Dividend payout ratio	%	83.5	80.0	144.0	80.1	126.4
Income tax expense	$'000	11 670	7 471	19 295	15 185	12 677
CSO funding	$'000	8 100	8 300	8 200	8 277	8 463

a Hunter Water Corporation (HWC) created a wholly-owned and controlled entity, Hunter Water Australia Pty Ltd, in November 1997, which commenced operations on 1 January 1999. The core services of the subsidiary include water treatment, civil engineering, surveying, laboratory services and selling services to other businesses. In 1996-97, HWC adopted the Urgent Issues Group (UIG) Abstract 11 to recognise the value of contributions received from developers as income and as an asset. In 1997-98, HWC adopted UIG Abstract 17, which states that the asset should be recognised at their assessed fair value when the government trading enterprise gains control of the contribution. **b** On 1 January 1999, legislation came into effect that changed HWC's status from a company to a statutory government-owned corporation. **c** Includes contributions for capital works and abnormal revenue of $11.6 million resulting from a reduction in superannuation liability. **d** Includes an asset revaluation increment of $54.3 million relating to water and sewerage assets and an expense of $1.6 million resulting from an increase in superannuation liability.

MELBOURNE WATER CORPORATION — Victoria

Melbourne Water Corporation (MWC) was separated into three retail water government trading enterprises (GTEs) — City West Water, Yarra Valley Water and South East Water — and a wholesale water and sewerage business in January 1995.[1] MWC provides waterways and drainage services and has water and sewerage supply agreements with the retail water GTEs. The retail water GTEs supply water and sewerage services.

MWC's total revenue, pre-tax operating profit, return on total assets and return on equity declined from 1996-97 to 1998-99. The decline from 1996-97 to 1997-98 was mainly due to the implementation of the Victorian Government's pricing reform package on 1 January 1998, which reduced MWC's bulk water charges.[2]

Revenue and profitability since the pricing reforms has been partly dependant on factors affecting water sales and building activity.[3] An increase in the level of building activity and high bulk water sales due to dry weather conditions in 1999-00 compared to the previous year resulted in a significant increase in revenue. In 2000-01, revenue declined by 3 per cent, due mainly to a 40 per cent decline in developer contributions as building activity slowed.

MWC's debt to equity, debt to total asset and total liabilities to equity ratios declined over the reporting period. In 1997-98, a debt for equity swap involved the transfer of $337 million of debt. Asset growth and a reduction in the level of borrowings in 1999-00 and 2000-01 have resulted in a continued decline in the debt to equity and debt to assets ratios.[4]

MWC is required to make tax-equivalent and dividend payments. The decrease in income tax expense in 1999-00 was attributable to the restatement of deferred tax balances resulting from the change in the future company tax rate from 36 per cent to 34 per cent in 2000-01 and 30 per cent thereafter.

MWC is not subject to community service obligations.

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1 The trading activities of MWC are dependent to a significant extent on the sale of bulk water and sewerage services to the three retail water GTEs. MWC also depends on the three retail GTEs for the provision of billing and collection of payments for drainage services.

2 A usage-based system for water and sewerage services was introduced under pricing reforms.

3 Under accounting standards, assets provided to GTEs by developers are recognised as revenue and assets at their fair value when the GTE gains control of the asset.

4 Assets increased in 2000-01 compared to the previous year as a result of capital expenditure of $105.4 million and the addition of previously understated crown land assets of $59.1 million.

MELBOURNE WATER CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*	*1999-00*	*2000-01*[c]
Size						
Total assets	$m	2 714	2 721	2 751	2 852	2 954
Total revenue	$m	680	560	443	477	461
Profitability						
Operating profit before tax (includes abnormals)	$'000	263 397	254 334	176 664	204 234	178 094
Operating sales margin	%	68.0	66.1	57.2	59.1	56.0
Cost recovery	%	319.3	295.4	233.5	243.4	226.5
Return on assets	%	17.0	13.6	9.3	10.1	8.9
Return on equity	%	29.5	19.7	11.6	17.7	10.4
Financial management						
Debt to equity	%	235.5	121.2	119.4	106.5	93.0
Debt to total assets	%	60.1	47.2	46.3	44.4	42.1
Total liabilities to equity	%	290.7	157.3	159.1	144.4	124.4
Interest cover	times	2.3	3.2	3.3	3.6	3.2
Current ratio	%	10.1	12.1	8.4	10.3	16.9
Leverage ratio	%	390.7	257.3	259.1	244.4	224.4
Payments to and from government						
Dividends	$'000	141 315	141 149	106 175	126 246	58 300
Dividend to equity ratio	%	25.1	16.1	10.0	11.3	4.7
Dividend payout ratio	%	84.9	81.8	86.6	64.1	45.2
Income tax expense	$'000	96 977	81 875	54 090	7 348[d]	49 066
CSO funding	$'000	0	0	0	0	0

a Crown land valued at $13.8 million was divested from the Melbourne Water Corporation (MWC). Includes a debt for equity swap with the Victorian Government of $250 million. **b** Implemented Victorian Government pricing reform package. This resulted in the reduction of MWC's bulk water charges to the three retail water government trading enterprises (City West Water, Yarra Valley Water and South East Water). Debt restructuring was part of this package and MWC swapped debt for equity with the Victorian Government of $337 million. **c** Includes a $59.1 million increase in the value of Crown land assets that was previously unrecognised. A change in accounting policy resulted in a final dividend not being provided for in 2000-01. If the estimated final dividend of $49.7 million is approved, the dividend to equity ratio increases from 4.7 per cent to 8.7 per cent. The dividend payout ratio increases from 45.2 per cent to 83.7 per cent. **d** Income tax expense decreased by $49.8 million due to a reduction in the future company tax rate from 36 per cent to 34 per cent in respect of 2000-01 and then to 30 per cent from 2001-02.

CITY WEST WATER Victoria

City West Water commenced operations on 1 January 1995. Its operating licence was issued under the *Water Industry Act 1994*. City West Water provides water, sewerage and trade waste services to approximately 268 000 residential, commercial and industrial properties in Melbourne's central business district, and its inner and western suburbs.

City West Water implemented the pricing reform package announced by the Victorian Government in October 1997, which involved a move from a substantially property-based to a usage-based system of billing. This package reduced operating revenue and recurrent cashflow, and increased the exposure of revenue to factors affecting the demand for water, including the weather.

Revenue and profitability declined in 2000-01 mainly due to a $26 million fall in the value of contributed assets associated with a lower level of development activity compared to the previous year. A rise in the value of water and sewerage infrastructure assets by $18 million also contributed to a decline in the return on assets and return on equity ratios.

City West Water's debt has been reduced by 30 per cent over the reporting period, contributing to an improvement in the interest cover ratio and a decline in the debt to equity, debt to total assets and debt to total liabilities ratios. Part of the reduction in debt in 1997-98 was due to a $20.6 million debt for equity swap with the Victorian Government.

The improvement in the current ratio in 2000-01 compared to the previous year is mainly due to a change in accounting policy relating to the provision for a final dividend.[1]

City West Water is required to make tax-equivalent and dividend payments. Income tax expense decreased in 1999-00 due to a reduction of the future company tax rate and deferred tax balances. City West Water does not receive community service obligation (CSO) payments.[2]

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1 A change in accounting policy in 2000-01 resulted in a final dividend not being provided for because it was not yet approved by the shareholding ministers. Prior to 2000-01, a final dividend was provided for as a current liability and paid to the government after it was approved. The change in accounting policy has also affected the comparability of the dividend to equity ratio and dividend payout ratio with previous years.

2 The model of CSO agreements has not been applied to Victorian water GTEs. As such, City West Water has no CSOs, despite being required to engage in non-commercial activities such as the delivery of water and sewerage concessions and grants (see chapter 6).

CITY WEST WATER (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*	*2000-01*[c]
Size						
Total assets	$m	542	577	606	625	641
Total revenue	$m	301	270	228	255	228
Profitability						
Operating profit before tax (includes abnormals)	$'000	39 474	76 538	83 495	110 147	82 340
Operating sales margin	%	20.9	34.2	42.2	48.0	41.2
Cost recovery	%	134.4	152.0	172.9	192.2	170.2
Return on assets	%	12.0	16.6	16.3	19.9	14.8
Return on equity	%	14.3	26.0	26.1	34.0	19.4
Financial management						
Debt to equity	%	111.2	90.8	78.6	57.1	46.7
Debt to total assets	%	46.3	40.8	37.3	30.3	27.4
Total liabilities to equity	%	146.5	129.3	116.0	91.6	72.3
Interest cover	times	2.6	5.6	7.4	9.7	8.1
Current ratio	%	40.2	41.5	26.6	32.7	56.1
Leverage ratio	%	246.5	229.3	216.0	191.6	172.3
Payments to and from government						
Dividends	$'000	27 709	49 148	39 939	57 400	22 400
Dividend to equity ratio	%	13.1	20.8	15.0	18.9	6.4
Dividend payout ratio	%	91.3	80.0	57.5	55.6	33.1
Income tax expense	$'000	9 132	15 108	13 981	6 915[d]	14 574
CSO funding	$'000	0	0	0	0	0

a City West Water implemented a price reform package in October 1997 that involved a move from a property-based to a usage-based billing system. **b** First full year of operation after the implementation of usage-based billing. The usage-based system changed the timing of cashflows such that customers are now billed in arrears. **c** A change in accounting policy resulted in a final dividend not being provided for in 2000-01. If the estimated final dividend of $31.2 million is approved, the dividend to equity ratio increases from 6.4 per cent to 15.4 per cent. The dividend payout ratio increases from 33.1 per cent to 79.1 per cent. **d** Income tax expense decreased due to a reduction in the future company tax rate from 36 per cent to 34 per cent in respect of 2000-01 and then to 30 per cent from 2001-02. Consequently, deferred tax balances have been remeasured using the appropriate new rates.

SOUTH EAST WATER — Victoria

South East Water (SEW) was incorporated in 1994 and commenced operations as a retail water supply and sewerage service business on 1 January 1995. Its operating licence was issued under the *Water Industry Act 1994*. SEW provides water supply and sewerage services to 1.3 million customers in the South East area of Melbourne.

SEW's cost recovery, return on total assets and return on equity declined from 1996-97 to 1998-99, due mainly to the implementation of the Victorian Government's pricing reform package in the second half of 1997-98. The reform involved a change from largely property-based to usage-based billing. With the implementation of the pricing reform, a subsidy received by SEW from City West Water ceased.[1]

Revenue from water and sewerage increased in 2000-01 compared to the previous year as a result of higher water consumption during dry weather conditions. However, lower levels of building activity reduced development related revenue from contributed assets and resulted in a decline in operating profit (before tax).

The decrease in SEW's debt to equity, debt to total asset and total liability to equity ratios in 1997-98 was the result of debt restructuring associated with the pricing reform package. The financial restructuring involved a debt for equity swap — debt of $160 million for $114.1 million in fully paid ordinary shares — and the establishment of a new portfolio with a more even spread of debt maturity and lower interest costs. Since 1997-98, debt has fallen in each year, contributing to a rise in the interest cover ratio and a decline in the debt to equity and debt to total assets ratios.

Since incorporation, SEW has made tax-equivalent and dividend payments. The decrease in income tax expenses during 1999-00 was attributable to the restatement of deferred tax balances resulting from the change in the future company tax rate from 36 per cent to 34 per cent in 2000-01 and 30 per cent thereafter.

SEW is not subject to community service obligations (CSO).[2]

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1 The Victorian Government's pricing reform package was implemented on 1 January 1998. The purpose of the subsidy was to place the three retail water government trading enterprises (GTEs) on a more equal financial footing in terms of return on assets. The amount of the subsidy was $6.2 million in 1996-97 and $7 million in 1997-98.

2 The model of CSO agreements has not been applied to Victorian water GTEs. As such SEW has no CSO, despite being required to engage in non-commercial activities such as the delivery of water and sewerage concessions and grants (see chapter 6).

SOUTH EAST WATER (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*[e]
Size						
Total assets	$m	997	1 000	1 031	1 048	1 070
Total revenue	$m	404	371	305	331	329
Profitability						
Operating profit before tax (includes abnormals)	$'000	76 802	81 538	76 710	104 883	103 587
Operating sales margin	%	31.8	30.6	31.8	37.9	37.7
Cost recovery	%	153.5	148.6	148.2	161.6	160.6
Return on assets	%	12.9	11.4	9.6	12.1	11.7
Return on equity	%	13.5	14.8	12.6	19.3	14.7
Financial management						
Debt to equity	%	127.3	69.2	67.5	59.5	53.2
Debt to total assets	%	47.6	34.8	34.2	31.4	30.2
Total liabilities to equity	%	168.3	99.2	100.4	90.9	77.6
Interest cover	times	2.5	3.5	4.8	6.0	6.0
Current ratio	%	37.2	58.6	41.7	36.2	64.4
Leverage ratio	%	268.3	199.2	200.4	190.9	177.6
Payments to and from government						
Dividends	$'000	60 000	54 800	49 730	68 175	33 000
Dividend to equity ratio	%	16.5	12.5	9.8	12.8	5.7
Dividend payout ratio	%	122.6	84.5	77.4	66.6	39.1
Income tax expense	$'000	27 865	16 700	12 459	2 488[f]	19 169
CSO funding	$'000	0	0	0	0	0

a Includes abnormal revenue of $1.2 million relating to a reduction in the provision for superannuation and abnormal expenses of $13.3 million relating to a loss on the write-off of assets ($2.6 million), write-down of land and buildings to recoverable amount ($1.1 million) and an increase in depreciation following reassessment of an asset's useful life ($9.6 million). **b** The Victorian Government's pricing reform package was implemented on 1 January 1998. It involved a change from property-based to usage-based pricing and included debt restructuring. Includes abnormal revenue of $5.4 million relating to profit on the sale of land and buildings and abnormal expenses of $18.6 million for asset write-offs ($2.1 million), write-down of land and buildings to recoverable amount ($1.7 million), an increase in depreciation following reassessment of an asset's useful life ($8.6 million), increase in the provision for unfunded superannuation ($0.7 million), contract termination ($2.5 million) and provision for refunds and revenue writebacks ($2.9 million). **c** Includes abnormal expenses of $3.7 million relating to an increase in the provision for unfunded superannuation ($2.3 million) and year 2000 compliance costs ($1.3 million). **d** Includes an abnormal expense of $0.7 million relating to year 2000 compliance costs. **e** Includes a revaluation increment of $1.9 million relating to land and buildings. A change in accounting policy for the provision for a final dividend resulted in a final dividend not being provided for. If the estimated final dividend of $34.3 million is approved, the dividend to equity ratio increases from 5.7 per cent to 11.7 per cent. The dividend payout ratio increases from 39.1 per cent to 79.7 per cent. **f** Income tax expense decreased by $18.4 million due to a reduction in the future company tax rate from 36 per cent to 34 per cent in respect of 2000-01 and then to 30 per cent from 2001-02.

YARRA VALLEY WATER — Victoria

Yarra Valley Water (YVW) began operating on 1 January 1995. Its operating licence was issued under the *Water Industry Act 1994*. It is a government-owned company, providing retail water supply and sewerage services as well as the collection of tradewaste to 1.5 million people in the eastern and northern suburbs of Melbourne.

YVW implemented the Victorian Government's pricing reform package on 1 January 1998. It involved a change from substantially property-based to usage-based charges. A subsidy received from City West Water ceased at the same time.[1] The effect of the reform package is evident in 2000-01 with revenue generated from core business activities, water and sewerage, being $126.6 million less than 1996-97.

Operating profit declined in 2000-01 compared to the previous year. This was mainly due to a lower level of building activity that resulted in a 40 per cent decline in contributed cash and assets.

The value of YVW's assets has increased in each year over the reporting period. In 2000-01, the increase was due to capital expenditure of $49.2 million and a revaluation increment of $1.7 million to land assets. Capital expenditure in 2000-01 was funded internally, with the level of borrowings remaining at a similar level to 1999-00.

YVW's debt to equity, debt to total assets and total liability to equity ratios have declined over the reporting period. This is mainly due to financial restructuring associated with the 1998 water reform package, which involved a reduction in debt of $100 million and the issuing of 43.5 million fully paid ordinary shares.

Since incorporation, YVW has been required to make tax-equivalent and dividend payments. Income tax expense was a negative figure in 1999-00, reflecting benefits generated from the restatement of deferred tax balances due to a change in the future company tax rate and an over-provision of tax for developer contributions in prior years. YVW has not identified any community service obligations (CSOs).[2]

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1 The reason for the subsidy was to make the three retail water government trading enterprises (GTEs) operate on an equal financial footing in terms of return on assets. The amount of the subsidy was $1.5 million in 1996-97 and $0.8 million in 1997-98.

2 The model of CSO agreements has not been applied to Victorian water GTEs. As such YVW has no CSOs, despite being required to engage in non-commercial activities such as the delivery of water and sewerage concessions and grants (see chapter 6).

YARRA VALLEY WATER (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*[e]
Size						
Total assets	$m	1 130	1 157	1 185	1 230	1 263
Total revenue	$m	439	389	332	353	342
Profitability						
Operating profit before tax (includes abnormals)	$'000	76 573	79 469	75 913	96 471	86 165
Operating sales margin	%	30.5	30.9	32.1	36.3	34.7
Cost recovery	%	146.8	145.6	148.0	157.2	153.0
Return on assets	%	12.1	10.6	9.1	10.6	9.5
Return on equity	%	11.4	12.5	11.3	18.7	11.9
Financial management						
Debt to equity	%	126.1	100.3	98.4	91.5	82.6
Debt to total assets	%	49.5	44.6	43.4	42.0	40.3
Total liabilities to equity	%	158.9	127.4	129.5	122.2	107.7
Interest cover	times	2.3	2.9	3.5	4.0	3.6
Current ratio	%	60.4	39.1	34.0	41.1	37.0
Leverage ratio	%	258.9	227.4	229.5	222.2	207.7
Payments to and from government						
Dividends	$'000	54 972	51 652	48 738	62 707	26 314
Dividend to equity ratio	%	12.9	10.9	9.5	11.7	4.5
Dividend payout ratio	%	112.5	87.4	84.0	62.8	38.2
Income tax expense	$'000	27 700	20 340	17 885	-3 417[f]	17 285
CSO funding	$'000	0	0	0	0	0

a Yarra Valley Water implemented the Victorian Government's pricing reforms that involved a change from property-based to usage-based charges. The pricing reform required Melbourne Water Corporation to reduce bulk water charges to the three retail government trading enterprises. An asset revaluation resulted in an increase in the value of assets by $25.4 million. Includes abnormal expenses of $6 million relating to redundancies ($0.7 million) and an asset write-off ($5.3 million). **b** Includes an abnormal expense of $1.9 million relating to redundancies. **c** Includes an abnormal expense of $1.1 million relating to redundancies. **d** Includes an abnormal expense of $0.5 million relating to redundancies. **e** Includes a revaluation increment of $11.7 million to land. A change in accounting policy in relation to the provision for a final dividend in 2000-01 resulted in a final dividend not being provided for. If the estimated final dividend of $29.7 million is approved, the dividend to equity ratio increases from 4.5 per cent to 9.6 per cent. The dividend payout ratio increases from 38.2 per cent to 81.3 per cent. **f** Income tax expense decreased due to a reduction in the future company tax rate from 36 per cent to 34 per cent in respect of 2000-01 and then to 30 per cent from 2001-02. Consequently, deferred tax balances have been remeasured using the appropriate new rates resulting in a decrease in tax payments of $16.6 million.

BARWON REGIONAL WATER AUTHORITY — Victoria

Barwon Regional Water Authority (Barwon Water) is a statutory authority, providing water and sewerage services to around 100 000 properties in Geelong and surrounding areas. Barwon Water also manages 20 kilometres of the Barwon River through urban Geelong.

Barwon Water's operating profit (before tax), return on assets and return on equity increased substantially in 1997-98 due to a merger with Otway Regional Water Authority, which resulted in abnormal revenue of $69.6 million. Property, plant and equipment were also revalued using the optimised deprival valuation method, resulting in a revaluation increment of $380 million.

An improvement in profitability in 2000-01 compared to the previous year was mainly due to a 3 per cent decline in expenses. Revenue from water sales and sewerage charges also increased as a result of the lifting of all water restrictions in November 2000. Water restrictions had applied since the beginning of 1997-98.

Barwon Water's debt to equity, debt to total assets, total liabilities to equity and leverage ratios declined over the reporting period. The current ratio and level of interest cover increased in 1997-98 — partly due to the State Government's financial assistance package that was utilised by Barwon Water to repay borrowings.

During 1998-99, Barwon Water became a participating authority under the *Borrowing & Investment Powers Act 1987*. Under the provisions of the Act, Barwon Water was able to restructure its debt portfolio, transferring all inscribed stock to the Treasury Corporation of Victoria (TCV) and simultaneously obtaining loans from TCV, resulting in reduced borrowing costs.

Barwon Water is required to pay dividends but no dividend was paid between 1998-99 and 2000-01. Barwon Water, as a non-metropolitan water authority, is not required to make tax-equivalent payments.[1]

Barwon Water is not subject to any community service obligations (CSOs).[2]

1 Only the metropolitan sector of the Victorian water industry is subject to a tax-equivalent regime.

2 The model of CSO agreements has not been applied to Victorian water government trading enterprises (see chapter 6).

BARWON WATER (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*	*2000-01*[c]
Size						
Total assets	$m	384	858	841	841	847
Total revenue	$m	64	145	68	73	71
Profitability						
Operating profit before tax (includes abnormals)	$'000	10 206	51 960	6 049	4 080	4 359
Operating sales margin	%	35.5	47.4	18.3	11.3	12.7
Cost recovery	%	154.0	123.6	124.8	118.7	114.3
Return on assets	%	6.3	11.4	1.6	1.0	1.1
Return on equity	%	4.7	10.4	0.6	0.5	0.6
Financial management						
Debt to equity	%	65.9	11.9	8.8	8.2	8.1
Debt to total assets	%	38.8	14.4	7.9	7.4	7.4
Total liabilities to equity	%	71.3	14.0	10.9	10.3	10.2
Interest cover	times	1.7	3.8	1.8	1.9	1.9
Current ratio	%	88.1	187.6	91.4	94.6	111.9
Leverage ratio	%	171.3	114.0	110.9	110.3	110.2
Payments to and from government						
Dividends	$'000	4 213	1 663	0	0	0
Dividend to equity ratio	%	1.9	0.3	0	0	0
Dividend payout ratio	%	41.3	3.3	0	0	0
Income tax expense	$'000	0	1 388	1 643	0	0
CSO funding	$'000	0	0	0	0	0

a Barwon Water received $86 million under a State Government financial assistance package, which was utilised to repay borrowings. On 1 July 1997, Barwon Water assumed responsibility for the majority of the Otway Regional Water Authority's assets, liabilities and reserves. The merger resulted in abnormal revenue of $69.6 million. On 30 April 1998, Barwon Water paid out the unfunded superannuation liability it held with the Local Authorities Superannuation Fund amounting to $3.6 million. Fixed assets were revalued on a current cost basis at 30 June 1998, resulting in an increment of $377.8 million. **b** The exchange of Barwon Water's entire inscribed stock to the Treasury Corporation of Victoria (TCV), and the simultaneous issue of an identical loan by TCV to Barwon Water, resulted in all Barwon Water's borrowings being undertaken through TCV and being subject to a Victorian Government guarantee under the *Borrowing & Investment Powers Act 1987.* The novation of debt to the TCV included 1635 inscribed stockholders ($14.5 million) and three institutional investors ($15.5 million). 1998-99 was the first full year of Stage 1 water restrictions. **c** Water restrictions were lifted in full in November 2000 after being in operation for 41 months.

SUNWATER Queensland

Sunwater was established as a government-owned corporation on 1 October 2000, assuming the roles and responsibilities of State Water Projects (SWP). SWP operated as a commercialised business unit within the Department of Natural Resources.[1]

Sunwater owns and operates bulk water storage and distribution infrastructure and supplies water to about 7500 customers, including irrigators, industrial customers and urban bulk water customers. It also provides facility management services to other water infrastructure owners, and engineering consultancy services to government and private sector clients.

Prices for rural customers are determined by Sunwater's shareholding Ministers. A price direction in October 2000 set a price path of between five and seven years covering most of Sunwater's supply schemes.

The fall in total assets in 1999-00 was attributable to a revaluation of non-current physical assets and a move from deprival valuation methodology to fair value methodology — the amount by which an asset could be exchanged between knowledgeable willing parties in an arms length transaction. The revaluation — which led to a fall in the value of assets from $2.1 billion to $235 million — resulted in $1.9 billion being written-down directly against accumulated funds. Subsequently, return on assets and return on equity improved.

In 1997-98 and 1998-99, Sunwater's predecessor SWP operated debt free. Therefore debt to equity and debt to total asset ratios are zero.[2] During 1999-00, SWP entered into financing arrangements with Queensland Treasury Corporation with the establishment of a $5 million loan. The loan is the first tranche of a loan facility of up to $25.6 million.

Sunwater is required to make income tax-equivalent and dividend payments. Sunwater receives community service obligation (CSO) funding from the State Government. CSO funding is provided to meet the shortfall in revenue in providing water to rural water users, specific costs associated with transition to compliance with new governing legislation and payment for new rural water assets or extensions to existing schemes that were built for reasons other than commercial return.

1 Eungella Water Pipeline Pty Ltd and North West Queensland Water Pipeline Pty Ltd are wholly-owned subsidiaries of Sunwater.

2 In 1997-98 commercialisation established SWP with a capital structure free of debt.

SUNWATER (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*[d]
Size						
Total assets	$m	2 110	2 096	2 102	235	293
Total revenue	$m	62	80	74	99	81
Profitability						
Operating profit before tax (includes abnormals)	$'000	-43 024	-11 843	-21 101	4 706	3 467
Operating sales margin	%	-30.5	-14.8	-31.7	2.5	2.8
Cost recovery	%	76.6	82.4	50.3	101.4	102.9
Return on assets	%	-1.0	-0.6	-1.0	0.4	1.5
Return on equity	%	-4.5.	-0.6	-1.0	0.4	1.4
Financial management						
Debt to equity	%	7.7	0	0	2.2	4.5
Debt to total assets	%	7.4	0	0	0.4	4.2
Total liabilities to equity	%	9.9	0.9	0.8	2.5	17.2
Interest cover	times	-0.8	0	0	4 707.0	9.1
Current ratio	%	100.8	447.0	630.2	309.9	256.1
Leverage ratio	%	109.9	100.9	100.8	102.5	117.2
Payments to and from government						
Dividends	$'000	0	0	0	0	0
Dividend to equity ratio	%	0	0	0	0	0
Dividend payout ratio	%	0	0	0	0	0
Income tax expense	$'000	0	0	0	0	1 809
CSO funding	$'000	0	0	28 500	25 681	14 713

a The Sun Water Projects (SWP) group separated from the Regional Infrastructure Development Program. SWP was fully commercialised on 1 July 1997. SWP is a separate reporting entity under the *Financial Administration and Audit Act 1977* and produces its own audited general purpose financial report. When commercialised, SWP was established with a capital structure free of debt. At 1 July 1997, a future income tax benefit was recognised up to the amount of the provision for deferred income tax. An amount of $856 425, which is the excess of the future income tax benefit over the provision for deferred income tax, has not been recognised. **b** As at 1 July 1999, SWP transferred all long service leave liabilities to a central actuarially assessed scheme administrated by the Government Superannuation Office. This financial effect has not been recognised for the year ending 30 June 1999. **c** A revaluation in 1999-00 resulted in $1.9 billion being written-down directly against accumulated funds. **d** Includes the operations of Sunwater from October 2000 to June 2001. SWP's revenues and expenses for the period July to September were combined with Sunwater to obtain results for the full financial year.

SA WATER CORPORATION — South Australia

SA Water Corporation (SA Water) was established on 1 July 1995 under the provisions of the *South Australian Water Corporation Act 1994*. SA Water provides water and wastewater services for both the metropolitan and country areas of SA.[1]

SA Water has recorded increases in revenue and operating profit (before tax) in each year over the reporting period. As a result, return on assets and return on equity indicators have steadily improved. The increase in profit in 2000-01 compared to the previous year was mainly due to an increase in revenue from water sales as a result of prolonged high temperatures.

As a result of improved profitability, interest cover has remained stable over the reporting period despite an increase in the level of borrowings in each year since 1997-98. Increases in the level of debt have resulted in a steady rise in the debt to equity, debt to total assets and total liabilities to equity ratios since 1997-98.

SA Water is subject to the South Australian Government's tax-equivalent regime and is required to make dividend payments.

SA Water receives community service obligation (CSO) payments relating to the provision of water and wastewater services in country areas, the administration of a pensioner concession scheme and the provision of water and wastewater concessions to exempt properties, such as charities.[2] In 2000-01, most of the CSO funding ($75.1 million) was related to the provision of water and wastewater services in country areas. SA Water also made payments of $1.1 million in 2000-01 on behalf of the State government for activities outside its normal course of business. No reimbursement for this expenditure was received by SA Water.

1 SA Water contracted out the operation, maintenance and management of Adelaide's water and wastewater system to United Water International in December 1995. In 1996, SA Water entered into the Water Treatment and Economic Development Agreement with Riverland Water Pty Ltd. Under this Agreement, Riverland Water was contracted to finance, design, construct, operate and maintain 10 water filtration plants for a minimum of 25 years.

2 The Department for Family and Youth Services provides funding to SA Water for the *administration* of pensioner concessions. The concessions are funded and paid directly by the Department of Treasury and Finance.

SOUTH AUSTRALIAN WATER CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*	*1999-00*[a]	*2000-01*
Size						
Total assets[b]	$m	5 757	5 766	5 897	6 026	6 059
Total revenue	$m	505	552	566	598	604
Profitability						
Operating profit before tax (includes abnormals)	$'000	135 568	170 737	179 802	196 445	200 539
Operating sales margin	%	44.8	47.5	47.9	48.0	47.9
Cost recovery	%	182.0	194.0	193.0	197.3	190.5
Return on assets	%	4.0	4.6	4.7	4.8	4.8
Return on equity	%	1.9	2.6	2.7	3.0	2.9
Financial management						
Debt to equity	%	22.2	21.2	22.0	22.6	25.9
Debt to total assets	%	18.0	16.9	17.5	17.8	20.0
Total liabilities to equity	%	25.9	25.4	27.0	28.4	29.5
Interest cover	times	2.5	2.9	3.0	3.2	3.2
Current ratio	%	109.4	103.9	86.9	62.2	97.3
Leverage ratio	%	125.9	125.4	127.0	128.4	129.5
Payments to and from government						
Dividends	$'000	91 200	105 800	144 400	175 200	135 470
Dividend to equity ratio	%	2.0	2.3	3.1	3.8	2.9
Dividend payout ratio	%	108.7	90.1	116.4	123.6	100.6
Income tax expense	$'000	51 698	54 253	55 762	54 706	65 827
CSO funding	$'000	72 000	74 365	77 135	85 259	86 104

a Includes abnormal expenses of $8.8 million relating to decommissioned or abandoned assets ($4.8 million), provision for legal claims ($1.1 million), redundancies ($2.4 million) and Goods and Services Tax implementation costs ($0.5 million). **b** Asset revaluations in each year of the reporting period resulted in an increase in the value of assets by $555 million in 1996-97, $4.1 million in 1997-98, $64.1 million in 1998-99, $87.2 million in 1999-00 and $9.5 million in 2000-01.

WATER CORPORATION — Western Australia

The Water Corporation was established on 1 January 1996, following a major restructure of the WA water industry. It operates under a 25 year operating licence issued by the Office of Water Regulation. The Water Corporation provides public water supply, sewerage, drainage and irrigation services to 1.8 million people in 255 towns and communities throughout WA.

Despite a 30 per cent decline in developer contributions in 2000-01 compared to the previous year, revenue increased as a result of additional water sales and a 2 per cent increase in prices. However, this was offset by a 6 per cent increase in total expenses, resulting in a fall in operating profit (before tax).

Capital expenditure of $500 million in 2000-01 was partly funded by a 45 per cent increase in the level of borrowings. As a result of higher debt levels, Water Corporation's debt to equity and debt to total assets ratios increased. Despite this higher debt level, the capitalisation of around $17 million of interest costs resulted in a reduction in interest expenses compared to 1999-00 and an improvement in the level of interest cover.[1]

The Water Corporation is required to make tax-equivalent and dividend payments. Income tax expense was relatively low in 1999-00 as a consequence of a restatement of deferred tax balances with the implementation of lower company tax rates.

The Water Corporation received community service obligation (CSO) payments from the WA Government from 1 July 1996. CSO payments have related to an ongoing $800 million infill sewerage program and revenue concessions. CSO payments have increased since 1997-98.

1 Australian accounting standards require the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a 'qualifying' asset. If interest expenses are capitalised, expenses associated with interest payments are included in subsequent depreciation expenses related to the qualifying asset.

WATER CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*	*1998-99*	*1999-00*	*2000-01*
Size						
Total assets	$m	8 578	8 710	8 919	9 174	9 457
Total revenue	$m	800	890	926	987	1 012
Profitability						
Operating profit before tax (includes abnormals)	$'000	286 784	360 048	375 548	452 238	445 083
Operating sales margin	%	42.2	45.2	44.3	49.4	47.0
Cost recovery	%	168.1	183.6	179.2	197.5	188.8
Return on assets	%	4.1	4.7	4.7	5.4	5.1
Return on equity	%	2.4	2.9	2.7	3.9	3.6
Financial management						
Debt to equity	%	7.7	5.7	6.8	7.1	10.4
Debt to total assets	%	6.9	5.2	6.2	6.4	9.1
Total liabilities to equity	%	11.9	10.3	12.1	13.7	16.3
Interest cover	times	5.6	8.4	11.2	13.2	14.5
Current ratio	%	130.2	57.3	47.9	47.8	51.2
Leverage ratio	%	111.9	110.3	112.1	113.7	116.3
Payments to and from government						
Dividends	$'000	198 692	158 706	196 111	201 215	240 753
Dividend to equity ratio	%	2.6	2.0	2.5	2.5	3.0
Dividend payout ratio	%	110.7	70.7	90.4	55.3	82.0
Income tax expense	$'000	107 314	135 699	158 570	139 894[b]	151 575
CSO funding	$'000	182 253	180 316	192 124	205 617	225 890

a Includes abnormal revenue of $24.6 million for unbilled water consumption and $26 million from a favourable tax ruling on rate revenue on the previous year. **b** Income tax expense decreased due to a reduction in the future company tax rate from 36 per cent to 34 per cent in respect of 2000-01 and then to 30 per cent from 2001-02.

HOBART REGIONAL WATER AUTHORITY — Tasmania

Hobart Regional Water Authority, trading as Hobart Water, was established as a joint authority under s. 38 of the *Local Government Act 1993*. Hobart Water commenced operations on 1 January 1997 when the assets, property rights and liabilities of its predecessor, the Hobart Regional Water Board, were transferred. Hobart Water provides bulk water supplies to eight councils in southern Tasmania.

Maximum prices for bulk water supplied by Hobart Water are determined by the Minister for Local Government following receipt of recommendations by the Government Prices Oversight Commission.[1]

Hobart Water introduced a new water pricing policy on 1 July 1997 that incorporates a two-part tariff.[2] Bulk water prices decreased by 3.6 per cent, in real terms, between 1997-98 and 1998-99. Real prices have been maintained at a similar level to 2000-01. The increase in revenue in 1999-00 and 2000-01 was largely due to higher water consumption during a period of prolonged dry conditions.

In 1997-98, an operating loss before tax by Hobart Water was due to an abnormal expense of $3.4 million relating to debt restructuring.

Hobart Water has been required to pay tax-equivalent and dividend payments since 1997-98. However, despite recording income tax expense over the reporting period, it has not paid tax due to the effect of timing and permanent differences.[3]

Hobart Water does not receive funding for community service obligations.[4]

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1 Under the *Government Prices Oversight Act 1995*, the recommendations may take the form of maximum revenues, maximum prices, pricing principles or a combination of these. Under the pricing principles included in a pricing investigation in 2001, the Government Prices Oversight Commission recommended that a two-part tariff structure should be implemented no later than 2001-02.

2 The model is structured such that the tariff is based on both the amount of water each council uses and a fixed charge apportioned on the basis of each council's share of average consumption for the previous three years.

3 An example of the effect of these differences is observable in 1999-00 when reported accounting profit was $2.8 million but taxable income was a $6.5 million loss.

4 In 2000-01, Hobart Water identified expenses of $239 000 relating to the maintenance of recreation facilities. This amount is not reimbursed by the Tasmanian Government.

HOBART REGIONAL WATER AUTHORITY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*	*1999-00*	*2000-01*
Size						
Total assets	$m	175	184	171	171	169
Total revenue	$m	18	18	17	19	20
Profitability						
Operating profit before tax (includes abnormals)	$'000	1 398	-1 261	2 862	2 757	2 535
Operating sales margin	%	33.2	14.9	25.8	24.0	23.5
Cost recovery	%	149.8	150.8	134.7	131.6	130.7
Return on assets	%	3.3	1.5	2.6	2.8	2.8
Return on equity	%	1.1	-1.6	2.6	1.4	1.5
Financial management						
Debt to equity	%	25.7	27.6	27.7	27.1	26.3
Debt to total assets	%	19.2	20.4	19.9	20.0	19.5
Total liabilities to equity	%	30.5	39.1	34.3	35.0	34.1
Interest cover	times	1.3	0.7	2.7	2.4	2.2
Current ratio	%	14.2	40.9	52.4	34.4	26.9
Leverage ratio	%	130.5	139.1	134.3	135.0	134.1
Payments to and from government						
Dividends	$'000	0	2 000	2 200	2 500	2 400
Dividend to equity ratio	%	0	1.5	1.7	2.0	1.9
Dividend payout ratio	%	0	-95.8	64.8	137.9	129.0
Income tax expense	$'000	0	828	-533	944	675
CSO funding	$'000	0	0	0	0	0

a Ownership of the organisation passed from the Tasmanian Government to the eight southern Tasmanian councils, which comprise the joint authority. All non-current assets were revalued using deprival value on 1 January 1997. The effect of the revaluation was to increase the value of non-current assets by $118 million. **b** From 1 July 1997, a new water pricing policy was introduced based on a two-part tariff. The two-part tariff incorporates a charge based on the amount of water each council uses and a fixed charge. Amendments to the *Local Government Act 1993* required the Hobart Regional Water Authority to make income tax-equivalent payments, applying AAS3 Accounting for Income Tax as outlined in the *Government Business Enterprises Act 1995*. Operating loss reflects a $3.4 million abnormal expense generated by debt restructuring.

NORTH WEST WATER AUTHORITY — Tasmania

The North West Water Authority (NWWA), trading as Cradle Coast Water, was established as a joint authority on 10 August 1999 under the *Local Government Act 1993*.[1] The NWWA assumed all the prescribed property, obligations and liabilities of its predecessor, the North West Regional Water Authority. Cradle Coast Water collects, treats and supplies bulk drinking water to its joint owning councils of Circular Head, Waratah-Wynyard, Central Coast, Devonport City, Latrobe and Kentish.

Maximum prices for bulk water supplied by Cradle Coast Water are determined by the Minister for Local Government following receipt of recommendations by the Government Prices Oversight Commission.[2]

Profitability increased in 2000-01 compared to the previous year largely due to a 12 per cent rise in revenue from the sale of water. As a result, the return on assets and return on equity ratios increased.

Total assets declined by $26.7 million from 1996-97 to 1997-98, following the revaluation of infrastructure assets to written-down deprival value. The value of assets in 2000-01 increased by 3 per cent compared to the previous year as a result of capital expenditure of $0.9 million and a $2 million upward asset revaluation.

Debt restructuring in 1997-98 resulted in interest expenses falling by 18 per cent compared to the previous year, despite a similar level of borrowings. Reductions in the level of debt each year since 1997-98 have resulted in a steady fall in the debt to equity and total liabilities to equity ratios.

Cradle Coast Water has been required to make income tax-equivalent and dividend payments since 1997-98.[3] Cradle Coast Water is also subject to payroll tax, capital gains tax-equivalents and sales tax-equivalents. Fluoridation is identified as a community service obligation and is reimbursed by the government.

1 The NWWA adopted the trading name Cradle Coast Water in July 2000.

2 Under the *Government Prices Oversight Act 1995*, the recommendations may take the form of maximum revenues, maximum prices, pricing principles or a combination of these. Under the pricing principles included in a pricing investigation in 2001, the Government Prices Oversight Commission recommended that a two-part tariff structure should be implemented no later than 2001-02.

3 No dividend was paid in 1997-98 and 1998-99 due to after tax losses.

NORTH WEST WATER AUTHORITY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*	*2000-01*[d]
Size						
Total assets	$m	89	61	61	59	61
Total revenue	$m	8	8	7	7	8
Profitability						
Operating profit before tax (includes abnormals)	$'000	-11	-2 354	1 311	838	1 390
Operating sales margin	%	36.2	0.4	39.3	29.9	34.7
Cost recovery	%	156.7	162.7	170.8	151.1	153.3
Return on assets	%	3.2	0.1	4.9	3.6	4.7
Return on equity	%	0	-5.4	0.6	1.9	3.7
Financial management						
Debt to equity	%	40.8	76.1	70.1	68.2	63.0
Debt to total assets	%	26.8	33.1	39.3	38.7	37.7
Total liabilities to equity	%	45.7	85.9	78.5	74.5	69.6
Interest cover	times	1.0	0	1.8	1.9	2.0
Current ratio	%	37.7	39.4	67.1	90.0	121.4
Leverage ratio	%	145.7	185.9	178.5	174.5	169.6
Payments to and from government						
Dividends	$'000	0	0	0	345	514
Dividend to equity ratio	%	0	0	0	1.0	1.5
Dividend payout ratio	%	0	0	0	53.9	40.0
Income tax expense	$'000	0	161	1 100	197	104
CSO funding	$'000	24	24	26	28	31

a The assets of the North West Water Authority's (NWWA's) predecessor, the North West Regional Water Authority (NWRWA), were revalued using written-down replacement cost value, which resulted in a reduction of the asset value by $6.7 million. **b** The NWRWA incurred abnormal expenses ($3.1 million). This included a $2.7 million loss on defeasance of loans and a $377 746 increase to the superannuation provision for redundancy payments in anticipation of the creation of a new joint authority. As a result of a debt restructure, financial expenses declined by $549 000. The price of water reduced from $0.72 per kilolitre to $0.70 per kilolitre. The NWRWA became subject to dividend and tax-equivalent payments. No dividend was paid due to after-tax losses. All infrastructure assets were revalued using deprival value. This resulted in the value of assets declining by $26.7 million. **c** The NWRWA incurred an abnormal expense of $155 000 due to an adjustment of the superannuation provision. The NWWA was established on 10 August 1999, staff, property, obligations and liabilities were transferred from the NWRWA to the NWWA. **d** The value of assets increased by $2 million resulting from a revaluation of infrastructure assets.

ESK WATER AUTHORITY — Tasmania

Esk Water Authority, trading as Esk Water, was established as a joint authority under the *Local Government Act 1993*. Esk Water commenced operations in July 1997 when the assets of its predecessors, the North Esk Scheme, West Tamar Scheme and the Launceston City Council, were transferred. Esk Water provides bulk water supply to councils and industrial users in the Launceston–Tamar Valley region.[1]

Maximum prices for bulk water supplied by the Esk Water are determined by the Minister for Local Government following receipt of recommendations by the Government Prices Oversight Commission.[2]

Profitability improved in 2000-01 compared to the previous year mainly due to a 13 per cent increase in revenue from water sales and a 2 per cent decrease in expenses. Most of the reduction in expenses was due to a fall in interest expenses associated with a decline in the level of debt.

The level of Esk Water's borrowings has fallen in each year over the reporting period and has contributed to a decline in the debt to equity and debt to total assets ratios. Some of the variability in the current ratio in 1999-00 and 2000-01 is due to changes in the maturity of Esk Water's debt.

Esk Water is required to make tax-equivalent and dividend payments. Differences between taxation and accounting depreciation rates may cause the actual tax-equivalent payments made to government to differ from those reported.[3]

Esk Water does not receive any funding for community service obligations.

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1 The participating councils are the four Tamar Valley councils, Launceston City, George Town, Meander Valley and West Tamar, which comprise the joint authority.

2 Under the *Government Prices Oversight Act 1995*, the recommendations may take the form of maximum revenues, maximum prices, pricing principles or a combination of these. Under the pricing principles included in a pricing investigation in 2001, the Government Prices Oversight Commission recommended that a two-part tariff structure should be implemented no later than 2001-02.

3 Valuation using the written-down replacement cost method for contributed assets, for taxation depreciation purposes, results in taxation depreciation rates being greater than accounting depreciation rates. As a result, the Authority may record both an accounting operating profit and a taxation loss. If a loss is recorded, tax-equivalent payments are not paid.

ESK WATER AUTHORITY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*[d]
Size						
Total assets	$m	n.r.	102	102	100	102
Total revenue	$m	n.r.	8	7	7	8
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	1 464	824	1 209	1 950
Operating sales margin	%	n.r.	30.4	21.9	25.0	30.5
Cost recovery	%	n.r.	143.7	128.0	130.5	144.0
Return on assets	%	n.r.	2.8	1.7	2.0	2.5
Return on equity	%	n.r.	1.3	0.6	1.0	1.5
Financial management						
Debt to equity	%	n.r.	15.1	15.2	12.8	8.9
Debt to total assets	%	n.r.	15.0	12.7	10.8	7.9
Total liabilities to equity	%	n.r.	17.7	19.6	16.6	13.9
Interest cover	times	n.r.	2.4	1.9	2.4	4.2
Current ratio	%	n.r.	503.1	174.2	83.2	175.6
Leverage ratio	%	n.r.	117.7	119.6	116.6	113.9
Payments to and from government						
Dividends	$'000	n.r.	351	198	594	1 337
Dividend to equity ratio	%	n.r.	0.5	0.2	0.7	1.5
Dividend payout ratio	%	n.r.	37.7	40.8	68.8	100.0
Income tax expense	$'000	n.r.	534	339	345	613
CSO funding	$'000	n.r.	0	0	0	0

a Assets from the North Esk Scheme, West Tamar Scheme and the Launceston City Council were transferred to the control and ownership of a joint authority, the Esk Water Authority on 1 July 1997. **b** Includes extraordinary expense of $1.4 million relating to asset transfers. **c** Includes abnormal revenue of $156 000 from the revaluation of superannuation liability. **d** A revaluation resulted in an increase of $3.3 million in the value of pipeline and other fixed assets. **n.r.** not relevant.

9 Urban transport

The financial performance of four urban transport government trading enterprises (GTEs) is reported in this chapter — the State Transit Authority (STA), TransAdelaide, Metro Tasmania and ACTION (see table 9.1).

At the end of 2000-01, the four GTEs controlled over $1.2 billion in assets and generated $680 million in revenue. TransAdelaide and the STA are the largest operators, accounting for 56 per cent and 36 per cent of assets, and 16 per cent and 70 per cent of revenues respectively. As a group, the values of their assets and total revenue grew 25 per cent and 5 per cent respectively over the reporting period.

For a discussion of the data and the performance indicators used and some of the factors that should be considered when assessing performance, see chapter 3.

9.1 Sector reforms

Urban transport GTEs underwent considerable administrative and operational change over the reporting period. These changes were largely introduced to increase their commercial focus and reduce their reliance on government contributions.

Governance arrangements for urban transport GTEs have been reformed to increase their corporate focus. For example, in 1997-98, the Metropolitan Transport Trust of Tasmania became a government-owned company (Metro Tasmania) subject to corporations law. Simlarly, on 9 August 2001, the ACT Legislative Assembly passed legislation to change the status of ACTION from a department to a statutory authority.

A further example of institutional reform designed to improve the commercial performance of GTEs is the introduction of competitive tendering arrangements. The tendering process was introduced in SA and required TransAdelaide to compete with the private sector on the basis of a set of costing rules aimed at ensuring competitive neutrality. On 22 April 2000, TransAdelaide ceased the provision of bus services in its own right after it was unsuccessful in tendering for the service contract to the Public Transport Board.

Table 9.1 **Monitored urban transport GTEs, 1996-97 to 2000-01**

1996-97	*1997-98*	*1998-99*	*1999-00*	*2000-01*
New South Wales				
State Transit Authority	→	→	→	State Transit Authority[a]
South Australia				
TransAdelaide	→	→	→	TransAdelaide
Tasmania				
Metropolitan Transport Trust	→	Metro Tasmania Pty Ltd[b] →	→	Metro Tasmania Pty Ltd
Australian Capital Territory				
ACTION	→	→	→	ACTION[c]

a On 22 April 2000, TransAdelaide ceased the provision of bus services in its own right after it was unsuccessful in tendering for the service contract to the Public Transport Board. **b** In February 1998, the Metropolitan Transport Trust became a government-owned company subject to corporations law. **c** ACTION is a division of the ACT Government's Department of Urban Services. On 9 August 2001, the ACT Legislative Assembly passed legislation to change the status of ACTION from a department to a statutory authority**.**

Over the reporting period, the pricing of urban transport services was determined by independent pricing regulatory bodies in NSW, Tasmania and ACT. In SA, prices were determined by the Public Transport Board, a statutory authority under the Department for Transport, Urban Planning and the Arts.

Urban transport fares generally increased over the reporting period, with three of the four GTEs experiencing a major price determination since 1996-97. Most recently, on 1 July 2000, Metro Tasmania increased fares — by an average of 8.2 per cent — following a ruling from the Tasmanian Government Prices Oversight Commission (GPOC 2000).

The market environment in which urban transport GTEs operate can have a significant impact on their financial performance. Urban transport GTEs have experienced a general fall in demand for their services over the reporting period, partly due to increased competition from private operators of urban transport, competition from privately-owned motor vehicles and changes in fares and population.

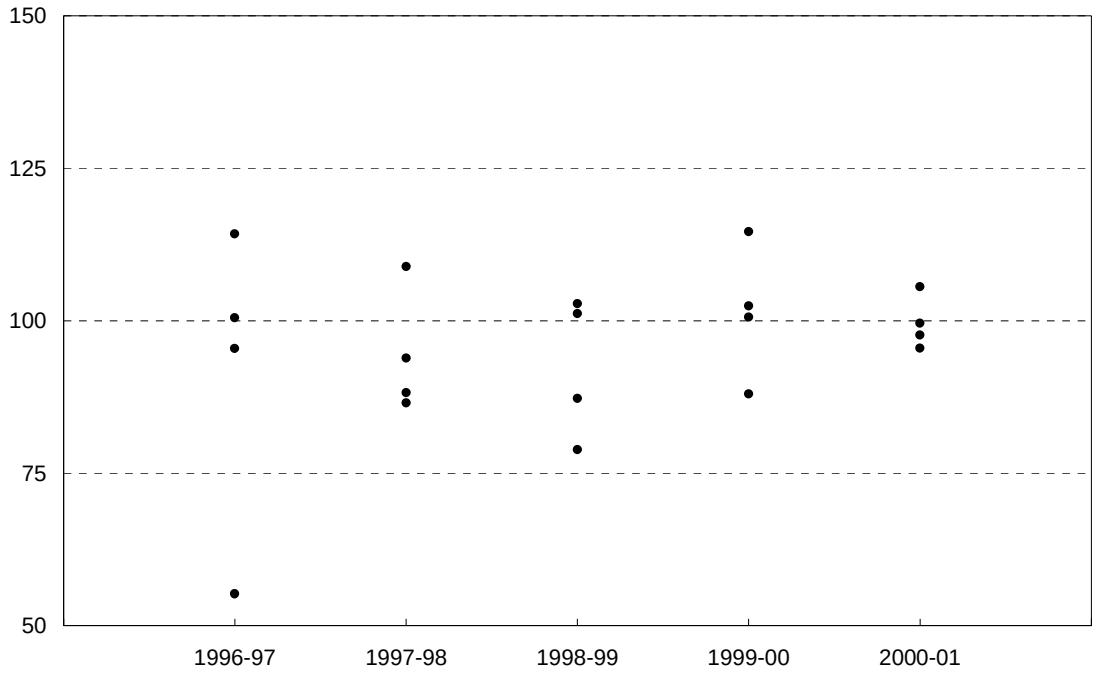
9.2 Profitability

Profitability indicators provide information on how GTEs are using the assets vested in them by shareholder governments to generate earnings. For a more detailed discussion of profitability indicators, see chapter 3.

In 2000-01, none of the urban transport GTEs reviewed returned a positive, pre-tax operating profit. The trend over the reporting period, of negative or small, positive operating results is mainly due to expenses growing faster than revenues. The increase in total expenses reflects higher labour and general maintenance costs, increased depreciation expenses and the introduction of accounting for superannuation liabilities, among other things.

The average level of cost recovery for urban transport GTEs overall has remained at around 100 per cent over the reporting period (see figure 9.1). The introduction of community service obligation (CSO) payments to ACTION in 1996-97 and Metro Tasmania in 1997-98 — to reflect the value of concession and other non-commercial benefits of public transport — significantly improved cost recovery for these GTEs.

Figure 9.1 **Cost recovery, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the cost recovery ratio for a government trading enterprise in that financial year. Cost recovery is the ratio of revenue from operations to expenses from operations. Revenue from operations is calculated by subtracting investment income and receipts from governments to cover deficits on operations from total revenue. Expenses from operations are calculated by subtracting gross interest expense from total expenses. Prior to 2000-01, abnormal items were also subtracted from operating expenses and revenue.

Over the reporting period, the return on assets varied across urban transport GTEs (see figure 9.2), although some convergence is evident in latter years. The major factors affecting urban transport GTEs' return on assets are changes in total revenues and total expenses. However, apart from operating profit, this performance measure is also influenced by changes in asset values — for example, through asset transfers, sale and lease-buy-back arrangements, asset revaluations, asset disposals and depreciation.

Overall, returns have improved over the reporting period. Indeed, all the GTEs surveyed earned a positive return on assets in 2000-01 — the first time this has happened. However, these returns are well below those required by private operators, indicative of the fact that urban transport GTEs are not being required to operate on a fully commercial basis.[1]

1 Governments may not require a commercial rate of return from urban transport GTEs because urban transport provides external benefits that are not captured on the balance sheet — such as road user cost, access for the young, elderly and poor and pollution savings. Governments may

Figure 9.2 **Return on assets, 1996-97 to 2000-01 (per cent)**

Note Each data point represents the return on assets ratio for a government trading enterprise in that financial year. Return on assets is the ratio of earnings before interest and tax (EBIT) to average total assets. EBIT is calculated by subtracting total expenses from total revenue (includes abnormals) and adding back gross interest expense. Average total assets are the average of the value of assets at the beginning and end of each financial year.

Like return on assets, the return on equity achieved by urban transport GTEs has varied substantially over the reporting period. No urban transport GTE had a positive return on equity in 2000-01.

9.3 Financial management

Financial management indicators provide information about the capital structure of GTEs and their ability to meet the cost of servicing debt and other liabilities as they fall due. For a more detailed discussion of financial management indicators, see chapter 3.

feel that there is scope for further efficiency gains within the GTEs. If prices have been set to reflect the efficient cost of service provision, low returns would be indicative of inefficient operations.

Most urban transport GTEs have undertaken debt restructuring over the reporting period, resulting in a reduction in debt levels. This restructuring includes debt for equity swaps, debt transfers to government and debt repayments.

Financial restructuring changes the capital structure of the GTEs, making it difficult to assess financial management performance over time. Asset revaluations also have an impact on performance indicators.

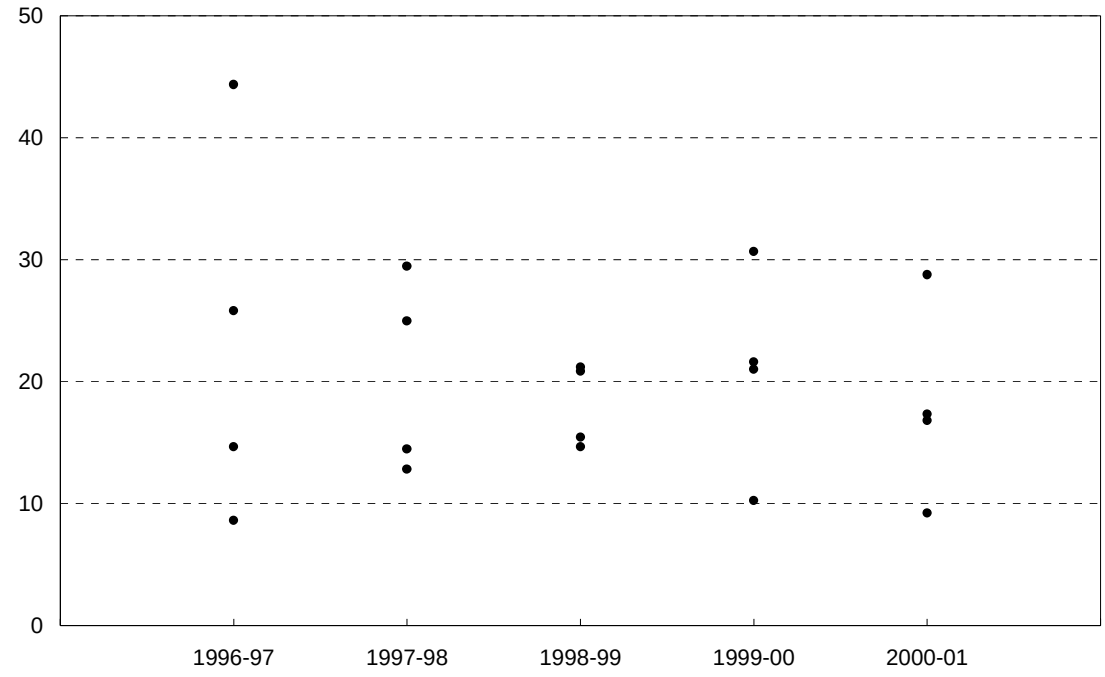
Over the reporting period, the debt to total assets ratio has generally declined across most GTEs (see figure 9.3). This may suggest a decrease in the proportion of total assets obtained through the use of borrowing. However, an improvement in this ratio can also result from debt restructuring and the transfer of liabilities to government departments. For example, ACTION's debt for equity swap improved their debt to total assets ratio in 1996-97 and the upward revaluation of assets by TransAdelaide achieved a similar result in 1996-97 and 1997-98.

The STA is the only urban transport GTE to have increased its level of debt over the reporting period (by over $90 million, or 275 per cent, since 1996-97). Borrowing for the purchase of new buses in 1999-00 and 2000-01 accounted for most of the increase in debt levels.

Sound financial management requires that profits are sufficient to ensure interest payments can be met. A high level of interest cover indicates that the entity can sustain a fall in profit or increased interest expense and still meet the cost of servicing debt.

In 2000-01, urban transport GTEs all reported interest cover levels of between zero and one. This indicates that the GTEs can currently meet their interest commitments from operating profit. However, there does not appear to be a significant margin to insulate the GTEs from increases in interest rates or falling revenues.

Figure 9.3 **Debt to total assets, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the debt to total assets ratio for a government trading enterprise in that financial year. Debt is defined to include all repayable borrowings (interest bearing and non-interest bearing), interest bearing non-repayable borrowings and finance leases. Average total assets are the average of the value of assets at the beginning and end of each financial year.

9.4 Financial transactions

As part of the reform process, governments have sought to facilitate competitive neutrality by giving GTEs a greater commercial focus and exposing them to incentives and regulations similar to those faced by private sector businesses. For a more detailed discussion of competitive neutrality principles, see chapter 3.

Traditionally, the additional social benefits associated with the provision of urban transport services were recognised implicitly by governments and paid for by funding operating deficits.

More recently, some governments have entered into CSO contracts with their GTEs. The STA, Metro Tasmania and ACTION receive explicit CSO payments, while TransAdelaide receives contract payments from the Public Transport Board, reported as a consolidated figure in total income.

CSO contracts across urban transport GTEs include the following common elements:

- Pricing CSO payment — to reimburse GTEs for offering fares at below the commercial level. The government pays the difference between the full fare applicable for the journey and the fare paid by the traveller;
- Service CSO payment — to reimburse GTEs for providing non-commercial services in excess of minimum service level requirements; and
- Concession CSO payment — to reimburse GTEs for offering government determined concessions. This includes the provision of free and concession travel for school students, and concession travel for tertiary students, pensioners and senior citizens, people with disabilities and welfare recipients.

Urban transport GTEs are required to make tax-equivalent and dividend payments, along with debt guarantee fee payments, to achieve competitive neutrality with private sector businesses.

TransAdelaide was the only GTE to make tax-equivalent payments to its shareholder government over the reporting period (in 1999-00 and 2000-01). Tax-equivalent payments were not required mainly because of negative operating results, accumulated tax losses and the impact of the introduction of the Goods and Services Tax and the reduction in the company tax rate from 1999-00.

No dividends were paid by the GTEs in 2000-01. Since 1996-97, each of the corporatised GTEs — the STA, Metro Tasmania and TransAdelaide — have made at least one dividend payment.

9.5 GTE performance reports

State Transit Authority (NSW)
TransAdelaide (SA)
Metro Tasmania (Tasmania)
ACTION (ACT)

STATE TRANSIT AUTHORITY — New South Wales

The State Transit Authority (STA) is a statutory body incorporated under the *Transport Administration Act 1988.* The STA operates three metropolitan passenger transport businesses — Sydney Buses, Sydney Ferries and Newcastle Bus and Ferry Services. The Authority operates within the regulatory framework of the *Passenger Transport Act 1990*.

In 2000-01, the STA recorded an operating deficit (before tax) of $4.4 million, which is in line with previous years in the reporting period.[1] Revenue increased in 2000-01, mainly due to growth in patronage of 2.2 per cent over the previous year. This was partly the result of the STA's involvement in the Sydney Olympic transport task. Expenses were 14 per cent higher in 2000-01 than 1999-00. This is despite the STA's fuel-price hedging policy securing a 6 per cent reduction in the fuel bill in 2000-01. The main factors that contributed to the rise in expenses included increases in wages and salaries and retirement benefit costs.

The STA commenced a bus replacement program in 1997-98. This was done to maintain the average age of the bus fleet below 12 years, as per the regulations to the *Passenger Transport Act 1990*. Debt levels increased from 1998-99 to 2000-01 to finance the capital costs of the replacement program. The increase in borrowings has affected debt to equity, debt to total assets and total liabilities to equity ratios, which have all increased since 1997-98.

Return on assets in 2000-01 was positive, despite the STA recording a negative operating result. This reflects the fact that borrowing costs as a percentage of total costs have increased due to the borrowing requirements of the STA's bus replacement program.[2]

Since 1995-96, the STA has not made tax-equivalent payments due to accumulated tax losses. The STA has an agreement with the NSW Government for the reimbursement of pricing, service and concession community service obligations (CSOs).[3] The government reimbursement for these services was almost $194 million in 2000-01 — continuing the upward trend in CSO payments observed over the reporting period.

1 The positive pre-tax profit recorded in 1999-00, includes one-off revenues of $3.2 million relating to the sale of properties in that year.

2 Return on assets is the ratio of earnings (before interest and tax expenses) to total assets. As such borrowing costs are not considered, whereas operating profit includes borrowing costs.

3 The STA does not receive CSO payments for non-commercial services provided by Sydney Buses.

STATE TRANSIT AUTHORITY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*[a]	*1999-00*[b]	*2000-01*
Size						
Total assets	$m	379	383	369	434	439
Total revenue	$m	362	372	394	424	479
Profitability						
Operating profit before tax (includes abnormals)	$'000	-3 982	-4 713	-9 635	699	-4 313
Operating sales margin	%	-0.9	-0.5	-1.5	1.3	0.9
Cost recovery	%	100.5	88.2	87.3	100.6	97.9
Return on assets	%	-0.4	-0.5	-1.3	1.6	1.2
Return on equity	%	-0.9	-2.4	-6.4	0.5	-3.0
Financial management						
Debt to equity	%	20.7	34.8	38.4	85.5	89.9
Debt to total assets	%	8.6	14.5	14.6	30.7	28.8
Total liabilities to equity	%	134.0	141.6	157.3	201.5	214.5
Interest cover	times	-0.6	-0.6	-1.0	1.1	0.6
Current ratio	%	38.6	36.7	35.0	42.8	44.9
Leverage ratio	%	234.0	241.6	257.3	301.5	314.5
Payments to and from government						
Dividends	$'000	0	0	16 560	0	0
Dividend to equity ratio	%	0	0	11.0	0	0
Dividend payout ratio	%	0	0	-171.9	0	0
Income tax expense	$'000	-2 536	-875	0	0	0
CSO funding	$'000	150 467	161658	167 837	178 297	193 675

a During 1998-99, the State Transit Authority (STA) sold property for $20 million. The net sale proceeds of $16.5 million was paid to the NSW Treasury as a special dividend on 30 June 1999. **b** The increase in the value of assets is due to $55.8 million in capital expenditure for bus replacement and a $26.7 million upward revaluation of non-current assets. The STA reported an abnormal gain of $3.2 million relating to profit on the sale of properties.

TRANSADELAIDE — South Australia

TransAdelaide provides passenger rail services to the Adelaide metropolitan area under contract to the Passenger Transit Board (PTB).[1] With the passing of the *TransAdelaide (Corporate Structure) Act 1998*, TransAdelaide became a statutory corporation subject to the provisions of the *Public Corporations Act 1993*. It has a wholly-owned subsidiary corporation, Austrics and is engaged in the Transitplus joint-venture with Australian Transit enterprises.[2]

Operating results over the reporting period have been affected by PTB's tendering policy, which has increased the competitive pressures faced by TransAdelaide. In 2000-01, TransAdelaide recorded a net operating loss (before tax) of $2.9 million. Pre-tax profits have trended down over the reporting period — the exception being 1999-00.[3]

Return on assets in 2000-01 was positive, despite TransAdelaide recording a negative operating result, which reflects the fact that borrowing costs comprise 9 per cent of TransAdelaide's total expenses — in 2000-01, the sector average was 3 per cent.[4]

Debt to equity and debt to total assets ratios improved in 2000-01, mainly due to asset revaluation. In 2000-01, TransAdelaide's non-current assets were independently revalued, increasing the value of TransAdelaide's asset base by almost $90 million.

TransAdelaide is required under the *Public Corporations Act 1993* to make tax-equivalent and dividend payments to the SA Government. However, dividend payments have not been made since 1998-99.

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1 TransAdelaide is required to compete with the private sector to secure PTB service contracts. On 22 April 2000, TransAdelaide ceased the provision of bus services in its own right after unsuccessful bids to the PTB. In December 2000, TransAdelaide secured the contract for the provision of rail transport services until 2005.

2 Austrics is a software development company involved in developing computerised scheduling software. In 2000, Transitplus Pty Ltd was awarded a five year contract for the provision of passenger transport to the Aldgate and Mount Barker area. Previously this service was provided by the former TransAdelaide subsidiary Hills Transit, which was dissolved by regulation on 30 June 2000.

3 Operating profit in 1999-00 was affected by TransAdelaide losing the PTB bus service contract in April 2000. This caused expenditures to fall by a greater magnitude than revenue for the 1999-00 financial year.

4 Return on assets is the ratio of earnings (before interest and tax expenses) to total assets. As such borrowing costs are not considered, whereas operating profit includes borrowing costs.

TRANSADELAIDE (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*
Size						
Total assets	$m	432	656	617	609	685
Total revenue	$m	191	193	249	227	107
Profitability						
Operating profit before tax (includes abnormals)	$'000	7 760	5 186	-1 349	9 162	-2 865
Operating sales margin	%	13.9	11.5	4.7	8.6	5.3
Cost recovery	%	114.2	108.9	102.8	114.6	105.5
Return on assets	%	6.8	4.3	1.9	3.4	1.1
Return on equity	%	4.5	1.6	0.4	0.9	-0.8
Financial management						
Debt to equity	%	89.4	36.6	31.3	30.1	21.7
Debt to total assets	%	44.4	29.5	20.9	21.0	17.4
Total liabilities to equity	%	115.9	49.9	45.5	42.4	32.6
Interest cover	times	1.4	1.3	0.9	1.8	0.7
Current ratio	%	76.2	71.1	93.0	127.6	89.5
Leverage ratio	%	215.9	149.9	145.5	142.4	132.6
Payments to and from government						
Dividends	$'000	100	1 267	1 155	0	0
Dividend to equity ratio	%	0.1	0.4	0.3	0	0
Dividend payout ratio	%	1.3	24.4	66.4	0	0
Income tax expense	$'000	0	0	-3 089	5 314	1 110
CSO funding	$'000	0	0	0	0	0

a TransAdelaide's assets were revalued upwards. **b** As part of the SA Government's asset management plan, TransAdelaide's bus fleet was transferred to Transport SA resulting in a fall in total assets. Half of the debt associated with bus fleet assets was transferred to Transport SA. Operating profit (before tax, including abnormals) also declined due to a net increase in abnormal expenses associated with the asset transfer. **c** Includes abnormal revenue relating to the withdrawal of bus services ($11.3 million) and abnormal expenses relating to loss on disposal of assets ($7.8 million), expenses associated with the withdrawal of bus services ($3.1 million), fleet and depot restoration costs ($5.9 million), Hills Transit termination payments ($0.6 million) and the write-off of tax losses associated with the bus business ($7.6 million). Includes an upward revaluation of land, buildings and rollingstock of $6.7 million.

METRO TASMANIA Tasmania

Metro Tasmania Pty Ltd (Metro) was incorporated on 2 February 1998, under the *Metro Tasmania Act 1997*. Upon incorporation, the assets and liabilities of the Metropolitan Transport Trust were transferred to Metro, which provides passenger bus services to Hobart, Launceston and Burnie. In May 1999, Metro formed a subsidiary company, Metro Coaches (Tas) Pty Ltd to operate bus services from Hobart to Blackman's Bay, the Channel, Campania and New Norfolk.

In 2000-01, passenger levels increased 2.3 per cent over 1999-00 levels. This is in contrast to an average 3 per cent decline, per annum over the past thirteen years (GPOC 2000).[1] Despite the increase in demand for Metro services and an increase in prices during 2000-01,[2] revenue was down on 1999-00 levels.[3] Consequently, Metro's pre-tax operating profit fell significantly in 2000-01 compared to 1999-00.

Debt to equity and debt to total assets ratios continued to decline in 2000-01, as Metro reduced its level of borrowings from Treasury. The ratios were also affected by increases in the asset revaluation reserve and the level of current assets.

The *Government Business Enterprises Act 1995* requires Metro to make dividend and income tax-equivalent payments to the Tasmanian Government. Over the reporting period Metro has only made one dividend payment — in 1999-00. Metro has not made any tax equivalent payments during the reporting period due to accumulated tax losses.

Metro entered into a community service contract with the Government on 31 October 1997. The agreement provides for concession travel for specified categories of passengers, including school children and pensioners, and for the provision of non-commercial services, such as late night services and weekend services. The amounts received by Metro over the reporting period under this service contract, have not been disclosed in its annual reports.

1 The fall in demand for Metro services has generally been attributed to declining population and competition from private motor vehicles. The greatest decline in demand for urban transport services occurred among full-fare paying adult passengers (GPOC 2000).

2 Maximum prices that Metro can charge are determined by the Government Prices Oversight Commission (GPOC). In 2000-01, GPOC finalised investigations into Metro's price framework, which resulted in an increase in adult and concession fares by an average of 8.2 per cent – the first price change since 1996-97. School student fares remained unchanged.

3 Revenue in 1999-00 was bolstered by one-off items relating to a reduction in superannuation provisions ($649 000).

METRO TASMANIA (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*
Size						
Total assets	$m	56	51	37	35	36
Total revenue	$m	31	32	28	30	29
Profitability						
Operating profit before tax (includes abnormals)	$'000	-3 826	-1 128	-69	763	-53
Operating sales margin	%	-16.9	-10.1	-0.7	2.9	-0.4
Cost recovery	%	55.2	93.8	101.1	102.4	99.6
Return on assets	%	-5.1	-1.6	1.0	3.3	0.6
Return on equity	%	-13.0	-5.5	-0.4	4.8	-0.3
Financial management						
Debt to equity	%	35.4	38.3	43.5	23.2	18.2
Debt to total assets	%	14.7	12.8	15.4	10.3	8.8
Total liabilities to equity	%	138.8	185.2	137.2	118.3	108.5
Interest cover	times	-3.1	-3.4	0.9	2.8	0.8
Current ratio	%	33.5	34.4	30.8	71.7	109.5
Leverage ratio	%	238.8	285.2	237.2	218.3	208.5
Payments to and from government						
Dividends	$'000	0	0	0	533	0
Dividend to equity ratio	%	0	0	0	3.4	0
Dividend payout ratio	%	0	0	0	69.9	0
Income tax expense	$'000	-561	0	0	0	0
CSO funding[d]	$'000	0	0	0	0	0

a On 31 October 1997, the Metropolitan Transport Trust (MTT) entered into a community service obligation (CSO) contract with the Tasmanian Government, replacing the previous system of funding for the provision of services. As a consequence, grants received from the Tasmanian Government are reclassified as operating income. On 2 February 1998, MTT was incorporated under the *Metro Tasmania Act 1997* to form Metro Tasmania Pty Ltd (Metro). The financial report for 1997-98 is a consolidation of MTT's and Metro's figures. Metro purchased 15 buses on the expiration of their operating lease for $2.4 million. Metro earned a profit from the disposal of fixed assets amounting to $40 216. **b** Includes an abnormal expense of $0.5 million relating to a change in assumptions of superannuation liabilities and an extraordinary expense of $2.2 million relating to underprovision for superannuation. **c** Includes abnormal revenue of $649 000 relating to a reduction in superannuation provisions. Metro also reported abnormal expenses relating to workers' compensation ($250 000), wholesale sales tax adjustment ($90 000) and costs incurred during a price regulation investigation by the Government Prices Oversight Commission ($130 000). **d** The level of CSO funding is not reported separately in Metro's financial statements.

ACTION — Australian Capital Territory

The Australian Capital Territory Internal Omnibus Network (ACTION) provides urban and school bus services to the Canberra metropolitan area. ACTION operates pursuant to the *Motor Omnibus Services Act 1955*, and during the reporting period was a division of the ACT Government's Department of Urban Services (DUS).[1] Prices for ACTION's services are set by the Independent Pricing and Regulatory Commission. On 9 August 2001, the ACT Legislative Assembly passed legislation to change the status of ACTION from a department to a statutory authority.

A 6 per cent decrease in operating expenses, compared to 1999-00, was the main contributor to improvements in the cost recovery ratio and pre-tax profit in 2000-01. The improvement in the return on assets ratio was due to a combination of the stronger operating result and a depreciation in the value of ACTION's assets during the year.

ACTION reduced its debt in 2000-01 by 26 per cent, continuing the decline in debt to equity and debt to total liabilities ratios observed over the reporting period. The lower level of debt reduced interest expenses by 9 per cent and resulted in an improvement in the level of interest cover.

ACTION did not pay income tax or make dividend payments over the reporting period.

In 1996-97, ACTION entered into a contract to fulfil community service obligations (CSOs). ACTION receives CSO payments for offering fares below a commercial level, general route off-peak services, concession travel for students and the provision of school services and special needs transport.[2] CSO funding comprises around 70 per cent of ACTION's total revenue. In order to fund its operating losses, ACTION also receives annual subsidies from the ACT Government.[3]

1 On 1 July 1998, ACTION entered into a purchaser–provider relationship with the DUS, whereby the DUS purchases public transport services from ACTION. As part of this arrangement, most of ACTION's property, including bus shelters and interchanges, were transferred to the DUS. ACTION retained its Belconnen and Tuggeranong depots and associated offices including ACTION's head office. Furthermore, ACTION sold part of its fleet of buses for $6.5 million under a sale and lease-buy-back arrangement.

2 ACTION operates special needs transport on a full cost recovery basis with revenue received from ACT Health Community Care, the ACT Department of Education and Canberra Hospital.

3 ACTION received subsidies of $3 million in 1996-97, $1 million in 1997-98, $2.3 million in 1998-99, $5.2 million in 1999-00 and $3.2 million in 2000-01.

ACTION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*
Size						
Total assets	$m	112	101	76	72	68
Total revenue	$m	65	56	57	67	65
Profitability						
Operating profit before tax (includes abnormals)	$'000	-7 651	-11 015	-14 733	-4 342	-1 176
Operating sales margin	%	-2.0	-13.5	-21.7	-3.3	1.1
Cost recovery	%	95.5	86.5	78.8	88.0	95.5
Return on assets	%	-1.1	-7.1	-13.9	-3.0	1.1
Return on equity	%	-13.2	-17.6	-28.7	-10.2	-2.9
Financial management						
Debt to equity	%	44.8	45.0	43.4	38.3	32.4
Debt to total assets	%	25.8	25.0	21.2	21.6	18.7
Total liabilities to equity	%	69.5	71.4	75.4	72.5	68.5
Interest cover	times	-0.2	-2.2	-5.1	-1.0	0.4
Current ratio	%	47.2	45.5	27.0	46.2	60.3
Leverage ratio	%	169.5	171.4	175.4	172.5	168.5
Payments to and from government						
Dividends	$'000	0	0	0	0	0
Dividend to equity ratio	%	0	0	0	0	0
Dividend payout ratio	%	0	0	0	0	0
Income tax expense	$'000	0	0	0	0	0
CSO funding	$'000	35 787	36 367	39 295	42 631	42 731

a The ACT Government extinguished all of ACTION's loans since self-government in 1989, converting debt of $23.9 million to equity. **b** Total revenue fell sharply between 1996-97 and 1997-98 resulting from declining fare revenue and reduced subsidy payments, and no revenue from asset disposals or recoveries from redundancies. **c** ACTION became liable for the payment of state and federal taxes and charges in 1998-99. On 1 July 1998, most of ACTION's property, including bus shelters and interchanges, were transferred to the Department of Urban Services as part of the implementation of the purchaser–provider governance arrangement. ACTION retained its Belconnen and Tuggeranong depots and associated offices including ACTION's head office. **d** Includes an abnormal gain of $1.1 million relating to participation in a Commonwealth Government program. An abnormal expense of $0.3 million was incurred relating to loss on the sale of obsolete stores.

10 Railways

The financial performance of five rail government trading enterprises (GTEs) is reviewed in this chapter — the NSW State Rail Authority (SRA), Freight Rail Corporation of NSW (FreightCorp), Queensland Rail (QR), the Western Australian Government Railways Commission (WAGRC) and National Rail Corporation (NRC) (see table 10.1). QR provides both passenger and freight services, FreightCorp and NRC provide only freight services, while the SRA and the WAGRC provide passenger services.

Victoria's rail services are not included as they have been contracted to the private sector. TransAdelaide is reported on in chapter 9 because it only provides urban passenger services.

At the end of 2000-01, the five GTEs monitored controlled $15.6 billion of assets and generated $5.1 billion in revenues. QR and the SRA are the largest operators, accounting for 47 per cent and 34 per cent of assets, and 41 per cent and 34 per cent of revenues respectively.

For a discussion of the data and the financial indicators used and some of the factors that should be considered when assessing performance, see chapter 3.

10.1 Sector reforms

Reforms within the rail sector have been aimed at improving performance by subjecting operators to stronger financial disciplines and greater competitive pressures. The main processes undertaken to encourage these reforms have been the vertical and horizontal separation of rail GTEs and the introduction of third-party access regimes.

Table 10.1 **Monitored rail GTEs, 1996-97 to 2000-01**

1996–97	*1997–98*	*1998–99*	*1999-00*	*2000-01*
New South Wales				
State Rail Authority	→	→	→	State Rail Authority
Freight Rail Corporation	→	→	→	Freight Rail Corporation[a]
Queensland				
Queensland Rail	→	→	→	Queensland Rail
Western Australia				
Western Australian Government Railways (WAGRC), trading as Westrail	→	→	→	Western Australian Government Railways (WAGRC)[b]
Commonwealth				
National Rail Corporation	→	→	→	National Rail Corporation[a]

a The joint sale of Freight Rail Corporation and National Rail Corporation to National Rail Consortium Pty Ltd was announced on 30 January 2002. **b** On 30 May 2000, the WA Government sought expressions of interest for the purchase of the WAGRC's freight operations. On 18 December 2000, the sale of the WAGRC's freight business to Australian Railroad Group (ARG) was finalised. The trading name Westrail is no longer used by the WAGRC in operating the remaining passenger rail services.

Third-party rail access regimes have been established in NSW, Queensland and WA. Access is provided to track infrastructure to promote improved performance through increased competition. This policy initiative is in accordance with National Competition Policy (NCP) agreements between the Commonwealth and the State and Territory governments.

The NSW Rail Access Corporation (RAC) was established in 1996. The RAC owned and was responsible for managing the State's rail infrastructure and for providing rail operators access to the network.[1]

In contrast to NSW, the Queensland and WA Governments set up internal business units — within integrated rail entities — that are responsible for third-party access.

In Queensland, the Network Access Unit — a division of QR — is responsible for negotiating access with third-party operators and the development of network access provisions.[2] Queensland's draft access undertaking was approved by the Queensland Competition Authority in December 2001 but has not yet received the Commonwealth Minister's endorsed as an effective regime.

In WA, the Office of the Independent Rail Access Regulator was established during 2000 to oversee the establishment of the rail access regime under the *Railways (Access) Act 1998*. The regime covers track controlled by the WAGRC and WestNet Rail, a subsidiary of the Australian Railroad Group (ARG).[3] Like Queensland, the Western Australian access regime has not been certified under the *Trade Practices Act 1974*.[4]

Structural reforms have also extended to the 'above rail' operations of GTEs. Horizontal separation of freight and passenger businesses has occurred in NSW and WA while QR has internally separated its freight and passenger transport operations. Private sector involvement has increased, through the contracting out of non-core activities. Joint ventures, such as QR's joint venture with Brisbane City Council, have also been established to develop commercially sustainable integrated public transport services.

1 On 1 January 2001, the RAC merged with Rail Services Australia to form the Rail Infrastructure Corporation.

2 QR has put in place accounting arrangements to separately identify network infrastructure and operating costs. These arrangements are designed to treat third-party operators and internal business groups equally for the purposes of access pricing.

3 The sale of the WAGRC's freight business on 18 December 2000 incorporated a 49 year lease of track infrastructure to the ARG.

4 Certification is not essential for rail access regimes to operate effectively. Under NCP arrangements, a third-party may apply to the National Competition Council to declare a service. This initiates a process of negotiation and, if required, compulsory arbitration in order to settle disputes between operators and track managers.

There has been some restructuring of interstate freight operations following the establishment of the NRC. In 1991-92, NRC was formed by the Commonwealth and State governments to take over interstate freight traffic from the State rail systems and Australian National (Commonwealth). Establishment involved the transfer of business and assets associated with interstate freight to NRC over much of the reporting period.[5]

Structural reforms that change the scope of a GTE's activities complicate the assessment of performance over time. Changes in the asset base, liability structure and revenue stream relativities that accompany such reforms result in inconsistencies in financial data over time. They also affect the financial ratios presented in the individual GTE performance reports.

The revenues and costs associated with operational restructuring, such as the sale of assets or redundancy costs, were included in the calculation of some financial ratios as abnormal revenues or expenses prior to 2000-01.[6] Hence, in some cases, movements in financial ratios may be due to the restructuring process rather than reflecting changes in GTE performance.

Over the reporting period, financial reforms have included debt restructuring, the revaluation of assets, the identification and direct funding of community service obligations (CSOs), the development of dividend policies and the introduction of tax-equivalent regimes. Many of these reforms were aimed at establishing competitive neutrality conditions agreed to under NCP.

Reforms that change the financial structure of a business will affect the financial ratios used to assess performance. Further, the consistency with which financial reforms are applied across GTEs has implications for performance comparisons.

10.2 Market environment

Rail GTEs have been operating in an increasingly competitive market environment. Rail transport has been largely displaced in many of its traditional markets by road transport, causing rail's share of the transport market to decline continually over the last 25 years.

5 In May 2000, NRC shareholders (the Commonwealth, NSW and Victorian governments) agreed to sell NRC to the private sector. The joint sale, with FreightCorp, was finalised on 30 January 2002.

6 Items that a GTE's management considered 'abnormal' — by reason of their size and effect on financial performance — were disclosed separately under accounting standards that applied until 2000-01. In 1998-99 and 1999-00, most abnormal items disclosed by GTEs appeared to be associated with reform (see chapter 3).

The declines in market share have been most significant in the provision of non-urban passenger services and the interstate transport of non-bulk commodities. Alternative transport modes, including the car, plane and bus, have largely replaced rail in non-urban passenger services. Car transport is also capturing a greater share of the urban transport market.

In the interstate transport of containerised freight, the volume carried on road has been increasing at about three times the growth in rail volumes (Rail Projects Taskforce 1999). Rail has gone from being the dominant transport mode to having a minor role in the transport of some agricultural products, livestock, fertilisers and cement.

Rail has maintained a dominant role in the transport of bulk commodities, such as coal, grain and iron ore. Rail is well suited to the transport of bulk commodities because it can handle the large volumes and heavy weights that are normally involved in their transport. The demand for rail transport — and consequently GTE revenues — is now greatly dependent on demand and supply conditions in commodity markets, particularly coal and grain. For example, QR has increased revenue in each of the past four years as the volume of coal and grain transported has increased.

The implementation of access regimes increased the scope for competition from other rail operators, particularly private rail operators. For example, FreightCorp has faced competition from other rail operators for the transport of freight on the NSW rail system since 1997-98. Reductions in rail access charges have also led to reduced freight rates and resulted in a decline in revenue for some rail GTEs.

10.3 Profitability

Profitability indicators provide information on how GTEs are using the assets vested in them by shareholder governments to generate earnings. For a more detailed discussion of profitability indicators, see chapter 3.

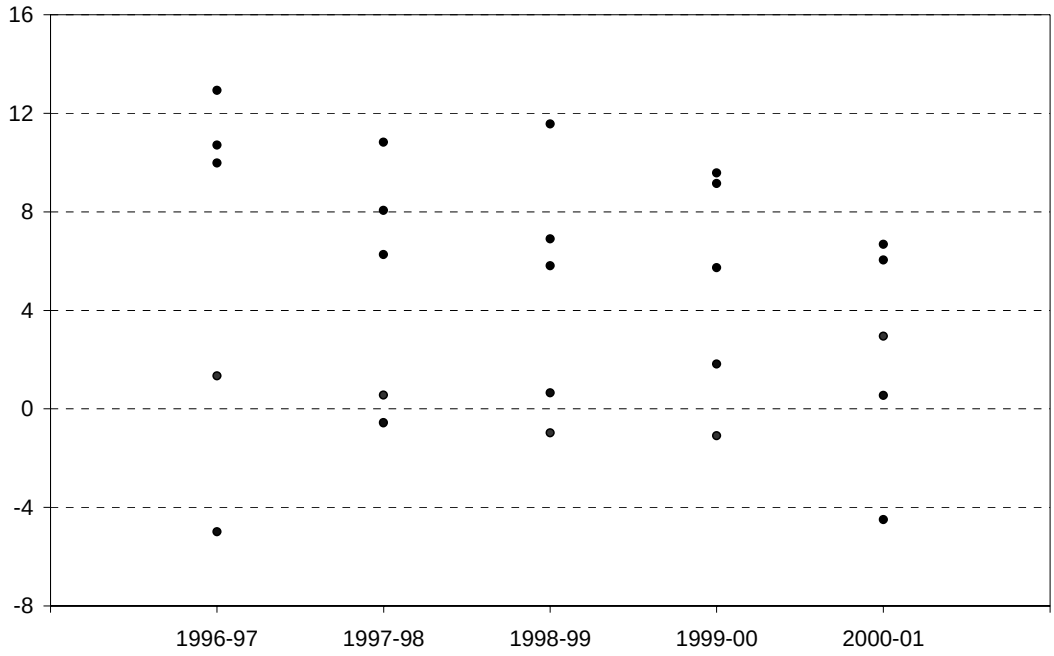
Profitability, in terms of return on assets, has been mixed. The average return on assets for rail GTEs over the reporting period has fluctuated between 2.6 per cent and 5 per cent annually (see figure 10.1).[7] QR and FreightCorp have consistently earned returns of between 5 and 15 per cent over the reporting period, although QR

[7] Asset revaluations may have a significant influence on the return on assets ratio because of their impact on asset values and operating profit (through depreciation expense). The WAGRC, FreightCorp and QR have revalued assets at some stage over the reporting period. In 1999-00, the accumulated balance of these revaluations was around $290 million (PC estimates). QR accounted for over 80 per cent of this amount.

and FreightCorp's returns declined between 1996-97 and 1998-99. The WAGRC achieved returns of between 9 and 12 per cent from 1996-97 to 1999-00 but extraordinary losses relating to the sale of the freight business resulted in the return on assets falling to -4.5 per cent in 2000-01.

NRC posted declining returns up to 1999-00, with negative returns recorded in 1998-99 and 1999-00. This trend was reversed in 2000-01, when NRC recorded a positive pre-tax operating profit for the first time since its inception. The SRA recorded negative returns on assets at the start of the reporting period. However, since the NSW rail industry was restructured in 1996-97, returns have improved — with positive returns made since 1998-99.

Figure 10.1 **Return on assets, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the return on assets ratio for a in that financial year. Return on assets is the ratio of earnings before interest and tax (EBIT) to average total assets. EBIT is calculated by subtracting total expenses from total revenue (includes abnormals) and adding back gross interest expense. Average total assets are the average of the value of assets at the beginning and end of each financial year.

In most cases, the trend for return on equity within the sector reflects the returns made on assets. One exception is the WAGRC, which was earning equity returns below zero early in the reporting period.[8] However, the WAGRC earned returns above 25 per cent on equity after financial restructuring in 1998-99 and 1999-00. The WAGRC's return on equity declined from 29 per cent in 1999-00 to *negative*

8 Return on equity will be negative where a firm is making operating losses or where a firm has negative equity. Equity is negative when liabilities exceed assets.

129 per cent in 2000-01, due to extraordinary losses incurred from the freight division sale.

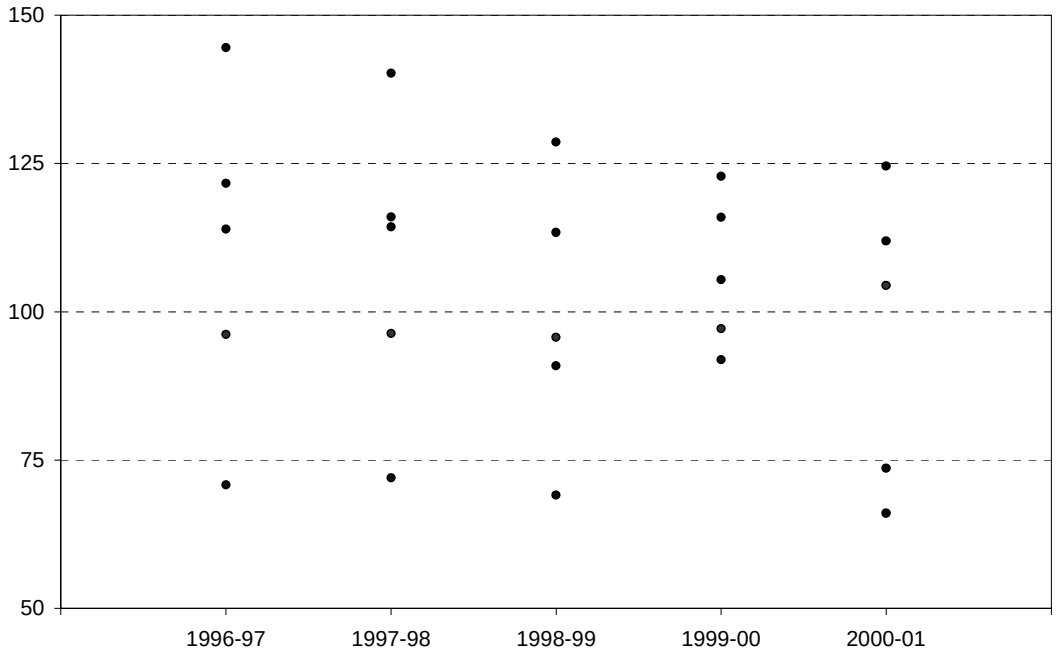
In some cases, the return on assets and equity reflect the impact of abnormal or extraordinary items on operating profit. For example, FreightCorp's return on equity ratio rose in 1999-00, reflecting a negative tax-equivalent expense in anticipation of its sale to the private sector.[9] The SRA improved its profitability in 1998-99 due to a transfer of assets from the NSW Department of Transport. By contrast, the WAGRC's returns on assets and equity both fell in 2000-01 due to extraordinary losses arising from the sale of its freight business.

As a group, rail GTEs have recovered 103 per cent of costs over the reporting period, although there is significant variation between GTEs (see figure 10.2). The best performers on a cost recovery basis have been QR and FreightCorp, with both achieving ratios of between 112 and 140 per cent over the reporting period. In 2000-01, the NRC recovered operating costs for the first time since it commenced operations in 1993.

The SRA is the only rail GTE not to have recovered operating costs in any year of the reporting period, maintaining a level of cost recovery of around 76 per cent.

9 Under accounting standards, future tax liabilities and benefits beyond 2000-01 would not be realisable with the sale of FreightCorp. As a result, tax-equivalent payments were reduced by $42 million for 1999-00 and led to the reporting of a negative tax-equivalent expense of $31 million. The return on equity ratio increases as the numerator used in its calculation is after-tax profit.

Figure 10.2 **Cost recovery, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the cost recovery ratio for a government trading enterprise in that financial year. Cost recovery is the ratio of revenue from operations to expenses from operations. Revenue from operations is calculated by subtracting investment income and receipts from governments to cover deficits on operations from total revenue. Expenses from operations are calculated by subtracting gross interest expense from total expenses. Prior to 2000-01, abnormal items were also subtracted from operating expenses and revenue.

10.4 Financial management

Financial management indicators provide information about the capital structure of GTEs and their ability meet the cost of servicing debt and other liabilities as they fall due. For a more detailed discussion of financial management indicators, see chapter 3.

Assessing the financial performance of rail GTEs is complicated by the financial restructuring that has occurred. For example, NRC received compensation payments from its shareholder governments between 1993 and 1996, to assist in rationalising inefficient functions transferred from State governments. The compensation payments are included within the data used to calculate NRC's financial ratios.

The remaining GTEs have not undertaken financial restructuring programs of this magnitude. However, some financial restructuring has occurred. In 1997-98, FreightCorp changed the basis upon which its debt is valued to more closely reflect market values. Prior to 1997-98, FreightCorp's debt was adjusted by amortising

discounts or premiums over the term of the borrowings. Since 1997-98, FreightCorp's borrowings have been recognised at end of financial year market values. Any increase or decrease in market values compared to the carrying amount was recognised as an expense or revenue in that period.

The change in the measurement basis of borrowings resulted in FreightCorp incurring significant restructuring expenses and a corresponding increase in the carrying amount of borrowings on the balance sheet. Hence, changes in FreightCorp's financial management performance may not reflect a change in FreightCorp's reliance upon debt finance, but the impact of the debt revaluation.

At the end of 2000-01, FreightCorp, QR and NRC were carrying debt levels equivalent to around 30 to 50 per cent of their total assets (see figure 10.3). These GTEs maintained this position over most of the reporting period. The SRA has had a debt to total assets ratio of around 4 per cent, a relatively low level of debt compared to other rail GTEs.

The WAGRC consistently maintained a debt to total assets ratio of around 80 per cent up to 1999-00. In 2000-01, the WA Treasury utilised the net proceeds of the sale of the WAGRC's freight division to retire a significant proportion of its accumulated debt. Consequently, its debt to total assets ratio fell to 59 per cent.

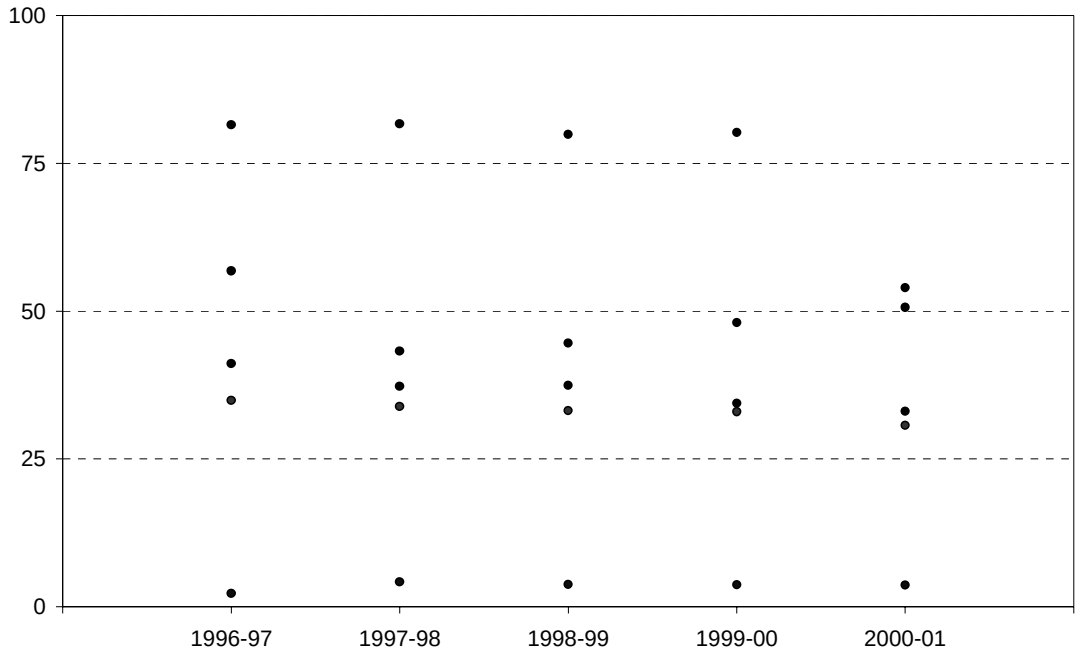
All rail GTE's, except for QR, have reduced their debt to total assets ratio since 1996-97.

Three of the five rail GTEs were operating with debt to equity ratios of between 60 and 160 per cent at the end of 2000-01. These GTEs have maintained this level over much of the reporting period. The WAGRC and the SRA have ratios that lie well outside this range. WAGRC reduced its exposure to debt following financial restructuring in 1996-97, although its debt to equity ratio remained over 600 per cent, substantially above the industry average.

The extraordinary losses stemming from the freight division sale in 2000-01 resulted in the WAGRC's debt to equity ratio increasing from 667 per cent in 1999-00, to over 3000 per cent in 2000-01.[10] SRA's debt to equity ratio, by contrast, has fallen from around 6 per cent at the start of the reporting period, to under 5 per cent in 2000-01.

10 Debt to equity is defined as debt divided by net assets (total assets less total liabilities).

Figure 10.3 **Debt to total assets, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the return on assets ratio for a government trading enterprise in that financial year. Return on assets is the ratio of earnings before interest and tax (EBIT) to average total assets. EBIT is calculated by subtracting total expenses from total revenue (includes abnormals) and adding back gross interest expense. Average total assets are the average of the value of assets at the beginning and end of each financial year.

Sound financial management requires that profits are sufficient to ensure interest payments can be met. A high interest cover ratio indicates that the entity can sustain a fall in profit or increased interest expense and still meet the cost of servicing debt.

In 2000-01, three of the five rail GTEs reported interest cover ratios between one and two. This indicates that these GTEs can currently meet their interest commitments from operating profit. However, there does not appear to be a significant margin to insulate these GTEs from increases in interest rates or falling revenues.

The WAGRC's interest cover was less than zero in 2000-01, indicating it may have to fund interest expenses from sources other than current operating profits.

A current ratio of less than 100 per cent indicates that the short-term obligations of the GTE may need to be met using sources of funds other than current assets.[11] The ability of rail GTEs to meet short-term liabilities has improved over the reporting

11 Current assets comprise cash and other assets that would, in the ordinary course of operations, be available for the conversion into cash within 12 months after the end of the reporting period.

period. The current ratio for the sector overall increased from 85 per cent in 1996-97 to 89 per cent in 2000-01. However, three of the five GTEs recorded a current ratio of less than 100 per cent in 2000-01 with NRC's ratio falling over the reporting period.

10.5 Financial transactions

As a part of the reform process, governments have sought to give GTEs a greater commercial focus and facilitate competitive neutrality by exposing them to incentives similar to those faced by private sector businesses. For a more detailed discussion of competitive neutrality principles, see chapter 3.

Governments act as the shareholder of rail GTEs on behalf of the community. Requiring dividend payments from GTEs is often justified as a return on shareholder funds. In 2000-01, FreightCorp and QR were the only GTEs required to make dividend payments. These GTEs paid $125 million in dividends, with around 56 per cent distributed by QR.

Up to 2000-01, the WAGRC had also been subject to a dividend payment policy. This requirement ended following the sale of the freight division in October 2000.

All rail GTEs, except the SRA and the WAGRC, are required to make income tax-equivalent payments. The SRA has not been subject to a tax-equivalent regime over the course of the reporting period. In 2000-01, following the sale of the freight business, the WA Treasury exempted the WAGRC from making tax-equivalent payments.

The level of tax-equivalent payments increased by $117 million in 2000-01 compared to 1999-00. This increase was due to adjustments made in 1999-00 to future tax benefits and liabilities following an announcement of a reduction in the company tax rate applying from 2000-01.[12]

Governments were also moving towards identifying, costing and explicitly funding CSOs provided by rail GTEs. Most of the rail GTEs had agreements to provide CSOs over the reporting period. CSOs may form a significant part of revenue for some GTEs. For example, CSO funding received by the SRA accounted for

12 Tax-effect accounting leads to differences in how tax applies to income and the timing of tax payments. Future tax benefits and liabilities were adjusted in 1999-00, in accordance with accounting standards following the announcement of a reduction in the company tax rate. The value of this adjustment, which reduced future tax payable by around $55 million for GTEs in the rail sector, was offset against the value of tax that applied to taxable income in 1999-00.

34 per cent of total revenue in 2000-01. CSO funding was provided for concession fares and the provision for low volume freight and regional services.

10.6 GTE performance reports

State Rail Authority (NSW)
Freight Rail Corporation (NSW)
Queensland Rail (Queensland)
Western Australian Government Railways Commission (WA)
National Rail Corporation (Commonwealth)

STATE RAIL AUTHORITY OF NSW — New South Wales

The State Rail Authority (SRA) is a statutory body operating urban and regional passenger services through its CityRail and Countrylink divisions. Its first full year of operation as a specialised passenger service was 1996-97.[1]

Total revenue increased 7 per cent in 2000-01 compared to the previous year, mainly due to an increase in passenger journeys and higher fares.[2] Part of the increase in revenue was also due to larger government contributions for asset upgrades. The increase in revenue was more than offset by a 12 per cent rise in expenses resulting in a decline in profitability.

Changes in both revenue and expenditure in 2000-01 were driven by the SRA's involvement in the Sydney Olympic Games and the implementation of recommendations arising from the McInerney Inquiry into the Glenbrook rail accident.

The increase in the SRA's current ratio in 2000-01 resulted from increases in cash and other investments and a restructuring of debt arrangements to pay for impending capital works.

The SRA is not required to make dividend or tax-equivalent payments to the NSW Government. Community service obligation (CSO) funding is provided for concession fares to specified classes of passengers and to meet revenue shortfalls resulting from the provision of services that are not commercially viable. In 2000-01, the SRA received CSO funding of $50 million to cover the net cost of Olympic services.

1 Prior to 1996-97, the SRA also provided freight services throughout NSW as well as interstate passenger and freight services. On 1 July 1996, the SRA was vertically and horizontally separated into four smaller entities — the SRA and Freight Rail Corporation (FreightCorp), which provide 'above rail' services, the Rail Access Corporation (RAC) and Rail Services Australia (RSA), which provide and maintain rail infrastructure. RSA and RAC merged in January 2001 to form the Rail Infrastructure Corporation, which manages track access and provides maintenance services.

2 CityRail fare prices were determined by the Independent Pricing and Regulatory Tribunal (IPART). In 2000-01, fares rose 8.1 per cent to compensate the SRA for the effects of the Goods and Services Tax. The current IPART determination is to be reviewed in June 2002. Countrylink fares are determined by the State Government and have remained unchanged since July 1999.

STATE RAIL AUTHORITY OF NSW (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*
Size						
Total assets	$m	4 622	4 528	5 450	5 356	5 362
Total revenue	$m	1 236	1 566	1 590	1 613	1 727
Profitability						
Operating profit before tax (includes abnormals)	$'000	-448 796	-45 384	13 530	84 134	14 055
Operating sales margin	%	-34.6	-1.8	1.8	6.0	1.6
Cost recovery	%	70.8	72.0	69.1	91.9	73.6
Return on assets	%	-5.0	-0.6	0.6	1.8	0.5
Return on equity	%	-6.7	-1.3	0.4	2.0	0.3
Financial management						
Debt to equity	%	5.6	5.8	4.5	4.8	4.8
Debt to total assets	%	2.2	4.2	3.8	3.7	3.7
Total liabilities to equity	%	35.6	35.3	29.3	30.5	30.0
Interest cover	times	-19.0	-1.3	1.7	7.1	1.9
Current ratio	%	48.8	46.5	37.0	31.5	65.7
Leverage ratio	%	135.6	135.3	129.3	130.5	130.0
Payments to and from government						
Dividends	$'000	0	0	0	0	0
Dividend to equity ratio	%	0	0	0	0	0
Dividend payout ratio	%	0	0	0	0	0
Income tax expense	$'000	0	0	0	0	0
CSO funding	$'000	507 501	495 525	483 650	478 900	593 116

a Higher revenues were the result of the sale of property, plant and equipment along with slightly higher passenger revenues. **b** Revenues increased due to asset disposal proceeds, higher passenger revenues, increases in NSW Government operating subsidies, interest received and other non-operating revenues. Operating profit includes a $51.6 million contribution from abnormal revenues. Abnormal revenues comprised a capital grant from the NSW Government for car parks, and bus and rail interchanges transferred from the Department of Transport. **c** Land was revalued upwards by $147 million and buildings by $304 million. Net assets to the value of $564 million were transferred to the Rail Access Corporation.

FREIGHT RAIL CORPORATION OF NSW — New South Wales

Freight Rail Corporation (FreightCorp) is a statutory government-owned corporation, which began operating in 1996-97 following the NSW Government's restructure of the State Rail Authority. FreightCorp undertakes 'above rail' freight operations, including the provision of logistical support to companies.[1] The NSW Government announced its intention to sell FreightCorp — in conjunction with the National Rail Corporation — in September 2000. The sale to National Rail Consortium Pty Ltd was announced in January 2002.

In 2000-01, operating profit (before tax) fell 31.6 per cent compared to 1999-00. Revenues decreased 8.2 per cent in 2000-01 mainly due to increased competition leading to decreases in freight rates. The decline in revenues continued the trend observed throughout the reporting period. External fuel price shocks and privatisation costs incurred during 2000-01, put pressure on overall operating costs. However, expenses declined by 6 per cent compared to 1999-00 levels, which Freightcorp attributed to productivity improvements.

The debt to equity and debt to total assets ratios have improved over the reporting period, with FreightCorp reducing its level of borrowings annually since 1996-97. In June 2000, borrowings were revalued at their capital value rather than their market value, resulting in a net gain of $8.3 million.[2] Return on equity dropped in 2000-01 as preference shares were recognised as equity rather than debt for the first time since their issue in 1996-97. This increased equity by $100 million in 2000-01.

FreightCorp is required to make tax-equivalent and dividend payments to the NSW Government. The dividend payout ratio in 2000-01 was over 400 per cent higher than 1999-00, mainly due to increases in dividend payments and income tax expenses.

FreightCorp has a community service obligation contract with the NSW Government to provide freight train services to regional areas at a non-commercial rate. The haulage of specific goods such as grain, sugar and petroleum products is also subsidised.

1 'Above rail' refers to services provided using locomotives, wagons, terminals and maintenance facilities. 'Below rail' includes the track, stations, signalling and other infrastructure used for running train services. Freightcorp negotiates access to below rail infrastructure with access managers around Australia.

2 The recognition of borrowings at their capital value results in any discount or premium on the face value of the loan being amortised over the life of the debt. Market valuation previously required any change to the market value of borrowings – discount or premium – to be brought to account, as a revenue or expense, in the current financial year.

FREIGHT RAIL CORPORATION OF NSW (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*	*2000-01*[c]
Size						
Total assets	$m	1 075	959	985	951	953
Total revenue	$m	832	772	690	642	590
Profitability						
Operating profit before tax (includes abnormals)	$'000	106 304	14 158	33 660	55 466	37 933
Operating sales margin	%	15.6	7.8	9.9	13.7	10.6
Cost recovery	%	121.6	116.0	113.4	115.9	111.9
Return on assets	%	12.9	6.3	6.9	9.1	6.7
Return on equity	%	27.9	3.6	2.6	18.0	6.5
Financial management						
Debt to equity	%	191.4	83.2	76.6	67.7	65.4
Debt to total assets	%	56.8	37.3	37.4	34.4	33.1
Total liabilities to equity	%	261.6	110.5	107.3	93.1	98.1
Interest cover	times	2.9	1.2	1.8	2.4	2.2
Current ratio	%	127.3	159.0	121.4	154.3	145.1
Leverage ratio	%	138.2	190.5	193.2	207.4	202.0
Payments to and from government						
Dividends	$'000	42 228	23 288	20 000	36 191	55 532
Dividend to equity ratio	%	14.2	6.2	4.3	7.5	11.4
Dividend payout ratio	%	51.0	171.6	166.3	41.5	176.4
Income tax expense	$'000	23 494	590	21 631	-31 762[d]	6 456
CSO funding[e]	$'000	60 618	90 000	80 000	76 500	72 221

a Operating profits declined as a result of abnormal expenses totalling $45.9 million. These expenses were related to restructuring costs associated with redundancies and debt. Redundancy costs include provision for severance payments. In previous years, debt had been valued at face value after deducting any unamortised discounts. FreightCorp changed the measurement of its borrowings to reflect market value. **b** Operating profits improved due to lower abnormal expenses of $13 million. **c** Equity increased by $100 million due to the recognition of preference shares as equity rather than debt. **d** The anticipated sale of FreightCorp resulted in the company no longer having virtual certainty regarding the realisation of future income tax benefits and deferred liabilities. A credit of $42 million was recorded due to the adjustment of deferred tax balances as required by AAS 3 and AAS 36 of the Australian Accounting Standards. Future tax benefits and liabilities were also adjusted in 1999-00, following the announcement by the Commonwealth Government in 1999 of a reduction in the company tax rate from 36 per cent in 1999-00, to 34 per cent for 2000-01 and then to 30 per cent from 2001-02. The fall in the future company tax rate reduced tax payable by $6.4 million. **e** Since 1997-98 community service obligation payments accommodate access charges paid by FreightCorp in providing these services.

QUEENSLAND RAIL — Queensland

Queensland Rail (QR) is a government-owned corporation that provides freight services throughout regional Queensland and operates passenger rail services in the Brisbane metropolitan area and between key regional centres.[1] QR also provides rail infrastructure access to third party operators.[2] In 2000-01, freight and passenger operations were restructured into two business units — Passenger Services and Coal and Freight Services.

From 1996-97 to 1999-00, total assets increased as QR undertook a major capital works program and acquired new rollingstock. In 1999-00, QR entered into a Cross-Border Lease transaction resulting in assets being written-down by $232 million. This contributed to the 6 per cent decline in total assets in 2000-01 compared to the previous year.[3]

Increased coal and freight revenues and static expenditures underpinned an improvement in the level of profit (before tax) in 2000-01. The fall in return on equity between 1999-00 and 2000-01, is mainly due to higher income tax-equivalent payments in 2000-01.

The rise in debt to equity and debt to total assets ratios over the reporting period is a consequence of QR increasing its level of debt from $2.5 billion in 1996-97, to $3.8 billion in 2000-01 to fund ongoing capital works programs. This has also caused interest cover to decline over the reporting period.

QR makes income tax-equivalent and dividend payments to the Queensland Government. QR has community service obligation (CSO) contracts with the Queensland Department of Transport. The Department makes payments for CSOs provided by QR for urban and intercity passenger services, low volume freight services and infrastructure. QR also receives reimbursements from various State Government departments for concessions provided to senior citizens, pensioners and students.

1 QR is the sole government-owned, rail based freight organisation in Australia, following the sale of Western Australian Government Railway Commission's freight division in December 2000 and the sale of National Rail Corporation and FreightCorp to National Rail Consortium Pty Ltd in January 2002.

2 The Queensland Competition Authority approved QR's access undertaking on 20 December 2001.

3 A Cross-Border Lease involves the leasing of equipment or assets between entities in different jurisdictions — that is, where the lessor is from overseas and the lessee is in Australia. The lease is structured so that tax savings may be passed on from the overseas lessor to the local lessee, thereby lowering leasing costs.

QUEENSLAND RAIL (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*	*1999-00*[b]	*2000-01*
Size						
Total assets	$m	6 487	7 031	7 609	7 796	7 354
Total revenue	$m	1 995	1 896	1 902	2 083	2 092
Profitability						
Operating profit before tax (includes abnormals)	$'000	389 020	304 609	167 886	176 817	185 531
Operating sales margin	%	30.8	28.7	22.2	21.1	21.8
Cost recovery	%	144.5	140.2	128.6	122.8	124.5
Return on assets	%	10.0	8.1	5.8	5.7	6.0
Return on equity	%	11.5	7.7	4.1	7.4	4.8
Financial management						
Debt to equity	%	108.5	116.5	126.9	159.9	174.8
Debt to total assets	%	41.1	43.3	44.6	48.4	50.7
Total liabilities to equity	%	177.6	180.3	195.6	234.6	234.5
Interest cover	times	2.7	2.3	1.7	1.7	1.7
Current ratio	%	77.7	106.7	134.0	87.1	117.3
Leverage ratio	%	277.6	280.3	295.6	334.6	334.5
Payments to and from government						
Dividends	$'000	240 345	100 000	95 000	101 000	69 736
Dividend to equity ratio	%	10.5	4.1	3.7	4.1	3.1
Dividend payout ratio	%	91.3	53.4	91.1	55.8	63.5
Income tax expense	$'000	125 893	117 301	63 656	-4 301	75 722
CSO funding [c]	$'000	659 325	541 568	533 417	670 826	637 269

a Dividend payout ratio declined as the reduction in tax was not as great as the decline in operating profit. This is due to an under-provision for tax made in the previous financial year. **b** The negative income tax expense in 1999-00 is largely the result of a decrease of $46.6 million due to a fall in the future company tax rate. Future tax benefits and liabilities were adjusted in 1999-00, following the announcement by the Commonwealth Government in 1999 of a reduction in the company tax rate from 36 per cent in 1999-00, to 34 per cent for 2000-01 and then to 30 per cent from 2001-02. **c** Community service obligation funding was reduced in 1997-98, following a decision by the Queensland Government.

WESTERN AUSTRALIAN GOVERNMENT RAILWAYS COMMISSION — Western Australia

The Western Australian Government Railways Commission (WAGRC) provides urban and regional passenger services throughout WA.[1] The WAGRC's country passenger services involve the operation of both trains and road coaches. The Perth metropolitan rail service is operated under contract to the Department of Transport.

On 30 May 2000, the WA Government sought expressions of interest for the purchase of the WAGRC's freight operations. On 18 December 2000, the freight business was sold to Australian Railroad Group (ARG). ARG paid the State Government $585 million and committed to invest a further $400 million in the State's rail system over the next five years. The net proceeds of the sale were used to retire a portion of the WAGRC's debt. The sale also saw the establishment of the Network and Corridor Division of the WAGRC, which manages the track lease arrangements with ARG.

The changes in performance indicators in 2000-01, can be attributed to the sale of the freight business, which accounted for over 60 per cent of total revenue in 1999-00. In 2000-01, total assets, revenue, expenditure and debt were all lower than in 1999-00. Although ordinary revenues and expenditures were reduced by similar magnitudes, the extraordinary $116 million loss of freight contract revenue, due to the sale, led to a pre-tax operating loss. Consequently, the cost recovery ratio, return on assets and return on equity all declined.

The retirement of debt accommodated by the sale of the freight division improved the WAGRC's debt to total assets ratio. The sale also significantly affected the WAGRC's debt to equity, liabilities to equity and leverage ratios.

From 1996-97 to 1999-00, the WAGRC was required to make dividend and tax-equivalent payments. In 2000-01, the WA Treasury determined that dividend and income tax-equivalent payments were no longer appropriate as the sale of the freight division had diminished the WAGRC's commercial viability.

The WAGRC receives funding for the provision of community service obligations (CS0s) relating to the provision of country rail and coach services and pensioner concessions. CSO payments increased in 2000-01 to cover the costs of residual freight servicing, surplus employees, transitional costs and network management brought about by the sale of the freight division.

1 Prior to 18 December 2000, the WAGRC traded under the name Westrail.

WESTERN AUSTRALIAN GOVERNMENT RAILWAYS COMMISSION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*[e]
Size						
Total assets	$m	1 137	1 244	1 337	1 407	1 124
Total revenue	$m	418	420	452	456	211
Profitability						
Operating profit before tax (includes abnormals)	$'000	30 684	46 554	69 023	49 020	-122 000
Operating sales margin	%	28.0	30.5	33.0	28.8	-27.2
Cost recovery	%	113.9	114.3	90.9	105.4	66.0
Return on assets	%	10.7	10.8	11.6	9.6	-4.5
Return on equity	%	-7.8	13.9	37.7	29.1	-129.0
Financial management						
Debt to equity	%	682.5	718.6	626.9	667.9	3 057.6
Debt to total assets	%	81.5	81.7	79.9	80.2	59.0
Total liabilities to equity	%	766.5	819.3	712.7	754.0	4 505.2
Interest cover	times	1.4	1.6	1.9	1.6	-0.9
Current ratio	%	44.2	34.9	28.5	39.3	45.9
Leverage ratio	%	866.5	919.3	812.7	854.0	4 605.2
Payments to and from government						
Dividends	$'000	1 508	32 868	44 744	47 569	0
Dividend to equity ratio	%	-0.6	24.7	29.8	28.9	0
Dividend payout ratio	%	7.6	177.6	79.1	99.4	0
Income tax expense [f]	$'000	10 926	28 043	12 437	1 180	0
CSO funding	$'000	19 870	19 711	19 547	21 116	35 743

a T WAGRC incurred an abnormal expense totalling $11.8 million. State Treasury assumed the WAGRC's unfunded superannuation liability totalling $725 million. A financial restructuring package negotiated with State Treasury introduced direct funding of the WAGRC's community service obligations and required the WAGRC to make income tax-equivalent payments. **b** Includes abnormal revenue of $402 000. **c** Includes abnormal revenue of $48 million. **d** Includes abnormal revenue relating to land rationalisation ($25.9 million) and asset contributions ($16.1 million). This was partly offset by abnormal expenses relating to depreciation on a written-off asset ($7.2 million), freight rate adjustment ($0.9 million) and legal settlements ($0.5 million). **e** The December 2000 sale of the freight division reduced the group's assets, debt, revenues and expenditure. The WAGRC incurred an extraordinary loss of $116 million in contract revenue due to the sale. From 2000-01, the WAGRC is no longer required to make dividend or tax-equivalent payments. CSO revenue includes funds to compensate for expenses brought about by the freight division sale. **f** Future tax benefits and liabilities were adjusted downwards by $1.7 million in 1999-00, following the announcement by the Commonwealth Government in 1999 of a reduction in the company tax rate from 36 per cent in 1999-00, to 34 per cent for 2000-01 and then to 30 per cent from 2001-02.

NATIONAL RAIL CORPORATION — Commonwealth

In 1993, National Rail Corporation (NRC) began operations, providing interstate rail freight transport services. NRC negotiates access to track around Australia. NRC was the only freight operator providing services across the Australian mainland standard gauge interstate rail system.

NRC's three shareholders — the Commonwealth, New South Wales and Victorian Governments — signed an agreement in May 2000 to sell 100 per cent of the company's shares to the private sector. The sale, which was held in conjunction with the sale of Freight Rail Corporation (NSW), was finalised on 30 January 2002.

In 2000-01, NRC recorded — for the first time since the corporation's inception — a positive pre-tax operating profit. Combined revenues from NRC's four business units — NR Intermodal, NR Express, Industrial Products and Services and Bulk Freight Services — increased by 2 per cent. In 2000-01, the introduction of a fuel surcharge on freight rates limited the escalating fuel costs that beset other freight rail operators in Australia. The combination of higher revenues and lower costs than in previous years allowed NRC to report a positive return on in 2000-01.

Assessing NRC's financial performance over the reporting period is difficult because of the restructuring that was occurring. For example, revenues up to 1997-98 include payments being made by shareholder governments to NRC to assist in the restructuring of the company and the integration of functions transferred from the shareholder States. These payments ceased in February 1998. However, restructuring expenses continued to be incurred in 1999-00. The NRC was also not directly compensated for costs relating to privatisation.

NRC is not required to make dividend payments, nor does it receive community service obligation payments from its shareholder governments. NRC has not had to make income tax equivalent payments because of losses throughout the reporting period.

NATIONAL RAIL CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*	*1999-00*	*2000-01*
Size						
Total assets	$m	862	897	825	767	780
Total revenue	$m	516	495	431	466	474
Profitability						
Operating profit before tax (includes abnormals)	$'000	-14 141	-20 406	-31 556	- 30 063	2 261
Operating sales margin	%	-2.1	-1.5	-4.2	-3.0	4.2
Cost recovery	%	96.1	96.3	95.7	97.1	104.4
Return on assets	%	1.3	0.6	-1.0	-1.1	2.9
Return on equity	%	-3.6	-2.3	-9.6	-10.4	-0.7
Financial management						
Debt to equity	%	74.1	75.8	80.0	81.5	74.2
Debt to total assets	%	34.9	33.9	33.2	33.0	30.7
Total liabilities to equity	%	114.4	128.1	131.0	138.2	144.0
Interest cover	times	0.4	0.2	-0.4	-0.4	1.1
Current ratio	%	211.5	121.0	103.3	62.8	68.4
Leverage ratio	%	139.9	172.8	180.8	173.4	195.3
Payments to and from government						
Dividends	$'000	0	0	0	0	0
Dividend to equity ratio	%	0	0	0	0	0
Dividend payout ratio	%	0	0	0	0	0
Income tax expense	$'000	-285	-11 434	4 480	5 104	4 556
CSO funding	$'000	0	0	0	0	0

a Profits over the first few years of the reporting period cannot be used as a measure of financial performance because of the compensation payments being made by shareholder governments to NRC. **b** Shareholder compensation payments were reduced by $25 million and ceased entirely in February 1998.

11 Ports

The financial performance of 15 port government trading enterprises (GTEs) is covered in this chapter (see table 11.1). In 2000-01, these GTEs were responsible for assets valued at $3.5 billion and earned around $650 million in revenue.

These GTEs vary in size and the range of services they provide. The principal activities undertaken include the provision and maintenance of port infrastructure and port services such as mooring, stevedoring and pilotage.

Financial performance summaries, including performance indicators for each GTE, are presented after this introduction. The performance indicators are consistent across individual GTEs. However, when making comparisons, care should be taken to consider changes in market environments, timing and valuation issues relating to chosen accounting methods.

For a discussion of the data and the performance indicators used and some of the factors that should be considered when assessing performance, see chapter 3.

11.1 Sector reforms

Industry reforms within the ports sector have been aimed at improving the efficiency and financial performance of GTEs by making them more commercially focused. In general, the reform process has been consistent with the recommendations set out in the 1993 Industry Commission report *Port Authority Services and Activities* (IC 1993). Some of the major recommendations to come from the Commission's report included:

- ports should be constituted as statutory bodies, which are separate from the departmental structure of government;
- ports should be exposed to a tax-equivalent regime, be reimbursed for any community service obligations (CSOs) and pay dividends from after tax profits;
- the adoption, where cost efficient, of a landlord model of operation;[1] and

[1] The landlord model is characterised by the port authority concentrating on the supply of core activities only, with the more contestable waterfront services, such as stevedoring and pilotage, supplied privately.

- where the landlord model is adopted, governments should identify and divest non-core activities and contract out, where cost effective, core activities.

The primary aim of these reforms has been to replicate market disciplines, including the establishment of clear objectives that eliminate any conflicts arising out of the commercial and non-commercial activities of the GTE. With reform there has been an increase in the scope for competition in the provision of port services, mainly through the competitive tendering and contracting out to private operators of activities such as stevedoring, pilotage, mooring, general maintenance and ship cleaning.

The majority of restructuring occurred prior to the reporting period. For example, three independent port corporations replaced the former Maritime Services Board of NSW in 1995-96.[2] In the same year, the Port of Melbourne Authority was divided into three separate entities.[3]

During the reporting period, there were changes to the framework governing some port GTEs. In WA, separate legislation covering several individual port authorities was repealed and replaced by the *Port Authorities Act 1999*. This provided for the commercialisation of port authorities and included provisions relating to the establishment of a board of directors, financial arrangements and dividend payments.

In NT, the *Darwin Port Authority Act 1983* was replaced by the *Darwin Port Corporation Act 1999*. Included in the new Act are provisions relating to the establishment of a commercial charter, a board of directors and ministerial directions.

The operational models adopted by individual GTEs differ greatly. Some of the factors that may have influenced the choice of model are government objectives and the type and volume of trade throughput. This variation in operational models can blur the distinction between core and non-core port services and activities.

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2 Newcastle Port Corporation, Port Kembla Port Corporation and Sydney Port Corporation were established.

3 Only two of these entities are monitored by this report, namely, Melbourne Port Corporation and the Victorian Channels Authority.

Table 11.1 **Monitored port GTEs, 1996-97 to 2000-01**

1996-97	*1997-98*	*1998-99*	*1999-00*	*2000-01*
New South Wales				
Newcastle Port Corporation	→	→	→	Newcastle Port Corporation
Port Kembla Port Corporation	→	→	→	Port Kembla Port Corporation
Sydney Ports Corporation	→	→	→	Sydney Ports Corporation
Victoria				
Melbourne Port Corporation	→	→	→	Melbourne Port Corporation
Victorian Channels Authority	→	→	→	Victorian Channels Authority
Queensland				
Gladstone Port Authority	→	→	→	Gladstone Port Authority
Port of Brisbane Corporation	→	→	→	Port of Brisbane Corporation

(Continued next page)

Table 11.1 (continued)

1996-97	*1997-98*	*1998-99*	*1999-00*	*2000-01*
Western Australia				
Fremantle Port Authority	→	→	→	Fremantle Port Authority
	Bunbury Port Authority[a] →	→	→	Bunbury Port Authority[b]
South Australia				
South Australian Ports Corporation	→	→	→	South Australian Ports Corporation[c]
Tasmania				
Burnie Port Corporation	→	→	→	Burnie Port Corporation
Hobart Ports Corporation	→	→	→	Hobart Ports Corporation
Port of Launceston Pty Ltd	→	→	→	Port of Launceston Pty Ltd
Port of Devonport Corporation	→	→	→	Port of Devonport Corporation
Northern Territory				
Darwin Port Authority	→	→	→	Darwin Port Corporation[d]

[a] Bunbury Port Authority was not monitored prior to 1997-98. [b] Bunbury Port Authority was corporatised in 1999-00. [c] In January 2001, legislation was passed by the SA parliament to facilitate the sale of SAPC. Final bids for SAPC were received by the South Australian Government in July 2001. [d] The Darwin Port Corporation was established in September 1999.

Several port GTEs also have interests in other operations. For example, the Brisbane Port Corporation partly owns Brisbane airport and the Port of Devonport Corporation and the Burnie Port Corporation both own and operate airports.

A number of reforms have led to improved pricing and allocative mechanisms over the reporting period. Consumption-based charging has been progressively introduced, resulting in port users incurring charges that relate to their individual service requirements, rather than the value of their cargo.

Despite the increasing use of consumption-based charges, inconsistencies remain in the types of charges levied across port GTEs for the provision of like services. Furthermore, the determination of port charges differs across jurisdictions. In some States, port charges are determined externally by independent pricing regulators, in others, individual ports have more autonomy in setting charges. For example, the port charges of Melbourne Port Corporation and the Victorian Channels Authority are determined by the Office of the Regulator-General (ORG).

11.2 Market environment

The level of revenue generated by port GTEs is strongly linked to trade throughput. Trade throughput is susceptible to changes in both domestic and international markets, particularly shifts in demand for key trade commodities. However, changing market environments do not impact on all GTEs uniformly because of differences in the composition and size of the markets served. The changes in market environment that can broadly be defined as common across all ports over the reporting period, include:

- an increase in the average total tonnage per ship visit resulting in a reduction in the number of ship visits and in the unit cost of exchanging cargo; and
- changes in trade throughput related to supply and demand conditions in overseas economies and markets. For example, trade throughput, for those ports monitored increased by 1.5 per cent in 1999-00 compared to the previous year. In 2000-01, throughput increased by 0.8 per cent (AAPMA 2001).

Changes in the market environment specific to particular ports also affected performance. Examples of these changes include:

- the closure of BHP–Billiton steel making facilities in Newcastle; and
- the cessation of general cargo shipping operated by Coastal Express Line at Port Launceston.

11.3 Profitability

Profitability indicators provide information on how GTEs are using the assets vested in them by shareholder governments to generate earnings. For a more detailed discussion of profitability indicators, see chapter 3.

Port GTEs experienced substantial variation in their profitability indicators over the reporting period. Some of this variation can largely be explained by restructuring related to the reform process.[4] For example, expenses and revenue related to restructuring — asset consolidation and disposal, superannuation adjustments and asset revaluations — added $41 million to revenue and $96.3 million to expenses in 1999-00.

Over the reporting period, all port GTEs recovered over 100 per cent of operating expenses (see figure 11.1). The cost recovery ratio for the sector as a whole has remained around 170 per cent over the reporting period, despite a general reduction in port charges (PC 2002). However, in 2000-01, the average cost recovery ratio declined to around 151 per cent.

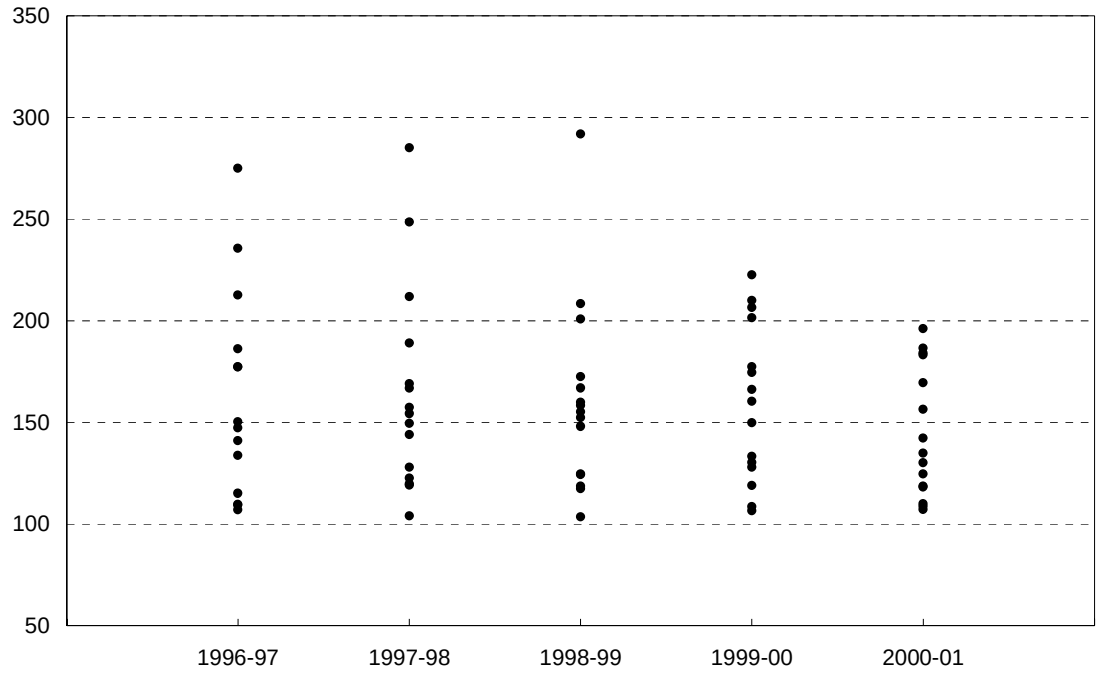
The average return on assets for the sector as a whole has fluctuated over the reporting period. The average in 1996-97 and 1997-98 was 9 per cent, 2.5 per cent in 1998-99, 6.3 per cent in 1999-00 and 6.3 per cent in 2000-01. This variability is mirrored in the rates of return generated by individual GTEs (see figure 11.2).

The rate of return for the sector as a whole in 2000-01, was above that recorded for 10 year bonds.[5] It is reasonable to expect that the appropriate return for these GTEs should be above the long-term bond rate.

4 Items that a GTE's management considered 'abnormal' — by reason of their size and effect on financial performance — were disclosed separately under accounting standards that applied until 2000-01. In 1998-99 and 1999-00, most abnormal items disclosed by GTEs appeared to be associated with reform (see chapter 2).

5 The rate of return for 10 year Commonwealth Government bonds at June 2001 was 6.0 per cent. This has declined from 7.1 per cent in June 1997 (RBA 2002).

Figure 11.1 **Cost recovery, 1996-97 to 2000-01 (per cent)**



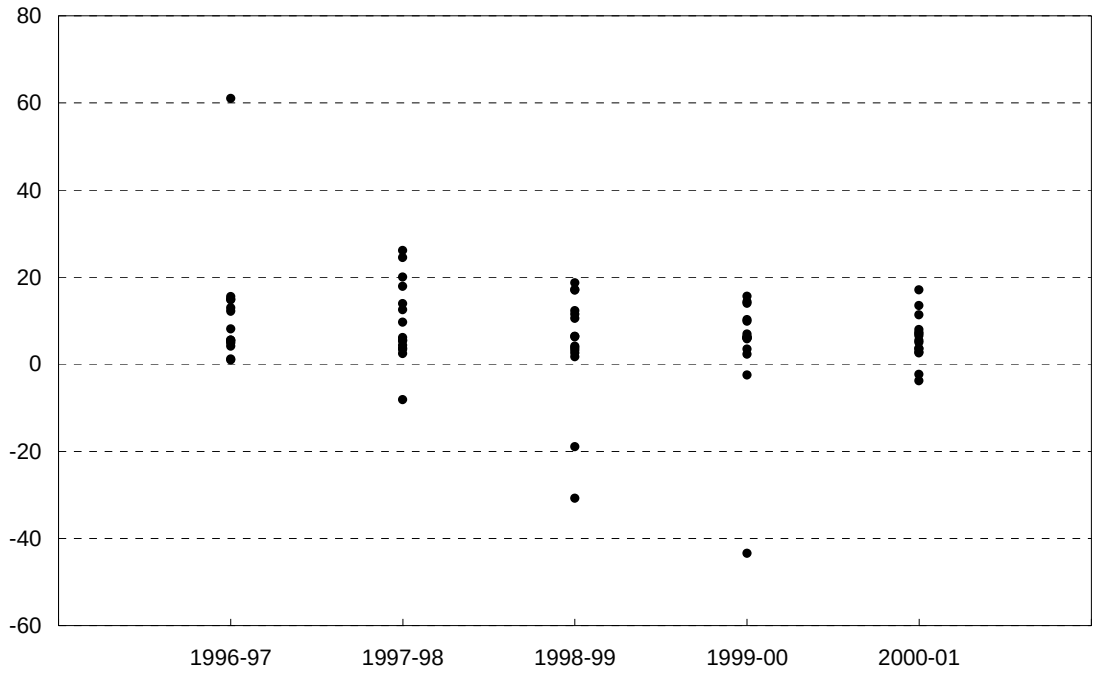
Note Each data point represents the cost recovery ratio for a government trading enterprise in that financial year. Cost recovery is the ratio of revenue from operations to expenses from operations. Revenue from operations is calculated by subtracting investment income and receipts from governments to cover deficits on operations from total revenue. Expenses from operations are calculated by subtracting gross interest expense from total expenses. Prior to 2000-01, abnormal items were also subtracted from operating expenses and revenue.

Downward asset revaluations have contributed to negative returns on assets in each circumstance where GTEs have recorded an operating loss.[6] For example, downward asset revaluations at Burnie Port Corporation resulted in negative return on assets in 1997-98, 1999-00 and 2000-01. The lowest return on assets over the reporting period occurred in 1999-00 at Darwin Port Corporation, where assets were revalued downward by 52 per cent.

Significant upward revaluations have also occurred. For example, Sydney Ports Corporation's assets were revalued upward by 67 per cent in 1997-98. The largest increase in asset value occurred in 1999-00, when the value of the Victorian Channels Authority's assets increased by 175 per cent due to channels ($78 million) being recognised as assets.

6 Downward asset revaluations tend to improve profitability in future periods because depreciation expenses will generally fall in line with the reduction in asset values. However, profitability is reduced by downward asset revaluations because the reduction is recognised as an expense against revenue earned in that year.

Figure 11.2 **Return on assets, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the return on assets ratio for a government trading enterprise in that financial year. Return on assets is the ratio of earnings before interest and tax (EBIT) to average total assets. EBIT is calculated by subtracting total expenses from total revenue (includes abnormals) and adding back gross interest expense. Average total assets are the average of the value of assets at the beginning and end of each financial year.

Another measure of profitability is return on equity — the ratio of a GTEs earnings to capital provided by the shareholder government. In the case of port GTEs, the return on equity closely followed return on assets. The ORG proposed a benchmark return on equity of 7.3 per cent for Melbourne Port Corporation and 6.7 per cent for the Victorian Channels Authority (ORG 2000). In 2000-01, only four port GTEs had a return on equity ratio of above 7 per cent compared to seven in 1996-97.

11.4 Financial management

Financial management indicators provide information about the capital structure of GTEs and their ability to meet the cost of servicing debt and other liabilities as they fall due. For a more detailed discussion of financial management indicators, see chapter 3.

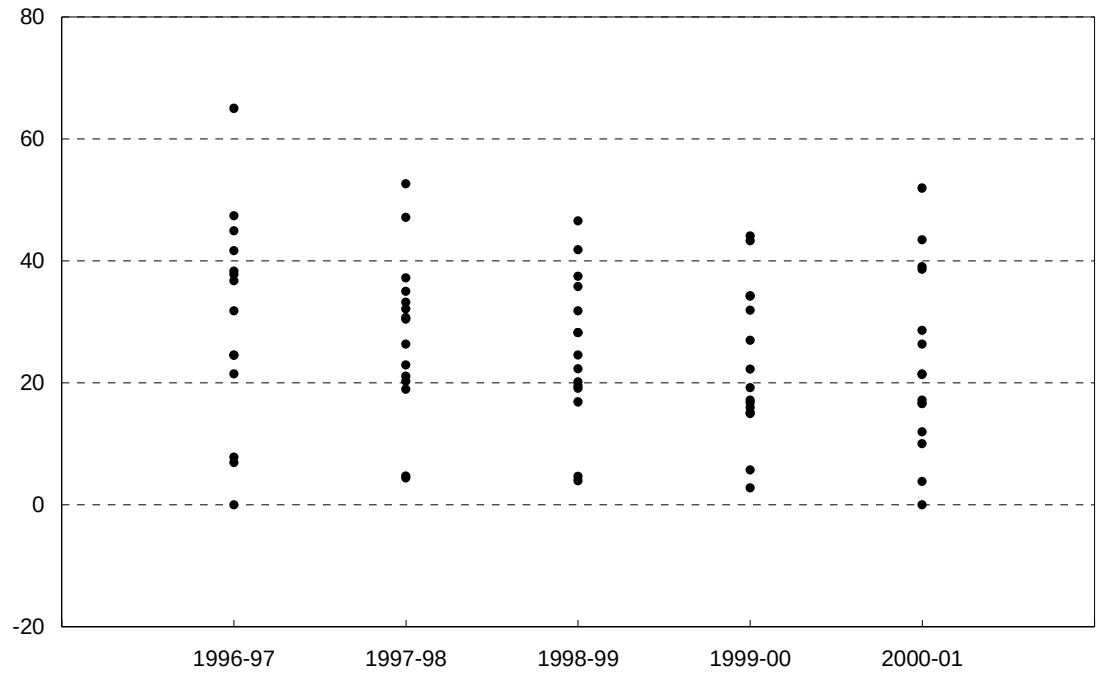
Over the reporting period, debt to total asset ratios for port GTEs have not only been influenced by the acquisition and retirement of debt, but also through changes in the total value of port assets (see figure 11.3). Asset revaluations have a large

impact on this ratio. For example, Sydney Ports Corporation's debt to total assets fell from 45 per cent to 28 per cent with no change in debt levels over the period 1996-97 to 1998-99.[7]

The level of debt for the ports sector overall in 2000-01 was similar to that at the beginning of the reporting period. Improvements in some GTE's debt positions have been achieved through the retirement of debt. For example, South Australian Ports Corporation reduced debt levels by 80 per cent over the reporting period, and as a result debt to total assets fell from 38.3 per cent in 1996-97 to 10 per cent in 2000-01.

Another indicator of financial management is interest cover, which measures the capacity of the GTE to meet periodic interest payments out of current earnings. The sector average in 2000-01 was 3.8 times, which was higher than the previous year (3.3 times), but lower than the average at the beginning of the reporting period (4.2 times).

Figure 11.3 **Debt to total assets, 1996-97 to 2000-01 (per cent)**



Note Each data point represents the debt to total assets ratio for a government trading enterprise in that financial year. Debt is defined to include all repayable borrowings (interest bearing and non-interest bearing), interest bearing non-repayable borrowings and finance leases. Average total assets are the average of the value of assets at the beginning and end of each financial year.

7 Sydney Ports Corporation's assets increased by 85 per cent in value terms between 1996-97 and 1998-99.

Changes in interest cover from year-to-year for some GTEs is related to restructuring. For example, Port Kembla Port Corporation's interest cover declined from 5.5 times in 1997-98 to –6.4 times in 1998-99 without any change in debt, due to an expense of $42.1 million resulting from a downward asset revaluation.

The ability of port GTEs to meet short-term liabilities has improved over the reporting period, with the current ratio for the sector overall increasing from 107 per cent in 1996-97 to 125 per cent in 2000-01. However, four GTEs recorded a current ratio of less than 100 per cent in 2000-01, indicating that the short-term obligations of these GTEs may need to be met using sources of funds other than current assets.[8]

11.5 Financial transactions

As a part of the reform process, governments have sought to give GTEs a greater commercial focus and facilitate competitive neutrality by exposing them to incentives and regulations similar to those faced by private sector businesses. For a more detailed discussion of competitive neutrality principles, see chapter 3.

Owner governments generally require their GTEs to make tax-equivalent and dividend payments along with debt guarantee fees. These measures were designed to encourage GTEs to act in a more commercial manner and have resulted in an increase in payments to governments.

The amount of dividend payable by each GTE depends on the dividend policy of its State or Territory government. In 2000-01, over half of the port GTEs had dividend payout ratios above 50 per cent. Three port GTEs — Darwin Port Corporation, Burnie Port Corporation and the Victorian Channels Authority did not pay a dividend relating to 2000-01.

The amount of income tax expense by port GTEs has been similar to the amount of dividends paid in most years over the reporting period. In 2000-01, port GTEs made $57 million in income tax-equivalent payments to owner governments. The Queensland and Victorian governments were the major beneficiaries, with each receiving 28 per cent of total income tax-equivalent payments by the monitored port GTEs.

The reform process aimed to distinguish between commercial and non-commercial activities. Port GTEs required to undertake non-commercial activities should

8 Current assets comprise cash and other assets that would, in the ordinary course of operations, be available for the conversion into cash within 12 months after the end of the reporting period.

receive CSO payments from shareholder governments equivalent to the cost of provision.

Port Kembla Port Corporation and Darwin Port Corporation are the only port GTEs to receive CSO payments.

In 2000-01, Port Kembla received CSO funding of $8.8 million. The payment was provided as compensation for the shortfall to income generated by the NSW Rental Relief Scheme for the Port Kembla Coal Terminal. The Darwin Port Corporation received $3.4 million for costs associated with the operation and management of the Stokes Hill wharf and precinct, the fishing harbour mooring basin and other wharf facilities. CSO funding was also received for the East Arm Port development.

11.6 GTE performance reports

Newcastle Port Corporation (NSW)
Port Kembla Port Corporation (NSW)
Sydney Ports Corporation (NSW)
Melbourne Port Corporation (Victoria)
Victorian Channels Authority (Victoria)
Gladstone Port Authority (Queensland)
Port of Brisbane Corporation (Queensland)
South Australian Ports Corporation (SA)
Fremantle Port Authority (WA)
Bunbury Port Authority (WA)
Burnie Port Corporation (Tasmania)
Hobart Ports Corporation (Tasmania)
Port of Devonport Corporation (Tasmania)
Port of Launceston Pty Ltd (Tasmania)
Darwin Port Corporation (NT)

NEWCASTLE PORT CORPORATION — New South Wales

Newcastle Port Corporation (NPC) was created as a separate corporatised entity on 30 June 1995 with the passing of the *Ports Corporatisation and Waterways Management Act 1995*. Newcastle is Australia's second largest port measured by mass tonnes with a total throughput of 73.9 million tonnes in 2000-01.

The fall in profit (before tax) in 2000-01 compared to the previous year was mainly due to a an increase in expenses. Around 40 per cent of the increase was attributable to a $3.6 million adjustment to prepaid superannuation assets following a reassessment of actuarial assumptions.

The decline in NPC's prepaid superannuation assets more than offset capital expenditure of $2.1 million in 2000-01, and accounted for most of the decline in total assets compared to the previous year. Capital expenditure has largely been funded from retained earnings over the reporting period, as NPC's debt level has remained stable.

The value of assets and equity increased in 1998-99 as a result of a 17 per cent upward revaluation of property, plant and equipment. The upward revaluation of assets resulted in a decline in NPC's debt to equity and debt to total assets ratios, without any real change in debt levels or liabilities.

A transfer of some short-term debt to long-term debt in 2000-01 resulted in an improvement in the current ratio.

The NPC is required to make both tax-equivalent and dividend payments. The reporting of a negative tax-equivalent payment in 2000-01 reflects the writeback of an adjustment to superannuation payments.

NEWCASTLE PORT CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*[d]
Size						
Total assets	$m	116	115	132	144	141
Total revenue	$m	38	47	40	38	38
Profitability						
Operating profit before tax (includes abnormals)	$'000	12 087	18 088	12 881	16 774	6 737
Operating sales margin	%	36.9	42.8	36.8	49.4	23.1
Cost recovery	%	150.3	157.3	158.2	177.4	130.1
Return on assets	%	12.2	17.9	12.3	14.0	6.6
Return on equity	%	12.1	17.3	10.8	14.1	8.2
Financial management						
Debt to equity	%	45.9	45.4	36.3	35.6	34.9
Debt to total assets	%	24.5	26.3	24.6	22.3	21.5
Total liabilities to equity	%	77.9	71.3	58.0	67.2	60.5
Interest cover	times	5.3	8.1	6.8	7.7	3.6
Current ratio	%	80.2	70.8	72.9	82.2	94.8
Leverage ratio	%	177.9	171.3	158.0	167.2	160.5
Payments to and from government						
Dividends	$'000	8 962	10 000	9 000	9 000	9 000
Dividend to equity ratio	%	14.3	15.1	12.0	10.6	9.5
Dividend payout ratio	%	118.1	87.5	111.3	75.3	116.0
Income tax expense	$'000	4 497	6 658	4 796	4 827	-1 023
CSO funding	$'000	0	0	0	0	0

a Total revenue and operating profit increased due to abnormal revenue resulting from interest earned ($4.7 million) from superannuation reserves not previously accounted for. **b** A revaluation of property, plant and equipment was brought to account as at 30 June 1999. This resulted in an increase in the value of total assets and a consequent fall in the return on assets and return on equity ratios. **c** Includes abnormal revenue of $4.1 million relating to superannuation interest earnings and a reduction in member liability due to a review of actuarial assumptions. A restatement of deferred tax balances following a change in the future company tax rate resulted in a decline in income tax payments of $1.4 million. **d** Includes an expense of $3.6 million relating to an adjustment to superannuation payments following a reassessment of actuarial assumptions. An asset revaluation of plant and breakwater assets resulted in a $2.5 million increase in the value of these assets. Income tax expense is negative due to a writeback of the tax effect on the superannuation adjustment expense.

PORT KEMBLA PORT CORPORATION — New South Wales

Port Kembla Port Corporation (PKPC) was formed on 1 July 1995 as part of the corporatisation of NSW ports. PKPC operates under the *Ports Corporatisation and Waterways Management Act 1995*. PKPC manages the port of Port Kembla and provides pilotage services, berths and equipment for private sector tenure or common use.

Improved profitability in 2000-01 compared to the previous year was underpinned by a 9 per cent increase in trade throughput. Expenses also declined by 4 per cent, mainly due to the inclusion of an abnormal expense of $4.1 million relating to asset transfers in 1999-00.

Debt levels remained stable over the reporting period. The debt to equity and total liabilities to equity ratios increased in 1998-99, mainly because of a revaluation decrement of $42.1 million following a recoverable amounts test.[1] The decline in the debt to equity ratio since 1998-99 is mainly due to an increase in the value of assets and a decrease in liabilities in 1999-00 and 2000-01.

PKPC is required to make both income tax-equivalent and dividend payments. Income tax expense is reported as a negative amount in 1999-00 largely due to a reduction in tax liability of $9 million relating to the recoverable amounts test undertaken in 1998-99.

In 2000-01, PKPC received $8.8 million in community service obligation (CSO) funding. CSO funding addresses the difference between the actual amount of income received by the corporation under the NSW Government Rental Relief Scheme for the Port Kembla Coal Terminal and what would have been payable under the original lease scheme.[2]

1 A recoverable amounts test is undertaken under accounting standards to ensure that the carrying value of non-current assets does not exceed their recoverable amount — the net amount that is expected to be recovered through the cash inflows and outflows arising from its continued use and subsequent disposal (AASB 1010).

2 Prior to 1999-00, the corporation provided rental relief to the lessee of the Port Kembla Coal Terminal but did not receive funding from the NSW Government.

PORT KEMBLA PORT CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*[a]	*1999-00*[b]	*2000-01*[c]
Size						
Total assets	$m	186	182	134	135	139
Total revenue	$m	38	39	28	32	33
Profitability						
Operating profit before tax (includes abnormals)	$'000	19 535	20 908	-34 633	8 302	10 588
Operating sales margin	%	63.6	64.5	-115.7	40.6	45.4
Cost recovery	%	275.0	285.0	172.5	201.4	183.2
Return on assets	%	12.9	13.9	-18.9	9.8	11.3
Return on equity	%	12.6	13.3	-49.1	23.7	11.3
Financial management						
Debt to equity	%	60.7	59.4	110.1	100.2	90.1
Debt to total assets	%	31.8	32.1	37.4	44.1	43.4
Total liabilities to equity	%	86.4	82.8	149.2	127.8	110.4
Interest cover	times	4.8	5.5	-6.4	2.7	3.2
Current ratio	%	68.3	97.9	51.4	91.9	137.4
Leverage ratio	%	186.4	182.8	249.2	227.8	210.4
Payments to and from government						
Dividends	$'000	8227	13 599	9 482	7 988	8 200
Dividend to equity ratio	%	8.4	13.6	12.4	14.2	13.1
Dividend payout ratio	%	66.8	102.4	-25.2	59.7	116.0
Income tax expense	$'000	7 214	7 622	2 995	-5 077[d]	3 516
CSO funding	$'000	0	0	0	4 490	8 784

a In June 1999, Port Kembla Port Corporation undertook a recoverable amounts test that resulted in a $42.1 million downward asset revaluation. **b** Includes an abnormal expense of $4.1 million relating to asset transfers and abnormal revenue of $2.2 million as a result of a reassessment of superannuation liabilities. **c** Includes a $0.7 million expense due to a reassessment of superannuation liabilities and a $0.7 million expense relating to redundancy provisions. **d** Income tax expense is reported as a negative amount in 1999-00 largely due to a reduction in tax liability of $9 million relating to the recoverable amounts test undertaken in 1998-99.

SYDNEY PORTS CORPORATION — New South Wales

The corporatisation of the ports of Sydney under the *Ports Corporatisation and Waterways Management Act 1995*, resulted in the establishment of Sydney Ports Corporation (SPC) on 1 July 1995. SPC manages the commercial ports of Sydney Harbour and Botany Bay.

Profitability declined in 2000-01, despite revenue remaining at a similar level. A 20 per cent increase in expenses was partly related to a $3.9 million payment arising from a revised assessment of future superannuation liabilities.

The rise in the value of assets in 1997-98 reflects the revaluation of property, plant and equipment on 30 June 1998.[1] In addition to the asset revaluation, SPC acquired land at Glebe Island and White Bay, purchased additional lots at Port Botany and incurred expenditure on road works. The asset revaluation resulted in a significant increase in equity that reduced SPC's debt to equity and total liabilities to equity ratios without any significant change in debt levels or liabilities.

Capital expenditure of $27.2 million in 2000-01 was largely funded from a provision of $20 million for the purchase of land made in the previous year and current financial assets. SPC's borrowings have remained at a similar level over the reporting period. As a result, the debt to equity, debt to total assets and total liabilities to equity ratios have steadily declined.

SPC is required to make both tax-equivalent and dividend payments to the NSW Government. Dividend payments are determined in consultation with the Treasury.

1 SPC carried out a revaluation of 95 per cent of its non-current assets using the deprival method. Assets not revalued were recorded at historical cost.

SYDNEY PORTS CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*	*2000-01*
Size						
Total assets	$m	337	524	544	581	576
Total revenue	$m	88	100	109	108	109
Profitability						
Operating profit before tax (includes abnormals)	$'000	38 370	40 858	49 469	45 059	33 044
Operating sales margin	%	57.6	52.8	55.2	52.2	41.0
Cost recovery	%	235.6	211.8	208.4	222.6	169.4
Return on assets	%	15.5	12.5	11.5	10.2	7.9
Return on equity	%	16.7	10.5	9.3	7.1	6.5
Financial management						
Debt to equity	%	102.9	44.4	42.1	40.9	39.7
Debt to total assets	%	44.9	35.0	28.2	27.0	26.4
Total liabilities to equity	%	130.1	54.5	52.0	56.6	49.8
Interest cover	%	3.8	4.2	5.2	4.6	3.6
Current ratio	%	101.5	185.9	99.5	124.7	95.8
Leverage ratio	%	230.1	154.5	152.0	156.6	149.8
Payments to and from government						
Dividends	$'000	14 558	12 749	13 639	13 030	10 994
Dividend to equity ratio	%	10.3	5.2	3.9	3.6	2.9
Dividend payout ratio	%	61.3	50.0	42.2	50.0	44.8
Income tax expense	$'000	14 619	15 359	17 177	19 001	8 478
CSO funding	$'000	0	0	0	0	0

a The increase in total assets resulted largely from a revaluation of property, plant and equipment on 30 June 1998. Sydney Ports Corporation (SPC) also purchased land at White Bay from the State Rail Authority and purchased land at Port Botany from the Marine Ministerial Holding Corporation. **b** SPC purchased ten hectares of land at Port Botany and received a $7.1 million capital grant from the NSW Government for the construction of a new passenger terminal at Darling Harbour.

MELBOURNE PORT CORPORATION — Victoria

Melbourne Port Corporation (MPC) commenced operations on 1 March 1996 under the *Ports Services Act 1995*. MPC is responsible for managing port land, coordinating future developments and ensuring the availability of adequate land and infrastructure to port service providers.

Prices charged for the provision of prescribed services, including the provision of berths and cargo marshalling facilities, are subject to regulation by the Office of the Regulator-General (ORG). In June 2000, the ORG determined that prices for prescribed services should be reduced by an average of 5.2 per cent per annum in real terms over the period 2000-01 to 2004-05. During 2000-01, MPC estimated that reductions in charges in 2000-01 led to foregone revenue of $1.8 million.

Trade growth in 2000-01 resulted in revenue remaining stable despite the reduction in charges. The improvement in profitability was mainly related to increases in the value of contributed assets ($1.3 million) and capital works grants from the Victorian Government ($3.4 million).

MPC revalued land, buildings and improvement assets in 2000-01. This resulted in the value of assets increasing by $26.4 million compared to the previous year.[1] Assets also increased in 2000-01 as a result of capital expenditure of $15.1 million.

Capital expenditure has largely been funded from retained earnings, permitting the level of debt to fall in each year over the reporting period. As a result, the debt to equity, debt to total assets and debt to total liabilities ratios have steadily declined in most years over the reporting period.

MPC is required to make both tax-equivalent and dividend payments to the Victorian Government. The decline in the value of dividends, and the dividend to equity and dividend payout ratios in 2000-01 is due to a change in accounting policy relating to the recognition of dividends.[2]

1 Upward asset revaluations also occurred in 1999-00 ($69.7 million) and in 1997-98 ($50.7 million).

2 The change in accounting policy resulted in a provision for a dividend not being recognised until a determination was made by the Treasurer. In previous years, MPC recognised the final dividend payment as a provision prior to the Treasurer's determination.

MELBOURNE PORT CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*[d]
Size						
Total assets	$m	482	533	513	568	596
Total revenue	$m	81	81	83	75	82
Profitability						
Operating profit before tax (includes abnormals)	$'000	28 045	37 272	46 496	30 002	34 226
Operating sales margin	%	45.8	59.8	65.8	49.2	49.0
Cost recovery	%	212.5	248.5	291.8	209.9	196.0
Return on assets	%	8.1	9.6	10.5	6.9	7.0
Return on equity	%	4.7	6.6	8.2	4.1	4.5
Financial management						
Debt to equity	%	33.6	25.7	26.1	17.7	14.0
Debt to total assets	%	24.5	20.2	19.1	15.0	12.0
Total liabilities to equity	%	41.8	33.1	33.7	24.7	19.5
Interest cover	times	3.9	4.2	6.4	5.1	6.4
Current ratio	%	90.4	153.7	85.2	40.8	160.1
Leverage ratio	%	141.8	133.1	133.7	124.7	119.5
Payments to and from government						
Dividends	$'000	4 227	7 987	34 074	8 644	4 800
Dividend to equity ratio	%	1.3	2.2	8.7	2.1	1.0
Dividend payout ratio	%	27.8	32.9	105.6	50.0	22.1
Income tax expense	$'000	12 842	13 012	14 224	12 713	12 512
CSO funding	$'000	0	0	0	0	0

a The increase in total assets largely resulted from an upward revaluation of Melbourne Port Corporation's land holdings ($50.7 million) and the retention of operating profits ($12.8 million). **b** Total assets fell as a result of a $26 million dividend payout from cash reserves, the depreciation of assets and the transfer of Station Pier to the Department of Infrastructure. Dividends include a special dividend of $26 million. **c** An abnormal expense of $2.3 million was incurred, resulting from the write-off of assets. **d** Total assets increased by $26.4 million as a result of a revaluation of buildings, improvements and land. No provision for a final dividend was made in 2000-01 as a result of a change in accounting policy. If the board's estimated final dividend of $4.5 million is agreed to by the Treasurer, the dividend to equity ratio would increase from 1 per cent to 1.9 per cent and the dividend payout ratio would increase from 22.1 per cent to 42.8 per cent.

VICTORIAN CHANNELS AUTHORITY — Victoria

The Victorian Channels Authority (VCA) is a statutory authority established under the *Port Services Act 1995*. The VCA commenced operations on 1 March 1996. The VCA is responsible for the safe navigation of shipping in Port Phillip and for the provision and maintenance of navigational aids and commercial navigation channels. It is also required to coordinate pollution control and emergency response.

The VCA is subject to price regulation in the form of an average revenue cap on the provision of channel services.[1] The presence of a revenue cap required the VCA to reduce expenses to maintain or improve profitability. The gradual decline in the cost recovery ratio over the reporting period, with the exception of 2000-01, suggests that it has not been possible to reduce expenses to the extent required.

The increase in total assets in 1997-98 reflects the inclusion of channel assets that were previously not recognised. The rise in total assets during 1999-00 is the result of the inclusion in financial reporting of the value of channels transferred to the VCA from predecessor bodies ($78.1 million).[2] The inclusion of these transferred assets has resulted in a $2 million increase in depreciation expense in 2000-01.

The VCA has not carried any debt over the reporting period. As a result, the debt to equity and debt to total assets ratios are zero.

The VCA is subject to tax-equivalent payments under the *State Owned Enterprises Act 1992*. In addition, the VCA is required to pay dividends to the Victorian Government, as determined by the Treasurer. No dividend was paid in 2000-01.

1 A pricing order covering the period 1997-98 to 1999-00 required the VCA to reduce the standard channel fee charged to shipping by 12 per cent annually in real terms. In December 1999, a price determination by the Office of the Regulator-General for the period 2000-01 to 2004-05 required the VCA to reduce average prices by 2.1 per cent per year in real terms.

2 Channels transferred from the former Port of Melbourne Authority and the Port of Geelong Authority were recorded for the first time, from 1 July 1999. The values are based on those previously held in the accounts of these authorities.

VICTORIAN CHANNELS AUTHORITY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*[e]
Size						
Total assets	$m	14	51	61	138	158
Total revenue	$m	22	21	25	19	20
Profitability						
Operating profit before tax (includes abnormals)	$'000	8 305	8 514	10 542	3 466	3 789
Operating sales margin	%	38.3	40.1	41.8	15.9	16.1
Cost recovery	%	177.3	166.8	148.0	118.9	119.2
Return on assets	%	61.0	26.1	18.7	3.5	2.6
Return on equity	%	77.9	4.1	8.2	1.0	0.3
Financial management						
Debt to equity	%	0	0	0	0	0
Debt to total assets	%	0	0	0	0	0
Total liabilities to equity	%	45.4	21.6	57.2	11.0	8.5
Interest cover	times	53.2	n.r	n.r	n.r	n.r
Current ratio	%	162.7	219.8	174.6	244.9	175.4
Leverage ratio	%	145.4	121.6	157.2	111.0	108.5
Payments to and from government						
Dividends	$'000	1 035	3 130	3 271	1 000	0
Dividend to equity ratio	%	14.2	12.1	8.1	1.2	0
Dividend payout ratio	%	18.2	291.7	98.6	122.5	0
Income tax expense	$'000	2617	7 441	7 225	2 650	3 410
CSO funding	$'000	0	0	0	0	0

a The Victorian Channels Authority (VCA) repaid total start up debt of $5 million during the year. **b** Assets rose largely as a result of the conversion of the total costs to capital associated with the Geelong channel improvement program. **c** Non-current assets increased resulting from additional costs associated with the dredging of the Port of Geelong ($4.3 million) and work in progress ($5.4 million). A change in accounting policy relating to provisions for channel dredging resulted in a $3.4 million provision for channel dredging in 1997-98 being added back to revenue as abnormal revenue in 1998-99. **d** Includes the value of channels transferred to the VCA from predecessor bodies ($78.1 million). **e** Includes expenses relating to channel deepening studies ($0.6) million and legal action ($0.2 million). Asset revaluations resulted in an increase in the value of assets of $12.5 million, most of which related to channel assets ($10.8 million). **n.r** Not relevant.

GLADSTONE PORT AUTHORITY — Queensland

The Gladstone Port Authority (GPA) was corporatised on 1 July 1994 under the *Government Owned Corporations Act 1993*. The GPA undertakes stevedoring activities, pilotage and the provision of infrastructure for bulk coal operations.

Growth in trade throughput in 2000-01 resulted in a 14 per cent increase in revenue. This was offset by a 21 per cent increase in expenses and resulted in a decline in profit (before tax) and return on assets. Part of the increase in expenses was related to higher depreciation expenses following a $16.2 million increase in the value of channels, plant and equipment due to an asset revaluation in January 2001.

The GPA's assets declined in 1998-99 following a recoverable amounts test.[1] The $139.2 million write-down of non-current assets was recorded as an abnormal expense item and resulted in a pre-tax operating loss. The impact of the loss is reflected in the negative return on assets, return on equity and interest cover ratios. The write-down largely related to user-funded assets, where port users provided the capital funding to construct the assets concerned.

Around 60 per cent of theGPA's outstanding debt in 2000-01 was non-interest bearing. Prior to 2000-01, a 10 year non-interest bearing loan was not included in the GPA's financial statements. If these borrowings were included and interest paid on the debt, the debt to equity, debt to total assets and debt to liabilities ratios would have been higher for previous years and interest cover would have been lower.

The GPA is required to make both tax-equivalent and dividend payments to the Queensland Government.

1 A recoverable amounts test is undertaken under accounting standards to ensure that the carrying value of non-current assets does not exceed their recoverable amount — the net amount that is expected to be recovered through the cash inflows and outflows arising from their continued use and subsequent disposal (AASB 1010).

GLADSTONE PORT AUTHORITY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*[a]	*1999-00*	*2000-01*[b]
Size						
Total assets	$m	452	464	358	369	389
Total revenue	$m	83	81	82	86	98
Profitability						
Operating profit before tax (includes abnormals)	$'000	17 174	13 259	-127 700	21 548	19 935
Operating sales margin	%	25.2	18.4	-156.9	25.0	19.7
Cost recovery	%	133.6	122.5	117.4	133.2	124.6
Return on assets	%	4.8	3.4	-30.8	6.1	5.4
Return on equity	%	2.7	1.9	-21.8	2.6	4.1
Financial management						
Debt to equity	%	8.9	5.4	5.2	3.5	4.3
Debt to total assets	%	7.8	4.7	4.0	3.1	3.8
Total liabilities to equity	%	15.8	15.2	14.9	15.5	15.7
Interest cover	times	5.0	6.8	-108.8	37.0	30.8
Current ratio	%	109.2	110.9	118.2	141.5	124.5
Leverage ratio	%	115.8	115.2	114.9	115.5	115.7
Payments to and from government						
Dividends	$'000	2 571	3 087	0	3 938	9 541
Dividend to equity ratio	%	0.7	0.8	0	1.2	2.9
Dividend payout ratio	%	24.9	41.3	0	48.1	70.7
Income tax expense	$'000	6 856	5 787	-49 901	13 354	6 434
CSO funding	$'000	0	0	0	0	0

a The Gladstone Port Authority undertook a recoverable amounts test on 30 June 1999. This resulted in a $139.2 million writedown of non-current assets, and a commensurate fall in operating profit (before tax, including abnormals), due to the increase in abnormal expenses. **b** An asset revaluation in January 2001 resulted in a net increase of $16.2 million in the value of assets, mainly relating to channels, plant and equipment.

PORT OF BRISBANE CORPORATION — Queensland

Port of Brisbane Corporation (PBC) was corporatised on 1 July 1994 under the provisions of the *Government Owned Corporations Act 1993*. PBC manages the Port of Brisbane, Brisbane Multimodal Terminal, the boat harbours of Manly, Scarborough, Cabbage Tree Creek and Gardens Point. It is also a major shareholder in Brisbane Airport Corporation Limited (BACL).

The decline in profitability in 2000-01 compared to the previous year was mainly the result of a 19 per cent increase in expenses. Expenses included $1.8 million relating to redundancy payments.

PBC's total assets have increased over the reporting period by over 40 per cent. The major contributors to this growth are investment in BACL and a number of upward revaluations. Total asset growth due to revaluation increments over the reporting period was $122.3 million.[1]

PBC invested in BACL in 1996-97. The initial investment was entirely funded through borrowings from the Queensland Treasury Corporation. In 1999-00, PBC increased its shareholding in BACL to 37.6 per cent.[2] The debt incurred through investment in BACL resulted in an increase in the debt to equity, debt to total asset and total liabilities to equity ratios.

In 2000-01, PBC's debt increased by 30 per cent compared to the previous year. Most of the increase related to borrowing for capital expenditure on seaport operations ($95.1 million). Around 25 per cent of the increase on borrowings ($16.4 million) was attributable to the interest expense incurred to fund the investment in BACL.[3]

PBC is required to make both tax-equivalent and dividend payments.

1 Over the reporting period, increases in the value of assets attributable to revaluations include $13.3 million in 1996-97, $5.2 million in 1997-98, $5.3 million in 1998-99, $35.9 million in 1999-00 and $62.6 million in 2000-01.

2 An additional investment of $20 million in BACL was made as part of a rights issue by BACL. The investment was funded through increased debt.

3 Interest expense related to BACL debt is capitalised. Under the terms of the loan, interest is payable only if cash income is available from the investment.

PORT OF BRISBANE CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*	*2000-01*[d]
Size						
Total assets	$m	621	625	658	737	868
Total revenue	$m	68	82	78	84	88
Profitability						
Operating profit before tax (includes abnormals)	$'000	27 470	16 568	26 341	26 205	19 535
Operating sales margin	%	39.7	32.5	52.2	51.6	44.3
Cost recovery	%	186.2	189.0	200.8	206.6	179.5
Return on assets	%	5.5	4.4	6.4	6.3	5.0
Return on equity	%	4.9	3.0	4.2	4.2	2.1
Financial management						
Debt to equity	%	48.4	46.5	48.9	52.2	60.2
Debt to total assets	%	37.7	30.7	31.8	34.2	38.6
Total liabilities to equity	%	55.5	51.9	57.8	61.0	68.8
Interest cover	times	32.9	2.6	2.8	2.3	2.0
Current ratio	%	101.6	81.3	81.0	94.0	73.9
Leverage ratio	%	155.5	151.9	157.8	161.0	168.8
Payments to and from government						
Dividends	$'000	7 126	4 780	15 805	17 580	13 184
Dividend to equity ratio	%	1.8	1.2	3.8	4.0	2.7
Dividend payout ratio	%	37.5	39.7	90.5	94.8	130.5
Income tax expense	$'000	8 454	4 514	8 884	7 667	9 429
CSO funding	$'000	0	0	0	0	0

a Total assets increased due to a $193 million investment in the Brisbane Airport Corporation Ltd and a revaluation increment of $13.3 million. The investment was funded through borrowings from the Queensland Treasury Corporation. Includes an abnormal expense of $3.6 million relating to a provision made for future repairs to wharves and extraordinary losses of $1.6 million due to the misappropriation of investment funds. **b** Includes abnormal revenue of $4.9 million due to a change in accounting policy relating to provisions for major repairs and abnormal expenses of $14.4 million relating to expenses incurred for major repairs ($10.4 million) and redundancy payments ($4.0 million). Increase in assets attributable to upward revaluations of $5.2 million. **c** Increase in assets attributable to revaluations of $5.3 million. Includes abnormal revenue of $3.0 million due to a change in accounting policy relating to provisions for major repairs and abnormal expenses of $3.0 million relating to expenses incurred on major repairs. **d** An asset revaluation resulted in an increase in the value of assets by $62.6 million, mainly relating to Port of Brisbane Corporation's investment in Brisbane Airport Corporation Ltd. Includes $1.8 million expense relating to redundancy payments.

SOUTH AUSTRALIAN PORTS CORPORATION — South Australia

South Australian Ports Corporation (SAPC) was established on 1 November 1995 under the provisions of the *Public Corporations Act 1993* and the *South Australian Ports Corporation Act 1994*. SAPC is responsible for managing seven SA ports.[1]

In January 2001, legislation was passed by the SA parliament to facilitate the sale of SAPC. Final bids for SAPC were received by the South Australian Government in July 2001.

The value of SAPC's assets has declined in most years over the reporting period. The decline in 1997-98 was due to asset sales ($11 million) and a downward revaluation of land ($2.3 million). Most of the fall in the value of total assets in 1999-00 was due to a reduction in cash assets ($8 million) used to repay debt. Asset sales resulted in a further reduction in the value of assets by $6 million in 2000-01 compared to the previous year.

The improvement in profitability in 2000-01 was mainly due to an increase in revenue associated with a 10 per cent growth in trade throughput.

The level of SAPC's borrowings has declined in each year over the reporting period, falling from $45 million in 1996-97 to $9.3 million in 2000-01. As a result, the debt to equity, debt to total assets and total liabilities to equity ratios have declined. Lower debt levels have also resulted in a reduction in interest expenses and contributed to an increase in the level of interest cover over the reporting period.

SAPC is required to make tax-equivalent and dividend payments. In addition, SAPC is required to pay debt guarantee fees and land tax to the South Australian Government.[2] SAPC also became liable for local council rate-equivalent payments on 1 July 1998.

SAPC is not required to perform any community service obligations by the SA Government.

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1 SAPC owns and manages the ports of Port Adelaide, Port Giles, Port Pirie, Port Lincoln, Klein Point, Wallaroo and Thevenard. In 2000-01, the ports of Kingscote, Cape Jervis and Penneshaw were transferred to Transport South Australia.

2 There is a 0.75 per cent charge levied on all outstanding borrowings, in order to reflect the guarantee provided by the Government.

SOUTH AUSTRALIAN PORTS CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*[e]
Size						
Total assets	$m	109	102	103	94	92
Total revenue	$m	49	51	42	38	43
Profitability						
Operating profit before tax (includes abnormals)	$'000	9 897	23 162	15 317	12 766	14 944
Operating sales margin	%	31.4	49.9	40.9	36.1	36.1
Cost recovery	%	177.2	154.3	166.8	160.3	156.4
Return on assets	%	14.8	24.5	17.0	14.3	17.0
Return on equity	%	12.2	36.9	17.5	14.0	15.9
Financial management						
Debt to equity	%	87.6	63.7	48.6	26.8	14.7
Debt to total assets	%	38.3	33.2	28.2	17.2	10.0
Total liabilities to equity	%	111.5	85.7	72.7	49.0	45.4
Interest cover	times	2.3	9.6	8.5	11.1	18.3
Current ratio	%	112.8	105.5	84.3	54.9	77.9
Leverage ratio	%	211.5	185.7	172.7	149.0	145.4
Payments to and from government						
Dividends	$'000	3 972	16 254	5 506	4 971	9 381
Dividend to equity ratio	%	7.9	30.6	9.6	8.1	14.9
Dividend payout ratio	%	64.6	82.8	54.9	58.1	93.4
Income tax expense	$'000	3 752	3 523	5 279	4 216	4 905
CSO funding	$'000	0	0	0	0	0

a An abnormal expense of $5.7 million associated with debt refinancing arrangements with the South Australian Financing Authority reduced operating profit. The decline in total assets resulted from a $15 million fall in current assets in the form of cash and receivables. **b** Includes abnormal revenue of $13.3 million relating to the sale of bulk loading facilities ($11.8 million) and a government grant for the development of port assets ($1.5 million). An abnormal expense of $1.1 million relating to the sale of bulk loading facilities was also incurred. The value of property, plant and equipment fell 11 per cent during 1997-98 due to a downward valuation of land assets as at 30 June 1998 coupled with accumulated depreciation for the year. South Australian Ports Corporation (SAPC) paid a final dividend to the SA Government on 30 June 1998. In addition, SAPC paid a special capital dividend of $11.6 million. **c** Includes abnormal revenue of $1 million relating to a government grant for the development of port assets and an abnormal expense of $0.3 million relating to a transfer of land assets. **d** Includes an abnormal expense of $0.6 million relating to a workers compensation and superannuation claim. **e** Included in dividends is a special capital dividend payment of $3.5 million relating to asset transfers. A direct adjustment to equity of $2.5 million was also made relating to the asset transfer. Assets related to the ports of Kingscote, Cape Jervis and Penneshaw were transferred to Transport South Australia.

FREMANTLE PORT AUTHORITY — Western Australia

The Fremantle Port Authority (FPA) was commercialised on 1 July 1996. The role of the port, as agreed by the WA Government in November 1995, is 'to facilitate trade in an efficient and commercial manner'. The FPA was corporatised in August 1999 under the *Port Authorities Act 1999*. The FPA provides and maintains port infrastructure and port services including ship scheduling, port communications and mooring. The FPA contracts out pilotage, stevedoring and towage to the private sector.

Under the WA port authorities financial policy, ports must use a return on assets target methodology based on deprival valuation for pricing purposes. The long-term average target range is 5 to 8 per cent.

Despite a decline in revenue as a result of a fall in trade throughput and a 6 per cent reduction in port charges in 2000-01, profitability improved compared to the previous year because of a 15 per cent reduction in expenses.

Asset revaluations have not significantly affected the FPA's asset values, which have increased in each year over the reporting period. In 1999-00, the value of seawalls, breakwaters and railways were adjusted downwards by $5.2 million. The decline in the return on assets and return on equity ratios since 1997-98 indicates that operating profit has not increased commensurate with the rise in asset values.

The FPA's debt has fallen by 50 per cent over the reporting period.[1] Lower debt levels have contributed to a rise in interest cover and a decline in the debt to equity, debt to total assets and debt to total liabilities ratios over most of the reporting period. However, the debt ratios rose in 2000-01 with a $10 million increase in borrowings to fund the acquisition of a bulk loader.

The FPA is required to make both income tax-equivalent and dividend payments to the WA Government.[2]

1 The FPA's debt fell from $44.2 million in 1996-97 to $21.6 million in 2000-01.

2 FPA is required to pay local government rate equivalent (LGRE) payments in addition to income tax-equivalent payments. All statutory port authorities in WA receive a uniform 35 per cent discount on LGREs in recognition that port GTEs provide, at their own cost, some of the services and infrastructure normally provided by local government.

FREMANTLE PORT AUTHORITY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*	*1999-00*[b]	*2000-01*
Size						
Total assets	$m	108	112	114	120	132
Total revenue	$m	53	62	55	60	54
Profitability						
Operating profit before tax (includes abnormals)	$'000	10 620	17 894	13 824	14 768	15 637
Operating sales margin	%	29.0	34.6	34.3	29.2	29.7
Cost recovery	%	140.9	144.0	152.3	149.9	142.2
Return on assets	%	14.9	20.0	17.1	15.6	13.5
Return on equity	%	22.7	27.4	14.5	12.4	12.1
Financial management						
Debt to equity	%	109.2	64.8	38.8	22.9	26.8
Debt to total assets	%	41.7	30.4	22.3	15.1	17.1
Total liabilities to equity	%	166.7	116.8	75.5	55.8	63.5
Interest cover	times	3.1	5.3	3.5	5.2	12.5
Current ratio	%	112.4	121.3	119.6	105.5	150.0
Leverage ratio	%	266.7	216.8	175.5	155.8	163.5
Payments to and from government						
Dividends	$'000	0	1262	845	1 750	1 907
Dividend to equity ratio	%	0	2.7	1.5	2.5	2.4
Dividend payout ratio	%	0	10.0	10.0	19.9	20.0
Income tax expense	$'000	5 616	5 270	5 377	5 989	6 102
CSO funding	$'000	0	0	0	0	0

a Includes abnormal revenue from compensation for costs incurred in regard to reclamation of land and the lease surrender on property from the WA Government. Abnormal expenses due to a downward revaluation of non-current assets ($2.7 million) and a lease surrender ($0.9 million) were also incurred. **b** Includes abnormal revenue of $4.3 million relating to land transfers and an abnormal expense of $5.2 million as a result of a revaluation of non-current assets using the deprival methodology.

BUNBURY PORT AUTHORITY — Western Australia

The Bunbury Port Authority (BPA) was commercialised in August 1999 under the *Port Authorities Act 1999*. Bunbury is a bulk cargo handling port, with alumina accounting for over 67 per cent of total throughput.

Under the WA port authorities financial policy, ports must use a return on assets target methodology based on deprival valuation for pricing purposes. The long-term average target range is 5 to 8 per cent. Increased trade throughput and a reduction in expenses resulted in a higher profit (before tax) in 2000-01 compared to the previous year. Included in revenue in 2000-01 was $0.4 million relating to the settlement of a legal dispute.

The Authority leased the provision of a range of port services in 1998-99. The restructuring resulted in $1.4 million in redundancy payments to facilitate the outsourcing of services. Profitability has improved in subsequent years due to the reductions in labour costs and lower borrowing costs because of debt restructuring.[1]

The rise in the BPA's current ratio in 2000-01 compared to 1999-00 was largely due to a change in accounting standards that resulted in a reclassification of some investments from non-current investments to cash assets.[2]

The Authority is required to make dividend payments to the WA Government. On 2000-01, the BPA paid a dividend based on 30 per cent of profit (after tax).[3] In addition, the BPA was required to pay income tax and sales tax-equivalents from 1 July 1999.[4]

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1 In July 1999, the BPA refinanced its outstanding capital works debt facility. It transferred $13.6 million from Treasury to the WA Treasury Corporation in order to receive benefits from more competitive interest rates and principal repayment arrangements.

2 Comparative information provided by BPA showed that the current ratio would have *fallen* from approximately 471 per cent to 391 per cent if the non-current investments had been included as cash assets in 1999-00.

3 The dividend policy applying previously was based on 20 per cent of the BPA's debt. The dividend of $951 000 declared in 1999-00 was revised to $633 719 to reflect the premature application of the 2000-01 dividend policy.

4 In January 1999 it was discovered that the BPA was not included in WA's income tax-equivalent payments regime. Treasury ruled that the Authority was not liable to make tax-equivalent payments from 1 July 1996 to 30 June 1999. BPA is required to pay local government rate equivalent (LGRE) payments in addition to income tax-equivalent payments. All statutory port authorities in WA receive a uniform 35 per cent discount on LGREs in recognition that port GTEs provide, at their own cost, some of the services and infrastructure normally provided by local government.

BUNBURY PORT AUTHORITY (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*	*1998-99*[a]	*1999-00*[b]	*2000-01*[c]
Size						
Total assets	$m	n.r.	75	91	94	99
Total revenue	$m	n.r.	14	14	14	15
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	2 890	1 870	4 400	5 888
Operating sales margin	%	n.r.	31.8	22.8	37.2	44.7
Cost recovery	%	n.r.	149.5	155.2	166.2	189.6
Return on assets	%	n.r.	6.1	4.1	5.9	7.3
Return on equity	%	n.r.	5.4	3.1	3.8	5.2
Financial management						
Debt to equity	%	n.r.	32.0	24.5	24.1	21.8
Debt to total assets	%	n.r.	22.9	20.2	19.2	16.6
Total liabilities to equity	%	n.r.	39.8	33.6	27.1	34.7
Interest cover	times	n.r.	2.7	2.2	5.3	6.4
Current ratio	%	n.r.	359.4	239.1	204.1	391.4
Leverage ratio	%	n.r.	139.8	133.6	127.1	134.7
Payments to and from government						
Dividends	$'000	n.r.	332	190	951	1 276
Dividend to equity ratio	%	n.r.	0.6	0.3	1.3	1.7
Dividend payout ratio	%	n.r.	11.5	10.2	35.5	33.3
Income tax expense	$'000	n.r.	0	0	1 720	2 058
CSO funding	$'000	n.r.	0	0	0	0

a The increase in total assets resulted from the valuation of Crown land controlled by the Bunbury Port Authority that was previously valued at zero in the financial statements. Freehold land in Glen Iris was also revalued by the Valuer-General on the basis of unimproved value. Includes $1.4 million in redundancy payments to workers as part of the restructuring process associated with outsourcing operations. **b** The dividend of $951 000 in 1999-00 was revised to $633 719 to reflect the premature application of a dividend policy in 1999-00 applying to WA port government trading enterprises for 2000-01. If the revised dividend was applied to 1999-00, the dividend to equity and dividend payout ratios for 1999-00 would be 0.9 per cent and 23.6 per cent respectively. **c** Includes $0.4 million in revenue arising from a legal settlement relating to towage licenses. **n.r.** Not relevant.

BURNIE PORT CORPORATION — Tasmania

Burnie Port Corporation (BPC) commenced operations on 30 July 1997 under the *Ports Companies Act 1997*. BPC also owns and manages the Burnie airport. In 2000-01, port operations accounted for 93 per cent of revenue earned and around 84 per cent of assets.

The decline in revenue in 2000-01 compared to the previous year was mainly due to a fall in port trade throughput. The operating loss in 2000-01 was partly due to expenses associated with downward revaluations of airport assets, prior to their sale, ($2.6 million) and a change in accounting policy relating to a lease ($1 million). Non-operating revenue related to the amortisation of deferred revenue ($1.5 million) partly offset these expenses.

Downward asset revaluations have contributed to changes in the value of BPC's assets and to operating losses in some years over the reporting period.[1] Asset revaluations resulted in expenses of $9.6 million in 1996-97, $5.1 million in 1999-00 and $2.6 million in 2000-01.

BPC's debt levels have fallen each year since 1997-98. As a result, the debt to equity and debt to total assets ratios have improved.

BPC is required to make both tax-equivalent and dividend payments to the Tasmanian Government. There was no income tax expense or provision for income tax over the reporting period due to carried forward tax losses. No dividends have been provided for or paid over the reporting period.

1 Under accounting standards (AASB 1010), any increase in the value of assets must be recorded in an asset revaluation reserve, with the exception of changes that reverse a downward revaluation previously recognised as an expense. A downward revaluation must be recognised as an expense, except for any decrement that reverses a previous revaluation increment.

BURNIE PORT CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*[e]
Size						
Total assets	$m	41	44	46	41	38
Total revenue	$m	12	16	13	15	12
Profitability						
Operating profit before tax (includes abnormals)	$'000	-1 523	-5 393	948	-2 584	-2 536
Operating sales margin	%	2.0	-23.7	19.7	-10.4	-12.0
Cost recovery	%	109.3	127.9	124.3	130.2	89.3
Return on assets	%	1.0	-8.1	6.3	-2.5	-2.3
Return on equity	%	-7.8	-28.9	4.8	-12.8	-14.4
Financial management						
Debt to equity	%	101.7	124.4	97.2	99.7	95.1
Debt to total assets	%	47.4	52.6	46.5	43.3	39.0
Total liabilities to equity	%	110.3	144.7	113.3	118.4	135.0
Interest cover	times	0.2	-1.8	1.5	-0.7	-0.6
Current ratio	%	175.6	228.8	195.6	101.5	206.6
Leverage ratio	%	210.3	244.7	213.3	218.4	235.0
Payments to and from government						
Dividends	$'000	0	0	0	0	0
Dividend to equity ratio	%	0	0	0	0	0
Dividend payout ratio	%	0	0	0	0	0
Income tax expense	$'000	0	0	0	0	0
CSO funding	$'000	0	0	0	0	0

a Operating profit was deflated by a $0.8 million loss on the disposal of a slewing crane. **b** Covers the 11 month period to 30 June 1998. In 1997-98, the Burnie airport was consolidated in Burnie Port Corporation's financial statements. Includes abnormal revenue related to the amortisation of deferred revenue arising from prior period sale and lease buy back transactions ($0.4 million), an adjustment to seaport dredging and airport runway provisions following a change in accounting policy ($4 million) and contributions by external parties to capital improvements ($0.1 million). Abnormal expenses included the capitalisation of finance leases due to a change in accounting policy ($0.9 million), a loss due to obsolete assets ($0.2 million), a revaluation decrement ($9.6 million) and redundancy payments ($0.08 million). **c** Includes abnormal revenue from prior period sale and lease buy back transactions ($0.5 million) and abnormal expenses resulting from a loss due to obsolete assets ($0.1 million) and redundancy payments ($0.2 million). **d** Includes an abnormal expense of $5.1 million due to asset devaluation. **e** Includes expenses relating to a downward revaluation of airport assets ($2.6 million) and a change in accounting policy relating to a lease ($1.0 million). Non-operating revenue of $1.5 million relating to the amortisation of deferred revenue is also included.

HOBART PORTS CORPORATION — Tasmania

Hobart Ports Corporation (HPC) was established on 30 July 1997 under the *Ports Companies Act 1997* with a statutory objective of facilitating trade for the benefit of Tasmania. HPC owns and operates port facilities in Hobart, Triabunna, Port Huon, Strahan, Stanley and King Island. HPC owns 98 per cent of Hobart International Airport Pty Ltd and 100 per cent of King Island Ports Corporation.

Total revenue increased in 2000-01 compared to the previous year due mainly to growth in HPC's stevedoring activities as trade throughput increased by 6 per cent. The improvement in profit (before tax) in 2000-01 was not fully reflected in the return on assets or return on equity ratios because of an increase in assets relating to loans to Hobart International Airport Pty Ltd.[1]

The debt to equity, debt to total assets and total liabilities to equity ratios rose in 2000-01 compared to the previous year because of a 40 per cent increase in the level of borrowings. However, interest expenses remained similar to previous years as the additional debt incurred was an interest free loan of $4.6 million from Hobart International Airport Pty Ltd.

HPC is required to make tax-equivalent payments to the Tasmanian Government. Dividend payments were introduced as part of corporatisation in 1997-98. The negative tax-equivalent payments recorded in 1998-99 were mainly related to HPC recording an operating loss (after tax) because of differences between accounting income and taxable income.[2] In 1999-00, negative tax-equivalent payments were mainly the result of the restatement of deferred tax balances following a reduction in the company tax rate for future years.

1 Most of the $9.6 million loan is interest free.

2 Tax-effect accounting in accordance with AASB 1020 *Accounting for income tax*, leads to differences in how tax applies to income and the timing of tax payments. Permanent differences between taxable income and accounting income arise when disparities between tax law and accounting standards occur. For example, depreciation on buildings is charged as an expense under accounting profit but may not be allowable as a tax deduction in the calculation of taxable income. Timing differences may arise, for example, because of different depreciation schedules adopted by the corporation and the tax office.

HOBART PORTS CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*	*2000-01*
Size						
Total assets	$m	51	61	61	64	70
Total revenue	$m	12	13	16	17	22
Profitability						
Operating profit before tax (includes abnormals)	$'000	1 763	1 709	371	765	1 220
Operating sales margin	%	11.0	13.4	6.0	7.8	7.9
Cost recovery	%	109.6	103.9	103.5	108.5	108.6
Return on assets	%	4.2	3.7	1.7	2.3	2.8
Return on equity	%	2.7	3.5	1.0	1.7	1.5
Financial management						
Debt to equity	%	8.0	23.3	22.7	20.8	29.8
Debt to total assets	%	6.9	18.9	16.8	15.9	21.4
Total liabilities to equity	%	18.1	34.3	35.0	33.5	45.6
Interest cover	times	6.6	5.9	1.5	2.1	2.8
Current ratio	%	508.2	137.3	136.0	146.9	100.7
Leverage ratio	%	118.1	134.3	135.0	133.5	145.6
Payments to and from government						
Dividends	$'000	0	160	700	540	540
Dividend to equity ratio	%	0	0.4	1.5	1.2	1.1
Dividend payout ratio	%	0	10.5	148.1	67.4	76.9
Income tax expense	$'000	610	179	-102	-37	518
CSO funding	$'000	0	0	0	0	0

a Total revenue increased by $0.4 million as a result of a gain on the cancellation of a creditor. This gain was offset by an increase in redundancy expenses. **b** Includes abnormal revenue ($1.3 million) resulting from the transfer of title to land and buildings held by the Crown to the King Island Ports Corporation on 12 June 1998. Additional revenue was generated from the write-off of rental charges owing to the Tasmanian Treasury relating to King Island Ports Corporation's facilities on 21 May 1998. Reporting period covers the 11 month period to 30 June 1998. The rise in total assets resulted from an increase in the value of property, plant and equipment. **c** Total revenue increased due to the sale of land ($0.4 million).

PORT OF DEVONPORT CORPORATION — Tasmania

Port of Devonport Corporation (PDC), formerly the Port of Devonport Authority, was corporatised under the *Port Companies Act 1997*, effective from 30 July 1997. PDC also owns the Devonport airport. In 2000-01, airport operations accounted for 14 per cent of PDC's revenue and represented 27 per cent of total assets.

In 1997-98, PDC consolidated the financial results for the Devonport airport in its financial statements.[1] Consolidation increased assets and improved PDC's debt to total assets, debt to equity and total liabilities to equity ratios. In addition, the consolidation improved PDC's return on assets, return on equity and cost recovery ratios over and above that which would have occurred for the port operations alone.[2]

Revenue increased by 5 per cent in 2000-01 compared to 1999-00 as a result of increased port throughput. However, the level of profit (before tax) decreased by 50 per cent, mainly due to a loss of $1.6 million on the disposal of buildings and other assets.

A refinancing of PDC's loan portfolio in 2000-01 resulted in interest payments declining by 17 per cent, despite maintaining a similar level of debt to 1999-00. Capital expenditure of $2.5 million in 2000-01 was financed largely from retained earnings.

PDC has been required to make tax-equivalent payments over the entire reporting period. Provisions for the payment of dividends have applied since July 1997. The dividend of $925 000 in 1999-00 includes $304 000 paid in relation to the previous year and $621 000 provided for in relation to 1999-00.

1 The 1997-98 financial statistics cover the 11 month period to 30 June 1998.

2 Devonport airport earned an operating profit in 1997-98 of $0.3 million.

PORT OF DEVONPORT CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*[d]
Size						
Total assets	$m	29	43	45	46	45
Total revenue	$m	9	9	10	10	11
Profitability						
Operating profit before tax (includes abnormals)	$'000	1 018	1 446	453	2 069	1 068
Operating sales margin	%	13.1	16.0	6.5	21.8	9.0
Cost recovery	%	115.0	119.1	118.6	127.8	109.9
Return on assets	%	5.6	5.4	2.6	5.9	3.5
Return on equity	%	3.1	3.8	0.2	3.6	0.6
Financial management						
Debt to equity	%	30.2	23.8	25.3	22.2	22.0
Debt to total assets	%	21.5	21.0	19.5	16.7	16.6
Total liabilities to equity	%	42.0	34.0	33.4	33.5	32.0
Interest cover	times	2.7	3.8	1.7	4.3	3.0
Current ratio	%	455.0	480.9	454.6	322.7	336.0
Leverage ratio	%	142.0	134.0	133.4	133.5	132.0
Payments to and from government						
Dividends	$'000	0	0	440	925	108
Dividend to equity ratio	%	0	0	1.3	2.7	0.3
Dividend payout ratio	%	0	0	657.1	75.8	50.0
Income tax expense	$'000	374	442	386	849	852
CSO funding	$'000	0	0	0	0	0

a In 1997-98, Port of Devonport Corporation (PDC) consolidated Devonport Airport in its financial statements. 1997-98 covers the 11 month period to 30 June 1998. The increase in PDC's total assets is largely attributable to the addition of Devonport Airport and all related investments. **b** Total assets increased with harbour deepening. Includes abnormal expenses of $0.9 million relating to depreciation adjustments from the reassessment of the useful life of non-current assets and the scrapping of fixed assets no longer held. **c** Dividend includes $304 000 paid in relation to the previous year and $621 000 provided for 1999-00. **d** Includes a net loss of $1.6 million on the sale on assets.

PORT OF LAUNCESTON PTY LTD — Tasmania

Port of Launceston Pty Ltd was established on 30 July 1997 under the *Port Companies Act 1997*. Upon commencing operations, Port of Launceston Pty Ltd acquired the Flinders Island Ports Company (formerly the Flinders Marine Board). A consolidated financial statement was produced in 1997-98. Consolidation had a minimal impact on the Port's performance indicators.

Increases in cargo throughput in each year over the reporting period have contributed to increases in revenue and a general improvement in operating profit. The increase in operating profit in 1999-00 was mainly due to abnormal revenue of $2 million relating to the settlement of a legal dispute.[1]

The level of borrowings has fallen each year since 1996-97, resulting in a decline in debt to equity and debt to total assets ratios. As a result of debt reduction, interest expense as a proportion of total expenses has declined from 18 per cent in 1996-97 to 12 per cent in 2000-01.

Port of Launceston Pty Ltd is required to make both tax-equivalent and dividend payments to the Tasmanian Government. The dividend to equity and dividend payout ratios in 2000-01 reflect the inclusion of a dividend of $0.6 million that was paid in relation to 1999-00, but was not declared in the financial statements for that year.[2]

1 The shipping company Coastal Express Line terminated a terminal lease in June 1996, which was due to run until April 2001. As a result, the Port of Launceston entered into legal action against the company and others. A $2 million settlement was reached after mediation and credited to revenue in 1999-00.

2 If the dividend payable was attributed to 1999-00, the dividend payout ratios for 1999-00 and 2000-01 are 50 per cent and 118 per cent respectively. The dividend to equity ratios would be 2.5 per cent and 1.4 per cent respectively.

PORT OF LAUNCESTON PTY LTD (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*[b]	*1999-00*[c]	*2000-01*[d]
Size						
Total assets	$m	47	43	44	43	42
Total revenue	$m	7	7	8	10	9
Profitability						
Operating profit before tax (includes abnormals)	$'000	-851	-290	220	1 476	478
Operating sales margin	%	5.2	13.3	19.8	25.0	15.3
Cost recovery	%	107.0	118.1	124.6	106.5	118.1
Return on assets	%	1.2	2.3	3.8	6.1	3.6
Return on equity	%	-3.0	-3.6	2.1	4.9	1.2
Financial management						
Debt to equity	%	61.2	65.2	64.2	55.6	50.0
Debt to total assets	%	36.7	36.6	35.8	31.9	28.6
Total liabilities to equity	%	67.7	69.7	84.6	72.8	72.6
Interest cover	times	0.4	0.8	1.1	2.2	1.4
Current ratio	%	170.3	83.7	95.4	178.4	154.2
Leverage ratio	%	167.7	169.7	184.6	172.8	172.6
Payments to and from government						
Dividends	$'000	0	0	150	0	939
Dividend to equity ratio	%	0	0	0.6	0	3.8
Dividend payout ratio	%	0	0	30.4	0	319.0
Income tax expense	$'000	-288	-664	-274	268	184
CSO funding	$'000	0	0	0	0	0

a Port of Launceston Pty Ltd consolidated Flinders Island Ports Corporation in its financial statements from 1997-98. As a result of increased redundancy expenses, operating profit was deflated by $0.2 million. **b** Both assets and liabilities increased in this year due to a change in the reporting treatment of future income tax benefit (non current asset) and the provision of deferred tax (non-current liabilities). Both total assets and total liabilities increased by $3.5 million. **c** Includes abnormal revenue of $2 million, mainly the result of the settlement of a writ issued by the port against Coastal Express Line for the termination of a lease. **d** A dividend was paid in relation to 1999-00 ($604 000), but was not declared within the reporting period. If the dividend payable was attributed to 1999-00, the dividend payout ratios for 1999-00 and 2000-01 are 50 per cent and 118 per cent respectively. The dividend to equity ratios would be 2.5 per cent and 1.4 per cent respectively.

DARWIN PORT CORPORATION — Northern Territory

Darwin Port Corporation (DPC) was established under the *Darwin Port Corporation Act 1999*. DPC, previously the Darwin Port Authority, began operating in September 1999 and is responsible for the management of the East Arm Port facility and the provision of services such as reception facilities for cruise and naval vessels.

Asset revaluations have significantly affected profitability indicators in 1999-00 and 2000-01. The value of assets decreased in 1999-00 by 50 per cent with a $60.6 million write-down of the East Arm Port facilities, using deprival methodology. Harbour improvements were revalued down by an additional $15 million in 2000-01.

Despite a decline in trade throughput in each year since 1996-97, total revenue has remained stable over the reporting period. The increase in revenue in 1999-00 was mainly due to $21 million in proceeds from the sale of non-current assets.

During 1999-00, DPC undertook debt restructuring. Debt levels were capped at $35 million and resulted in a 40 per cent reduction in DPC's borrowings. DPC was able to reduce its debt levels by transferring land and buildings valued at $20.5 million to the Government in exchange for the retirement of an equivalent level of debt.

DPC is required to make tax-equivalent and dividend payments to the Northern Territory Government. Dividend payments are set at 50 per cent of operating profit after tax. As a consequence, no dividend was paid in 1999-00 and 2000-01.

DPC receives community service obligation (CSO) funding to cover costs associated with the operation and management of the Stokes Hill wharf and precinct, the fishing harbour mooring basin and other wharf facilities. CSO funding was also received for the East Arm Port development.[1]

1 This CSO addressed debt servicing and costs incurred in the duplication of services. Funding associated with the East Arm Port development accounts for the largest share of DPC's CSO payments.

DARWIN PORT CORPORATION (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*[e]
Size						
Total assets	$m	111	135	136	68	62
Total revenue	$m	14	16	17	38	15
Profitability						
Operating profit before tax (includes abnormals)	$'000	-562	4 040	495	-47 685	-5 202
Operating sales margin	%	0.4	40.F8	24.3	-117.5	-20.5
Cost recovery	%	147.3	169.0	159.9	174.4	134.8
Return on assets	%	0.5	5.4	3.3	-43.4	-3.8
Return on equity	%	-2.3	4.4	-1.0	-97.7	-21.1
Financial management						
Debt to equity	%	113.6	78.9	76.6	132.4	173.1
Debt to total assets	%	65.0	47.1	41.8	34.2	51.9
Total liabilities to equity	%	118.4	83.7	83.6	158.3	218.0
Interest cover	times	4.8	2.5	1.1	-12.5	-0.9
Current ratio	%	206.1	341.4	170.6	244.2	180.9
Leverage ratio	%	218.4	183.7	183.6	258.3	318.0
Payments to and from government						
Dividends	$'000	1 031	1 064	1 374	0	0
Dividend to equity ratio	%	2.5	1.7	1.9	0	0
Dividend payout ratio	%	-108.4	38.7	-178.2	0	0
Income tax expense	$'000	389	1 290	1 266	1 234	-362
CSO funding	$'000	1 965	3 602	5 273	5 436	3 400

a In July 1996, Darwin Port Corporation revalued its non-current assets using the deprival method, as a result, assets increased by $20 million. Capital works in progress relating to the East Arm Port increased total assets by $28.9 million. Operating profit (before tax, including abnormals) was deflated by $4.2 million relating to a downward adjustment to asset value due to revaluation. **b** Capital works in progress relating to the East Arm Port increased total assets by $20.9 million in 1997-98. **c** Operating profit decreased due to a $2.2 million downward revaluation of assets. **d** Operating profit decreased due to a $60.6 million write-down of assets due to the application of deprival methodology to port infrastructure. **e** Includes a $14.8 million revaluation decrement resulting from a revaluation of harbour improvements using deprival methodology.

12 Commonwealth GTEs

Three Commonwealth government trading enterprises (GTEs) are covered in this chapter — Airservices Australia, Australia Post and Telstra. These GTEs vary significantly in size and in the range of services that they provide.

For a discussion of the data and the performance indicators used and some of the factors that should be considered when assessing performance, see chapter 3.

AIRSERVICES AUSTRALIA — Commonwealth

Airservices Australia (ASA) was established in July 1995 under the *Air Services Act 1995*, and is responsible for providing and managing Australia's air navigation and air traffic services infrastructure.

Location specific pricing was introduced for fire fighting and rescue services in July 1997 and for terminal navigation in July 1998.[1] The aim of these pricing reforms was to price services more efficiently to reflect the cost of providing services at individual airports. Since then, average real prices to users have fallen by 25 per cent.

The improvement in profitability in 2000-01 compared to the previous year mainly reflects an 11 per cent reduction in expenses as a result of a reduction in labour costs and depreciation expenses. Part of the increase in the return on assets and return on equity indicators is related to the $50 million decline in the carrying value of infrastructure, plant and equipment and a $34 million decline in the provision for separations and redundancies.

ASA received a $7 million Commonwealth Government community service obligation (CSO) payment in 2000-01 aimed at enabling it to continue to cap prices at regional and General Aviation Airport Procedures airports. ASA also internally funds a number of non-commercial community service activities, including a telephone complaints service regarding aircraft noise, aircraft noise and flight path monitoring and the provision of environmental information.[2]

ASA is required to make both tax-equivalent and dividend payments. The dividend in 2000-01 includes a final dividend of $8.5 million for the year ending 30 June 2000 and an interim dividend of $13.6 million for the six months ending 31 December.

1 Terminal navigation charges are levied for the use of terminal navigation facilities and services for each landing, practice instrument approach or practice instrument approach immediately followed by a landing at an aerodrome with a control service for aircraft. These charges vary with maximum take-off weight of the aircraft, the time services are used and if the aerodrome is located in a capital city.

2 In 2000-01, ASA estimated that community services activities cost $11.4 million. This covered several activities including a shortfall in the subsidy used to maintain price capping ($4.9 million), provision of environmental information ($2.9 million), Sydney Olympics ($1.4 million) and noise inquiry lines ($1.4 million).

AIRSERVICES AUSTRALIA (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]	*1999-00*[d]	*2000-01*
Size						
Total assets	$m	732	747	671	619	592
Total revenue	$m	619	607	605	636	583
Profitability						
Operating profit before tax (includes abnormals)	$'000	16 963	-48 012	-173 178	78 291	86 695
Operating sales margin	%	4.8	-6.1	-27.2	13.4	15.4
Cost recovery	%	107.3	107.0	108.0	110.0	116.7
Return on assets	%	4.0	-4.9	-23.1	13.3	15.5
Return on equity	%	1.9	-9.2	-44.8	15.9	23.2
Financial management						
Debt to equity	%	41.6	49.8	48.3	42.3	40.7
Debt to total assets	%	20.6	22.7	14.5	15.5	16.5
Total liabilities to equity	%	93.5	121.7	214.3	162.0	140.9
Interest cover	times	2.3	-3.1	-17.9	11.0	13.0
Current ratio	%	38.7	2.6	46.8	85.5	76.5
Leverage ratio	%	193.5	221.7	314.3	262.0	240.9
Payments to and from government						
Dividends	$'000	5 950	5 950	0	13 000	22 100
Dividend to equity ratio	%	1.5	1.7	0	5.8	9.2
Dividend payout ratio	%	76.7	-18.0	0	36.4	39.5
Income tax expense	$'000	9 205	-15 025	-49 815	42 544	30 744
CSO funding	$'000	8 121	0	11 000	11 000	7 000

a Includes abnormal expenses of $34.9 million from revaluation decrement on land, buildings, and infrastructure. Plant and equipment revaluation decrement in 1997 of $7.3 million is related to the shortening of its useful life as a result of the Government's decision to auction the 1.8GHz spectrum. This figure also included allowances for changes to staff awards and redundancy payments arising from organisational restructure and staff termination payments arising from the transfer of the Search and Rescue (SAR) function to Australia Maritime Safety Authority (AMSA). **b** Includes abnormal expenses of $80.7 million from charges to profits for the provision for litigation, separation and redundancy payments and direct project costs arising from major organisational restructuring, provision for legal costs, revaluation decrement on infrastructure, plant and equipment, provision for early retirement benefits and staff termination payments arising from the transfer of the SAR function to AMSA. **c** Includes abnormal expenses of $228.2 million from separation and redundancy payments, devaluation of property, plant and equipment, Business Transformation Program costs, year 2000 direct project costs, Avgas refund and provisions for legal costs and litigation. **d** Includes abnormal revenue of $21.1 million generated by the write-back of legal provisions and asset sales. Successful outcomes in litigation enabled the write-back of legal provisions totalling $30.9 million relating to the Compass I, Compass II cases and Hughes litigation.

AUSTRALIA POST — Commonwealth

Australia Post was established in 1975 and corporatised in 1989 under the *Australian Postal Corporation Act 1989*. Its principal activities are letter delivery, parcel delivery, third party agency services (receiving bill payments for other companies) and the sale of postal products and merchandise. Australia Post holds a legislative monopoly for the processing and distribution of letters under 250 grams.

Despite a reduction in mail volumes compared to previous years, Australia Post returned a record profit in 2000-01. Several one-off factors contributed to the profit result, including asset sales and a reduction in redundancy expenses. The result was achieved despite the full absorption of the goods and services tax, which Australia Post estimated to have cost it $95.5 million.

Debt levels have been stable since 1998-99 after two successive increases in the level of debt were recorded in 1996-97 and 1997-98. As a result, debt to equity and debt to total assets ratios have declined since 1998-99. Increases in operating profit over recent years have also resulted in a rise in interest cover.

Australia Post is subject to all taxes and pays dividends to the Commonwealth Government. In 2000-01, Australia Post made provisions to pay an ordinary dividend of $164.7 million to the Commonwealth Government, representing 60 per cent of profit after income tax. A special dividend of $109.8 million was also paid.

Australia Post is required to internally fund two non-commercial activities. Community service obligations (CSOs), as set out in s. 27 of the *Australian Postal Corporation Act 1989*, require that all Australians be provided with a letter service which reasonably meets their needs on an equitable basis and a domestic standard letter service at a uniform price. In addition, Australia Post must ensure that performance standards for the letter service reasonably meet the social, industrial and commercial needs of the Australian community. The uniform standard letter service has remained unchanged at 45 cents since January 1992.[1]

Since 1989, the Commonwealth Government has directed Australia Post to provide, free of charge, pensioner mail redirection for the first month after a pensioner changes address. Australia Post estimated that this Ministerial direction cost $4.3 million in 2000-01.

1 Australia Post receives no financial assistance from the Government to meet these CSOs. The cost of CSOs was estimated by Australia Post to be $92 million for 2000-01 using avoidable cost methodology (see chapter 6).

AUSTRALIA POST (continued)

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*	*1997-98*[a]	*1998-99*	*1999-00*[b]	*2000-01*
Size						
Total assets	$m	2 589	2 736	2 854	3 037	3 199
Total revenue	$m	3 155	3 300	3 468	3 743	3 733
Profitability						
Operating profit before tax (includes abnormals)	$'000	353 100	335 200	373 000	391 900	402 100
Operating sales margin	%	11.5	10.3	11.0	10.9	11.2
Cost recovery	%	112.9	113.0	112.5	113.5	112.7
Return on assets	%	15.1	13.4	14.2	14.4	14.0
Return on equity	%	26.9	26.3	27.1	25.0	24.7
Financial management						
Debt to equity	%	43.0	52.2	54.7	47.8	47.5
Debt to total assets	%	14.8	16.8	19.0	18.0	17.0
Total liabilities to equity	%	202.6	218.9	194.3	173.8	186.6
Interest cover	times	16.3	17.0	15.8	13.3	13.1
Current ratio	%	87.5	90.6	87.9	93.8	100.2
Leverage ratio	%	302.6	318.9	294.3	273.8	286.6
Payments to and from government						
Dividends	$'000	219 900	215 100	148 700	155 700	274 500
Dividend to equity ratio	%	25.3	25.1	16.3	15.0	24.7
Dividend payout ratio	%	94.3	95.6	60.0	60.0	100.0
Income tax expense	$'000	119 900	110 200	125 200	132 400	127 600
CSO funding[c]	$'000	0	0	0	0	0

a Net abnormal expenses of $41.2 million came from charges resulting from year 2000 software modification costs, and charges resulting from a bond rate movement effect on employee entitlement provisions. **b** Net abnormal expenses of $34 million incurred for year 2000 compliance and GST implementation costs. **c** Australia Post internally funds a standard letter service. This was estimated by Australia Post to cost $92 million in 2000-01. A Commonwealth Government direction in 1989 to provide free mail redirection for eligible pensioners is also internally funded and was estimated by Australia Post to cost $4.3 million in 2000-01.

TELSTRA — Commonwealth

Telstra Corporation Limited was established in April 1993 and operates under the *Telecommunications Act 1997*. Telstra's principal activities include providing telephone exchange lines, local and long-distance phone services, international services, mobile telecommunication services, and a range of data, Internet and on-line services.

Revenue and operating profit increased steadily over the reporting period. Revenue growth has been mainly attributable to new product areas such as mobile services, data services, facsimile and ISDN services. Included in operating profit in 2000-01 were unusual revenue items of $2.9 billion, mainly relating to the sale of a global wholesale business. This was partly offset by unusual expense items of $2.3 billion relating to the value of asset sales and acquisition costs.

The debt to equity and debt to total assets ratios have risen since 1997-98. The increase was driven by an 80 per cent growth in the level of borrowings to fund higher levels of capital expenditure and investments.

Telstra is subject to all taxes and pays dividends to its shareholders.[1] Some of the variability in the dividend payout ratio over the reporting period can be explained by special dividend payments, $3.2 billion in 1996-97 and $2.1 billion in 1998-99.

Telstra's Universal Service Obligation (USO) requires that standard telephone services, including services for the disabled, public payphones and prescribed carriage services, are reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry on business. Telstra is also subject to the Digital Data Obligation (DDO), and must provide reasonable and equitable access on a 64kbps ISDN service or a broadly comparable satellite downlink service to at least 96 per cent of the Australian population.

Telstra does not receive Government funding for the USO or DDO.[2]

1 Telstra was first partially privatised in November 1997, when 33 per cent of the Corporation was floated. The second sell-off of 16 per cent occurred in October 1999. The Commonwealth Government retains 50.1 per cent of issued shares.

2 The net cost of universal service provision in 2000-01 was shared among carriers based on proportion of eligible telecommunications revenue. Telstra estimated that it funded over 75 per cent of the USO cost of $299 million in 2000-01.

Performance indicators 1996-97 to 2000-01

	Units	*1996-97*[a]	*1997-98*	*1998-99*	*1999-00*[b]	*2000-01*[c]
Size						
Total assets	$m	25 858	26 470	27 682	30 339	37 473
Total revenue	$m	15 983	17 302	18 218	19 840	23 086
Profitability						
Operating profit before tax (includes abnormals)	$'000	2 073 000	4 468 000	5 320 000	5 349 000	6 297 000
Operating sales margin	%	15.6	29.2	32.1	29.9	30.2
Cost recovery	%	136.1	141.3	147.4	148.7	143.4
Return on assets	%	10.3	19.5	21.8	20.6	20.8
Return on equity	%	14.2	31.0	32.6	33.5	32.1
Financial management						
Debt to equity	%	80.3	69.7	70.1	84.6	102.0
Debt to total assets	%	31.8	29.5	26.6	33.9	41.3
Total liabilities to equity	%	160.2	138.9	168.9	161.5	173.1
Interest cover	times	5.0	8.0	10.2	9.5	9.2
Current ratio	%	70.3	52.8	44.8	51.9	67.4
Leverage ratio	%	260.2	238.9	268.9	261.5	273.1
Payments to and from government						
Dividends[d]	$'000	4 146 000[e]	1 802 000	4 247 000	2 316 000	2 445 000
Dividend to equity ratio	%	36.7	17.1	39.7	21.2	19.3
Dividend payout ratio	%	257.7	55.3	121.8	63.1	60.2
Income tax expense	$'000	464 000	1 211 000	1 832 000	1 676 000	2 236 000
CSO funding	$'000	0	0	0	0	0

a Includes net abnormal expenses of $1.7 billion. This was attributable to provisions for broadband network rationalisation, loss on long-term construction contracts, the write-down of broadband network communication assets and most significantly, provisions for redundancy and restructuring which accounted for almost half of the abnormal expenses. **b** Includes abnormal expense of $574 million for planned and actual redundancies. **c** Includes net unusual revenues of $600 million, mainly relating to the sale of a global wholesale business, acquisition costs and superannuation adjustments. **d** Part of the dividend payments since 1998-99 have been paid to private shareholders. **e** As part of a restructuring of Telstra's capital base in preparation for privatisation, a special dividend payment of $3 billion was made to the Commonwealth Government in 1996-97. A special dividend of $2.1 billion was also paid in 1998-99.

A Participating enterprises

Table A.1 **Participating enterprises by jurisdiction, 2000-01**

GTE	*Industry Classification*
New South Wales	
Delta Electricity	Electricity
Macquarie Generation	Electricity
Pacific Power	Electricity
TransGrid	Electricity
Advance Energy	Electricity
Australian Inland Energy	Electricity
EnergyAustralia	Electricity
Eraring Energy	Electricity
Great Southern Energy	Electricity
Integral Energy	Electricity
NorthPower	Electricity
Hunter Water Corporation	Water
Sydney Water Corporation	Water
Sydney Catchment Authority	Water
State Transit Authority	Urban Transport
State Rail Authority of NSW	Railways/Urban Transport
Freight Rail Corporation of NSW	Railways
Newcastle Port Corporation	Port Authorities
Port Kembla Port Corporation	Port Authorities
Sydney Ports Corporation	Port Authorities
Victoria	
Barwon Water	Water
City West Water	Water
Melbourne Water Corporation	Water
South East Water	Water
Yarra Valley Water	Water
Melbourne Port Corporation	Port Authorities
Victorian Channels Authority	Port Authorities

(Continued next page)

Table A.1 (continued) **Participating enterprises by jurisdiction, 2000-01**

GTE	*Industry Classification*
Queensland	
CS Energy	Electricity
Stanwell Corporation	Electricity
Tarong Energy	Electricity
Enertrade	Electricity
Powerlink	Electricity
Ergon Energy	Electricity
Energex	Electricity
Sun Water	Water
Queensland Rail	Railways/Urban Transport
Gladstone Port Authority	Port Authorities
Port of Brisbane Authority	Port Authorities
South Australia	
SA Water Corporation	Water
TransAdelaide	Urban Transport
South Australian Ports Corporation	Port Authorities
Western Australia	
Western Power	Electricity
Water Corporation	Water
Western Australian Government Railways Commission	Railways
Bunbury Port Authority	Port Authorities
Fremantle Port Authority	Port Authorities
Tasmania	
Hydro-Electric Corporation	Electricity
Aurora Energy	Electricity
Transend Networks	Electricity
Hobart Regional Water Authority	Water
North West Water Authority	Water
Esk Water Authority	Water
Metro Tasmania Pty Ltd	Urban Transport
Burnie Port Corporation	Port Authorities
Hobart Port Corporation	Port Authorities
Port of Devonport Corporation	Port Authorities
Port of Launceston Pty Ltd	Port Authorities
Australian Capital Territory	
ACTION	Urban Transport

(Continued next page)

Table A.1 (continued) **Participating enterprises by jurisdiction, 2000-01**

GTE	*Industry Classification*
Northern Territory	
Darwin Port Authority	Port Authorities
Commonwealth	
Snowy Mountains Hydro-Electric Authority	Electricity
National Railway Corporation	Railways
Airservices Australia	Other Commonwealth
Australia Post	Other Commonwealth
Telstra Corporation	Other Commonwealth

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