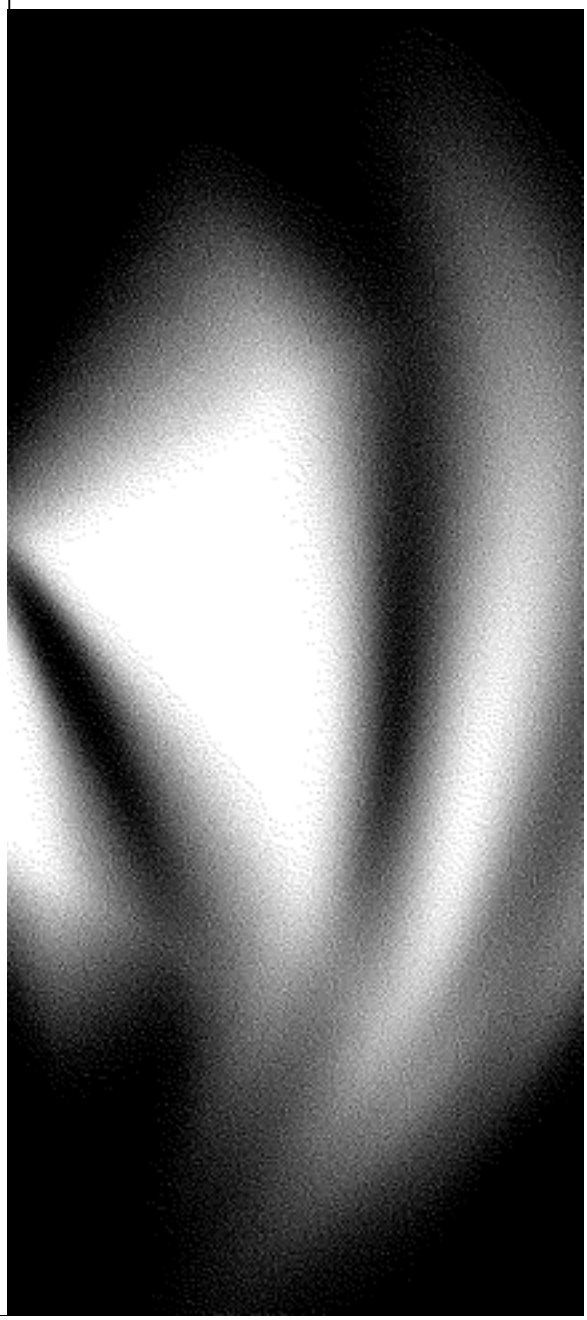
PRODUCTIVITY COMMISSION

Financial Performance of Government Trading Enterprises 1994-95 to 1998-99

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.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Information on the Productivity Commission, its publications and its current work program can be found on the World Wide Web at www.pc.gov.au or by contacting Media and Publications on (03) 9653 2244.

Foreword

This report is the first in a series initiated by the Productivity Commission into the financial performance of Government Trading Enterprises (GTEs). The study forms part of a continuing program of research into the performance of economic infrastructure industries and the impact of micro-economic reforms. It is the successor to a series of broader reports by the Steering Committee on National Performance Monitoring of Government Trading Enterprises with the Commission as secretariat.

The results of this study indicate that the financial management of GTEs has continued to improve over recent years, resulting in higher returns to the community. However, performance varies within and across industries, with many GTEs still not achieving an adequate rate of return — despite a decade of reform.

Poor financial performance of GTEs may have adverse implications for the efficient use of community resources, as well as the position of private sector competitors, suggesting the need for a closer examination of the underlying causes.

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 welcomes feedback on this report, consistent with its objective of improving the information base on key issues affecting Australia's economic performance and community living standards.

Gary Banks
Chairman

July 2000

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Abbreviations

ACCC	Australian Competition and Consumer Commission
AIE	Australian Inland Energy
AMSA	Australian Maritime Safety Authority
AUSTA Electric	Queensland Generation Corporation
BPA	Bunbury Port Authority
BPC	Burnie Port Corporation
CAA	Civil Aviation Authority
COAG	Council of Australian Governments
CPI	Consumer Price Index
CPSIR	Common Public Sector Interest Rate
CSO	Community Service Obligation
DBNGP	Dampier to Bunbury National Gas Pipeline
DNR	Department of Natural Resources (QLD)
DPA	Darwin Port Authority
DUS	Department of Urban Services (ACT)
EBIT	Earning Before Interest and Tax
FPA	Fremantle Port Authority
FRC	Freight Rail Corporation
GBE	Government Business Enterprise
GHz	Giga (10^9) Hertz

GPA	Gladstone Port Authority
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 Review Tribunal
ISDN	Integrated Service Data Network
Kilolitres	1000 litres
kV	Kilo Volt
kWh	Kilo (10^3) watt hours
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
NRC	National Rail Corporation
NWRWA	North West Regional Water Authority

ORG	Office of the Regulator-General
PBC	Port of Brisbane Corporation
PDC	Port of Devonport Corporation
PKPC	Port Kembla Port Corporation
PLC	Port of Launceston 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
ROA	Return on Assets
ROE	Return on Equity
RSA	Rail Services Australia
SA Water	South Australian Water Corporation
SAPC	South Australia Ports Corporation
SAR	Search and Rescue
SCA	Sydney Catchment Authority
SCI	Statement of Corporate Intent
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
SMHEA	Snowy Mountains Hydro-Electric Authority
SOC	State Owned Corporation
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
TJ	Tera (10^{12}) joules
TUOS	Transmission use of system prices
UIG	Urgent Issues Group
USO	Universal Service Obligation
VCA	Victorian Channels Authority
YVW	Yarra Valley Water

Box 1 **Key messages**

- There has been a steady improvement in financial performance for most GTEs.
- Most GTEs are now required to recover costs and pay dividends, debt guarantee levies and tax-equivalent payments — as a means of imposing financial market disciplines for good governance and to ensure competitive neutrality. Governments generally identify Community Service Obligations (CSOs) and meet their cost.
- Despite a general improvement, some GTEs are not sufficiently profitable to ensure that the community is earning a rate of return equivalent to the risk-adjusted cost of capital. This is particularly so in the urban transport and rail sectors. However, there are GTEs in most industries that are consistently under-performing.
- Failure to earn adequate returns may have implications for a GTE's long-term viability and expose governments and the broader community to additional risk. An inadequate return on assets also militates against prices providing signals for efficient investment.
- Competition policy reforms have resulted in numerous structural changes in the GTE sector. Associated with these reforms have been asset transfers, asset revaluations, debt restructuring and liability transfers — many of which appear as abnormal items in the financial statements of GTEs.
- Care has to be exercised when examining trends in profitability and financial management for individual GTEs because of the large number of abnormal items.
- Where financial performance is unlikely to improve, there is a need to review operating costs, prices, CSO payments (where appropriate), asset values and the structure of the balance sheet. Where poor performance is industry-wide there may be a case for reviewing governance arrangements, given that reform measures have been in place for some time.
- The spread of financial management performance indicators within industries suggests that the financial restructuring of GTEs may be incomplete, limiting the effectiveness of strategies aimed at replicating financial market disciplines applying to the private sector.

1 Introduction and findings

This report contains a consistent set of financial performance indicators for 63 Government Trading Enterprises (GTEs) (see attachment A for a list of monitored GTEs).[1] The study forms part of the Commission's research program into micro-economic reform.

The information was compiled for the purpose of making a general assessment of financial performance. It does not provide information suitable for a detailed analysis of the performance of individual GTEs — a thorough examination of their respective financial statements is required for that purpose.

The performance assessment focuses on the effectiveness of reform measures which have been aimed at giving the Boards of GTEs clear financial objectives, replicating financial market disciplines and ensuring competitive neutrality. Financial performance monitoring facilitates transparency and hence, accountability. It also facilitates yardstick competition — which is important in industries where businesses do not face vigorous competition.

The influences on performance over time are identified to provide some explanation of the factors outside the control of GTEs that affect their performance. Some of these include structural reform, government policy, changes in the market environment, financial arrangements, comparability of data and changes in accounting procedures.

GTE performance reports are presented on an industry basis — electricity and gas; water, sewerage, drainage and irrigation; urban transport; railways; and ports (chapters 2 to 6 respectively). The Commonwealth Government GTEs — Airservices Australia, Australia Post and Telstra Corporation — that do not have peers in other jurisdictions are reported separately in chapter 7.

[1] The 63 GTEs monitored in this report generated $47.8 billion in total revenue representing 8 per cent of gross domestic product.

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 — was established to oversee the monitoring process, chaired and serviced by the Industry Commission, a predecessor of the Productivity Commission. The Committee — referred to hereafter as 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 first released by the Commission.

In continuing to provide a consistent set of financial performance information, it was the Commission's intention to minimise the burden on GTEs by seeking to use existing sources of financial data. The main source for this study was the Australian Bureau of Statistics' (ABS) Government Finance Statistics (GFS) collection provided by State and Territory Governments.

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. One GTE was added as a consequence and a number were eliminated because they had been privatised.

Each industry chapter includes a summary which draws on the information in the performance reports to make general comments on structural reform, market environment and performance. State and Territory governments were given the opportunity to review the GTE performance reports.

1.2 Data

The data used in calculating the financial performance indicators in this report were taken from three sources:

- *Previous Steering Committee publications* — data collected for these reports was used to generate the performance indicators for 1994-95 to 1996-97.
- *The GFS collection* — data collected by State Treasuries for the ABS was used to generate the performance indicators for 1997-98 and 1998-99 in most cases. The ABS developed a concordance between the definitions used for the GFS collection and those used for previous Steering Committee publications (see attachment B).
- *GTE annual report financial statements* — data was extracted from GTE financial statements for 1997-98 and 1998-99 to supplement the GFS data. In particular, financial statement data was used where accrual GFS data was unavailable or where certain items are not reported separately under the GFS.

The GFS collection provides details of revenues, expenses, cash flows and assets and liabilities of the Australian public sector. The GFS collection is based on international standards set out in the System of National Accounts 1993. Most GTEs adopt Australian Accounting Standard 31 (AAS31) 'Financial Reporting by Governments' in the preparation of their financial statements.

Accounting reports prepared under AAS31 and statistical reports prepared using GFS serve different purposes and are aimed at different sets of users. Consequently, there is a small number of discrepancies between GFS data, financial statement data and the data collected for previous Steering Committee reports.[2]

These discrepancies arise mainly because of the different treatment of certain transactions under the frameworks used to generate the data. The major differences include:

- *Gains and losses on assets* — profit and loss on the sale of assets, realised and unrealised gains and losses on derivative financial instruments, and realised and unrealised gains and losses on securities valued at historic cost are treated as either revenue or expenses under AAS31. These are treated as revaluations under the GFS and as such are excluded from the net operating balance.

2 Most of the financial data collected for previous Steering Committee publications was based on AAS31.

- *Abnormal items* — for the GFS only, abnormal items that represent revenue and expense *transactions* relevant to the period are included in the net operating balance. All abnormal items recorded in the period are included under AAS31.

Further, *distributions to owners* in the form of dividends are regarded as operating expenses for the GFS. Under normal accounting conventions they are not. For the purposes of consistency and in order to derive meaningful indicators, the total expense figures sourced from the GFS were adjusted to exclude both dividends and income tax expense.

These differences become less apparent in the calculation of performance indicator ratios. However, there will be small discrepancies between the financial indicators derived for previous Steering Committee reports and those presented for 1997-98 and 1998-99.

These differences should also be taken into account when making comparisons between the financial indicators presented in this report and those presented elsewhere. However, they are not expected to be significant when considering financial performance at a broad level.

The ABS has only recently moved to collecting GFS data on an accrual basis. Consequently, not all jurisdictions were able to provide the Commission with consistent accrual financial data for 1997-98 and 1998-99. Where accrual GFS data were unavailable for these years, the Commission used data from GTE annual financial statements. This data is generally consistent with that collected for Steering Committee publications.

The move to accrual based GFS also contributed to delays in the Commission receiving the requested data. In the future, these delays are not expected to arise.

Funding for the provision of Community Service Obligations (CSOs) and abnormal revenues and expenses are not explicitly identified under the GFS.[3] Consequently, the Commission relied on GTE annual report financial statements for this information.[4]

3 A CSO 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 to generally undertake, or which it would only do commercially at higher prices (SCNPMGTE 1994).

4 Under the GFS, abnormal revenue and expense items are allocated directly to their substantive transactions and are not separately identifiable.

1.3 Performance indicators

The financial performance indicators in this report are presented under three broad headings — profitability, financial management and financial transactions (see attachment B for how indicators are derived).

Profitability

Profitability indicators provide a clear, 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.[5] Profitability indicators provide governments and the community with a method of evaluating the efficiency with which GTEs are using the assets vested in them.

Profitability is influenced by a number of factors including prices, business volumes and expenses. Other factors largely outside the control of GTEs can affect financial outcomes.

Over the monitoring period, abnormal items contributed to variability in a number of profitability indicators — either through their impact on operating profit, total assets, total liabilities or a combination of these. Abnormal items resulted from asset revaluations, asset transfers, asset sales, financial restructuring and changes to the provision for employee entitlements and liability transfers.[6]

In the presence of abnormal items, it may be difficult to judge whether a GTE has performed satisfactorily during a particular financial year simply because it failed to achieve a specified rate of return.

The profitability indicators used in this report include operating profit, cost recovery, return on assets and return on equity. Each indicator of profitability assists in making assessments about the underlying performance of GTEs.

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5 If a company is listed on the stock exchange, the value of its equity will 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 financial performance.

6 Asset revaluations — both as a result of the adoption of current valuation methods and periodic revaluations — have a significant impact on performance indicators. The benefit of asset revaluations is that they provide a better indication of the current value placed on assets by GTEs, resulting in a value for depreciation expense that is more representative of the capital service flow. However, revaluations make it more difficult to discern trends in underlying performance.

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 and includes abnormals.

Cost recovery — is an indicator of the ability of a GTE to generate adequate revenue to meet expenses. Unlike other measures of profitability it excludes abnormal revenue and expenses. Investment income, receipts from government to cover operating deficits and gross interest expense are also excluded.

A cost recovery ratio of 100 per cent indicates that a GTE is able to meet its operating expenses from its operating revenue, before the cost of servicing debt is taken into account.

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.

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.

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 profitability or an increase in the cost of servicing debt can result in liquidity problems if a GTE's debt structure is not well managed.

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 abnormal revenues, abnormal expenses, changes in asset values and financial restructuring — that have to be taken into account when assessing financial management performance, particularly over time.

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

shareholder governments. The greater the debt to equity ratio, the more geared the GTE. An acceptable level of debt to equity changes with time and varies between industries.

Both these ratios will be affected by changes in asset values arising from asset revaluations, asset transfers or sales. The methodology used in asset valuation varies over time and across GTEs. In addition, some GTEs use different asset valuation methodologies, depending on the type of assets. Consequently, reported asset values may vary significantly between GTEs and for a given GTE over time. This can reduce comparability.

Apart from the value of assets, the debt to equity ratio is also affected by changes in liabilities. 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, by increasing (decreasing) total liabilities, decrease (increase) the value of equity, other things being equal.

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

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, 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). Generally, interest cover of 2 times is considered the lowest acceptable level and the point where interest rate rises will not result in losses.[7] However, interest cover of 3 times is considered to be a more comfortable zone of operation as interest payments will not place strain upon potential profitability.

Interest cover includes abnormal revenues and expenses and can vary significantly over time. The current ratio is less volatile because abnormals are excluded. Consequently, the current ratio is a more stable indicator of liquidity.

7 See Hey-Cunningham 1998.

Financial transactions

In 1995, the Council of Australian Governments (COAG) agreed to a series of reforms designed to improve the performance of GTEs and encourage them to operate on a commercial basis. These reforms encompassed a range of initiatives, including the application of competitive neutrality principles to each of the industries covered in this report.

Competitive neutrality policies are designed to expose GTEs to similar incentives and 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 are intended to make GTEs operate under arrangements similar to those applying to the private sector. Generally, they require GTEs to pay tax on their operating profit at the same company tax rate as private firms.

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 governments for that year because of timing differences.

Where a GTE is not subject to a tax-equivalent regime, it potentially possesses a significant competitive advantage over its competitors. This is because, all else being equal, the GTE can earn the same after-tax commercial rate of return as its competitors at lower prices. Hence, private sector operators, or other GTEs that are subject to tax-equivalent payments, may not be able to compete and potential competitors may be dissuaded from entering the market.

Debt guarantee fees

A debt guarantee fee is a way of ensuring that financial decisions reflect normal commercial circumstances rather than rely on the guarantee by a government. This fee increases the notional cost of capital to a level obtainable by the GTE as a stand-alone entity with no explicit or implicit government guarantee on debt.

In order to fully replicate the disciplines imposed by financial markets, these fees should reflect differences in the costs of intermediation. These differences arise because investors in private businesses sometimes incur higher transaction costs in obtaining information and in monitoring the borrower. These higher transaction costs are reflected in the cost of capital.

The Commission was unable to collect information about debt guarantee fees and actual tax-equivalent payments. However, it is the general policy of governments that GTEs make these payments as part of competitive neutrality undertakings under National Competition Policy agreements.

Dividends

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 firms, which usually return some of their profits to shareholders.

When a GTE is not required to pay dividends, it has proportionately more funds available for re-investment into its business, either for the development of new services or the improvement of existing ones. Further, the GTE need not rely on debt-financing to the extent that its rivals must, and thus incurs lower overall operating costs.

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.

Community service obligations

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

Historically, governments have recognised these benefits through the funding of operating deficits that GTEs often incurred as a result of providing these services. However, with the advent of National Competition Policy agreements, most governments now make specific payments for the provision of certain CSOs such as pensioner concession fares. The CSO payments received by each of the monitored GTEs are recorded within this report.

1.4 Implications of financial reporting for transparency and accountability

A key objective of governments when establishing a national system of performance monitoring was to increase accountability for performance. There are substantial public assets under the control of GTEs that are not exposed to actual factor market disciplines, nor competition in many cases. The requirement for accountability still exists, even though recent reforms have increased the commercial focus of GTEs, exposed some to greater competition and imposed financial market disciplines.

Another key objective of governments was to expose GTEs to yardstick competition — providing a basis for comparison as an incentive for managers to improve performance relative to other GTEs and over time. Despite recent reforms aimed at increasing the level of competition faced by GTEs, some still operate in markets where there is little direct competition. In these circumstances, yardstick competition — facilitated by performance monitoring — can add pressure for improvement.

Performance monitoring will only facilitate accountability through transparency and yardstick competition if the information provided is comparable, consistent and as complete as possible, both across GTEs and over time. Without consistency, transparency is diminished because it becomes harder to distil meaningful conclusions about underlying performance.

There are a number of factors which might diminish consistency and comparability.

Asset values and valuation

Asset values and related expenses impact on almost all the financial indicators presented in this report. Over the monitoring period, there have been significant changes in the asset values of most GTEs as a result of asset transfers, revaluations and changes in asset valuation methodologies.

The majority of monitored GTEs now report in some form of ‘current valuation terms’, although variations in the precise methods adopted remain, thereby diminishing comparability.

Consequently, comparisons of performance over time based on indicators that include an estimate of asset value have to be interpreted with care, where a loss of comparability has occurred through changes to the asset base or asset valuation method.

Governments commonly require customers or developers to provide GTEs with the capital to finance the infrastructure necessary to supply services to new customers. These payments, in cash or kind, are referred to as developer charges or contributed assets. In some sectors (water and electricity), contributed assets can represent a significant proportion of annual revenues and the overall asset base.

In the past, contributed assets were accounted for in a number of ways — as assets and revenues, as contributions by owners (that is, equity injections), as liabilities or deferred revenue, or as a reduction in the cost of assets acquired. This lack of consistency affected comparability of performance monitoring information because the accounting treatment can have a significant effect on the assets and liabilities recognised in the balance sheet as well as the profit and loss statement.

Consequently, the Steering Committee recommended that all contributions be amortised over the life of the asset. The Committee adopted the position that all such contributions represent a financing device and are relevant to the provision of infrastructure services over the lifetime of the asset.

The Steering Committee also took the view that a rate of return should not be earned on contributed assets — customers had met the cost of contributed assets and GTEs are not faced with their expense. Consequently, as GTEs do not incur a liability to service a debt, it should only be necessary to recover operating costs.

Contributed revenue was therefore excluded from total revenue. This tended to understate the return on assets and return on equity ratios because contributed assets were not excluded from the asset base.

Australian Accounting Standards provide little guidance for how GTEs should account for developer or asset contributions. Consequently, the Urgent Issues Group (UIG) of the Australian Accounting Research Foundation (AARF) has issued two abstracts dealing with contributed assets.[8]

Under the AARF abstracts, contributions of assets, or payments to assist in the acquisition of non-current assets, other than contributions by owners are to be recognised as assets and revenues at their fair value when the GTE gains control of these assets. In addition, where there is an obligation to repay part or all of the contribution, either as a part of the conditions of the contribution or because of a

8 The AARF issues UIG Consensus Views as Abstracts to assist in the interpretation of an existing Accounting Standard or guidance in the absence of a standard. Abstract 11, 'Accounting for Contributions of, or Contributions for the Acquisition of, Non-Current Assets', was issued in December 1996. Abstract 17, 'Developer and Customer Contributions in Price Regulated Industries', was issued in May 1998.

breach of the conditions attaching to the contribution, a liability and expense for the amount repayable must be recognised.

Most GTEs are now following UIG Abstracts 11 and 17. With this more consistent treatment of contributed assets, contributed revenue has been included for 1997-98 and 1998-99. Prior to this, however, the revenue was excluded.

Although this change has introduced an inconsistency, the Commission decided to adjust the indicators to be consistent with current accounting practice. This change affects the performance comparisons for individual GTEs over time. However, it has less of an impact on comparisons across GTEs at any point in time.

Use of abnormals

The inclusion of abnormal items in many financial indicators makes it difficult to compare the performance of GTEs over time and across GTEs at a given point in time. For example, some GTEs make profits and earn positive returns in some years because of the inclusion of abnormal items and not because of performance improvements.

That said, abnormal items have generally arisen out of reforms that are expected to eventually lead to improved performance. However, as they are a recognition of poor performance in the past and a necessary cost of improved performance in the future, they were included in this report.

The size and frequency of abnormal items in financial statements can be expected to fall over time as markets are liberalised and the reform process continues. The expected outcome will be a reduction in variation in performance within the GTE sector.

CSO payments

Where GTEs are required to provide CSOs, the cost of provision should be taken into account when assessing the financial performance of a GTE.

As noted earlier, most governments have moved to identifying and costing CSOs. They have adopted policies where most CSOs delivered by GTEs are now identified. In many cases, these services are provided on a competitive basis. For those that are not, consistent costing methods are now applied.

Many CSOs are directly funded through State and Territory budgets. However, alternative financing mechanisms such as cross-subsidies between users, internal funding and acceptance of lower rates of return remain. For example, Western

Power is required to offer uniform tariffs to all but large business customers in rural and metropolitan areas, despite differences in the cost of providing services. The losses incurred in providing uniform tariffs are met internally, although CSO payments are received for providing customer rebates.

There was no explicit reporting of CSO funding by Victorian water GTEs in their 1997-98 and 1998-99 financial statements. One of these GTEs, Barwon Water, has indicated that further work is required to adequately define CSOs and the appropriate level of compensation.

Commonwealth GTEs do not receive any direct CSO funding. In Australia Post's case, for example, the cost of providing a uniform letter service is met through cross-subsidies from within the reserved letter service. Telstra's universal service obligation is funded through a telecommunications industry levy.

These alternative funding mechanisms militate against transparency. In many cases there is no basis for determining whether CSOs have been costed appropriately, or if they have been costed at all. They can also affect the financial performance of GTEs when all costs are not fully recovered, reducing revenues and profitability.

1.5 Effectiveness of financial reforms

An important objective of the GTE reform process has been to replicate financial market disciplines. Doing so creates incentives for sound investment, resource allocation and management decisions generally.

Profitability

Assets must be used to generate profits in order to add value to shareholders' equity (in this case, governments on behalf of the broader community). Profit levels must also be sufficient to generate returns similar to those which could be achieved from alternative investments with a similar level of risk.

Returns earned by a GTE that are too low may have implications for its long-term viability, and expose governments and the broader community to additional risk. An inadequate return on assets also raises doubt about whether resources are being used efficiently or whether prices are providing signals for efficient investment.

If resources cannot generate returns equivalent to the opportunity cost of capital — the returns available from investment elsewhere at similar levels of risk — those resources should be diverted to other uses. Where prices do not reflect costs, including the cost of capital, inappropriate investment may result.

Poor returns also raise issues relating to competitive neutrality. Where GTEs are not earning a commercial rate of return they have the potential to offer lower prices than their private sector counterparts.

Although the volatility in the indicators makes it difficult to examine trends, it is possible to detect a steady improvement in the financial performance of most GTEs over the monitoring period. For example, more are recovering over 100 per cent of their operating costs and more are earning positive returns on assets and equity.

However, there are a number of GTEs that continue to perform poorly. Some GTEs, most notably in the urban transport and rail sectors (see chapters 4 and 5) are not meeting their recurrent costs and are consequently earning very low or negative returns on assets and equity.

The inability of a GTE to meet its recurrent costs raises concerns about its financial viability and exposes the community to additional risk. Under these circumstances a GTE will be unable to meet its commitments from its current earnings, raising questions about the adequacy of existing governance arrangements and pricing (including CSOs where appropriate).

Although some GTEs are earning nominal rates of return above 7 per cent, the majority are not (see table 1.1 and figure 1.1). Currently, the rate of return on 10-year bonds is 6.55 per cent (June 2000). Given the non-diversifiable risk inherent in any business activity, it is reasonable to expect that GTEs should be generating returns above this rate for their shareholder governments on behalf of the community.[9]

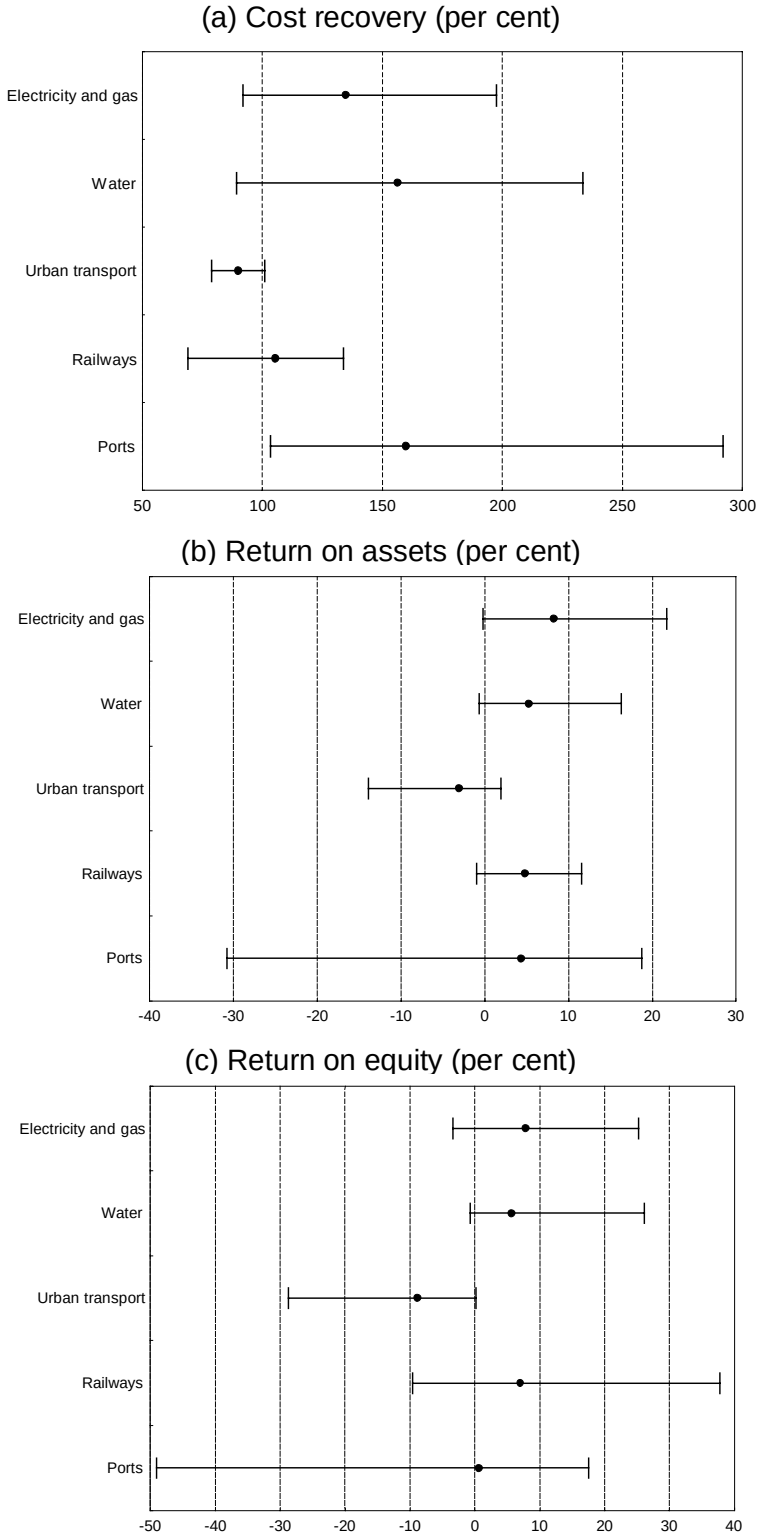
Table 1.1 **Selected profitability measures across industries, 1998-99 (per cent)**

Industry	*Cost recovery*		*Return on assets*		*Return on equity*	
Electricity and gas	134.9	(7.1)	8.3	(1.2)	7.9	(1.6)
Water drainage, sewerage and irrigation	156.5	(9.5)	5.3	(1.2)	5.6	(2.1)
Urban transport	90.1	(4.1)	-3.1	(3.2)	-8.8	(5.9)
Railways	105.5	(10.6)	4.8	(2.0)	7.0	(7.2)
Ports	159.8	(11.8)	4.4	(3.3)	0.6[a]	(4.1)

Note Indicators are industry-wide means. Standard errors are shown in brackets. [a] The low return on equity arises because both Port Kembla Corporation and Gladstone Port Authority made significant operating losses as a result of abnormals associated with the downward revaluation of their asset base in 1998-99.

9 Non-diversifiable risk is the systematic or 'market risk' which cannot be diversified.

Figure 1.1 **Selected profitability measures across industries, 1998-99 (per cent)**



Note The dot represents the mean value and the 'whiskers' represent the range of values for a given performance indicator by industry. For example, in 1998-99 the minimum cost recovery ratio achieved in the electricity and gas industry was 92 per cent , while the maximum value was 198 per cent. The mean cost recovery ratio for the industry was 135 per cent.

GTE performance for 1997-98 and 1998-99 is significantly correlated at the industry level. The degree of correlation differed across indicators. Cost recovery, which is unaffected by abnormals, had the highest level of correlation across all industries.

This suggests that performance was consistent between 1997-98 and 1998-99. The 1998-99 results are not unduly influenced by factors such as abnormals that may arise in a particular year and not in others.

There are a number of reasons why GTEs might not generate commercial returns — earnings volatility, costs may be too high, assets may be overvalued, CSO payments may be inadequate or some combination of these.

Earnings will vary from year to year as a consequence of changes in the market environment and this will contribute to volatility in the returns GTEs earn. That said, GTEs like any other business should be aware of the dynamics of their market environment and aim to maximise their risk adjusted return to shareholders within that environment.

Inappropriate asset valuation has implications for the ability of GTEs to earn commercial returns. Assets should be valued to reflect current market conditions. If assets are overvalued, GTEs will not appear to earn sufficient returns. Further, inappropriate asset valuation has implications for the efficiency of prices.

Payments for CSOs might be insufficient to meet the cost of provision. To the extent that GTEs do not receive an adequate financial return on the assets used in delivering CSOs, they will not meet the cost of their capital.

Financial management

Replicating financial market disciplines provides incentives for GTEs to make better use of debt and equity financing. Debt levels for many GTEs have fallen over the monitoring period, suggesting that some GTEs may have relied too heavily on low cost government guaranteed debt financing in the past. Alternatively, low debt levels might suggest insufficient investment in capital stock. Debt levels could have fallen for a number of reasons, including debt for equity swaps, debt repayment and debt restructuring.

Many of the monitored GTEs have an interest cover of less than 3 times. Under some circumstances, they could have to meet financial commitments from sources of funds other than earnings from operations, such as injections of equity capital.

Across industry sectors there is significant variation in the financial management performance indicators presented in this report (see table1.2 and figure 1.2). The large spread in these indicators might suggest that the financial restructuring of GTEs is incomplete. It also has implications for the effectiveness of measures aimed at replicating financial market disciplines. To the extent that this is the case, there may be scope for further restructuring of balance sheets.

Table 1.2 **Selected financial management performance measures across industries, 1998-99**

Industry	*Debt to equity*		*Current ratio*		*Interest cover*	
	per cent		per cent		times	
Electricity and gas	68.5	(12.8)	115.2	(16.9)	4.4	(0.8)
Water drainage, sewerage and irrigation	41.2	(10.7)	105.9	(43.5)	4.0	(0.8)
Urban transport	39.8	(2.5)	45.4	(13.8)	-1.1	(1.2)
Railways	183.0	(100.8)	84.8	(19.6)	1.3	(0.4)
Ports	44.9	(7.7)	145.2	(25.0)	-4.9	(7.2)

Note Indicators are industry-wide means. Standard errors are shown in brackets.

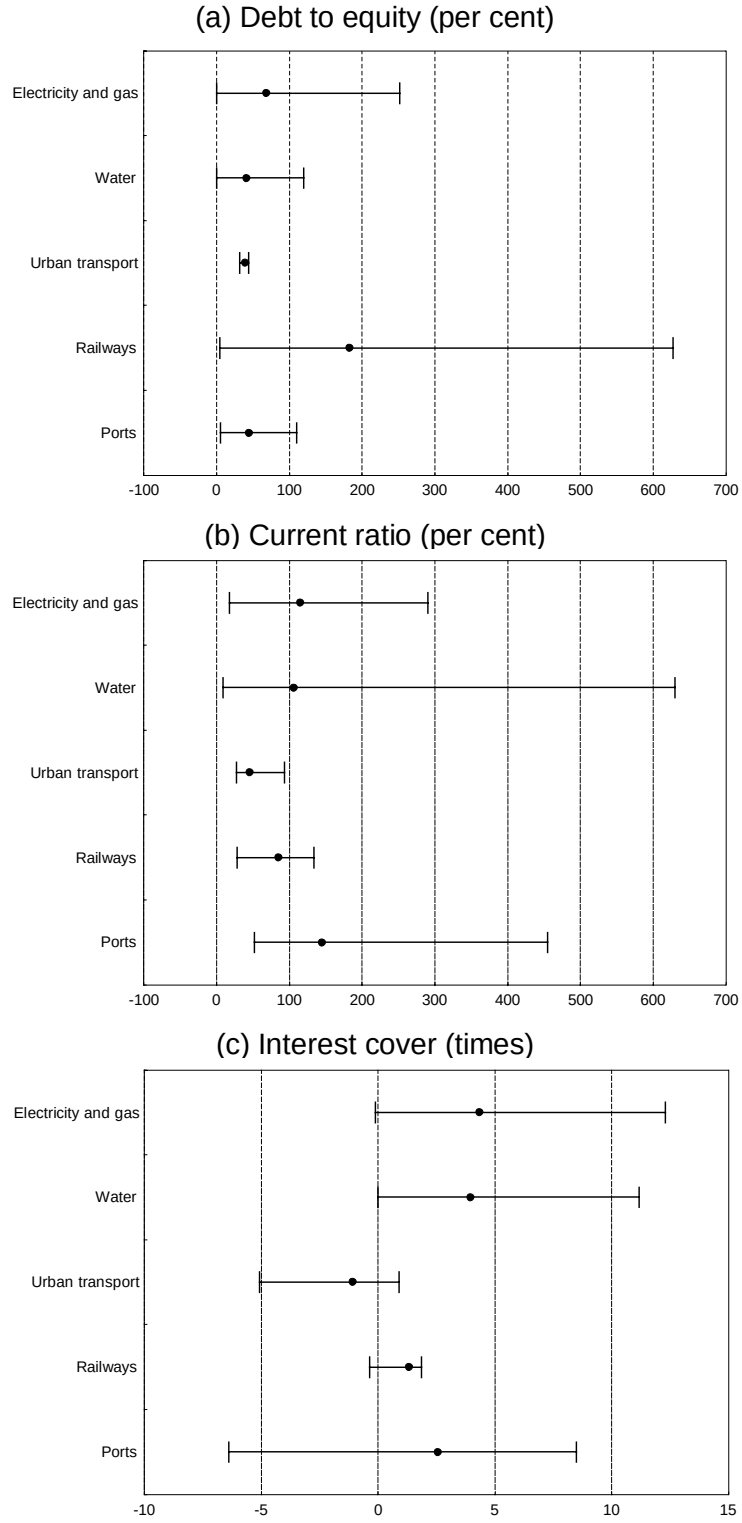
Overall

Care must be taken not to generalise to individual GTEs. However, if there continues to be ongoing under-performance after many years of reform, there may be systemic problems with the implementation of government reform policies, GTE governance or both.

Where financial performance and management is proven to be unsatisfactory within particular GTEs after detailed examination, there is a need to review operating costs, prices, CSO payments (where appropriate), asset values and the structure of the balance sheet.

More generally, where unsatisfactory performance is an industry phenomenon, there may be a case for reviewing governance arrangements in some industries, given their poor performance and the length of time that reforms have been in place.

Figure 1.2 **Selected financial management performance measures across industries, 1998-99**



a The dot represents the mean value and the 'whiskers' represent the range of values for a given performance indicator by industry. For example, in 1998-99 the minimum debt to equity ratio achieved in the electricity and gas industry was zero, while the maximum value was 251 per cent. The mean debt to equity ratio for the industry was 69 per cent.

2 Electricity and gas

The financial performance of 22 electricity and one gas Government Trading Enterprise (GTE) are covered in this chapter.[1] The GTEs vary significantly in their size and the range of generation, transmission, distribution and retail services they provide. In 1998-99, the electricity and gas GTEs monitored in this report generated almost $15 billion in revenue and controlled assets valued at almost $37.5 billion.

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 1.

2.1 Sector reforms

Governments have introduced reforms aimed at improving the efficiency and financial performance of electricity and gas GTEs. Information on the nature of these reforms provides an important context to changes in financial performance over time.

Sector reforms also have implications for the consistency of performance measures over time as they influence the operating environment and the way that GTEs undertake their business.

The Australian electricity supply industry has undergone significant reform during the 1990s. Historically, the industry developed on a State-by-State basis with a government owned vertically integrated utility dominating each jurisdiction with limited scope for competition. In most jurisdictions covered by this report generation and distribution have now been separated from transmission activities (see table 2.1).

The major driver for structural reform in the electricity industry has been a series of inter-governmental agreements, culminating in the National Competition Policy

1 This chapter does not cover former GTEs which have been privatised. Nor does it provide any information on Power and Water Authority (Northern Territory) as detailed disaggregated information on its electricity and water businesses was unavailable.

(NCP) agreements, aimed at establishing a competitive national electricity market.[2] The intention behind structural change within the electricity supply industry has been to introduce competition in the generation and retail sectors by separating these contestable elements from the natural monopoly elements of transmission and distribution.[3] Of the jurisdictions monitored in the report, only Western Australia is not party to the NCP agreements on electricity.

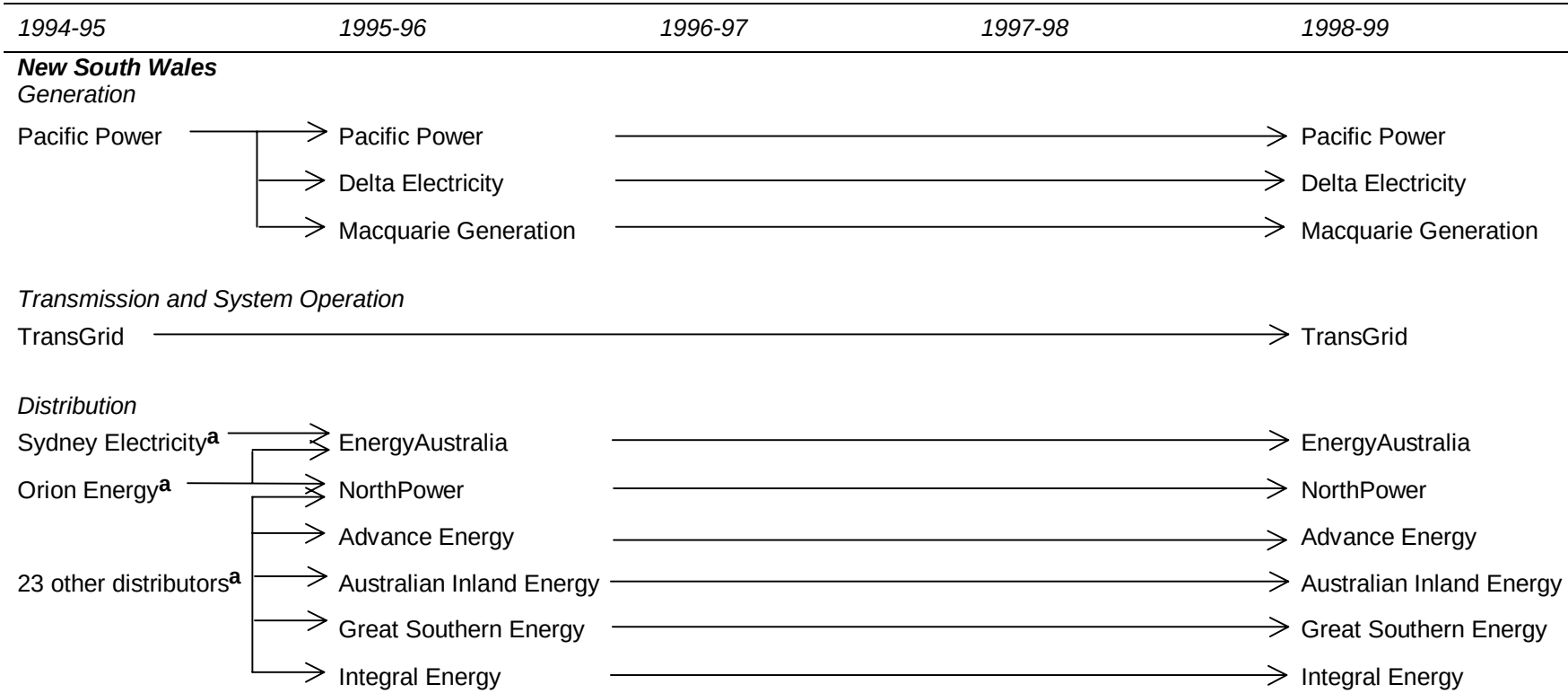
As part of the reform of the NSW electricity industry, Pacific Power was restructured into a transmission network and three generators. On 1 February 1995, its transmission activities were transferred to TransGrid and six of Pacific Power's power stations were transferred to two new generators — Delta Electricity and Macquarie Generation. In October 1995, the existing 25 electricity distributors were amalgamated to form six new distribution businesses with each responsible for the distribution of electricity within a franchise area.

In Queensland, AUSTA Electric was horizontally separated into three competing government owned 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.

2 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 the 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.

3 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.

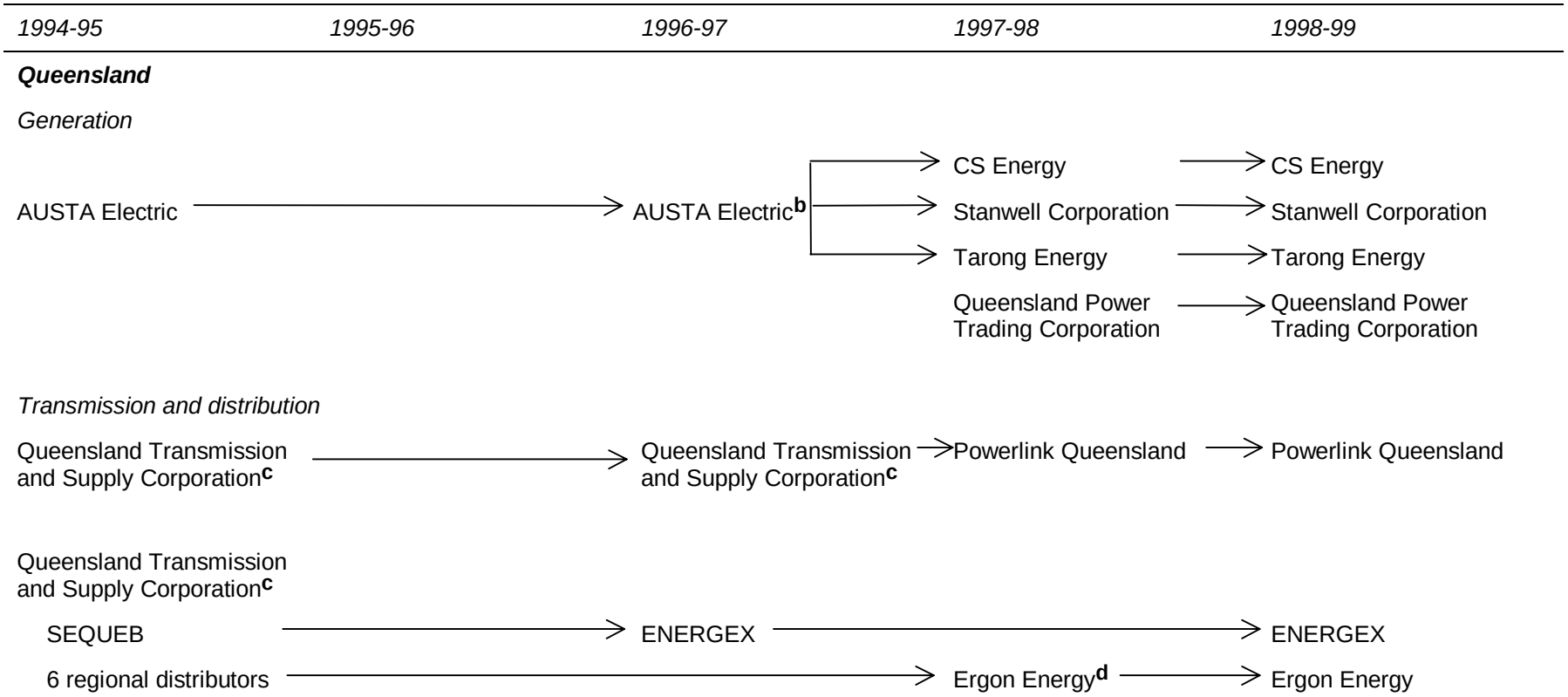
Table 2.1 **Monitored electricity and gas GTEs, 1994-95 to 1998-99**



[a] In March 1996, 25 distributors were amalgamated to form six State owned corporations.

(Continued next page)

Table 2.1 (continued) **Monitored electricity and gas GTEs, 1994-95 to 1998-99**



b 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. **c** 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, one of which was SEQEB and Powerlink Queensland, which manages Queensland's high voltage transmission system. On 1 July 1997, QTSC's subsidiaries were established as independent government owned corporations. **d** Ergon Energy Corporation was formed following the amalgamation of the six regional distributors.

(Continued next page)

Table 2.1 (continued) **Monitored electricity and gas GTEs, 1994-95 to 1998-99**

1994-95	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Western Australia				
Western Power	→	→	→	Western Power
AlintaGas	→	→	AlintaGas[f] →	AlintaGas
Tasmania				
Hydro-Electric Corporation	→	→	Hydro-Electric Corporation[g] →	Hydro-Electric Corporation
				Transend Networks
				Aurora Energy
Commonwealth				
Snowy Mountains Hydro-Electric Authority	→	→	→	Snowy Mountains Hydro-Electric Authority

e The State Energy Commission of Western Australia was restructured in 1994-5 to form separate electricity (Western Power) and gas (AlintaGas) businesses. **f** AlintaGas ceased responsibility for gas transmission with the sale of the Dampier to Bunbury Natural Gas Pipeline in March 1998. **g** On 1 July 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.

Three new retail corporations were established and two of these merged to form Ergon Energy. Ergon Energy was owned by six of the regional distribution corporations. Ergon Energy is now a wholly-owned subsidiary of the Ergon Energy Corporation following the amalgamation of the six regional distributors on 30 June 1999.

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 gained permanent status as Queensland's fourth generator in June 1999.

In Western Australia, the State Energy Commission of Western Australia (SECWA) was restructured in 1994-95 into separate electricity (Western Power) and gas (AlintaGas) businesses. In Tasmania, the Hydro-Electric Corporation (HEC) was restructured into three businesses on 1 July 1998. The HEC retained responsibility for generation, the transmission network was transferred to Transend Networks and the retailing and distribution functions were transferred to Aurora Energy.

Reform of Australia's gas industry was also initially driven by a series of inter-governmental agreements and more recently by government commitments arising from the NCP agreements. Reform of the gas industry was aimed at removing impediments to free and fair trade in natural gas. This involved introducing a uniform framework for access to gas transmission pipelines, reform of gas franchise arrangements and structural separation or 'ring fencing' of vertically integrated transmission and distribution activities.[4]

In Western Australia, AlintaGas became responsible for both the transmission and distribution of gas following the restructure of SECWA. With the sale of the Dampier to Bunbury Natural Gas Pipeline (DBNGP) in March 1998, AlintaGas is no longer involved in the gas transmission market.

2.2 Market environment

The market environment that GTEs operate in also has an impact on their performance. One of the most significant changes to the market environment of electricity GTEs over the monitoring period has been the continued development of the National Electricity Market (NEM).

4 'Ring fencing' involves splitting financial and administrative business units within a single entity.

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, South Australia and the Australian Capital Territory. Queensland GTEs are not yet physically connected to the NEM but operate within a wholesale market under the same principles. An interconnector between Queensland and NSW is currently being constructed. There are also proposals to build another link between NSW and South Australia and an underwater link between Tasmania and Victoria.

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 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, jurisdictions have also progressively introduced choice of electricity supplier starting with the largest users of electricity. The proportion of contestable customers is scheduled to increase over the coming years as retail franchises expire. This has increased the scope for greater competition within the retail electricity market.

The development of the NEM has a number of implications for the environment in which electricity GTEs operate. 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 third parties a right of access to the services of these networks to facilitate their entry into the market.

With the introduction of the NEM and its market rules, electricity GTEs have had to come to terms with operating in a new environment. It takes time to develop the level of understanding and experience necessary to operate effectively in this new environment. Generator inexperience in bidding and contracting strategies and an over capacity of supply (in NSW and Victoria) have contributed to significant volatility in wholesale electricity prices in the initial stages of the NEM.

Volatility in wholesale electricity prices has also 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. Electricity futures contracts based on wholesale market prices in

the NSW and Victorian regions of the NEM are traded on the Sydney Futures Exchange.

Although Western Australia is not party to the NEM it has, under its commitments to the NCP, introduced choice in electricity supplier for large users of electricity. In addition, the *Electricity Corporation Act 1994* provides for third party access to Western Power's electricity transmission network. As a consequence, Western Power now faces the prospect of greater competition than it has in the past.

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

In Queensland, pricing policy for contestable customers is set by shareholding Ministers. The Director General of Mines and Energy, the Queensland Electricity Reform Unit and the Minister for Mines and Energy are involved in regulating the prices charged for use of the transmission network. In Tasmania, an independent electricity regulator is responsible for regulating electricity prices.

2.3 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 1.

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

All the electricity and gas GTEs monitored use current valuation methods to value their assets, although the actual method used varies between GTEs. Asset values have fallen over the monitoring period for some GTEs following asset write-downs. Great Southern Energy (NSW) for example, has written-down some assets each year since 1995-96. In other cases, asset revaluations have resulted in an increase in the value of assets. For example, North Power (NSW) revalued its network assets upwards in both 1997-98 and 1998-99.

Pacific Power's and the Hydro-Electric Corporation's asset values fell significantly in 1995-96 and 1998-99, respectively — following the transfer of assets to newly formed GTEs as part of an industry restructure. The value of AlintaGas's assets fell following the sale of the DBNGP.

The treatment of contributed assets can also have a material effect on financial performance and asset and liability recognition (see chapter 1). Where contributed assets are an issue most GTEs indicate that they are now following Urgent Issue Group (UIG) 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.[5]

The Productivity Commission's treatment of contributed assets has changed over the monitoring period (see chapter 1). Therefore, it should be noted that the impact of these assets on profitability ratios such as return on assets has changed after 1997-98.

Operating profit before tax (including abnormals) has been variable over the monitoring period. This variability not only reflects the influence of abnormals but the impact of the continuing development of the NEM as GTEs come to terms with operating in a new market environment.

Most of the monitored electricity and gas GTEs have made operating profits over the monitoring period. However, some incurred operating losses in their first year of operation. Pacific Power's operating profit has deteriorated over the monitoring period and in 1998-99 they incurred a loss for the first time.

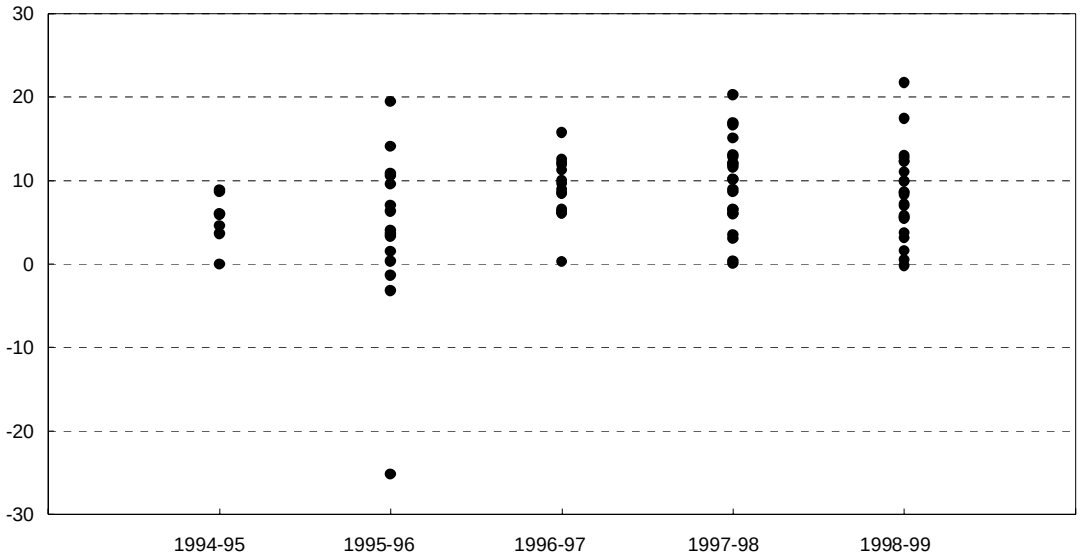
The Snowy Mountains Hydro-Electric Authority (SMHEA) has made an operating loss in each year of the monitoring period. This largely reflects the way the Authority is funded and the impact of an asset revaluation in 1991. The SMHEA only receives funding to meet annual depreciation charges and not the additional depreciation expense resulting from the asset revaluation.

The return on assets earned by monitored electricity and gas GTEs has been variable across the monitoring period. This not only reflects variability in operating profit, but also the impact of changes in asset values. For example, the upward revaluation of North Power's network assets in 1998-99 combined with a decrease in operating profit resulted in a significant fall in the return on assets ratio.

5 The Australian Accounting Research Foundation issues UIG Consensus Views as Abstracts to assist in the interpretation of an existing Accounting Standard or guidance in the absence of one.

Most of the monitored electricity and gas GTEs earned a return of between 3 and 10 per cent on assets during the 1998-99 financial year (see figure 2.1). A number of GTEs including Transgrid, Western Power and AlintaGas have maintained fairly constant rates of return over the monitoring period. For others like Pacific Power the return on assets has consistently fallen, reflecting the continued deterioration in profitability.

Figure 2.1 **Return on assets, 1994-95 to 1998-99 (per cent)**



Note Each data point represents the return on assets ratio for a GTE 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 (including abnormals) and adding back gross interest expense. Average total assets are defined as the service potential or future economic benefits, controlled by the entity as a result of past transactions or other events (measured as the average of the value of assets at the beginning and end of the reporting period).

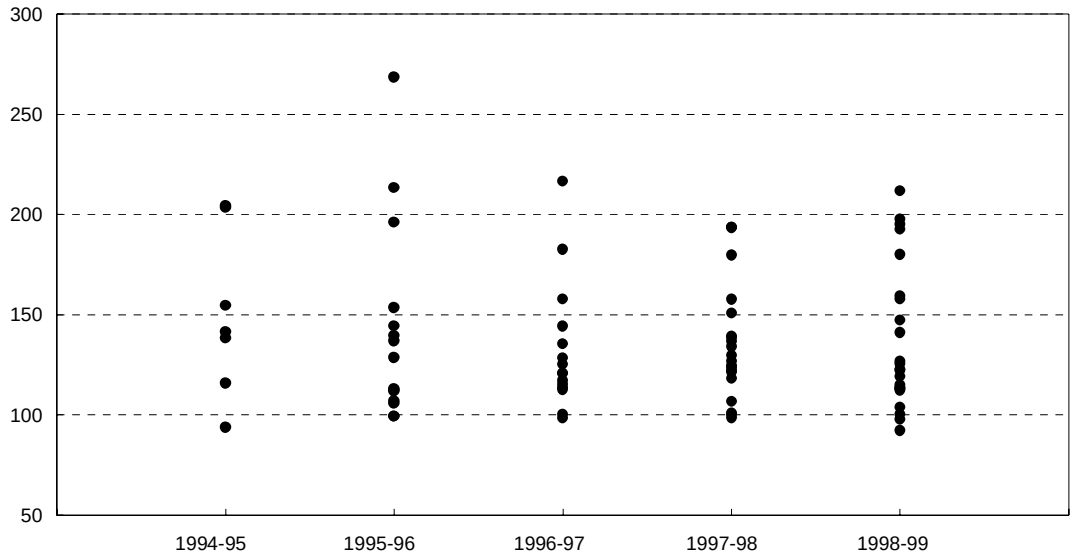
The variability in profitability is also reflected in the return on equity ratio. Most of the monitored electricity and gas GTEs have had unstable return on equity ratios over the monitoring period. In 1998-99, more than half were below 7 per cent. Two had return on equity ratios of over 20 per cent.

Estimates of the weighted average cost of capital for gas and electricity providers, by IPART, the NSW Treasury, the ACCC and others (see IPART 1998), would suggest that a nominal post tax return of 7 per cent would be sufficient to meet the risk-adjusted cost of capital.

The cost recovery ratio 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.

Over the monitoring period, most electricity and gas GTEs have recovered between 100 and 150 per cent of operating costs (see figure 2.2). The SMHEA has generated a cost recovery ratio of just under 100 per cent in each year of the monitoring period, in 1998-99 falling to 92 per cent in 1998-99. Pacific Power's cost recovery ratio fell below 100 per cent for the first time in 1998-99.

Figure 2.2 **Cost recovery, 1994-95 to 1998-99 (per cent)**



Note Each data point represents the cost recovery ratio for a GTE in that financial year. Cost recovery is the ratio of revenue from operations to expenses from operations. Revenue from operations is calculated by subtracting abnormal revenue, investment income and receipts from governments to cover deficits on operations from total revenue. Expenses from operations are calculated by subtracting abnormal expenses and gross interest expense from total expenses.

Over the monitoring period, profitability as measured by operating profit before tax (including abnormals), return on assets, return on equity and cost recovery has been variable for the monitored electricity and gas GTEs. This variability reflects the impact of abnormals largely arising from continued reform, and the fact that most of these GTEs are still coming to terms with operating in a new market environment and increasing competition with the continued development of the NEM.

2.4 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 1.

As a part of the reform process, governments typically imposed financial restructuring on their electricity GTEs. This has involved the transfer of both assets and liabilities to State governments, and the withdrawal of equity. Financial restructuring is often justified on the grounds of establishing more appropriate capital structures for GTEs following the reform process.

Financial restructuring makes it difficult to undertake comparisons of financial performance over time. In Queensland, for example, 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, the capital restructure was completed with a corresponding reduction in share capital and hence equity. This resulted in an increase in the debt to equity, debt to total assets and total liabilities to equity ratios in 1998-99.

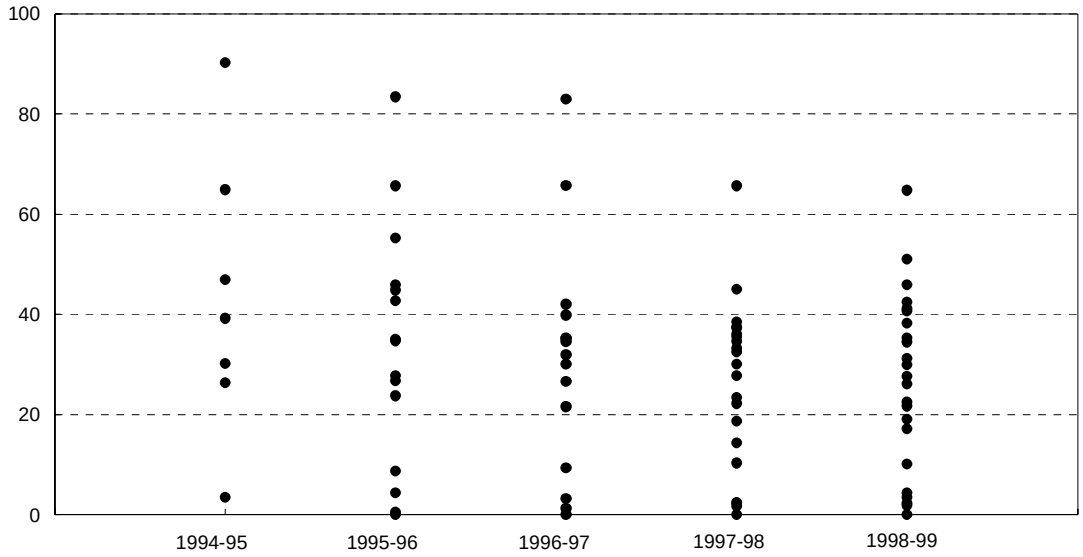
The level of debt carried by most electricity GTEs has fallen or remained relatively constant over the monitoring period. A number of electricity GTEs have reduced their debt levels through financial restructuring which has allowed them to reduce repayment periods and to negotiate improved interest terms. Debt levels have also fallen following the transfer of assets and liabilities to new entities as part of industry restructuring.

AlintaGas used some of the proceeds ($1 024 million) from the sale of the DBNGP to retire debt. This resulted in an 84 per cent reduction in debt levels between 1994-95 and 1998-99 and a significant reduction to interest expense. In 1995-96, interest expense accounted for 31 per cent of total expenses, by 1998-99 this had fallen to 4.6 per cent.

In some cases, debt levels have increased over the monitoring period as the result of financial restructuring by shareholder governments. For example, Energex was directed to make interest free loans (valued at $300 million) as part of a capital restructure to the Queensland Government in 1997-98. These were financed through an increase in long term debt held by Energex.

Falling debt levels have resulted in lower debt to total asset and debt to equity ratios for a number of GTEs. Some electricity GTEs hold low levels of debt and this is reflected in relatively low ratios. Most of the monitored electricity and gas GTEs have debt to total asset ratios within 20 and 50 per cent (see figure 2.3). This indicates that, in most cases, at least 50 per cent of assets have been acquired using equity finance.

Figure 2.3 **Debt to total assets, 1994-95 to 1998-99 (per cent)**



Note Each data point represents the debt to total assets ratio for a GTE in that financial year. Debt is defined to include all repayable borrowings (interest bearing and non-interest bearing), interest bearing non-repayable borrowing and finance leases. Total assets are defined as the service potential or future economic benefits, controlled by the entity as a result of past transactions or other events (measured as the average of the value of assets at the beginning and end of the reporting period).

In 1998-99, more than half of the monitored electricity and gas GTEs had an interest cover of over 3 times suggesting that they are comfortably able to meet periodic interest payments. Some GTEs, such AlintaGas, have significantly improved their interest cover over the period by retiring and restructuring some of their debt holdings.

2.5 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 1.

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 and gas GTEs. Governments have also moved towards clearly defining, costing and explicitly financing Community Service Obligations (CSOs).

Over the monitoring period, an increasing number of electricity and gas GTEs have been required to make tax-equivalent and dividend payments. Most now make such

payments. The exception is the SMHEA which operates on a cost recovery basis and is not required to make dividend or tax payments.

Typically, electricity and gas GTEs incur tax-equivalent expense at a rate of 36 per cent of operating profit. The adoption of tax-effect accounting means that the income tax-equivalent expense for any year differs from the actual amount of tax paid to State governments for that year because of timing differences.[6]

Dividend payments represent a return on shareholder funds and their size reflects financial performance. There has been significant variation in the level of dividend paid or provided for by GTEs over the monitoring period, reflecting annual variations in profitability.

In most cases, dividend targets are agreed to by the GTEs and their shareholding Ministers. For example, NSW electricity corporations operating under the *Energy Services Corporations Act 1995*, are required to determine a share dividend scheme in consultation with their voting shareholders. Annual dividends are declared in accordance with this scheme. In contrast, the Hydro-Electric Corporation (Tasmania) is required to recommend a dividend which meets a primary benchmark of at least 50 per cent of after tax profit and a secondary benchmark of a dividend and tax-equivalent payment of at least 70 per cent.

A number of GTEs have also been required to make special dividend payments which are unrelated to the current year's performance. Pacific Power, for example, made a dividend payment in 1998-99 despite making a loss. This special dividend arose out of an agreement with the NSW Government where Pacific Power receives a fee to offset any costs associated with managing transitional issues related to the restructure of the generation sector. Pacific Power is required to make a dividend payment equivalent to this fee.

AlintaGas also made a significant special dividend payment ($1.2 billion) in 1997-98 following the sale of the DBNGP.

As part of the reform process, governments have also moved to identify, cost and fund CSOs provided by electricity GTEs. Several of the electricity GTEs received CSO funding over the monitoring period. Generally, retailers meet these obligations although there are some examples of CSOs being placed on generators. CSO funding has been received for the provision of rebates, concessions, the uneconomic supply of electricity to some customers and electrical inspections.

6 Timing differences may arise because of the different depreciation schedules adopted by the GTE and the tax office, for example.

The total level of CSO payments to electricity GTEs has increased over the monitoring period, in part, reflecting an increase in the funding received and the increasing number of GTEs receiving CSO funding.

2.6 GTE performance reports

Delta Electricity (NSW)
Macquarie Generation (NSW)
Pacific Power (NSW)
TransGrid (NSW)
Advance Energy (NSW)
Australian Inland Energy (NSW)
EnergyAustralia (NSW)
Great Southern Energy (NSW)
Integral Energy (NSW)
NorthPower (NSW)
CS Energy (QLD)
Stanwell Corporation (QLD)
Tarong Energy (QLD)
Queensland Power Trading Corporation (QLD)
Powerlink (QLD)
Ergon Energy (QLD)
Energex (QLD)
Western Power (WA)
Hydro-Electric Corporation (Tas)
Aurora Energy (Tas)
Transend Networks (Tas)
Snowy Mountains Hydro-Electric Authority (C'wealth)
AlintaGas (WA)

DELTA ELECTRICITY — New South Wales

Following a restructure of the NSW electricity industry, Delta Electricity commenced operations as a generator in March 1996. Delta Electricity operates under the *Energy Services Corporations Act 1995* and the *State Owned Corporations Act 1989*.

Delta Electricity operates mainly in the wholesale electricity market selling to energy retailers and a few large industrial customers. Delta operates four power stations with a combined generating capacity of 4 240 MW.

Delta Electricity's operating profit, return on assets and return on equity have all steadily increased between 1995-96 and 1998-99.[1] The sharp increase in these indicators for 1996-97 reflects the impact of additional revenue generated through a number of lease transactions relating to the Mt Piper Power Station — brought to account as abnormal revenue.[2]

Delta Electricity's debt to equity, debt to total asset and leverage ratios have fallen consistently over the period reflecting a decreasing reliance on debt. At the same time, Delta Electricity have maintained their interest cover.

Delta Electricity is required to make tax-equivalent and dividend payments. Under the *Energy Services Corporations Act 1995*, Delta's voting shareholders are required to determine a share dividend scheme in consultation with the board of directors. Dividends are declared in accordance with this scheme. Since 1995-96, Delta Electricity has distributed $248.6 million to the NSW Government in dividend payments.

In 1997-98, Delta Electricity received $5.4 million in Community Service Obligation (CSO) income from the NSW Government for subsidised sales contracts assigned to Delta on its establishment. Delta has received no other CSO income over the monitoring period.

1 Delta Electricity commenced operations in March 1996. Hence, the data for the 1995-96 financial year relates only to operations between March and June 1996.

2 Delta Electricity entered into 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 (via various overseas parties) back to Delta. The effect of these arrangements is that Delta Electricity retains legal title to, beneficial ownership of and continues to operate the power station. Delta is prevented from mortgaging or allowing any other lien to exist over the facility. The net income from these transactions was recognised as abnormal revenue.

DELTA ELECTRICITY (continued)

Table 2.1 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*[b]	*1997-98*	*1998-99*[c]
Size						
Total assets	$M	n.r.	1 481	1 495	1 337	1 361
Total revenue	$M	n.r.	220	701	573	574
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	29 339	131 232	54 636	60 684
Operating sales margin	%	n.r.	22.1	25.3	15.3	16.0
Cost recovery	%	n.r.	128.4	100.0	118.1	119.0
Return on assets	%	n.r.	3.3	12.5	6.5	6.9
Return on equity	%	n.r.	2.8	3.1	4.5	5.3
Financial management						
Debt to equity	%	n.r.	98.2	73.4	58.8	57.8
Debt to total assets	%	n.r.	44.8	35.1	30.0	31.2
Total liabilities to equity	%	n.r.	119.2	110.2	85.2	87.0
Interest cover	times	n.r.	2.5	3.4	2.5	2.9
Current ratio	%	n.r.	279.3	81.5	117.5	89.5
Leverage ratio	%	n.r.	219.2	210.2	185.2	187.0
Payments to and from government						
Dividends	$'000	n.r.	14 376	180 150	21 402	32 695
Dividend to equity ratio	%	n.r.	2.1	26.0	3.0	4.5
Dividend payout ratio	%	n.r.	76.6	849.6	67.1	85.0
Income tax expense	$'000	n.r.	10 562	110 029	22 733	22 218
CSO funding	$'000	n.r.	0	0	5 400	0

a Delta Electricity commenced operations as an electricity generator in March 1996. Hence, the data for the 1995-96 financial year relates only to operations between March and June 1996. In December 1995, the NSW wholesale electricity market commenced operating. **b** A number of the ratios for 1996-97 financial year 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. In May 1997, trading between the NSW and Victorian pools was introduced as the first stage of the National Electricity Market (NEM). **c** The NEM officially commenced operating in December 1998. **n.r.** Not relevant.

MACQUARIE GENERATION — New South Wales

Macquarie Generation was established as a State owned corporation in March 1996 following a restructure of the NSW electricity industry. Macquarie operates two coal-fired power stations and generates electricity for sale into the National Electricity Market (NEM). The power stations have a combined generating capacity of 4 640 MW.

1996-97 was Macquarie Generation's first full year of operation. The phased introduction of contestability in the NSW retail market and the progression of the NEM to allow trading between the NSW and Victorian wholesale pools contributed to lower wholesale electricity prices after 1997.[1] Falling wholesale prices contributed to reduced total revenue and operating profit in 1997-98. Despite this, Macquarie was able to maintain a cost recovery ratio of over 100 per cent.

With limited scope to reduce fuel costs because of the nature of their take or pay contracts for coal, Macquarie Generation withdrew two of its eight generating units from production at the beginning of 1998-99. This, in addition to lower maintenance costs and higher average pool prices, resulted in increased operating profit.

Debt restructuring has also allowed Macquarie Generation to reduce its debt levels and the cost of financing that debt. Consequently, there has been a steady decrease in the debt to equity and leverage ratios.

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 in consultation with the board of directors.

The NSW Government provides Macquarie Generation with funding for the provision of Community Service Obligations (CSOs). Macquarie Generation is reimbursed for the full cost of providing rebates and subsidies to certain customers in line with NSW Government policy decisions. In 1997-98, there was a significant increase in CSO funding.

1 As a part of the development of the NEM, retail competition has been introduced in stages. The first stage involved giving choice of retail supplier to only the largest consumers of electricity (from October 1996).

MACQUARIE GENERATION (continued)

Table 2.2 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*[b]	*1997-98*	*1998-99*[c]
Size						
Total assets	$M	n.r.	2 518	2 260	2 199	2 138
Total revenue	$M	n.r.	311	866	696	719
Profitability						
Operating profit before tax, (includes abnormals)	$'000	n.r.	50 550	173 817	53 518	70 141
Operating sales margin	%	n.r.	28.9	30.9	19.2	21.3
Cost recovery	%	n.r.	139.5	144.2	123.3	126.5
Return on assets	%	n.r.	3.6	11.3	6.0	7.1
Return on equity	%	n.r.	3.5	12.0	3.7	4.7
Financial management						
Debt to equity	%	n.r.	149.5	108.4	107.3	98.6
Debt to total assets	%	n.r.	55.2	42.0	45.0	42.4
Total liabilities to equity	%	n.r.	171.1	144.4	135.3	129.6
Interest cover	times	n.r.	2.2	2.8	1.7	1.8
Current ratio	%	n.r.	100.9	43.8	73.4	42.1
Leverage ratio	%	n.r.	271.1	244.4	235.3	229.6
Payments to and from government						
Dividends	$'000	n.r.	24 770	125 000	35 000	40 000
Dividend to equity ratio	%	n.r.	2.7	13.5	3.8	4.3
Dividend payout ratio	%	n.r.	76.6	112.4	100.9	91.6
Income tax expense	$'000	n.r.	18 198	62 591	18 840	26 468
CSO funding	$'000	n.r.	2 447	2 891	20 336	18 153

a Macquarie Generation commenced operations on 1 March 1996. Data relates only to the four months to June 1996. **b** In May 1997, trading between the NSW and Victorian wholesale electricity pools was introduced as the first stage of the National Electricity Market (NEM). **c** The NEM officially commenced operating in December 1998. **n.r.** Not relevant.

PACIFIC POWER — New South Wales

Pacific Power's primary business is generating electricity for sale into the National Electricity Market (NEM). It is made up of four interrelated businesses — a domestic and international coal business, a thermal power station, an engineering services business and a business developing alternative sources of energy.

In moving towards the NEM, the NSW Government established a wholesale electricity market for the State. As part of this process, Pacific Power's transmission network was transferred to the newly formed TransGrid in 1994-95. In 1995-96, six power stations were transferred to Delta Electricity and Macquarie Generation.

The fall in profitability for 1996-97 would have been more significant if not for abnormal revenue of $399.3 million associated with the assumption by the Crown of accrued employee entitlements. The jump in the debt to equity ratio in 1996-97 reflects the replacement of debt issues through the NSW Treasury Corp and all remaining interest swaps with new debt instruments at market interest rates. This resulted in an increase in Pacific Power's opening debt levels of $99 million.

The introduction of competition through the NSW wholesale electricity market and the NEM has had a significant impact on Pacific Power's financial performance. Difficult market conditions characterised by excess generating capacity in NSW and an inflow of relatively cheaper electricity from Victorian generators, contributed to deteriorating financial performance in 1997-98 and 1998-99.

The return on assets and return on equity ratios have fallen significantly since 1996-97. The return on equity ratio was negative in 1998-99, reflecting the operating loss made in that financial year. In addition, the cost recovery ratio is now below 100 per cent which suggests that Pacific Power is unable to meet operating expenses from operating revenue.[1]

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, where Pacific Power receives a fee to offset any costs associated with managing transitional issues related to the restructure of generation in 1996. Under the agreement Pacific Power was required to make a special dividend payment equivalent to this fee.

1 Operating expenses excludes abnormal and gross interest expenses. Operating revenue excludes abnormal revenue, investment income and payments from government to cover operating deficits.

PACIFIC POWER (continued)

Table 2.3 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*[b]	*1997-98*	*1998-99*[c]
Size						
Total assets	$M	8 111	2 609	2 139	2 148	2 125
Total revenue	$M	3 070	2 369	937	785	865
Profitability						
Operating profit before tax (includes abnormals)	$'000	536 069	521 756	152 376	25 767	-39 274
Operating sales margin	%	27.7	30.8	22.5	9.0	0.9
Cost recovery	%	138.2	144.3	128.4	106.7	97.7
Return on assets	%	8.9	14.1	9.6	3.5	0.5
Return on equity	%	6.8	13.2	8.4	0.9	-2.0
Financial management						
Debt to equity	%	57.9	59.2	65.5	69.7	67.0
Debt to total assets	%	3.5	4.4	3.2	2.3	2.3
Total liabilities to equity	%	101.7	192.7	106.6	110.0	115.0
Interest cover	times	2.6	3.2	3.0	1.5	0.2
Current ratio	%	90.6	77.2	66.7	90.0	72.2
Leverage ratio	%	201.7	292.7	206.6	210.0	215.0
Payments to and from government						
Dividends	$'000	412 250	315 675	219 937	21 982	27 660
Dividend to equity ratio	%	8.1	12.9	22.8	2.1	2.8
Dividend payout ratio	%	118.9	97.1	271.7	232.1	-138.0
Income tax expense	$'000	189 365	196 615	71 422	16 298	-19 230
CSO funding	$'000	5 000[d]	0	0	0	0

a In 1995-96, assets ($4.5 billion) and liabilities ($2.2 billion) associated with six power stations were transferred to Delta Electricity and Macquarie Generation. **b** Includes abnormal revenue of $399 million associated with a reduction in the provision for employee accrued entitlements which were assumed by the Crown. In May 1997, trading between the NSW and Victorian wholesale electricity pools was introduced as the first stage of the National Electricity Market (NEM). **c** The NEM officially commenced operating in December 1998. **d** Pacific Power received a CSO payment related to the provision of drought relief.

TRANSGRID — New South Wales

TransGrid is a State owned corporation responsible for the management and development of the NSW high voltage electricity network. It transmits power between generators, bulk distributor corporations, some direct customers and to other States.[1] TransGrid's high voltage transmission network, comprising 72 substations and power station switchyards and 11 500km of transmission lines, is interconnected with the Victorian and South Australian systems.

TransGrid was formed as a statutory authority on 1 February 1995, under the *Electricity Transmission Authority Act 1994*. Following the initial establishment of the National Electricity Market (NEM) during 1996-97, TransGrid had the role of market and system operator for NSW.[2] This role was subsequently transferred to the National Electricity Market Management Company in December 1998. On 14 December 1998, TransGrid became a corporatised entity under the *State Owned Corporations Act 1989*.

The fall in total revenue in 1996-97 reflects lower network charges flowing from an Independent Pricing and Regulatory Tribunal (IPART) determination.[3] Profitability improved in the following two years largely as a result of reduced expenses.

Over the period, TransGrid's debt to equity, leverage and debt to total asset ratios improved. TransGrid's improved debt position was achieved through debt restructuring which involved reducing the level and duration of outstanding debt and negotiating improved interest rate terms. The reduction in debt levels also allowed TransGrid to improve its interest cover substantially.

TransGrid makes tax-equivalent and dividend payments. As a State owned corporation, TransGrid is required to have a share dividend scheme which has been approved by the NSW Treasurer. Dividends are declared in accordance with the scheme. TransGrid is not required to perform any community service obligations by the NSW Government.

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1 TransGrid is also responsible for the development and provision of engineering and commercial services to customers in Australia and overseas.

2 As 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 to avoid distortion of TransGrid's financial performance.

3 During March 1996, IPART set maximum revenue caps for TransGrid for the three years to June 1999.

TRANSGRID (continued)

Table 2.4 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*[a]	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	2 021	2 166	2 115	2 095	2 238[b]
Total revenue	$M	165	402	386	374	371
Profitability						
Operating profit before tax (includes abnormals)	$'000	27 387	95 770	78 309	95 765	90 487
Operating sales margin	%	44.3	49.6	46.9	50.0	48.1
Cost recovery	%	204.4	196.0	182.4	199.9	192.5
Return on assets	%	3.6	9.5	8.5	8.9	8.3
Return on equity	%	2.0	5.9	4.4	5.5	4.9
Financial management						
Debt to equity	%	99.8	83.3	79.8	71.4	60.8
Debt to total assets	%	46.9	42.6	39.8	37.4	35.2
Total liabilities to equity	%	112.9	102.1	97.9	89.7	78.2
Interest cover	times	1.6	1.9	1.7	2.0	2.0
Current ratio	%	22.7	40.9	45.1	106.1	49.9
Leverage ratio	%	212.9	202.1	197.9	189.7	178.2
Payments to and from government						
Dividends	$'000	16 361	59 774	54 963	49 616	54 105
Dividend to equity ratio	%	1.7	5.9	5.1	4.6	4.6
Dividend payout ratio	%	84.9	100.6	115.7	82.8	92.8
Income tax expense	$'000	8 117	36 351	30 812	35 848	32 164
CSO funding	$'000	0	0	0	0	0

Note 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. **a** TransGrid commenced operations on 1 February 1995. The data for the 1994-95 financial year relates only to operations between February and June 1995. **b** TransGrid's grid infrastructure assets were revalued using optimised depreciated replacement cost. This resulted in an increase in the value of infrastructure assets of $152.8 million.

ADVANCE ENERGY — New South Wales

Advance Energy was established as a State owned corporation on 1 March 1996 as part of the reform of the NSW electricity supply industry. Advance Energy is one of six distribution companies formed through the amalgamation of 25 distributors in 1995.

Under the retail supply market arrangements, Advance Energy is required to supply all its franchise customers with electricity. Advance's franchise region and distribution network are located in central NSW and cover a geographical area of 167 000 square kilometres. With the staged introduction of retail competition, whereby customers can choose between retail suppliers, Advance Energy is now able to supply electricity to non-franchise customers.[1]

In March 1996, the Independent Pricing and Review Tribunal (IPART) set revenue caps for the network and retail supply businesses of the distributors for the three years to June 1999. Only revenue generated from franchise customers is subject to the revenue cap.

The sharp increase in operating profit in 1997-98, reflects a 10 per cent increase in Advance's customer base, one off gains from energy trading and from a change in the treatment of capital contributions.[2] The increase in operating profit is also reflected in the return on asset and return on equity ratios.

Advance's debt to equity and debt to total asset ratios have risen slightly over the monitoring period, reflecting an increase in the level of debt held. However, both ratios remain relatively low.

Advance Energy is required to make both tax-equivalent and dividend payments.

Advance 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.

1 As part of the development of the National Electricity Market, retail competition has been introduced in stages. The first stage involved giving choice of retail supplier to only the largest consumers of electricity (from October 1996).

2 1997-98 is the first year that capital contributions were included in total revenue (see note **c** in table 1.5).

ADVANCE ENERGY (continued)

Table 2.5 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*[b]	*1997-98*[c]	*1998-99*[d]
Size						
Total assets	$M	n.r.	319	341	367	379
Total revenue	$M	n.r.	189	199	219	230
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	-6 682	24 811	43 897	24 354
Operating sales margin	%	n.r.	-3.9	13.6	21.0	11.8
Cost recovery	%	n.r.	106.8	117.0	124.3	113.4
Return on assets	%	n.r.	-1.4	8.4	16.7	12.3
Return on equity	%	n.r.	-3.8	6.3	17.5	7.8
Financial management						
Debt to equity	%	n.r.	12.3	13.2	17.7	17.8
Debt to total assets	%	n.r.	8.7	9.3	14.3	19.1
Total liabilities to equity	%	n.r.	41.6	45.6	62.4	57.8
Interest cover	times	n.r.	-1.9	9.3	17.3	8.4
Current ratio	%	n.r.	98.7	106.8	82.7	89.6
Leverage ratio	%	n.r.	141.6	145.6	162.4	157.8
Payments to and from government						
Dividends	$'000	n.r.	1 701	17 963	37 568	3 773
Dividend to equity ratio	%	n.r.	0.8	7.8	16.3	1.6
Dividend payout ratio	%	n.r.	-20.1	124.9	93.6	20.7
Income tax expense	$'000	n.r.	1 801	10 434	3 766	6 130
CSO funding	$'000	n.r.	315	2 318	2 466	2 464

a Data for the 1995-96 financial year reflects the combined operations of five former distributors to February 1996 and the newly established Advance Energy for the four month period to 30 June 1996. **b** Customers consuming $\geq$ 40GWh were given the choice of retail supplier from October 1996 and customers consuming $\geq$ 4GWh were given the choice of retail supplier from April 1997. In May 1997, trading between the NSW and Victorian wholesale electricity pools was introduced as the first stage of the National Electricity Market (NEM). **c** 1997-98 is the first year that capital contributions by customers are included in total revenue. 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. Customers consuming $\geq$ 750MWh were given the choice of retail supplier from July 1997. **d** Customers consuming $\geq$ 160MWh were given the choice of retail supplier from July 1998. The NEM officially commenced operating in December 1998. **n.r.** Not relevant.

AUSTRALIAN INLAND ENERGY — New South Wales

Australian Inland Energy (AIE) was established as a State owned corporation on 1 March 1996 as part of the reform of the NSW electricity supply industry.[1] AIE is one of six distribution companies formed through the amalgamation of 25 distributors in 1995. It assumed the operations of the former Broken Hill Electricity and part of the operations of the former Murray River Electricity. AIE provides energy services to approximately 19 300 customers within a 155 100 square kilometre area in the far west and south-west of NSW.

AIE incurred an operating loss in their first year of operation and this is reflected in most of their financial ratios for 1995-96. The operating loss is attributable to abnormal expenses ($11.5 million) related to the corporatisation and amalgamation process.

AIE has retained most of their contestable customers following the staged introduction of retail competition as part of the National Electricity Market (NEM).[2] Since 1996-97, profitability has improved steadily as has the return on assets and the return on equity. Cost recovery and operating sales margin have also increased steadily since 1996-97, suggesting improved efficiency. AIE holds no debt and has maintained its total liabilities to equity ratio fairly constant between 1996-97 and 1998-99.

AIE operates under a revenue cap as determined by the Independent Pricing and Review Tribunal (IPART). Prices for contestable customers are unregulated.[3] AIE also receives an operating subsidy from the NSW Government in recognition of the uneconomic nature of supplying electricity in sparsely populated areas.

Since 1996-97, AIE has made tax-equivalent and dividend payments. The dividend for 1998-99 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.

1 AIE was originally known as Far West Energy but was renamed by the board of directors in May 1996.

2 As part of the development of the NEM, retail competition has been introduced in stages. The first stage involved giving choice of retail supplier to only the largest consumers of electricity (from October 1996).

3 In March 1996, IPART set revenue caps for the network and retail supply businesses of the distributors for the three years to June 1999.

AUSTRALIAN INLAND ENERGY (continued)

Table 2.6 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*[b]	*1997-98*[c]	*1998-99*[d]
Size						
Total assets	$M	n.r.	45	53	58	63
Total revenue	$M	n.r.	30	38	38	39
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	-11 286	7 721	11 312	13 174
Operating sales margin	%	n.r.	-39.1	19.1	28.1	32.0
Cost recovery	%	n.r.	99.3	120.6	139.1	147.1
Return on assets	%	n.r.	-25.2	15.7	20.2	21.7
Return on equity	%	n.r.	-30.2	11.8	18.7	21.3
Financial management						
Debt to equity	%	n.r.	0	0	0	0
Debt to total assets	%	n.r.	0	0	0	0
Total liabilities to equity	%	n.r.	20.0	31.6	31.0	30.9
Interest cover	times	n.r.	n.r.	n.r.	n.r.	n.r.
Current ratio	%	n.r.	251.7	231.0	290.1	278.7
Leverage ratio	%	n.r.	120.0	131.6	131.0	130.9
Payments to and from government						
Dividends	$'000	n.r.	0	3 100	3 583	5 721[e]
Dividend to equity ratio	%	n.r.	0	8.0	8.4	12.3
Dividend payout ratio	%	n.r.	0	67.6	45.0	57.9
Income tax expense	$'000	n.r.	0	3 132	3 341	3 296
CSO funding	$'000	n.r.	0	0	0	0

a In 1995-96, Australian Inland Energy incurred abnormal expenses ($11.5 million) related to the amalgamation and corporatisation process. In particular, there was a $10.9 million write-down in the value of current assets and a restructuring provision of $0.3 million. **b** Customers consuming $\geq$ 40GWh were given the choice of retail supplier from October 1996 and customers consuming $\geq$ 4GWh were given the choice of retail supplier from April 1997. **c** Customers consuming $\geq$ 750MWh were given the choice of retail supplier from July 1997. **d** Customers consuming $\geq$ 160MWh were given the choice of retail supplier from July 1998. The NEM officially commenced operating in December 1998. **e** Includes an additional dividend of $2.2 million relating to the construction of the Balranald substation. **n.r.** Not relevant.

ENERGYAUSTRALIA — New South Wales

EnergyAustralia was established as a State owned corporation on 1 March 1996 as part of the reform of the NSW electricity supply industry. EnergyAustralia is one of six distribution companies formed through the amalgamation of 25 distributors in 1995.[1] EnergyAustralia's franchise distribution area covers over 22 275 square kilometres with more than 23 000GWh of electricity distributed annually to over 1.3 million customers.

EnergyAustraliia made an operating loss in 1995-96 largely as a result of abnormal expenses ($175.3 million) incurred in the corporatisation and amalgamation process. The staged introduction of the National Electricity Market and choice of retail supplier has resulted in significant volatility in energy prices. Since 1996-97, the revenue derived from energy sales has consistently fallen.

Improvements in total revenue over this period, either reflect increased revenue from capital contributions or the impact of abnormal items. Over this period, EnergyAustralia has maintained a cost recovery ratio of over 125 per cent. EnergyAustralia operates under a revenue cap determined by the Independent Pricing and Review Tribunal (IPART). Prices for non-franchise customers are unregulated.[2]

In 1997-98, EnergyAustralia moved from treating customer and developer capital contributions as revenue when received to recording them as a liability until the assets are constructed.[3] This change in accounting policy reduced total revenue.

EnergyAustralia is required to make tax-equivalent and dividend payments. EnergyAustralia's distribution policy (tax and dividend payments) is agreed to by the voting shareholders and the board of directors and is outlined in their statement of corporate intent. Over the monitoring period, EnergyAustralia has met or exceeded its agreed distribution targets.

The NSW Government funds EnergyAustralia for the provision of agreed community service obligations. EnergyAustralia receives funding for the provision of rebates to pensioners and low income households, medical rebates for life support systems and the electricity payment assistance scheme.

1 Energy Australia was formed from the amalgamation of Sydney Electricity and Orion Energy.

2 In March 1996, IPART set revenue caps for the network and retail supply businesses of the distributors for the three years to June 1999.

3 The change was made to reflect Urgent Issues Group Abstract 17 issued by the Australian Accounting Research Foundation.

ENERGYAUSTRALIA (continued)

Table 2.7 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*[b]	*1997-98*[c]	*1998-99*[d]
Size						
Total assets	$M	n.r.	3 634	3 609	3 746	3 788
Total revenue	$M	n.r.	1 981	2 061	1 839[e]	1 852
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	-16 864	309 758[f]	360 384[g]	285 022[h]
Operating sales margin	%	n.r.	2.0	20.8	25.1	19.5
Cost recovery	%	n.r.	112.3	125.1	129.6	125.3
Return on assets	%	n.r.	1.5	12.2	12.8	9.9
Return on equity	%	n.r.	-1.2	13.0	15.0	11.3
Financial management						
Debt to equity	%	n.r.	83.2	83.7	82.6	79.9
Debt to total assets	%	n.r.	34.9	35.2	35.5	34.4
Total liabilities to equity	%	n.r.	138.0	136.6	137.1	133.5
Interest cover	times	n.r.	0.8	3.4	4.3	4.2
Current ratio	%	n.r.	76.1	67.3	96.7	117.8
Leverage ratio	%	n.r.	238.0	236.6	237.1	233.5
Payments to and from government						
Dividends	$'000	n.r.	32 613	199 166	177 868	138 800
Dividend to equity ratio	%	n.r.	2.1	13.1	11.5	8.7
Dividend payout ratio	%	n.r.	-184.3	100.4	76.6	76.5
Income tax expense	$'000	n.r.	827	111 371	128 195	103 664
CSO funding	$'000	n.r.	22 683	24 606	25 800	28 500

a In 1995-96, EnergyAustralia incurred abnormal expenses ($175.3 million) related to the amalgamation and corporatisation process. **b** Customers with sites consuming $\geq$ 40GWh given the choice of retail supplier from October 1996 and customers with sites consuming $\geq$ 4GWh given the choice of retail supplier from April 1997. **c** Customers with sites consuming $\geq$ 750MWh given the choice of retail supplier from July 1997. **d** Customers with sites consuming $\geq$ 160MWh given the choice of retail supplier from July 1998. The NEM officially commenced operating in December 1998. **e** 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. **f** Includes net abnormals of $19.5 million related to prepaid superannuation contributions. **g** Includes net abnormals of $54.3 million related to prepaid superannuation contributions. **h** Includes abnormal expenses of $13.3 million relating to unfunded superannuation contributions. **n.r.** Not relevant.

GREAT SOUTHERN ENERGY — New South Wales

Great Southern Energy was established, as a State owned corporation in 1996, through the merger of nine southern NSW electricity distributors.[1] Great Southern Energy distributes and retails electricity to approximately 223 000 customers over a franchise area of 174 450 square kilometres. Great Southern Energy is 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.

In its first year of operation, Great Southern Energy incurred a significant operating loss (including abnormals). This largely reflects the impact of abnormal expenses related to the amalgamation process. In particular, there was an expense of $18.3 million associated with an asset revaluation, $14.6 million relating to a restructure provision and $8.1 million associated with changes to the provision for employee entitlements. If the impact of abnormals is excluded Great Southern Energy generated an operating profit.

Operating profit has fluctuated significantly over the monitoring period largely as a result of abnormals. Great Southern Energy has maintained market share following the phased introduction of contestability in the retail electricity market. Revenue from electricity sales has increased steadily over the monitoring period.[2] Great Southern Energy has also been able to purchase energy at lower cost and this has contributed to improved profitability.

Great Southern Energy operates under a revenue cap as determined by the Independent Pricing and Review Tribunal (IPART). Prices for non-franchise customers are unregulated.[3]

Great Southern Energy is required to make tax-equivalent and dividend payments. Over the monitoring period, Great Southern has declared dividends in accordance with NSW Treasury financial distribution policy. The declared dividend for 1998-99 includes an additional $5 million dividend as agreed with Treasury in accordance with the statement of corporate intent.

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1 Eight southern electricity distributors were merged with the southern part of the former Illawarra Electricity to form Energy South in October 1995. On 1 March 1996, Energy South became Great Southern Energy.

2 As a part of the development of the National Electricity Market, retail competition has been introduced in stages. The first stage involved giving choice of retail supplier to only the largest consumers of electricity (from October 1996).

3 In March 1996, IPART set revenue caps for the network and retail supply businesses of the distributors for the three years to June 1999.

GREAT SOUTHERN ENERGY (continued)

Table 2.8 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*[b]	*1997-98*[c]	*1998-99*[d]
Size						
Total assets	$M	n.r.	497	579	628[e]	626
Total revenue	$M	n.r.	291	315	346	369
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	-17 602	43 581	95 511	74 378
Operating sales margin	%	n.r.	-8.9	13.5	28.9	21.3
Cost recovery	%	n.r.	105.6	115.3	139.2	122.2
Return on assets	%	n.r.	-3.2	8.9	16.9	13.0
Return on equity	%	n.r.	-5.9	6.8	16.0	13.0
Financial management						
Debt to equity	%	n.r.	17.2	25.0	24.5	23.6
Debt to total assets	%	n.r.	0.5	1.2	1.7	1.9
Total liabilities to equity	%	n.r.	41.3	57.0	69.1	65.0
Interest cover	times	n.r.	-9.2	11.0	16.4	11.6
Current ratio	%	n.r.	185.0	153.6	154.1	128.2
Leverage ratio	%	n.r.	141.3	157.0	169.1	165.0
Payments to and from government						
Dividends	$'000	n.r.	3 376	28 171	43 117	41 004
Dividend to equity ratio	%	n.r.	1.0	7.8	11.6	10.9
Dividend payout ratio	%	n.r.	-16.4	115.4	72.8	83.8
Income tax expense	$'000	n.r.	3 024	19 165	36 283	25 467
CSO funding	$'000	n.r.	0	0	0	0

a In 1995-96, Great Southern Energy incurred abnormal expenses ($41 million) related to the amalgamation process. In particular, there was an expense of $18.3 million associated with an asset revaluation, $14.6 million relating to a restructure provision and $8.1 million associated with changes to the provision for employee entitlements. **b** Customers consuming $\geq$ 40GWh were given the choice of retail supplier from October 1996 and customers consuming $\geq$ 4GWh were given the choice of retail supplier from April 1997. **c** Customers consuming $\geq$ 750MWh were given the choice of retail supplier from July 1997. In 1997-98, Great Southern Energy incurred abnormal revenue ($22.3 million) related to a superannuation actuarial assessment ($17.4 million) and an adjustment on the previous year's Transgrid charges ($4.9 million). Great Southern Energy also incurred abnormal expenses ($13.4 million) related mainly to restructuring and relocation costs ($1.8 million) and an asset valuation adjustment ($8.7 million). **d** Customers consuming $\geq$ 160MWh were given the choice of retail supplier from July 1998. The National Electricity Market officially commenced operating in December 1998. Great Southern incurred abnormal expenses ($6.9 million) related mainly to a superannuation actuarial assessment ($4.2 million) and asset write-offs ($2 million). **e** 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. **n.r.** Not relevant.

INTEGRAL ENERGY — New South Wales

Integral Energy was established as a State owned corporation under the *Energy Services Act 1995*, following the merger of Prospect Electricity and the major portion of Illawarra Electricity in October 1996. Integral Energy distributes and retails electricity to over 1.8 million people in 755 000 households and businesses across a franchise area of 24 500 square kilometres in Greater Western Sydney, the Illawarra and the Southern Highlands, as well as operating a gas business.

In 1995-96, Integral Energy incurred abnormal expenses of $37.2 million associated with the amalgamation process. In that year, Integral also returned $500 million to the NSW Government as part of an equity restructuring. This return of equity was financed through borrowings.

With the introduction of a wholesale market for electricity and the phased introduction of choice in retail electricity supply, Integral Energy has been able to expand its customer base beyond its franchise area.[1] The ability to purchase electricity through the wholesale market at relatively low prices contributed to the increase in profitability in 1996-97.

Integral Energy increased operating profit significantly through lower electricity purchasing costs and increased total revenue in 1997-98, despite volatility in wholesale prices. This largely reflects increased revenue from the use of Integral Energy's network by other electricity retailers for the sale of electricity to customers within Integral's franchise area.

Higher wholesale prices, low margins and increasing competition at the retail level along with significant abnormal expenses ($36.5 million) contributed to lower operating profit in 1998-99. The significant losses incurred by its retail business resulted in a move to reduce their share of the contestable retail market.

Integral Energy is required to make tax-equivalent and dividend payments. The distribution policy is agreed to by the voting shareholders and the board and is outlined in their Statement of Corporate Intent (SCI). Since 1996-97, Integral Energy has not met the target dividend distribution outlined in their SCI. Integral Energy receives funding for the provision of community service obligations related primarily to rebates for pensioners.

1 As part of the development of the National Electricity Market, retail competition has been introduced in stages. The first stage involved giving choice of retail supplier to only the largest consumers of electricity (from October 1996).

INTEGRAL ENERGY (continued)

Table 2.9 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*[b]	*1997-98*[c]	*1998-99*[d]
Size						
Total assets	$M	n.r.	2 068	1 954	1 828	1 844
Total revenue	$M	n.r.	1 108	1 047	1 119	1 177
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	48 020	51 813	158 599	37 713
Operating sales margin	%	n.r.	7.1	11.1	19.7	8.6
Cost recovery	%	n.r.	111.7	120.7	121.2	113.3
Return on assets	%	n.r.	4.0	6.1	11.9	5.6
Return on equity	%	n.r.	1.4	1.7	13.1	2.8
Financial management						
Debt to equity	%	n.r.	120.4	99.8	96.7	102.4
Debt to total assets	%	n.r.	45.8	34.5	36.1	38.2
Total liabilities to equity	%	n.r.	162.7	180.8	159.3	169.3
Interest cover	times	n.r.	2.4	1.7	3.4	1.6
Current ratio	%	n.r.	110.6	94.1	152.4	124.6
Leverage ratio	%	n.r.	262.7	280.8	259.3	269.3
Payments to and from customers						
Dividends	$'000	n.r.	27 487	98 460	92 066	45 918
Dividend to equity ratio	%	n.r.	3.5	13.1	12.0	6.8
Dividend payout ratio	%	n.r.	243.2	768.8	91.7	242.0
Income tax expense	$'000	n.r.	36 720	39 006	58 221	18 738
CSO funding	$'000	n.r.	n.r.	12 770	12 978	13 069

a In 1995-96, Integral Energy incurred abnormal expenses of 37.2 million related to the amalgamation process. **b** Customers consuming $\geq$ 40GWh were given the choice of retail supplier from October 1996 and customers consuming $\geq$ 4GWh were given the choice of retail supplier from April 1997. In 1996-97, 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 incurred. **c** Customers with sites consuming $\geq$ 750MWh were given the choice of retail supplier from July 1997. In 1997-98, Integral Energy incurred 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. **d** Customers consuming $\geq$ 160MWh were given the choice of retail supplier from July 1998. The National Electricity Market officially commenced operating in December 1998. In 1998-99, 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). **n.r.** Not relevant.

NORTHPOWER — New South Wales

NorthPower was established as a State owned corporation in October 1996 following the merger of eight distributors. NorthPower's network franchise area covers an area of 230 000 square kilometres in northern NSW. Currently, NorthPower has approximately 360 000 customers.

In 1995-96, NorthPower incurred abnormal expenses of $126.1 million as a result of an asset revaluation, redundancy and early retirement payments, a loan revaluation, and a restructuring provision. NorthPower also returned $70 million to the NSW Government as a part of capital restructuring.

The phased introduction of choice in retail supply allowed NorthPower to expand its customer base to outside the franchise area.[1] Growth in the franchise area and contestable customer gains contributed to increased total revenue, as did abnormals related to the overpayment of superannuation contributions. Abnormal expenses relating to restructuring costs and a change in the provision for employee entitlements had a negative impact on profits.

There was a significant increase in operating profit before tax (including abnormals) in 1997-98. Growth in electricity sales contributed to increased revenue, as did abnormals relating to changes in employee entitlements and a recoupment of superannuation contributions. Increased depreciation associated with an upward revaluation of network assets, abnormal expenses related to redundancy payments and the sale of property were more than offset by lower wholesale electricity charges and a fall in interest expense following a debt restructure.

Although total revenue continued to increase in 1998-99, operating profit before tax (including abnormals) fell as a result of an increase in energy purchasing costs and increased depreciation charges associated with a further upward revaluation of network assets. The increase in the value of network assets also contributed to significant falls in the debt to equity and debt to total asset ratios in 1997-98 and 1998-99. The asset revaluation and the significant decrease in operating profit contributed to the sharp fall in the return on asset and equity ratios for 1998-99.

NorthPower makes tax-equivalent and dividend payments. Distribution targets are agreed to by voting shareholders and the board of directors and have been met or exceeded in all years except 1996-97.

1 As part of the development of the National Electricity Market, retail competition has been introduced in stages. The first stage involved giving choice of retail supplier to only the largest consumers of electricity (from October 1996).

NORTH POWER (continued)

Table 2.10 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*[b]	*1997-98*[c]	*1998-99*[d]
Size						
Total assets	$M	n.r.	638	665	831[e]	1 117[f]
Total revenue	$M	n.r.	397	420	461	478
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	114 781	30 237	102 387	46 972
Operating sales margin	%	n.r.	30.7	9.6	24.1	11.3
Cost recovery	%	n.r.	268.4	113.7	126.7	114.9
Return on assets	%	n.r.	19.5	6.6	15.1	5.8
Return on equity	%	n.r.	30.2	3.8	16.1	4.5
Financial management						
Debt to equity	%	n.r.	42.0	35.3	27.2	22.2
Debt to total assets	%	n.r.	23.7	21.5	18.6	17.1
Total liabilities to equity	%	n.r.	77.3	67.5	62.8	48.6
Interest cover	times	n.r.	13.3	3.4	11.0	6.0
Current ratio	%	n.r.	106.9	112.2	114.9	100.4
Leverage ratio	%	n.r.	177.3	167.5	162.8	148.6
Payments to and from government						
Dividends	$'000	n.r.	6 341	17 969	58 080	35 522
Dividend to equity ratio	%	n.r.	1.8	4.7	12.8	5.6
Dividend payout ratio	%	n.r.	5.8	126.1	79.3	126.2
Income tax expense	$'000	n.r.	6 043	15 990	29 134	18 829
CSO funding	$'000	n.r.	1 791	6 215	7 863	7 996

a In 1995-96, NorthPower incurred abnormal expenses of $126.1 million. In particular, redundancy and early retirement payments (11.3 million), a write-down in the value of assets ($105.5 million), debt restructuring ($4.9 million) and a provision for the cost of restructuring the organisation ($4.5 million). **b** In 1997-98, NorthPower incurred $17.4 million in 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. Customers consuming $\geq$ 40GWh were given the choice of retail supplier from October 1996 and customers consuming $\geq$ 4GWh were given the choice of retail supplier from April 1997. **c** In 1997-98, 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 incurred 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). Customers consuming $\geq$ 750MWh were given the choice of retail supplier from July 1997. **d** In 1998-99, 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). Customers consuming $\geq$ 160MWh were given the choice of retail supplier from July 1998. The National Electricity Market officially commenced operations in December 1998. **e** The carrying amounts of network system assets were revalued upwards. **f** The carrying amounts of network assets were revalued upwards by $247 million. **n.r.** Not relevant.

CS ENERGY — Queensland

CS Energy was established as a government owned corporation on 1 July 1997 as part of the reform of the Queensland electricity supply industry. CS Energy is subject to the provisions of the *Government Owned Corporation Act 1993*. Previously the assets of CS Energy formed part of Queensland's largest generator AUSTA Electric.[1] CS Energy operates three power stations, generating electricity for Queensland's wholesale electricity market.[2]

The significant increase in operating profit before tax (including abnormals) in 1998-99 reflects increased revenue from electricity sales. CS Energy was able to capitalise on high pool prices and the volatility of the Queensland electricity market during 1998-99. The increase in operating profit had a positive impact on a number of ratios, including return on assets and return on equity.

CS Energy is required to make tax-equivalent and dividend payments. CS Energy has not been required to perform any community service obligations over the monitoring period.

1 On 1 July 1997, AUSTA Electric was separated into three independent and competing generation corporations and an engineering services corporation.

2 The Queensland wholesale electricity market commenced operating on 18 January 1998 based on the National Electricity Market (NEM). The Queensland market is not physically connected to the NEM. However, a major interconnection between NSW and Queensland is planned to be in service by 2001.

CS ENERGY (continued)

Table 2.11 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*
Size						
Total assets	$M	n.r.	n.r.	n.r.	927	1 100
Total revenue	$M	n.r.	n.r.	n.r.	447	478
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	n.r.	98 566	161 826
Operating sales margin	%	n.r.	n.r.	n.r.	25.3	36.6
Cost recovery	%	n.r.	n.r.	n.r.	133.9	157.8
Return on assets	%	n.r.	n.r.	n.r.	13.1	17.4
Return on equity	%	n.r.	n.r.	n.r.	11.1	17.6
Financial management						
Debt to equity	%	n.r.	n.r.	n.r.	36.8	44.6
Debt to total assets	%	n.r.	n.r.	n.r.	23.3	26.1
Total liabilities to equity	%	n.r.	n.r.	n.r.	63.5	85.4
Interest cover	times	n.r.	n.r.	n.r.	6.4	12.3
Current ratio	%	n.r.	n.r.	n.r.	89.0	81.4
Leverage ratio	%	n.r.	n.r.	n.r.	163.5	185.4
Payments to and from government						
Dividends	$'000	n.r.	n.r.	n.r.	38 800	75 800
Dividend to equity ratio	%	n.r.	n.r.	n.r.	6.9	13.1
Dividend payout ratio	%	n.r.	n.r.	n.r.	62.3	74.3
Income tax expense	$'000	n.r.	n.r.	n.r.	36 315	59 825
CSO funding	$'000	n.r.	n.r.	n.r.	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 was established on 1 July 1997 as part of the restructure of the Queensland electricity supply industry. Stanwell Corporation is one of three generators established following the restructure of AUSTA Electric.[1] Stanwell Corporation operates three power stations with a combined generating capacity of 1 566 MW and supplies the Queensland wholesale electricity market.[2]

The increase in operating profit before tax (including abnormals) in 1998-99 largely reflects increased revenue from electricity sales, and an increase in gross proceeds from the sale of non-current assets. Improved profitability contributed to an increase in the rates of return on assets and equity for that year.

The debt to equity and debt to total asset ratios fell in 1998-99, following a reduction in the level of debt held by Stanwell. Current borrowing fell to zero and non-current borrowing fell slightly.

Stanwell is required to make income tax-equivalent and dividend payments. Its dividend policy as agreed with its shareholding ministers is outlined it the statement of corporate intent. The board of directors makes a recommendation on the dividend to be paid taking into account the end of year financial results, the existing and target capital structure, future capital investment commitments and the capacity to pay.

Stanwell Corporation is not required to perform any community service obligations by the Queensland Government.

1 An engineering services corporation was also established through the restructure of AUSTA Electric.

2 The Queensland wholesale electricity market commenced operating on 18 January 1998 based on the National Electricity Market (NEM). The Queensland market is not physically connected to the NEM. However, a major interconnection between NSW and Queensland is planned to be in service by 2001.

STANWELL CORPORATION (continued)

Table 2.12 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*
Size						
Total assets	$M	n.r.	n.r.	n.r.	1 769	1 715
Total revenue	$M	n.r.	n.r.	n.r.	384	450
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	n.r.	123 171	179 538
Operating sales margin	%	n.r.	n.r.	n.r.	44.3	48.7
Cost recovery	%	n.r.	n.r.	n.r.	179.7	194.9
Return on assets	%	n.r.	n.r.	n.r.	10.1	12.7
Return on equity	%	n.r.	n.r.	n.r.	7.5	11.6
Financial management						
Debt to equity	%	n.r.	n.r.	n.r.	62.9	51.0
Debt to total assets	%	n.r.	n.r.	n.r.	37.2	29.9
Total liabilities to equity	%	n.r.	n.r.	n.r.	73.8	68.0
Interest cover	times	n.r.	n.r.	n.r.	3.5	5.3
Current ratio	%	n.r.	n.r.	n.r.	155.1	204.4
Leverage ratio	%	n.r.	n.r.	n.r.	173.8	168.0
Payments to and from government						
Dividends	$'000	n.r.	n.r.	n.r.	40 000	107 808
Dividend to equity ratio	%	n.r.	n.r.	n.r.	3.8	10.6
Dividend payout ratio	%	n.r.	n.r.	n.r.	50.8	91.5
Income tax expense	$'000	n.r.	n.r.	n.r.	44 441	61 752
CSO funding	$'000	n.r.	n.r.	n.r.	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 as a government owned corporation on 1 July 1997, as part of the restructure of the Queensland electricity supply industry. Previously the assets of Tarong Energy formed part of Queensland's largest generator, AUSTA Electric.[1] Tarong Energy operates two power stations and generates electricity for Queensland's wholesale electricity market.[2]

The failure of one of their transformers in August 1998, contributed to lower generating capacity and to the fall in total revenue in 1998-99. The unit was out of service for two months while a replacement transformer was transported to the station and installed. Lower expenses contributed to the increase in operating profit before tax (including abnormals) in 1998-99.

Tarong Energy is required to make tax-equivalent and dividend payments. The dividend distribution policy is agreed to following consultation with the shareholding ministers.

Tarong Energy is not required to perform any community service obligations by the Queensland Government.

1 On 1 July 1997 AUSTA Electric was separated into three independent and competing generation corporations and an engineering services corporation.

2 A wholesale electricity market was introduced in Queensland in March 1998 based on the National Electricity Market (NEM). The Queensland market is not physically connected to the NEM. However, a major interconnection between NSW and Queensland is planned to be in service by 2001.

TARONG ENERGY (continued)

Table 2.13 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*
Size						
Total assets	$M	n.r.	n.r.	n.r.	1 391	1 263
Total revenue	$M	n.r.	n.r.	n.r.	439	433
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	n.r.	127 310	135 949
Operating sales margin	%	n.r.	n.r.	n.r.	36.5	37.2
Cost recovery	%	n.r.	n.r.	n.r.	157.5	159.3
Return on assets	%	n.r.	n.r.	n.r.	12.1	12.2
Return on equity	%	n.r.	n.r.	n.r.	10.0	10.7
Financial management						
Debt to equity	%	n.r.	n.r.	n.r.	54.0	34.2
Debt to total assets	%	n.r.	n.r.	n.r.	32.5	21.7
Total liabilities to equity	%	n.r.	n.r.	n.r.	72.8	50.4
Interest cover	times	n.r.	n.r.	n.r.	4.6	6.2
Current ratio	%	n.r.	n.r.	n.r.	133.9	92.9
Leverage ratio	%	n.r.	n.r.	n.r.	172.8	150.4
Payments to and from government						
Dividends	$'000	n.r.	n.r.	n.r.	73 500	52 582
Dividend to equity ratio	%	n.r.	n.r.	n.r.	9.0	6.4
Dividend payout ratio	%	n.r.	n.r.	n.r.	90.0	60.0
Income tax expense	$'000	n.r.	n.r.	n.r.	45 644	48 313
CSO funding	$'000	n.r.	n.r.	n.r.	0	0

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

QUEENSLAND POWER TRADING CORPORATION Queensland

The Queensland Power Trading Corporation (QPTC) was established on 1 July 1997 following a restructure of Queensland's electricity supply industry. QPTC originally operated as the Queensland Transitional Trading Power Corporation. Its role was 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 former Queensland Transmission and Supply Corporation.

Subsequently, the corporation was also responsible for trading electricity generated from several privately owned power stations into the Queensland wholesale electricity market.[1] Although originally established as a transitional body, the QPTC gained a more permanent status as Queensland's fourth generator from June 1999.

Following the restructure of the industry most of the existing industry assets were reallocated to the new electricity corporations. Those that were not needed were passed to QPTC. In addition, on 1 April 1999 all remaining assets and liabilities of the Queensland Generation Corporation (AUSTA Electric) became the assets of QPTC.

In 1998-99, there was a significant fall in the total assets held by the QPTC. As a part of the restructuring process, QPTC 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 QPTC in relation to the transferred shares.

On 1 April 1999, the net assets of AUSTA Electric were transferred to QPTC 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. The remainder of the debt ($307 million) is still current and is to be considered in the determination of the final structure of the QPTC balance sheet.

The QPTC has made tax-equivalent payments but not dividend payments over the monitoring period. QPTC is not required to perform any community service obligations by the Queensland Government.

1 The Queensland wholesale electricity market commenced operating on 18 January 1998 based on the principles of the National Electricity Market (NEM). The Queensland market is not physically connected to the NEM. However, a major interconnection between NSW and Queensland is planned to be in service by 2001.

QUEENSLAND POWER TRADING CORPORATION (continued)

Table 2.14 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*[b]
Size						
Total assets	$M	n.r.	n.r.	n.r.	3 528	553
Total revenue	$M	n.r.	n.r.	n.r.	921	737
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	n.r.	8 159	28 067
Operating sales margin	%	n.r.	n.r.	n.r.	1.0	3.8
Cost recovery	%	n.r.	n.r.	n.r.	100.7	103.8
Return on assets	%	n.r.	n.r.	n.r.	0.3	1.6
Return on equity	%	n.r.	n.r.	n.r.	0.2	1.1
Financial management						
Debt to equity	%	n.r.	n.r.	n.r.	2.6	21.7
Debt to total assets	%	n.r.	n.r.	n.r.	2.4	4.3
Total liabilities to equity	%	n.r.	n.r.	n.r.	4.2	37.3
Interest cover	times	n.r.	n.r.	n.r.	2.8	7.3
Current ratio	%	n.r.	n.r.	n.r.	2 467.1	289.8
Leverage ratio	%	n.r.	n.r.	n.r.	104.2	137.3
Payments to and from government						
Dividends	$'000	n.r.	n.r.	n.r.	0	0
Dividend to equity ratio	%	n.r.	n.r.	n.r.	0	0
Dividend payout ratio	%	n.r.	n.r.	n.r.	0	0
Income tax expense	$'000	n.r.	n.r.	n.r.	2 345	7 449
CSO funding	$'000	n.r.	n.r.	n.r.	0	0

a The Queensland Power Trading Corporation (QTPC) was established on 1 July 1997. Hence, 1997-98 is the first year where financial data were available. **b** As a part of the restructuring process, QPTC 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 QPTC in relation to the transferred shares. On 1 April 1999, the net assets of AUSTA Electric were transferred to QPTC 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. The remainder of the debt ($307 million) is still current. **n.r.** Not relevant.

POWERLINK QUEENSLAND — Queensland

Powerlink Queensland was established in 1995 as a subsidiary of the Queensland Transmission and Supply Corporation. On 1 July 1997, Powerlink became a government owned corporation reporting directly to its shareholding ministers.[1] Powerlink owns and operates the Queensland transmission network. Powerlink's high voltage transmission grid extends over more than 1 700km, from north of Cairns in far north Queensland to the New South Wales border.

The Queensland interim wholesale market commenced operating in January 1998. The Queensland System Operator, a ring fenced business unit within Powerlink, acted as market and system operator. With the official commencement of the National Electricity Market (NEM) in December 1998, this role was transferred to the National Electricity Market Management Company (NEMMCO). Although the Queensland wholesale electricity market is not physically connected to the national grid, it operates under the NEM's market rules.[2]

Powerlink's transmission network prices are subject to regulation. Transmission use of system prices were initially set by the regulator — the Director General of Mines and Energy to apply from 1 July 1997. The Queensland Electricity Reform Unit is currently setting revised revenue caps for the period 1999-00 to 2001-02, at which time Powerlink will be regulated by the Australian Competition and Consumer Commission.

As a 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 in 1997-98. This resulted in a 90 per cent increase in debt. In 1998-99, the capital restructure was completed with a corresponding reduction in share capital and hence equity. This resulted in an increase in the debt to equity, debt to total asset and total liabilities to equity ratios in 1998-99.

Powerlink is required to make income tax-equivalent and dividend payments. In both 1997-98 and 1998-99, Powerlink exceeded the dividend distribution targets set out in its statement of corporate intent. Powerlink is not required to perform any community service obligations by the Queensland Government.

1 The data included in this report refers only to Powerlink after it became an independent corporation in 1997-98.

2 Powerlink is in the process of constructing the interconnector, which will connect Queensland to NSW, and the national grid. It is scheduled to be operational by the end of 2000.

POWERLINK QUEENSLAND (continued)

Table 2.15 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*[b]
Size						
Total assets	$M	n.r.	n.r.	n.r.	1 842	1 737
Total revenue	$M	n.r.	n.r.	n.r.	246	259
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	n.r.	68 421	58 515
Operating sales margin	%	n.r.	n.r.	n.r.	43.6	37.2
Cost recovery	%	n.r.	n.r.	n.r.	193.4	197.5
Return on assets	%	n.r.	n.r.	n.r.	6.5	5.4
Return on equity	%	n.r.	n.r.	n.r.	4.5	4.1
Financial management						
Debt to equity	%	n.r.	n.r.	n.r.	63.2	95.5
Debt to total assets	%	n.r.	n.r.	n.r.	38.4	41.1
Total liabilities to equity	%	n.r.	n.r.	n.r.	83.4	125.7
Interest cover	times	n.r.	n.r.	n.r.	2.7	2.5
Current ratio	%	n.r.	n.r.	n.r.	305.5	50.7
Leverage ratio	%	n.r.	n.r.	n.r.	183.4	225.7
Payments to and from government						
Dividends	$'000	n.r.	n.r.	n.r.	39 300	27 253
Dividend to equity ratio	%	n.r.	n.r.	n.r.	4.0	3.1
Dividend payout ratio	%	n.r.	n.r.	n.r.	88.1	75.0
Income tax expense	$'000	n.r.	n.r.	n.r.	23 793	22 178
CSO funding	$'000	n.r.	n.r.	n.r.	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. The Queensland interim wholesale market commenced operating in January 1998. The Queensland System Operator, a ring fenced business unit within Powerlink was given responsibility for managing the market and system security. 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. **b** The National Electricity Market officially commenced operating in December 1998 and the role of market operator was transferred to the National Electricity Market Management Company. 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. **n.r.** Not relevant.

ERGON ENERGY — Queensland

In January 1995, the Queensland Government corporatised the Queensland Electricity Commission and separated the generation function from transmission and distribution. The transmission and distribution assets were owned by seven regional distribution corporations, which were in turn, owned by the Queensland Transmission and Supply Corporation (QTSC) — a holding company. In December 1996, QTSC was abolished and the distribution companies were restructured, as separate government owned corporations.

Three new retail corporations were established and two of these merged to form Ergon Energy.[1] Ergon Energy was owned by six of the regional distribution corporations. Ergon Energy is now a wholly owned subsidiary of Ergon Energy Corporation Ltd following the amalgamation of the six regional distributors on 30 June 1999.

Ergon Energy received Community Service Obligation (CSO) income in both 1997-98 and 1998-99. The significant increase in CSO income in 1998-99 reflects the impact of a high pool price in the wholesale electricity market. CSO payments were substantially greater than budgeted by both Ergon and the Queensland Government. The CSO regime was only finalised subsequent to the year's end.

Ergon Energy is required to make tax-equivalent and dividend payments. The board recommended that no dividend be paid in 1998-99.

1 The other retail corporation is Energex Retail.

ERGON ENERGY (continued)

Table 2.16 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*[b]
Size						
Total assets	$M	n.r.	n.r.	n.r.	288	297
Total revenue	$M	n.r.	n.r.	n.r.	629	1 151
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	n.r.	7 575	8 057
Operating sales margin	%	n.r.	n.r.	n.r.	0.8	0.1
Cost recovery	%	n.r.	n.r.	n.r.	100.2	100.1
Return on assets	%	n.r.	n.r.	n.r.	3.0	3.1
Return on equity	%	n.r.	n.r.	n.r.	3.7	5.5
Financial management						
Debt to equity	%	n.r.	n.r.	n.r.	23.0	22.2
Debt to total assets	%	n.r.	n.r.	n.r.	10.3	10.1
Total liabilities to equity	%	n.r.	n.r.	n.r.	124.1	123.4
Interest cover	times	n.r.	n.r.	n.r.	7.7	8.8
Current ratio	%	n.r.	n.r.	n.r.	258.1	261.7
Leverage ratio	%	n.r.	n.r.	n.r.	224.1	223.4
Payments to and from government						
Dividends	$'000	n.r.	n.r.	n.r.	1 184	0
Dividend to equity ratio	%	n.r.	n.r.	n.r.	0.9	0
Dividend payout ratio	%	n.r.	n.r.	n.r.	25.2	0
Income tax expense	$'000	n.r.	n.r.	n.r.	2 877	827
CSO funding	$'000	n.r.	n.r.	n.r.	29 847	251 633

a Ergon Energy was established on 1 July 1997. Hence, 1997-98 is the first year where financial data are available. Customers with sites using $\geq$ 40GWh were given the choice of retail supplier from 29 March 1998. **b** Customers with sites using $\geq$ 4GWh given the choice of retail supplier from October 1998. **n.r.** Not relevant.

ENERGEX — Queensland

South East Queensland Electricity Board (SEQEB) became a subsidiary of the Queensland Transmission and Supply Corporation on 1 January 1995. On 1 July 1997, the corporation and a newly formed, wholly owned subsidiary were registered to become South East Queensland Electricity Corporation (SEQEC) Pty Ltd (a licensed distributor) and Southern Electricity Retail Corporation (SERC) Pty Ltd (a licensed retailer). On 30 October 1997, SEQEB changed its trading name to ENERGEX.

Following the acquisition of Allgas Energy Ltd during 1998-99, ENERGEX Retail sells gas and electricity products and services to more than one million customers.

The fall in operating profit in 1996-97 largely reflects the impact of abnormal expenses related to redundancy payments and a land and building valuation decrement ($5 million).

The incorporation of SEQEC and its wholly owned subsidiary SERC during 1997-98 make, it difficult to compare financial performance with previous years. The phased introduction of customer choice of retail supplier and the acquisition of Allgas Ltd have contributed to the growth in total revenue since 1997-98.[1]

As a part of a capital restructure, Energex was directed by its shareholding ministers to make interest free loans (valued at $300 million) to the Queensland Government in 1997-98. These were financed through an increase in long term debt held by Energex. In 1998-99, the loan was restructured as a reduction in issued capital.

Energex is required to make income tax-equivalent and dividend payments. Its dividend distribution policy is outlined in a statement of corporate intent agreed to by its shareholding ministers.

Energex receives community service obligation funding from the Queensland Government for the uneconomic supply of electricity to some franchise customers, electrical inspections, pensioner rebates and the administration of pensioner rebates.[2]

1 Customers with sites using $\geq$ 40GWh were given the choice of retail supplier from 29 March 1998. Customers with sites using $\geq$ 4GWh were given the choice of retail supplier from October 1998.

2 CSO funding for electrical inspections ceased in 1997-98.

ENERGEX (continued)

Table 2.17 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]
Size						
Total assets	$M	2 242	2 275	2 334	2 927	2 962
Total revenue	$M	1 282	1 303	1 343	1 424	1 560
Profitability						
Operating profit before tax (includes abnormals)	$'000	134 931	98 239	86 314	186 993	87 171
Operating sales margin	%	14.3	11.5	9.9	17.1	10.0
Cost recovery	%	115.7	113.0	112.6	122.0	112.2
Return on assets	%	8.7	7.0	6.1	8.6	5.5
Return on equity	%	7.2	5.4	4.9	8.4	4.5
Financial management						
Debt to equity	%	49.4	44.7	47.9	67.0	110.0
Debt to total assets	%	30.2	27.7	30.0	34.6	45.9
Total liabilities to equity	%	64.9	62.4	61.7	93.9	141.4
Interest cover	times	3.3	2.6	2.6	3.9	2.2
Current ratio	%	142.7	111.5	161.8	265.1	132.1
Leverage ratio	%	164.9	162.4	161.7	193.9	241.4
Payments to and from government						
Dividends	$'000	46 400	55 450	20 296	105 500	63 607
Dividend to equity ratio	%	3.0	4.0	1.4	7.0	4.6
Dividend payout ratio	%	41.5	74.9	29.4	83.6	104.1
Income tax expense	$'000	23 194	24 239	17 288	60 726	26 073
CSO funding	$'000	9 820	20 820	22 341	21 734	22 625

a In 1996-97, 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 Pty Ltd and Southern Electricity Retail Corporation Pty Ltd. As a consequence, data for this year and previous years is not directly comparable. In 1997-98, Energex incurred abnormal expenses related to redundancy payments ($13.4 million). Customers with sites using $\geq$ 40GWh given the choice of retail supplier from 29 March 1998. **c** In 1998-99, Energex incurred abnormal expenses 14.2 million related to redundancy payments (5.8 million), year 2000 compliance costs (4.7 million) and write-off expenses ($3 million). Customers with sites using $\geq$ 4GWh given the choice of retail supplier from October 1998.

WESTERN POWER — Western Australia

Western Power was established on 1 January 1995 as a corporatised entity following the disaggregation of the State Energy Commission of Western Australia into separate gas and electricity businesses. Western Power operates six major power stations and 27 smaller power stations with a total capacity of more than 3 300 MW. Western Power is also involved in the transmission and distribution of electricity. Its 775 000 customers are supplied through two major interconnected systems — in the south-west corner of Western Australia and the Pilbara in the north — as well as 29 separate systems in remote parts of the State.

Western Power have been able to improve profitability over the monitoring period largely through increased revenue from electricity sales, funding for the provision of Community Service Obligations (CSOs) and cost management.[1] For a number of years Western Power have been trying to renegotiate down the price of gas purchased from the North West Shelf. Following arbitration, the issue was finally resolved in 1998-99 and this had a considerable impact on fuel costs for that year. Western Power was also able to renegotiate lower charges for coal transported by Westrail to its Kwinana Power Station.

Over the monitoring period, Western Power has carried a high level of debt as reflected in its debt to equity and debt to total asset ratios. Debt restructuring in 1998-99 contributed to a fall in the debt to equity ratio and should result in lower interest expenses in the future.

1996-97 was the first year that Western Power received funding, from the Western Australian Government, for the provision of CSOs. Western Power receives funding in relation to rebates provided to customers. 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.

1 From January 1997 all customers taking supply at 66kV and above are able to purchase electricity from the supplier of their choice via Wester Power's transmission network. From 1 July 1999, customers with an average load exceeding 5 MW were given choice of supplier. In addition, from 1 January 1998, customers within the regional non-interconnected systems with an average load exceeding 300 000 kWh were given choice of supplier.

WESTERN POWER (continued)

Table 2.18 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*[a]	*1995-96*	*1996-97*	*1997-98*	*1998-99*[b]
Size						
Total assets	$M	3 168	3 388	3 684	3 990	4 018
Total revenue	$M	647	1 311	1 336	1 398	1 604[c]
Profitability						
Operating profit before tax (includes abnormals)	$'000	75 153	138 325	155 370	227 620	223 369
Operating sales margin	%	29.2	26.9	26.2	27.8	24.4
Cost recovery	%	141.3	136.8	135.4	138.4	141.0
Return on assets	%	6.0	10.8	10.0	10.2	9.9
Return on equity	%	8.4	13.7	14.2	18.0	15.1
Financial management						
Debt to equity	%	342.1	325.0	317.9	299.0	251.2
Debt to total assets	%	64.8	65.6	65.7	65.6	64.7
Total liabilities to equity	%	427.6	412.1	404.3	373.9	289.8
Interest cover	times	1.7	1.6	1.8	2.4	2.3
Current ratio	%	232.3	166.9	154.8	108.1	106.5
Leverage ratio	%	527.6	512.1	504.3	473.9	389.8
Payments to and from government						
Dividends	$'000	0	25 000	30 000	30 000	42 332
Dividend to equity ratio	%	0.0	4.0	4.3	3.8	4.5
Dividend payout ratio	%	0.0	29.0	30.4	21.2	30.0
Income tax expense	$'000	24 920	52 116	56 598	85 986	82 273
CSO funding	$'000	0	0	28 800	31 400	32 788

a Western Power commenced operations on 1 January 1995. Data for the 1994-95 financial year relates only to operations between January and June 1995. **b** Western Power incurred abnormal revenue $127.6 million 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 Western Australian Government relating to future gas royalties from the North West Shelf ($57.2 million). Western Power also incurred abnormal expenses $164.7 million relating to debt re-financing ($107.5 million) and the write-down of prepaid gas following the agreement reached regarding the North West Shelf gas royalties ($57.2 million). **c** 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.

HYDRO–ELECTRIC CORPORATION Tasmania

On 1 July 1998, the Hydro-Electric Corporation (HEC) was separated into three businesses.[1] With control of the State's 27 hydro, one thermal, two diesel power stations and a wind farm, the HEC generates electricity and provides system control and consulting services on mainland Tasmania. The HEC is also responsible for generation, distribution and retailing on the Bass Straight Islands, although service delivery has been contracted to Aurora Energy.

The financial impact of the restructure was a reduction in the HEC's equity of $520.1 million being the net assets that were transferred to the two new businesses. The restructure makes direct comparisons of financial performance with previous years difficult.

The HEC is subject to the *Government Business Enterprises Act 1995* (GBE Act) and is required to make tax-equivalent and dividend payments and a debt guarantee fee.[2] The GBE Act also provides for the payment of special dividends. Special dividendS are unrelated to the current year's profits and are seen as a return on excess reserves, capital or a provision to the government as owner. Between 1994-95 and 1998-99, the HEC has made $167.4 million in dividend payments including a special dividend of $40 million in 1997-98 and 1998-99 respectively.

1998-99 was the first year that the HEC received an explicit Community Service Obligation (CSO) payment. The CSO payment covers the provision of electricity to customers on the Bass Strait Islands, which is supplied at below the cost of production.

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. All assets and liabilities relating to the transmission, distribution and retailing of electricity were transferred from HEC to Transend Networks and Aurora Energy.

2 Under the Guidelines for Dividend Returns from Government Business Enterprises (issued in June 1997), GBEs are required to recommend a dividend which meets a primary benchmark of at least 50 per cent of after tax profit and a secondary benchmark of a dividend and tax-equivalent payment of at least 70 per cent of pre tax profit.

HYDRO–ELECTRIC CORPORATION (continued)

Table 2.19 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*[a]
Size						
Total assets[b]	$M	4 106	4 584	4 374	4 041	3 199
Total revenue	$M	487	517	528	538	323
Profitability						
Operating profit before tax (includes abnormals)	$'000	29 036	64 766	85 486	94 693	26 792
Operating sales margin	%	49.9	52.8	53.2	46.8	41.5
Cost recovery	%	203.4	213.3	216.5	193.4	179.9
Return on assets	%	5.9	6.3	6.3	6.0	3.7
Return on equity	%	-0.2	1.0	1.3	1.7	0.1
Financial management						
Debt to equity	%	77.8	58.5	59.1	67.7	47.4
Debt to total assets	%	39.1	34.7	31.8	33.2	22.4
Total liabilities to equity	%	99.1	77.6	81.2	95.9	87.0
Interest cover	times	1.1	1.3	1.4	1.6	1.2
Current ratio	%	50.4	41.0	26.1	27.7	17.9
Leverage ratio	%	199.1	177.6	181.2	195.9	187.0
Payments to and from government						
Dividends	$'000	11 000	28 979	27 153	57 709	42 591
Dividend to equity ratio	%	0.5	1.2	1.1	2.6	2.3
Dividend payout ratio	%	-233.0	127.5	84.0	148.3	1 643.8
Income tax expense	$'000	33 757	42 037	53 180	55 790	24 201
CSO funding	$'000	0	0	0	0	4 390

Note Over the period, the Hydro-Electric Corporation (HEC) has incurred significant abnormal expenses largely as the result of payments made to employees under redundancy and voluntary advance retirement programs. In 1997-98, the HEC incurred abnormal expenses relating to the refurbishment of property assets relating to villages around power stations in readiness for their disposal. In 1998-99, 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. **a** 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 for 1998-99 relates only to the restructured HEC. **b** Property, plant and equipment is revalued each year to its deprival value. Consequently, in 1994-95 and 1995-96 there was an increase in the carrying amount of fixed assets of $56.7 million and $524 million respectively. In 1996-97 and 1997-98 there was a decrease in the carrying amount of fixed assets of $171.7 million and $329 million, respectively.

AURORA ENERGY — Tasmania

Aurora Energy Pty Ltd was established on 1 July 1998 following the structural separation of the Hydro-Electric Corporation (HEC).[1] Aurora is mainland Tasmania's only electricity distribution and retail company. Aurora was formed under the *Electricity Companies Act 1997* and incorporated under corporations law.

Aurora is subject to the income tax-equivalent provisions of the *Government Business Enterprises Act 1995* (GBE Act). In its first year of operation Aurora Energy declared a dividend of $6.2 million — 50 per cent of after tax operating profit.[2]

In addition to declaring a dividend, Aurora Energy is also required to make a contribution to the consolidated fund ($14.2 million in 1998-99) under the provisions of the *Electricity Entities (Contributions Act) 1997*. This levy is 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.

Under the *Electricity Companies Act 1997*, Aurora Energy is also subject to the debt guarantee provisions of the GBE Act. The guarantee fee rate is based on the difference between interest rates at which GBEs have borrowed and interest rates which would have been payable had GBEs raised funds on the open market, without any explicit or implicit assistance from the Tasmanian Government.

Aurora Energy has a Community Service Activity Agreement with the Tasmanian Government under which it receives a payment for providing pensioners with discounted electricity.

1 The HEC continues to be responsible for the generation of electricity, system control and provides consulting services on mainland Tasmania. The HEC is also responsible for generation, distribution and retailing on the Bass Straight Islands, although service delivery has been contracted to Aurora Energy. Transend Networks is responsible for electricity transmission.

2 Under the *Government Business Enterprises Act 1995*, nominated GBEs are required to make dividend payments. Aurora Energy is a state owned company and is not explicitly subject to these provisions. It is not clear what dividend requirements have been placed on Aurora Energy by its shareholder government.

AURORA ENERGY (continued)

Table 2.20 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*[a]
Size						
Total assets	$M	n.r.	n.r.	n.r.	n.r.	762
Total revenue	$M	n.r.	n.r.	n.r.	n.r.	543
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	n.r.	n.r.	26 596
Operating sales margin	%	n.r.	n.r.	n.r.	n.r.	11.9
Cost recovery	%	n.r.	n.r.	n.r.	n.r.	112.7
Return on assets	%	n.r.	n.r.	n.r.	n.r.	8.6
Return on equity	%	n.r.	n.r.	n.r.	n.r.	5.5
Financial management						
Debt to equity	%	n.r.	n.r.	n.r.	n.r.	171.2
Debt to total assets	%	n.r.	n.r.	n.r.	n.r.	51.0
Total liabilities to equity	%	n.r.	n.r.	n.r.	n.r.	235.7
Interest cover	times	n.r.	n.r.	n.r.	n.r.	1.7
Current ratio	%	n.r.	n.r.	n.r.	n.r.	72.2
Leverage ratio	%	n.r.	n.r.	n.r.	n.r.	335.7
Payments to and from government						
Dividends	$'000	n.r.	n.r.	n.r.	n.r.	6 200
Dividend to equity ratio	%	n.r.	n.r.	n.r.	n.r.	2.7
Dividend payout ratio	%	n.r.	n.r.	n.r.	n.r.	50.0
Income tax expense	$'000	n.r.	n.r.	n.r.	n.r.	14 196
CSO funding	$'000	n.r.	n.r.	n.r.	n.r.	9 826

Note Aurora Energy commenced operations on 1 July 1998 following the restructure of the former 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. [a] In 1998-99, Aurora incurred abnormal expenses ($3.8 million) relating to payments to staff under redundancy and voluntary advanced retirement programs and Aurora Energy rebranding costs. **n.r.** Not relevant.

TRANSEND NETWORKS — Tasmania

Transend Networks owns and operates the electricity transmission system in Tasmania, which includes almost 3 500km of overhead transmission lines and 45 substations. Transend commenced trading on 1 July 1998 following the structural separation of the Hydro-Electric Corporation (HEC).[1]

Transend Networks was formed under the *Electricity Companies Act 1997* and incorporated under Corporations Law. In its first year of operation (1998-99) Transend generated $34.6 million in operating profit before tax (including abnormals) and controlled assets valued at $406 million.

Transend is subject to the income tax-equivalent provisions of the *Government Business Enterprises Act 1995*. In 1998-99, Transend declared a dividend of $9.9 million — 50 per cent of after tax operating profit.[2]

Transend Networks is not required to perform any community service obligations.

1 The HEC continues to be responsible for the generation of electricity on mainland Tasmania. Aurora Energy is responsible for electricity distribution and retailing.

2 Under the *Government Business Enterprises Act 1995* nominated GBEs are required to make dividend payments. Transend Networks is a state owned company and is not explicitly subject to these provisions. It is not clear what dividend requirements have been placed on Transend Networks by its shareholders.

TRANSEND NETWORKS (continued)

Table 2.21 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	n.r.	n.r.	n.r.	n.r.	406
Total revenue	$M	n.r.	n.r.	n.r.	n.r.	66
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	n.r.	n.r.	34 656
Operating sales margin	%	n.r.	n.r.	n.r.	n.r.	52.8
Cost recovery	%	n.r.	n.r.	n.r.	n.r.	211.7
Return on assets	%	n.r.	n.r.	n.r.	n.r.	8.6
Return on equity	%	n.r.	n.r.	n.r.	n.r.	5.7
Financial management						
Debt to equity	%	n.r.	n.r.	n.r.	n.r.	4.0
Debt to total assets	%	n.r.	n.r.	n.r.	n.r.	3.5
Total liabilities to equity	%	n.r.	n.r.	n.r.	n.r.	15.7
Interest cover	times	n.r.	n.r.	n.r.	n.r.	91.7
Current ratio	%	n.r.	n.r.	n.r.	n.r.	27.1
Leverage ratio	%	n.r.	n.r.	n.r.	n.r.	115.7
Payments to and from government						
Dividends	$'000	n.r.	n.r.	n.r.	n.r.	9 994
Dividend to equity ratio	%	n.r.	n.r.	n.r.	n.r.	2.8
Dividend payout ratio	%	n.r.	n.r.	n.r.	n.r.	50.0
Income tax expense	$'000	n.r.	n.r.	n.r.	n.r.	14 668
CSO funding	$'000	n.r.	n.r.	n.r.	n.r.	0

n.r. Not relevant.

SNOWY MOUNTAINS HYDRO–ELECTRIC AUTHORITY — Commonwealth

The Snowy Mountains Hydro-Electric Authority (SMHEA) was established in 1949 under Commonwealth legislation to construct and operate the Snowy Mountains Scheme — a dual-purpose hydro-electric and irrigation development in the Snowy Mountains. The SMHEA is responsible for the collection, storage diversion and release of water for irrigation purposes and the generation and transmission of electricity for NSW, Victoria and the Australian Capital Territory. The Commonwealth, NSW and Victoria are joint shareholder governments of the SMHEA.

The SMHEA remains a statutory authority and does not face the same type of financial market disciplines imposed on corporatised government trading enterprises by their shareholder governments.

The SMHEA generates its revenue through contributions from the recipients of the Scheme's energy production. Under the *Snowy Mountains Hydro-Electric Power Act 1949*, contributions are made to the Authority's revenue on the basis of the net cost of production.[1] The Authority does not generate any revenue from its water operations.

Over the monitoring period, the SMHEA has maintained a cost recovery ratio of over 90 per cent and earned a relatively low return on assets. The operating losses incurred over the period largely reflect the impact of an asset revaluation in 1991. The move from historical cost to current replacement cost and written-down value resulted in additional depreciation charges. The Authority is unable to charge additional depreciation expense on revalued assets to the net cost of production and so the shareholder governments do not meet these charges.

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.

The Commonwealth, NSW and Victorian Governments have agreed on a set of principles for the reform of the Scheme. The Authority is in the process of being corporatised, however a number of issues including the final capital structure are still to be negotiated between the joint shareholder governments.

1 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.

SNOWY MOUNTAINS HYDRO–ELECTRIC AUTHORITY (continued)

Table 2.22 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	3 687	3 605	3 423	3 346	3 241
Total revenue	$M	175	171	171	156	138
Profitability						
Operating profit before tax (includes abnormals)	$'000	-92 019	-80 276	-79 402	-80 138	-78 783
Operating sales margin	%	-6.7	-0.7	-1.7	-1.6	-8.7
Cost recovery	%	93.7	99.3	98.3	98.4	92.0
Return on assets	%	0.0	0.3	0.3	0.1	-0.2
Return on equity	%	-3.5	-3.1	-3.2	-3.3	-3.4
Financial management						
Debt to equity	%	37.7	38.6	38.2	39.6	39.7
Debt to total assets	%	26.3	26.7	26.6	27.7	27.6
Total liabilities to equity	%	41.6	42.8	39.9	41.4	41.7
Interest cover	times	0	0.1	0.1	0	-0.1
Current ratio	%	18.6	9.2	43.0	19.7	36.5
Leverage ratio	%	141.6	142.8	139.9	141.4	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

ALINTAGAS Western Australia

AlintaGas was established on 1 January 1995 as a corporatised entity following the disaggregation of the State Energy Commission of Western Australia into separate gas and electricity businesses. AlintaGas supplies and distributes natural gas to residential, business and industrial customers in Perth, Mandurah, Geraldton, Bunbury, Busselton and Kalgoorlie-Boulder.

AlintaGas was also responsible for the transmission of gas up until the sale of the Dampier to Bunbury Natural Gas Pipeline (DBNGP) in March 1998. The DBNGP was sold to Epic Energy for $2.3 billion. The profit arising from the sale ($1.2 billion) was recorded as an extraordinary revenue item and is not reflected in the total revenue and profitability ratios.

AlintaGas used some of the proceeds ($1 billion) from the sale of the DBNGP to retire debt. This resulted in a significant fall in AlintaGas's debt to equity, debt to total assets and total liabilities to equity ratios in 1997-98. It also resulted in a significant fall in interest expenses. In 1995-96, interest expense accounted for 31 per cent of total expenses, by 1998-99 this had fallen to 4.6 per cent.

The Western Australian Government has announced its intention to sell AlintaGas by mid 2000. The Government plans to sell between 40 and 60 per cent to a cornerstone purchaser and to float the remainder on the Australian stock exchange.

AlintaGas is required to make tax-equivalent payments and made dividend payments in both 1997-98 and 1998-99. The significant dividend payment in 1997-98 reflects the requirement to pay a special dividend ($1.2 billion) following the sale of the DBNGP.

AlintaGas is not required to perform any community service obligations by the Western Australian Government.

ALINTAGAS (continued)

Table 2.23 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*[a]	*1995-96*[b]	*1996-97*[c]	*1997-98*[d]	*1998-99*[e]
Size						
Total assets	$M	1 548	1 470	1 474	622	486
Total revenue	$M	201	445	471	449	337
Profitability						
Operating profit before tax (includes abnormals)	$'000	1 447	29 682	52 051	32 407	47 583
Operating sales margin	%	35.3	35.8	37.2	27.0	15.4
Cost recovery	%	154.6	153.4	157.7	150.6	122.6
Return on assets	%	4.6	10.6	11.9	11.6	11.0
Return on equity	%	1.7	19.0	25.2	14.9	25.3
Financial management						
Debt to equity	%	1 369.1	1 019.2	767.3	194.6	190.9
Debt to total assets	%	90.2	83.4	82.9	22.2	40.6
Total liabilities to equity	%	1 417.4	1 090.9	827.0	420.8	312.4
Interest cover	times	102.1	122.9	142.3	136.4	455.8
Current ratio	%	60.3	79.2	53.0	118.9	52.0
Leverage ratio	%	1 517.4	1 190.9	927.0	520.8	412.4
Payments to and from government						
Dividends	$'000	0	0	0	1 206 099[f]	31 412
Dividend to equity ratio	%	0	0	0	866.5	26.5
Dividend payout ratio	%	0	0	0	5 813.9	104.8
Income tax expense	$'000	-281	8 290	16 415	11 662[g]	17 623
CSO funding	$'000	0	0	0	0	0

a AlintaGas commenced operations on 1 January 1995. Data for the 1994-95 financial year relates only to operations between January and June 1995. **b** In 1995-96, AlintaGas incurred abnormal revenue of $6.9 million related to a foreign exchange gain. **c** In 1996-97, AlintaGas incurred abnormal revenue of $4.3 million related to a foreign exchange gain. **d** In March 1998, AlintaGas sold the Dampier to Bunbury Natural Gas Pipeline (DBNGP) for $2 302 million. The proceeds from the sale were used to retire debt and to meet costs associated with the sale process. A significant proportion was paid to the Western Australian Government as a special dividend. The profit from the sale was treated as extraordinary revenue and is not reflected in the total revenue and operating profit figures. Financial performance for 1997-98 is not directly comparable with previous years. AlintaGas also incurred an abnormal expense ($29.6 million) related to the refinancing of its remaining debt. From 1 January 1999, all customers using more than 250TJ per annum at one site were given the choice of supply. Restrictions relating to the sale of liquefied petroleum gas in the Perth metropolitan area were also removed. **e** AlintaGas incurred abnormal expenses ($1.2 million) related to future privatisation costs. **f** Includes $1 206 million in a special dividend payment following the sale of the DBNGP. **g** Excludes $46.6 million attributable to profit on the extraordinary item associated with the sale of the DBNGP.

3 Water, sewerage, drainage and irrigation

The financial performance of 13 water Government Trading Enterprises (GTEs) are discussed in this chapter.[1] Service providers include government departments, statutory corporations and local governments. They undertake a variety of activities, including water treatment, bulk water supply, reticulation and retail supply, sewerage collection and treatment, drainage and irrigation.

At the end of 1998-99, water GTEs monitored in this report generated almost $4.5 billion in revenue and controlled assets valued at almost $39 billion. It should be noted that this study only covers a limited number of water service providers. In most cases, it does not include water services provided by non-metropolitan urban water authorities, regional water authorities and local governments.

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 1.

3.1 Sector reforms

Industry reforms within the water industry have been aimed at improving the efficiency and financial performance of the water GTEs by making them 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 are to introduce:

- consumption-based two-part tariffs, full cost recovery and remove or make transparent subsidies and cross-subsides;
- explicit identification and funding of Community Service Obligations (CSOs);

[1] The financial performance of Gosford City Council Water & Sewerage Department and Wyong Shire Water Department in New South Wales, Brisbane Water and Gold Coast Water in Queensland, ACTEW Corporation in the ACT and the Power and Water Authority in the Northern Territory is not reported as detailed and disaggregated information were unavailable.

- 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.

This water resource policy agreed to by all Australian Governments has and will continue to fundamentally change the way water is allocated, delivered and paid for.

Almost all jurisdictions have implemented two-part tariffs for water and sewerage services and removed many cross-subsidies between customer classes. However, Western Australia, South Australia and Tasmania mostly retain property-based charges for sewerage services.

Regulatory, standard setting and resource management functions have been removed from service providers in most jurisdictions. For example, the Water Authority of Western Australia became the Water Corporation on 1 January 1996. At the same time, the Water and Rivers Commission and the Office of Water Regulation were established — the former to manage and protect Western Australia's water, and the latter to administer a licensing scheme that sets service standards for the Water Corporation and other water service providers respectively.

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, in 1996 the South Australia Government contracted out the management and operation of the water supply for the Adelaide metropolitan area to a private company. In contrast, Sydney Water and Hunter Water (NSW), changed status from company to statutory State owned corporations on 1 January 1999 — to give the responsible Minister greater power to access information and issue directions to the corporations (see table 3.1).

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

Table 3.1 **Monitored Water GTEs, 1994-95 to 1998-99**

1994-95	*1995-96*	*1996-97*	*1997-98*	*1998-99*
New South Wales				
Hunter Water Corporation	→	→	→	Hunter Water Corporation[a]
Sydney Water Board	→	→	→	Sydney Water Corporation[a]
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	→	Department of Natural Resources, State Water Projects[b]	→	Department of Natural Resources, State Water Projects

a Changed from a company to a statutory State owned corporation **b** Fully commercialised on 1 July 1997.

(Continued next page)

Table 3.1 (continued) **Monitored Water GTEs, 1994-95 to 1998-99**

1994-95	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Western Australia				
Water Authority of Western Australia	→	→	→	Water Authority of Western Australia
South Australia				
SA Engineering and Water Supply Department	→	→	→	South Australian Water Corporation
Tasmania				
Hobart Regional Water Board	→	Hobart Regional Water Authority →	Hobart Regional Water Authority[c] →	Hobart Regional Water Authority
Rivers and Water Supply Commission, North Esk	→	Esk Water Authority →	Esk Water Authority[c] →	Esk Water Authority
North West Regional Water Authority	→	→	→	North West Regional Water Authority [d]

[c] Control and ownership transferred to local governments' joint venture. [d] North West Regional Water Authority established on 10 August 1999 as a local government Joint Authority, North West Water Authority.

3.2 Market environment

A number of factors influence the market environment that water GTEs operate in. In particular, the demand and supply for water is greatly affected by weather conditions.

Weather conditions affect both demand and supply. For example, due to a dry summer, Sydney Water supplied 2 404 million litres a day in March 1998 compared to 1 700 million litres per day at the same time in 1996-97. On the supply side, 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. Previously, with revenue typically raised through property value 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.

As a commodity, water is different from products or services that are provided by other industries discussed in this report because of its scarcity and impact on the environment. Water GTEs are usually required to strike a balance between the consumptive and environmental needs in generating an acceptable return to shareholder governments.

Under their operating licences, the amount of water GTEs can draw from their surface and ground water sources is usually limited for environmental reasons. For example, the Water 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, State governments or an independent pricing body regulates water prices. For example, in NSW the Independent Pricing and Regulatory Tribunal (IPART) is responsible for setting prices for major urban centres and for rural bulk water.

3.3 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 1.

The water industry is very diverse. Some GTEs undertake a range of activities like bulk water provision, reticulation, sewerage and drainage, (for example Hunter Water). Others such as State Water Projects (Queensland) undertake only one activity. This diversity in activities affects costs and the scope to recover costs in the transition to full commercialisation. Accordingly, it can also affect the comparability of financial performance.

The accounting treatment of contributed assets can have a material effect on profitability and asset and liability recognition. Almost all GTEs indicate that they are following Urgent Issue Group (UIG) 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.[2]

The Productivity Commission's treatment of contributed assets has changed over the monitoring period (see chapter 1). Therefore, it should be noted that the impact of these assets on profitability ratios such as return on assets has changed after 1997-98.

The profitability of most water GTEs has improved over the period. Operating profit is influenced by the combination of prices, business volumes and expenses. The impact of these factors varies between GTEs. The increase in profitability of water GTEs has contributed to an improved return on assets. However, most GTEs lie below a rate of return of 6 per cent (see figure 3.1). Currently, the rate of return on 10-year bonds is 6.55 per cent (June 2000). It is reasonable to expect that the appropriate return for these GTEs should be at least equal or above the long-term bond rate.

The return on assets is also affected by asset valuations. For example, the value of Barwon Water's non-current assets increased from 30 June 1998 as a consequence of moving from historical cost to current replacement cost. This contributed to the decline in return on assets ratio for 1998-99.

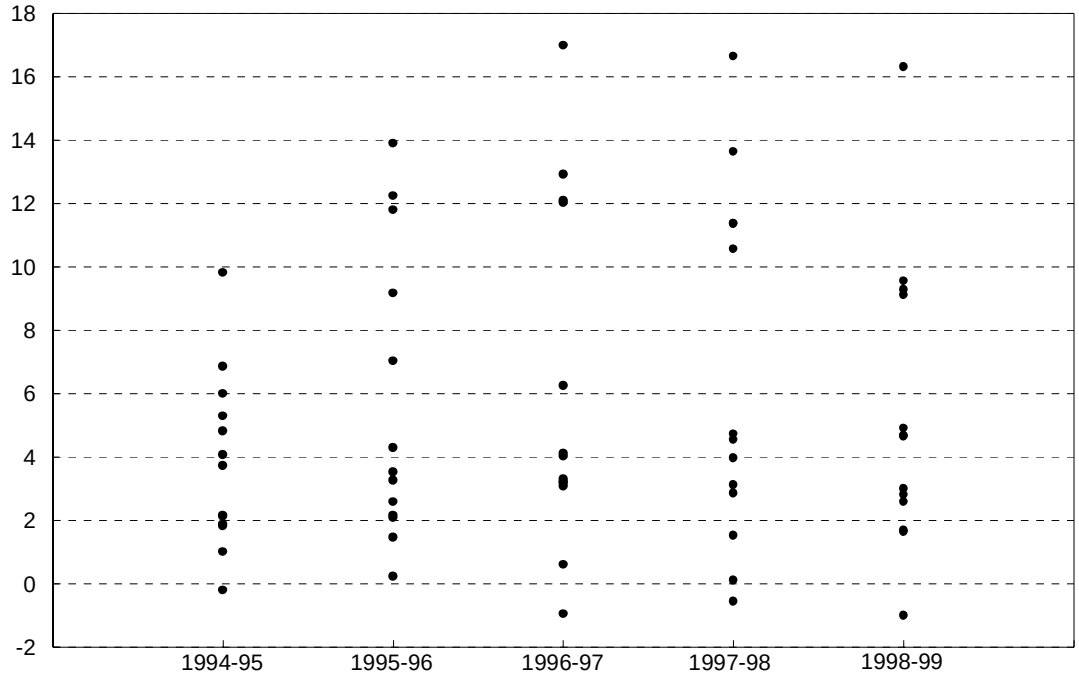
Another ratio used to measure profitability is return on equity — the rate of earnings on capital provided by shareholder governments. Over the monitoring period, the return on equity for most water GTEs has improved.

Return on equity is affected by debt restructuring and operating profits. For example, the Water Corporation of Western Australia's return on equity increased from 0.9 per cent to 2.7 per cent when operating profit increased over the

2 The Australian Accounting Research Foundation issues UIG Consensus Views as Abstracts to assist in the interpretation of an existing Accounting Standard or guidance in the absence of one.

monitoring period and interest expenses reduced with debt reduction implemented in 1996-97.

Figure 3.1 **Return on assets, 1994-95 to 1998-99 (per cent)**

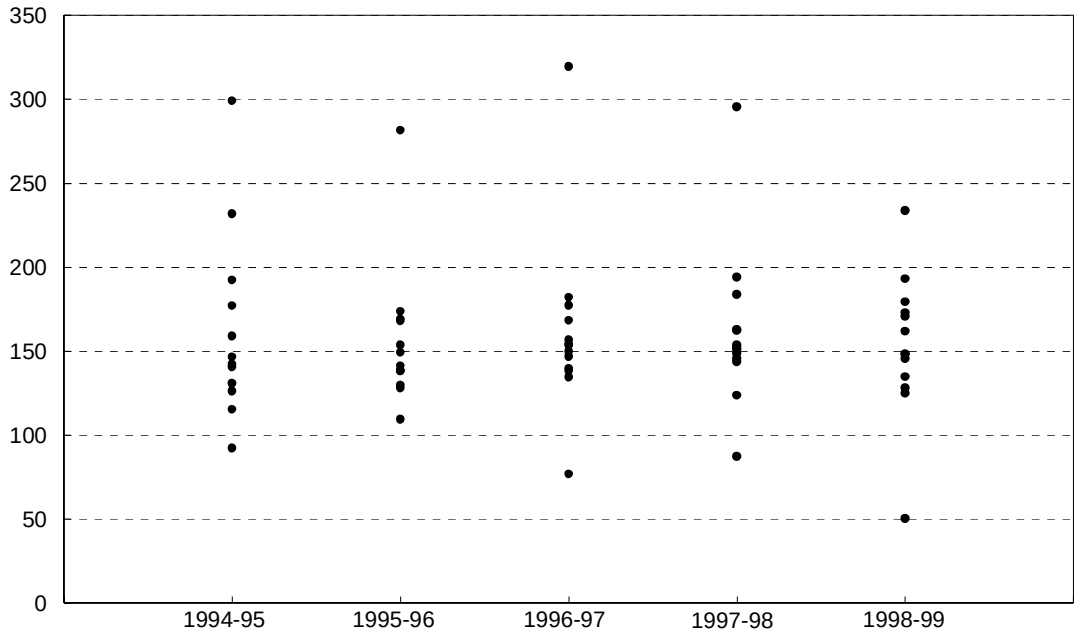


Note Each data point represents the return on assets ratio for a GTE in that financial year. Return on assets is the ratio of earnings before interest and tax (EBIT) to average total assets. EBIT is calculated by subtracting total expenses from total revenue (including abnormals) and adding back gross interest expense. Average total assets are defined as the service potential or future economic benefits, controlled by the entity as a result of past transactions or other events (measured as the average of the value of assets at the beginning and end of the reporting period).

The cost recovery ratio indicates a GTE's ability to generate adequate revenue to cover expenses. High levels of cost recovery can be expected from highly capital intensive industries because of the need to meet expenses associated with maintaining and replacing capital.

Most GTEs achieved a cost recovery between 100 and 200 per cent. Over the monitoring period, Melbourne Water maintained a cost recovery ratio of over 200 per cent. On the other hand, State Water Projects (Queensland) has generally been unable to achieve a cost recovery ratio of 100 per cent despite receiving CSO payments to cover the costs of operation, maintenance and administration (see figure 3.2).

Figure 3.2 **Cost recovery, 1994-95 to 1998-99 (per cent)**



Note Each data point represents the cost recovery ratio for a GTE in that financial year. Cost recovery is the ratio of revenue from operations to expenses from operations. Revenue from operations is calculated by subtracting abnormal revenue, investment income and receipts from governments to cover deficits on operations from total revenue. Expenses from operations are calculated by subtracting abnormal expenses and gross interest expense from total expenses.

3.4 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 1.

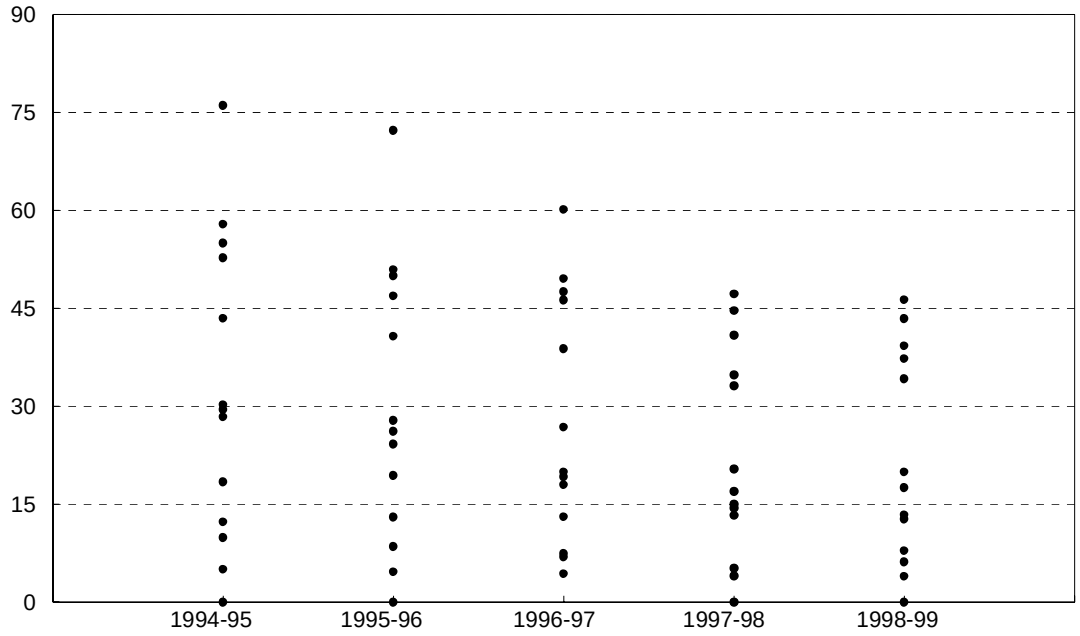
Many water GTEs have undergone financial restructuring as part of the reform process. This has largely involved debt for equity swaps, debt repayments and debt novation.[2] The main aim of financial restructuring has been to establish a capital structure that is commercially viable.

The magnitude of debt restructuring has typically depended on the GTE's initial capital structure. For example, the Hunter Water Corporation's capital structure was changed in 1994-95 to reduce exposure to interest rate fluctuations — they converted $20 million in variable rate debt to long-term fixed rate debt.

2 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.

Overall, debt levels have declined over the period and as a result financial management ratios have improved. At the end of 1998-99 most GTEs have debt to total assets of below 25 per cent (see figure 3.3).

Figure 3.3 **Debt to total assets, 1994-95 to 1998-99 (per cent)**



Note Each data point represents the debt to total assets ratio for a GTE 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. Total assets are defined as the service potential or future economic benefits, controlled by the entity as a result of past transactions or other events (measured as the average of the value of assets at the beginning and end of the reporting period).

The four GTEs which had debt to total assets of above 45 per cent between 1994-95 and 1996-97 are Melbourne Water and the three retail companies 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.

Across the monitoring period, the debt to equity ratio for most GTEs has been more than 100 per cent. The Melbourne Water Corporation had the highest debt to equity ratio — 527 per cent in 1994-95. This has subsequently declined over the monitoring period following two debt for equity swaps in 1996-97 and 1997-98 respectively.

Most GTEs have current ratios below 100 per cent indicating that it would be difficult to meet short-term liabilities by realising short-term assets. Water GTEs have become less liquid over the monitoring period. For example, the Western

Australia Water Corporation current ratio has fallen to below 50 per cent as a result of increased current liabilities, such as tax-equivalent payments.

Over the monitoring period, there has been an increase in the number of GTEs that achieved more than 3 times in interest cover. A higher 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 most cases, improvements in interest cover over the monitoring period have resulted from debt restructuring or increased operating profits.

3.5 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 1.

The timing of the introduction of tax-equivalent regimes has varied between jurisdictions. However, by the end of the monitoring period all water GTEs were required to make tax-equivalent payments.

Dividends represent a return to shareholder government equity. Almost all the monitored water GTEs are required to make dividend payments. The amount payable by each GTE depends on the dividend policy of their State government. In 1998-99, most GTE's dividend payout ratios — the proportion of operating profit that is paid or provided for as dividend — were between 50 per cent and 100 per cent.

One of the requirements of the COAG reforms is the disclosure of the costs of providing water services at less than full cost recovery and the compensation of these costs as CSO payments. This achieves transparency in CSO funding and removes the conflict between non-commercial objectives and cost recovery. Some examples of CSOs are concessions, sewer backlog programs and free provision of water for fire-fighting purposes.

Most water GTEs have CSO arrangements with their shareholder governments. GTEs that receive explicit CSO funding have reported the amount in their financial statements. CSOs provided by Victorian water GTEs were internally funded until 1996-97. For 1997-98 and 1998-99, no explicit funding is reported in their financial statements. Barwon Water has indicated that further work is required to adequately define CSOs and the appropriate level of compensation.

3.6 GTE performance reports

Sydney Water Corporation (NSW)
Hunter Water Corporation (NSW)
Melbourne Water Corporation (Vic)
City West Water (Vic)
South East Water (Vic)
Yarra Valley Water (Vic)
Barwon Water (Vic)
Department of Natural Resources, State Water Projects (QLD)
South Australian Water Corporation (SA)
Water Corporation (WA)
Hobart Regional Water Authority (Tas)
North West Water Authority (Tas)
Esk Water Authority (Tas)

SYDNEY WATER CORPORATION — New South Wales

The Sydney Water Corporation (SWC) was established as a statutory State owned corporation on 1 January 1999 following the enactment of the *Water Legislation Amendment (Drinking Water and Corporate Structure) Act 1998*.[1] Sydney Water supplies drinking water and provides wastewater services and some stormwater services to the people of Sydney, the Blue Mountains and Illawarra. It serves more than 3.9 million customers.

The increase in Sydney Water's operating profit before tax (including abnormals) in 1997-98, resulted from increased water consumption caused by high temperatures and little rain, abnormal revenue of $41.6 million from the capitalisation of water meter assets, and reduced operating costs. Sydney Water's operating profit in 1998-99 was significantly affected by water contamination incidents in July, August and September 1998. These incidents resulted in Sydney Water incurring an abnormal expense of $55.4 million and $19.2 million in forgone revenue following a decision to defer a price increase for a period of 12 months.[2]

Following the contaminated water incidents, the NSW Government established the McClellan Inquiry. As a consequence of this Inquiry, the Sydney Catchment Authority (SCA) was established in December 1998 and commenced operations in July 1999. The staff, assets, rights and liabilities relating to catchment management were transferred from the SWC to the SCA. The assets included catchments, dams and bulk water pipelines amounting to $647 million.

Return on asset and return on equity increased between 1994-95 and 1997-98, but declined in 1998-99. This reflects the impact of a pricing reform package introducing a $20 million and $40 million property tax reduction on customer's bills in 1997-98 and 1998-99 respectively.

Sydney Water is required to makes tax-equivalent and dividend payments.[3] Sydney Water receives funding for the provision of community service obligations.

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1 This amendment changed the status of the SWC from a company to a statutory state owned corporation, and gives the Minister responsible for Sydney Water greater power to access information.

2 The abnormal expense included a $15 rebate to affected customers ($19.2 million), outstanding and paid insurance claims ($14.0 million), monitoring and testing costs ($12.5 million), other costs ($7.7 million) and costs associated with the McClellan Inquiry ($2.0 million).

3 The SWC is 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.

SYDNEY WATER CORPORATION (continued)

Table 3.1 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*	*1997-98*	*1998-99*[b]
Size						
Total assets	$M	13 570	13 294	13 416	14 061	13 278
Total revenue	$M	1 318	1 168	1 283	1 372	1 377
Profitability						
Operating profit before tax (includes abnormals)	$'000	113 995	160 665	237 133	369 634	233 737
Operating sales margin	%	21.0	26.8	30.3	37.7	28.5
Cost recovery	%	130.6	138.3	138.3	153.6	145.3
Return on assets	%	2.2	2.6	3.2	4.0	3.0
Return on equity	%	0.6	0.6	1.3	2.2	1.4
Financial management						
Debt to equity	%	15.8	16.1	16.0	15.8	16.9
Debt to total assets	%	12.3	13.0	13.1	13.3	13.3
Total liabilities to equity	%	21.8	22.9	23.0	21.7	22.8
Interest cover	times	1.6	1.9	2.3	3.1	2.3
Current ratio	%	70.6	61.5	55.6	60.2	24.5
Leverage ratio	%	121.8	122.9	123.0	121.7	122.8
Payments to and from government						
Dividends	$'000	63 482	40 000	77 646	209 000	91 683
Dividend to equity ratio	%	0.5	0.4	0.7	1.9	0.8
Dividend payout ratio	%	88.2	59.5	56.2	86.0	60.1
Income tax expense	$'000	42 044	93 402	98 966	126 533	81 160
CSO funding	$'000	45 600	82 000	93 800	89 700	105 200

a Sydney Water abolished property tax to the residential sector from October 1995. **b** Sydney Water recorded an abnormal expense of $55.4 million due to the water contamination incidents that occurred in July, August and September 1998. Sydney Water Corporation was established as a statutory State 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*. The SCA commenced operations in July 1999. The SCA was formed to improve the catchment management process and thereby drinking water quality. The financial statistics cover Sydney Water's combined financial performance as both a company and statutory State owned corporation. The SWC is 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.

HUNTER WATER CORPORATION — New South Wales

Hunter Water Corporation (HWC) was established as a State owned corporation on 1 January 1999 following the enactment of the *Water Legislation Amendment (Drinking Water and Corporate Structure) Act 1998.*[1] The HWC provides water, waste water and drainage services to a population of almost half a million people from five councils. These include Newcastle, Lake Macquarie, Maitland, Cessnock and Port Stephens. In November 1997, Hunter Water created a wholly owned and controlled entity known as Hunter Water Australia Pty Ltd.[2]

Hunter Water's operating profit before tax (including abnormals) was influenced by climatic changes in 1997-98. Water consumption increased by 7.6 per cent in 1997-98 as a result of a hot, dry summer.[3] Operating profits were affected by higher costs due to an increased level of maintenance and repair work. The decline in operating profit in 1998-99 is attributed to reduced income from water usage charges due to the mild and wet summer and increased operational costs.[4]

Return on asset and return on equity have increased over the monitoring period but declined in 1998-99 as a result of reduced demand.[5]

Interest cover and the current ratio increased significantly from 1994-95 to 1995-96 due to the conversion of variable rate debt of $20 million into long-term fixed rate debt, and the consolidation of 13 loans into 7 loans. The current ratio declined sharply from 1997-98 to 1998-99 due to a loan of $18 million.

Hunter Water is required to make tax-equivalent and dividend payments. community service obligations provided by Hunter Water are funded by the NSW Government and reported explicitly in the financial statements.

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1 This amendment changed the status of the HWC from a company to a statutory state owned corporation, and gives the Minister responsible for Hunter Water greater power to access information.

2 Hunter Water Australia Pty Ltd's core services involve water treatment, engineering, surveying, laboratory services and selling their expertise to the external market. The Hunter Water Australia's financial results are incorporated with those of the HWC.

3 The increase in consumption is not reflected in the total revenue figure (table 3.2) in 1997-98 because abnormal revenue in 1996-97 was higher than 1997-98.

4 The increased operational costs have been driven by additional maintenance and repair work to attend to sewer breaks and storm damage to assets, increased levels of camera inspection, water jetting of blocked sewer mains, and additional costs in relation to water treatment.

5 A class of assets representing 20 per cent of total assets is revalued annually and 80 per cent is indexed annually to maintain current values. This did not have a significant impact on financial ratios.

HUNTER WATER CORPORATION (continued)

Table 3.2 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*	*1997-98*[b]	*1998-99*[c]
Size						
Total assets	$M	1 675	1 972	2 027	2 038	2 064
Total revenue	$M	130	129	154	148	139
Profitability						
Operating profit before tax (includes abnormals)	$'000	19 322	32 891	54 207	56 205	50 548
Operating sales margin	%	20.7	27.7	37.3	40.5	39.0
Cost recovery	%	126.1	138.3	139.6	162.2	161.6
Return on assets	%	1.8	2.2	3.1	3.1	2.8
Return on equity	%	0.4	1.0	2.3	2.6	1.7
Financial management						
Debt to equity	%	5.5	4.8	4.8	4.4	4.3
Debt to total assets	%	5.1	4.7	4.4	4.0	4.0
Total liabilities to equity	%	9.8	10.2	10.4	9.5	9.9
Interest cover	times	2.8	6.0	8.5	8.8	8.2
Current ratio	%	135.7	192.7	187.4	151.1	91.5
Leverage ratio	%	109.8	110.2	110.4	109.5	109.9
Payments to and from government						
Dividends	$'000	17 399	29 600	35 500	39 000	45 000
Dividend to equity ratio	%	1.2	1.8	2.0	2.1	2.4
Dividend payout ratio	%	329.7	177.6	83.5	80.0	144.0
Income tax expense	$'000	14 045	16 226	11 670	7 471	19 295
CSO funding	$'000	7 700	8 000	8 100	8 300	8 200

a Variable rate debt of $20 million was converted to long-term fixed rate debt and consolidated from 13 loans into 7. **b** Hunter Water 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 external markets. In 1996-97, Hunter Water adopted the Urgent Issues Group (UIG) Abstract 11 to recognise as income and assets the value of contributions received from developers. In 1997-98, Hunter Water adopted UIG Abstract 17, which states that these assets should be recognised at their assessed fair value. **c** On 1 January 1999, legislation came into effect that changed Hunter Water's status from a company to a statutory State owned corporation.

MELBOURNE WATER CORPORATION — Victoria

Melbourne Water Corporation (MWC) was separated into three retail water businesses (City West Water, Yarra Valley Water and South East Water) and a wholesale water and sewerage business in January 1995.[1] MWC supplies water and sewerage services to the retail water companies through separate bulk water and sewerage supply agreements. It also provides waterways and drainage services.

MWC's total revenue, operating profit before tax (including abnormals), return on total assets and return on equity have significantly declined from 1996-97 to 1997-98, and have continued to decline over the remainder of the monitoring period. The decline in 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 to the retail water companies.[2]

MWC's operating profit declined even though there was an increase in bulk water sales due to continuing dry weather conditions and a reduction in operating costs as a result of improved water supply asset management.

MWC's debt to equity, debt to total asset and total liabilities to equity ratios declined significantly from 1995-96 to 1996-97 and have continued to decline over the monitoring period. The significant decline from 1995-96 to 1996-97 was due to a debt for equity swap with the Victorian Government amounting to $250 million. In 1998-99, the debt for equity swap involved the transfer of $337 million of debt for an equivalent increase in State equity.[3]

There is also an ongoing debt repayment program. This program has resulted in the reduction of debt servicing charges and hence, an increase in interest cover.

MWC is required to make income tax-equivalent and dividend payments. It 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 companies. MWC also depends on the three retail companies for the provision of billing and collection services with respect to drainage rates.

2 A usage-based billing system for retail water and sewerage services was introduced under the pricing reforms.

3 The debt reduction in 1996-97 was to make MWC's debt ratios commercially acceptable. In 1997-98 capital restructuring was part of the pricing reform package.

MELBOURNE WATER CORPORATION (continued)

Table 3.5 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*[a]	*1997-98*[b]	*1998-99*
Size						
Total assets	$M	2 698	2 731	2 714	2 721	2 751
Total revenue	$M	344	687	680	560	443
Profitability						
Operating profit before tax (includes abnormals)	$'000	36 189	146 469	263 397	254 334	176 664
Operating sales margin	%	46.9	54.9	68.0	66.1	57.2
Cost recovery	%	231.7	281.4	319.3	295.4	233.5
Return on assets	%	6.0	13.9	17.0	13.6	9.3
Return on equity	%	6.1	29.6	29.5	19.7	11.6
Financial management						
Debt to equity	%	527.9	452.5	235.5	121.2	119.4
Debt to total assets	%	76.0	72.3	60.1	47.2	46.3
Total liabilities to equity	%	594.3	530.0	290.7	157.3	159.1
Interest cover	times	1.3	1.6	2.3	3.2	3.3
Current ratio	%	9.8	7.9	10.1	12.1	8.4
Leverage ratio	%	694.3	630.0	390.7	257.3	259.1
Payments to and from government						
Dividends	$'000	28 826	80 000	141 315	141 149	106 175
Dividend to equity ratio	%	7.4	19.5	25.1	16.1	10.0
Dividend payout ratio	%	120.6	65.7	84.9	81.8	86.6
Income tax expense	$'000	12 294	24 639	96 977	81 875	54 090
CSO funding	$'000	0	0	0	0	0

a Crown land valued at $13.8 million was divested from the Melbourne Water Corporation (MWC). Debt for equity swap with the Victorian Government amounting to $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 companies (City West Water, Yarra Valley Water and South East Water). Debt restructuring was part of this package and MWC swapped its debt for equity with the Victorian Government amounting to $337 million.

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 248 000 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 rate-based to a usage-based system of billing. This reduced operating revenue, recurrent cashflow and increased the exposure of revenue to weather conditions.

Operating profit before tax (including abnormals) increased in 1997-98 contrary to a decline in revenue. This was mainly due to lower bulk supply charges from the Melbourne Water Corporation, lower financial charges through debt restructuring and cessation of subsidy payments to South East Water and Yarra Valley Water.[1] Increased water consumption due to dry weather conditions and increased developer contributions also contributed to the increase in operating profit. Return on asset and return on equity have improved substantially over the monitoring period.

City West Water's debt to equity, debt to total asset and leverage ratios declined from 1996-97 to 1997-98 due to a debt for equity swap. It involved the issue of fully paid ordinary shares amounting to $20.6 million.[2] Interest cover has increased as a result of debt reduction.

City West Water is required to make tax-equivalent and dividend payments. In 1997-98, City West Water paid its largest dividend to the Victorian Government since it commenced operations in 1995.

City West Water's Community Service Obligations (CSOs), as outlined in the 1998-99 financial statement, include administering Government funded concessions, free water for fire-fighting purposes and dialysis patients and free educational materials for schools. However, funding for these CSOs is not explicitly reported.

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1 The subsidy was provided to ensure that the three retail water companies operated on an equal footing in terms of return on assets. The subsidy payments ceased with the implementation of Victorian Government's pricing reform package.

2 Debt restructuring was part of the Victorian Government's pricing reform package that was implemented on 1 January 1998.

CITY WEST WATER (continued)

Table 3.4 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*[a]	*1995-96*	*1996-97*[b]	*1997-98*[c]	*1998-99*[d]
Size						
Total assets	$M	505	516	542	577	606
Total revenue	$M	142	294	301	270	228
Profitability						
Operating profit before tax (includes abnormals)	$'000	-7 892	32 356	39 474	76 538	83 495
Operating sales margin	%	3.3	19.9	20.9	34.2	42.2
Cost recovery	%	115.3	128.0	134.4	152.0	172.9
Return on assets	%	1.0	11.8	12.0	16.6	16.3
Return on equity	%	-3.7	12.0	14.3	26.0	26.1
Financial management						
Debt to equity	%	138.0	117.5	111.2	90.8	78.6
Debt to total assets	%	52.7	46.9	46.3	40.8	37.3
Total liabilities to equity	%	161.8	153.5	146.5	129.3	116.0
Interest cover	times	0.4	2.2	2.6	5.6	7.4
Current ratio	%	48.9	40.2	40.2	41.5	26.6
Leverage ratio	%	261.8	253.5	246.5	229.3	216.0
Payments to and from government						
Dividends	$'000	0	21 000	27 709	49 148	39 939
Dividend to equity ratio	%	0	10.6	13.1	20.8	15.0
Dividend payout ratio	%	0	88.1	91.3	80.0	57.5
Income tax expense	$'000	-696	8 518	9 132	15 108	13 981
CSO funding	$'000	0	0	0	0	0

a Only 6 months worth of data is recorded for 1994-95 as the company was formed midway though the year. **b** The basis for recording data in 1996-97 was improved and is therefore not directly comparable with previous years. **c** City West Water implemented a price reform package in October 1997 that involved a move from a rate-based to a usage-based system. **d** First full year of operation after the implementation of usage-based billing. The usage-based system changed the timing of cashflow such that customers are now billed in arrears.

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 1.4 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 1997-98 with the implementation of the Victorian Government's pricing reform package in the second half of 1997-98. The reform involved a move from rate-based to usage-based billing. With the implementation of the pricing reform, the subsidy received by SEW from City West Water ceased.[1] However, operating profit before tax (including abnormals) increased in 1997-98. This is mainly due to the reduction in bulk water supply charges from the Melbourne Water Corporation.[2] Increased water consumption due to dry weather conditions, and a decline in interest charges as a result of retired debt, have also contributed to the increase in operating profit.

SEW's debt to equity, debt to total asset and total liability to equity ratios decreased sharply, and the current ratio increased from 1996-97 to 1997-98, as a result of debt restructuring which was part of the pricing reform package. The financial restructuring involved:

- a debt for equity swap, debt of $160 million for $114.1 million fully paid ordinary shares to the State Trustees Limited on behalf of the State Government; and
- the establishment of a new portfolio with a more even spread of debt maturity and lower interest costs.

SEW also retired $24 million of debt. The reduction in debt has resulted in an increase in interest cover.

Since incorporation, SEW has made tax-equivalent and dividend payments. SEW provides community service obligations but funding is not explicitly reported in the financial statements.

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 companies on a more equal financial footing.

2 The pricing reform package required Melbourne Water Corporation to reduce bulk water charges to the three retail companies.

SOUTH EAST WATER (continued)

Table 3.6 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*
Size						
Total assets	$M	974	992	997	1 000	1 031
Total revenue	$M	182	385	404	371	305
Profitability						
Operating profit before tax (includes abnormals)	$'000	17 805	64 541	76 802	81 538	76 710
Operating sales margin	%	25.5	30.9	31.8	30.6	31.8
Cost recovery	%	146.6	149.1	153.5	148.6	148.2
Return on assets	%	4.8	12.2	12.9	11.4	9.6
Return on equity	%	3.0	11.4	13.5	14.8	12.6
Financial management						
Debt to equity	%	166.7	141.4	127.3	69.2	67.5
Debt to total assets	%	57.9	50.9	47.6	34.8	34.2
Total liabilities to equity	%	188.1	180.5	168.3	99.2	100.4
Interest cover	times	1.6	2.2	2.5	3.5	4.8
Current ratio	%	42.5	24.5	37.2	58.6	41.7
Leverage ratio	%	288.1	280.5	268.3	199.2	200.4
Payments to and from government						
Dividends	$'000	13 000	51 300	60 000	54 800	49 730
Dividend to equity ratio	%	3.8	14.8	16.5	12.5	9.8
Dividend payout ratio	%	126.7	130.3	122.6	84.5	77.4
Income tax expense	$'000	7 548	25 158	27 865	16 700	12 459
CSO funding	$'000	0	0	0	0	0

a The Victorian Government's pricing reform package was implemented on 1 January 1998. It involved a move form rate-based to usage-based pricing and included debt restructuring. South East Water provides Community Service Obligations. However, funding is not explicitly reported in the financial statements.

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 State owned company and provides water, collects waste and supplies sewerage services 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 move from rate-based to usage-based billing, which increased the proportion of customer accounts that are based on usage charges. This has also increased the exposure of revenue to weather conditions. With the implementation of the pricing reform, a subsidy received from City West Water also ceased.[1]

Despite the decline in total revenue, operating profit before tax (including abnormals) increased in 1997-98. This was attributed to a reduction in bulk water supply charges from Melbourne Water Corporation and operating cost savings.[2] The increase in profit in 1997-98 is also attributed to a higher level of developer activity and increased water consumption as a result of dry weather conditions.

YVW's return on asset and return on equity increased in 1996-97 as a result of the increase in operating profit. This was attributed to increased demand as a result of dry weather conditions, sale of property for $10.1 million and a meter replacement program that contributed to accurate water usage charges. Return on assets declined in 1997-98 following an asset revaluation that resulted in an increase of $25.4 million.

YVW's debt to equity, debt to total asset and total liability to equity ratios declined from 1996-97 to 1997-98. This is due to YVW's financial restructuring which involved a reduction in debt of $100 million and the issuing of 43.5 million fully paid ordinary shares. Interest cover has increased as a result of debt reduction.

Since incorporation YVW has been required to make tax-equivalent and dividend payments. YVW has not identified any Community Service Obligations (CSOs).[3]

1 The reason for the subsidy was to make the three retail water companies operate on an equal financial footing.

2 Refer to note **b** in table 3.7.

3 YVW provided CSOs that were internally funded in 1996-97. YVW were unable to clarify the CSO arrangements in place in 1997-98 and 1998-99.

YARRA VALLEY WATER (continued)

Table 3.7 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*[a]	*1995-96*	*1996-97*	*1997-98*[b]	*1998-99*
Size						
Total assets	$M	1 080	1 093	1 130	1 157	1 185
Total revenue	$M	214	415	439	389	332
Profitability						
Operating profit before tax (includes abnormals)	$'000	27 529	42 808	76 573	79 469	75 913
Operating sales margin	%	26.4	23.9	30.5	30.9	32.1
Cost recovery	%	142.1	141.1	146.8	145.6	148.0
Return on assets	%	5.3	9.2	12.1	10.6	9.1
Return on equity	%	4.3	6.4	11.4	12.5	11.3
Financial management						
Debt to equity	%	145.8	130.0	126.1	100.3	98.4
Debt to total assets	%	55.0	50.0	49.5	44.6	43.4
Total liabilities to equity	%	165.4	161.9	158.9	127.4	129.5
Interest cover	times	1.9	1.8	2.3	2.9	3.5
Current ratio	%	38.9	18.3	60.4	39.1	34.0
Leverage ratio	%	265.4	261.9	258.9	227.4	229.5
Payments to and from government						
Dividends	$'000	16 700	45 900	54 972	51 652	48 738
Dividend to equity ratio	%	4.1	11.1	12.9	10.9	9.5
Dividend payout ratio	%	95.7	174.6	112.5	87.4	84.0
Income tax expense	$'000	10 084	16 524	27 700	20 340	17 885
CSO funding	$'000	0	0	0	0	0

a 1995 figures based on half year results ending 30 June 1995. **b** Yarra Valley Water implemented the Victorian Government's pricing reforms that involved a move from rate-based to usage-based charges. The pricing reform required Melbourne Water Corporation to reduce bulk water charges to the three retail companies. The pricing reform also involved financial restructuring. Freehold land was revalued, resulted in an increase of $25.4 million.

BARWON WATER Victoria

Barwon Regional Water Authority is a statutory authority, providing water and sewerage services to more than 250 000 households in Geelong and surrounding areas. Barwon Water also manages 20 kilometres of the Barwon River through urban Geelong.

Barwon Water's return on asset and return on equity increased substantially in 1997-98. The increase in these ratios is attributed to the merger with Otway Regional Water Authority, which resulted in abnormal revenue of $69.6 million.[1] The significant decline in the above ratios in 1998-99 resulted from an increase in depreciation expense of fixed assets and a change in pricing structure which eliminated cross-subsidies between residential and business customers.[2]

Barwon Water's debt to equity, debt to total asset, total liabilities to equity and leverage ratios declined sharply over the monitoring period. There was a significant increase in the current and interest cover ratios in 1997-98 — partly due to the State Government's Financial Assistance Package which was utilised by Barwon Water to repay borrowings. Barwon Water also paid out its unfunded superannuation liability held with the Local Authorities Superannuation Fund.[3]

During 1998-99, Barwon Water became a participating authority under the *Borrowing & Investment Power Act 1987*. Under the provisions of the Act, Barwon Water was able to restructure its debt portfolio, transferred all inscribed stock to the Treasury Corporation of Victoria (TCV) and simultaneously obtained loans from TCV.[4] This resulted in reduced borrowing costs.

Barwon Water is required to make dividend payments but will not pay a dividend for 1998-99 based on the final result for the reporting period. Barwon Water was not required to pay tax-equivalent payments until 1997-98.

Barwon Water indicates that further work is required to adequately define and quantify the extent of community service obligation undertaken by the authority and the extent of compensation applicable.

1 The Otway Region Water Authority's asset rights, liabilities and obligations were transferred to the Barwon Water Authority on 1 July 1997.

2 Assets were revalued using optimised deprival valuation principles, resulting in an increase of $377.8 million.

3 Refer to note **a** in table 3.3.

4 Refer to note **b** in table 3.3.

BARWON WATER (continued)

Table 3.3 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*[b]
Size						
Total assets	$M	370	378	384	858	841
Total revenue	$M	68	62	64	145	68
Profitability						
Operating profit before tax (includes abnormals)	$'000	19 705	11 386	10 206	51 960	6 049
Operating sales margin	%	49.5	40.9	35.5	47.4	18.3
Cost recovery	%	192.2	169.0	154.0	123.6	124.8
Return on assets	%	9.8	7.0	6.3	11.4	1.6
Return on equity	%	10.2	5.5	4.7	10.4	0.6
Financial management						
Debt to equity	%	75.3	71.2	65.9	11.9	8.8
Debt to total assets	%	43.5	40.7	38.8	14.4	7.9
Total liabilities to equity	%	82.1	76.6	71.3	14.0	10.9
Interest cover	times	2.3	1.8	1.7	3.8	1.8
Current ratio	%	82.6	85.6	88.1	187.6	91.4
Leverage ratio	%	182.1	176.6	171.3	114.0	110.9
Payments to and from government						
Dividends	$'000	3 873	4 160	4 213	1 663	0
Dividend to equity ratio	%	2.0	2.0	1.9	0.3	0
Dividend payout ratio	%	19.7	36.5	41.3	3.3	0
Income tax expense	$'000	0	0	0	1 388	1 643
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, which significantly increased return on asset and return on equity. 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 Power Act 1987.* The novation of debt to the TCV included 1 635 inscribed stockholders ($14.5 million) and three institutional investors ($15.5 million). 1998-99 is the first full year of Stage one water restriction, which were implemented in January 1998.

DEPARTMENT OF NATURAL RESOURCES, STATE WATER PROJECTS — Queensland

The Commercial Water Services Program is delivered by State Water Projects (SWP), which is a commercialised business unit within the Department of Natural Resources (DNR). SWP was fully commercialised on 1 July 1997 in accordance with the *Queensland Competition Authority Act 1997*.[1] It develops and manages State owned bulk water storage and distribution infrastructure and supplies water to about 7 500 customers throughout Queensland. The unit also provides facility management services to other water infrastructure owners, and engineering consultancy services to government and private sector clients.

SWP's total revenue has increased over the monitoring period, but it is still making a substantial loss. Historical pricing levels have not provided sufficient revenue to fund the ongoing refurbishment of assets. In addition, a capital investment program administered by the DNR is declining in terms of infrastructure development funding. In 1998-99, the SWP's cost recovery was only 50 per cent.

SWP's debt to equity and debt to total asset ratios are zero from 1997-98 onwards, as a result of commercialisation which established SWP with a capital structure free of debt. The current ratio has increased over the monitoring period as a result of increased cash reserves and reduced creditors.[2]

SWP is required to make income tax-equivalent payments.

SWP receives Community Service Obligation (CSO) funding from the State Government.[3] CSO funding meets the shortfall in income resulting from costs of operation, maintenance and administration. The CSO will reduce in line with the Government's determination of any future price increases.

1 The SWP group was separated from the Regional Infrastructure Development Program.

2 The SWP group has implemented more effective collection practices. Monies outstanding for more than 180 days were reduced from $1.5 million at 1 July 1998 to $0.33 million at 30 June 1999.

3 CSO funding was first reported in financial statements in 1998-99.

DEPARTMENT OF NATURAL RESOURCES, STATE WATER PROJECTS (continued)

Table 3.8 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*[a]	*1997-98*[b]	*1998-99*[c]
Size						
Total assets	$M	1 840	1 855	2 110	2 096	2 102
Total revenue	$M	46	49	62	80	74
Profitability						
Operating profit before tax (includes abnormals)	$'000	-3 874	4 178	-43 024	-11 843	-21 101
Operating sales margin	%	-8.5	8.4	-30.5	-14.8	-31.7
Cost recovery	%	92.2	109.2	76.6	87.1	50.3
Return on asset	%	-0.2	0.2	-1.0	-0.6	-1.0
Return on equity	%	n.p.	n.p.	-4.5.	-0.6	-1.0
Financial management						
Debt to equity	%	0	0	7.7	0	0
Debt to total assets	%	0	0	7.4	0	0
Total liabilities to equity	%	n.p.	n.p.	9.9	0.9	0.8
Interest cover	times	0	0	-0.8	0	0
Current ratio	%	n.p.	n.p.	100.8	447.0	630.2
Leverage ratio	%	n.p.	n.p.	109.9	100.9	100.8
Payments to and from government						
Dividends	$'000	0	0	0	0	0
Dividend to equity ratio	%	n.r.	n.r.	n.r.	0	0
Dividend payout ratio	%	n.r.	n.r.	n.r.	n.r.	n.r.
Income tax expense	$'000	n.r.	n.r.	n.r.	n.r.	n.r.
CSO funding	$'000	0	0	0	0	28 500

a Department of Natural Resources – State Water Projects (SWP) reported its financial operation on a full accrual basis for the first time in 1996-97. Therefore, comparison with prior years is not meaningful. **b** The 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. **c** As at 1 July 1999, SWP will transfer all long service leave liabilities to a central actuarially assessed scheme administrated by the Government Superannuation Office. SWP will not be required to hold its liability for long service leave on its balance sheet. This financial effect has not been recognised for the year ending 30 June 1999. **n.p.** Not provided. **n.r.** Not relevant.

SOUTH AUSTRALIAN WATER CORPORATION South Australia

South Australian Water Corporation (SA Water) was established in 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 South Australia.

In December 1995, SA Water contracted out the operation, maintenance and management of Adelaide's water and wastewater system to United Water International.[1] 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. Four filtration plants have been constructed and four were commissioned for construction in 1998-99.[2]

SA Water's operating profit before tax (including abnormals), return on asset and return on equity increased sharply between 1995-96 to 1996-97 followed by a steady increase between 1996-97 and 1998-99. The sharp rise in these indicators for 1996-97 reflects increased water and wastewater revenues, falling operating costs and a reduction in interest costs in part due to improved debt management.[3] The return on asset and return on equity ratios have improved over the monitoring period.

SA Water's debt to equity, debt to total asset and leverage ratios have remained steady while interest cover increased during the period.

SA Water is subject to the South Australian Government's taxation equivalent regime and is required to make dividend payments.

Under a Community Service Obligation (CSO) policy, SA Water receives supplementary payments relating to the provision of water and wastewater services in country areas starting from 1996-97. Prior to 1996-97, the costs of CSOs were met internally by other profitable activities.

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1 Operations under the contract commenced in January 1996 for a term of 15 years with requirements for significant improvements in efficiency and service, with cost saving.

2 The Riverland Water contract involves an obligation on the part of its major shareholder, United Utilities Australia Ltd (formerly North West Water Australia Ltd) to generate substantial exports of technical and managerial expertise.

3 1996-97 is the first year of explicit CSO payments from the South Australian Government.

SOUTH AUSTRALIAN WATER CORPORATION (continued)

Table 3.9 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*[b]	*1997-98*	*1998-99*
Size						
Total assets	$M	5 345	5 511	5 757	5 766	5 897
Total revenue	$M	417	401	505	552	566
Profitability						
Operating profit before tax (includes abnormals)	$'000	3 586	3 288	135 568	171 737	179 802
Operating sales margin	%	26.3	27.9	44.8	47.5	47.9
Cost recovery	%	140.6	138.1	182.0	194.7	193.0
Return on assets	%	2.1	2.1	4.0	4.6	4.7
Return on equity	%	0.1	-0.2	1.9	2.6	2.7
Financial management						
Debt to equity	%	22.5	24.1	22.2	21.2	22.0
Debt to total assets	%	18.4	19.4	18.0	16.9	17.5
Total liabilities to equity	%	24.0	26.1	25.9	25.4	27.0
Interest cover	times	1.0	1.0	2.5	2.9	3.0
Current ratio	%	85.5	47.1	109.4	103.9	86.9
Leverage ratio	%	124.0	126.1	125.9	125.4	127.0
Payments to and from government						
Dividends	$'000	60 300	38 000	91 200	105 800	144 400
Dividend to equity ratio	%	1.4	0.9	2.0	2.3	3.1
Dividend payout ratio	%	1 681.5	-437.4	108.7	90.1	116.4
Income tax expense	$'000	0	11 976	51 698	54 253	55 762
CSO funding	$'000	0	0	72 000	74 365	77 135

a South Australian Water Corporation was established on 1 July 1995. **b** The Adelaide water and wastewater system was contracted out to United Water. The contract commenced on 1 January 1996 for a term of 15 years, with 1996-97 being the first full financial year of operation.

WATER CORPORATION — Western Australia

The Water Corporation was established on 1 January 1996, following a major restructure of the Western Australian water industry. It operates under a 25 year operating licence issued by the Office of Water Regulation. It provides public water supply, sewerage, drainage and irrigation services to a population of over 1.7 million including 300 towns and communities throughout Western Australia.

The Water Corporation's total revenue, operating profit before tax (including abnormals), return on total assets and return on equity have increased over the monitoring period. This is due to:

- increased water sales as a result of hot and dry weather conditions, particularly in 1997-98;
- increased tariffs for services; and
- a higher level of property development and increased developer contributions.[1]

The Water Corporation's debt to equity, debt to total asset and total liabilities to equity ratios are low and have declined over the monitoring period. There was a significant increase in interest cover from 1995-96 to 1996-97 due to debt reduction amounting to $125 million, and a sharp increase in operating profit.[2]

Interest cover is increasing over time as the reduction in debt continues. The current ratio decreased sharply from 1996-97 to 1997-98 due to an early repayment of loans to the Western Australian State General Loan Fund and the Commonwealth Government, which lowered the cash balance.

The Water Corporation is required to make tax-equivalent and dividend payments. Tax-equivalent payments were payable from 1 July 1996. The Water Corporation received Community Service Obligation (CSO) payments from the Western Government from 1 July 1996.[3]

1 The tariff reform in 1997-98 involved an increase in prices by 4 per cent for customers using less than 350 kilolitres per annum and an increase of 10 per cent for those who use more.

2 The increase in profit is attributable to abnormal revenue of $24.6 million for unbilled water consumption, $26 million from a favourable tax ruling on rate revenue on the previous year and $71 million in developer's contributions.

3 The Water Corporation has agreed to a fixed reduction of 2.5 per cent a year to CSO payments for country services.

WATER CORPORATION (continued)

Table 3.10 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*[b]	*1997-98*	*1998-99*
Size						
Total assets	$M	8 236	8 436	8 578	8 710	8 919
Total revenue	$M	589	587	800	890	926
Profitability						
Operating profit before tax (includes abnormals)	$'000	63 245	42 802	286 784	360 048	375 548
Operating sales margin	%	22.1	16.8	42.2	45.2	44.3
Cost recovery	%	131.0	129.8	168.1	183.6	179.2
Return on assets	%	1.9	1.5	4.1	4.7	4.7
Return on equity	%	0.9	0.3	2.4	2.9	2.7
Financial management						
Debt to equity	%	11.1	9.5	7.7	5.7	6.8
Debt to total assets	%	9.9	8.5	6.9	5.2	6.2
Total liabilities to equity	%	14.5	12.9	11.9	10.3	12.1
Interest cover	times	1.7	1.5	5.6	8.4	11.2
Current ratio	%	480.1	281.9	130.2	57.3	47.9
Leverage ratio	%	114.5	112.9	111.9	110.3	112.1
Payments to and from government						
Dividends	$'000	25 748	58 903	198 692	158 706	196 111
Dividend to equity ratio	%	0.4	0.8	2.6	2.0	2.5
Dividend payout ratio	%	40.7	293.9	110.7	70.7	90.4
Income tax expense	$'000	0	22 758	107 314	135 699	158 570
CSO funding	$'000	0	0	182 253	180 316	192 124

a The Water Corporation commenced operations on 1 January 1996 after the disaggregation of the Water Authority of Western Australia. **b** The Water Corporation received payments for the provision of Community Service Obligations from the Western Australian Government from 1 July 1996. The significant increase in profit is attributed to abnormal revenue of $24.6 million for unbilled water consumption, $26 million from a favourable tax ruling on rate revenue on the previous year and $71 million in developer's contributions. There was a 2.9 per cent growth in the customer base. Developer's contributions are recognised as revenue and the after tax value is transferred to a reserve during the year of receipt. On average developer's contributions account for 10 per cent of total operating revenue.

HOBART REGIONAL WATER AUTHORITY — Tasmania

Hobart Regional Water Authority, trading as Hobart Water, was established as a joint authority in accordance with s. 38 of the *Local Government Act 1993*. The authority commenced operation 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.

Hobart Water made an operating loss before tax (including abnormals) in 1997-98 when Hobart Water's entire debt with the Tasmanian Public Finance Corporation (Tascorp) was re-financed. The restructuring resulted in an abnormal loss of $3.4 million. Return on asset and return on equity have declined significantly as a result.

Hobart Water introduced a new water pricing policy on 1 July 1997 that incorporates a two-part tariff.[1] The real price of water for 1998-99 was reduced by 1 per cent at the same time.

Hobart Water's total liability to equity increased from 1996-97 to 1997-98 as a result of a loss incurred from financial restructuring and the inclusion of provisions for dividends payable and deferred income tax liabilities for the first time. The current ratio increased significantly in 1997-98 as a result of increased investment and debtors.[2] Interest cover increased sharply in 1998-99 as a result of the debt reduction strategy, implementation of a new debt management policy and low interest rates.[3] Hobart Water retired a debt of $1.1 million and made a net interest cost saving of $395 000 on borrowings in 1998-99.[4]

Hobart Water is required to pay tax-equivalent and dividend payments. As a result of tax losses there were no tax-equivalent payments in 1997-98 and 1998-99.

Currently, there is no Community Service Obligation (CSO) framework for local government, therefore no explicit funding of CSOs.

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1 Refer to note **b** in table 3.11.

2 Debtors increased due to a change in the billing cycle.

3 Hobart Water planned to recover the abnormal loss incurred as a result of financial restructuring in 1997-98, through a debt reduction strategy of $1.1 million per year for the next three financial years commencing 1998-99.

4 In 1998 a new facility agreement was signed between Hobart Water and Tascorp which does not require a guarantee as security over Hobart Water debt. From 3 July 1998, Hobart Water is not required to pay a loan guarantee fee.

HOBART REGIONAL WATER AUTHORITY (continued)

Table 3.11 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*[a]	*1997-98*[b]	*1998-99*
Size						
Total assets	$M	184	184	175	184	171
Total revenue	$M	18	17	18	18	17
Profitability						
Operating profit before tax (includes abnormals)	$'000	763	1 470	1 398	-1 261	2 862
Operating sales margin	%	37.0	37.6	33.2	14.9	25.8
Cost recovery	%	158.8	153.5	149.8	150.8	134.7
Return on assets	%	3.7	3.5	3.3	1.5	2.6
Return on equity	%	0.6	1.2	1.1	-1.6	2.6
Financial management						
Debt to equity	%	41.3	37.6	25.7	27.6	27.7
Debt to total assets	%	28.4	26.2	19.2	20.4	19.9
Total liabilities to equity	%	48.0	43.6	30.5	39.1	34.3
Interest cover	times	1.1	1.3	1.3	0.7	2.7
Current ratio	%	68.1	90.6	14.2	40.9	52.4
Leverage ratio	%	148.0	143.6	130.5	139.1	134.3
Payments to and from government						
Dividends	$'000	0	0	0	2 000	2 200
Dividend to equity ratio	%	0	0	0	1.5	1.7
Dividend payout ratio	%	0	0	0	-95.8	64.8
Income tax expense	$'000	0	0	0	828	-533
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 replacement 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 Hobart Water to calculate income tax-equivalent, applying AAS3 Accounting for Income Tax (Tax Effect Accounting) as outlined in the *Government Business Enterprises Act 1995*.

NORTH WEST REGIONAL WATER AUTHORITY — Tasmania

North West Regional Water Authority (NWRWA) is a statutory authority. It collects and treats water in bulk and supplies water to the councils of Circular Head, Waratah-Wynyard, Central Coast, Devonport City, Latrobe and Kentish.

NWRWA's total revenues and assets have declined over the monitoring period. NWRWA went from earning a significant profit in 1995-96 to a loss in 1996-97. The change is attributed to abnormal revenue of $517 000 in 1995-96, a slight decrease in water consumption and an increase in depreciation in 1996-97, following an upward revaluation of non-current assets in 1995-96.[1] Total assets declined by $26.7 million from 1996-97 to 1997-98, as a result of a revaluation of infrastructure assets, to written-down deprival value.

NWRWA's significant operating loss in 1997-98 is attributed to abnormal expenses of $3.1 million of which $2.7 million represents a loss on the defeasance of loans and the introduction of the taxation equivalent regime.[2] The significant decline in the interest cover ratio reflects the decline in operating profit. Operating profit increased in 1998-99 as a result of interest cost savings of $785 000 following debt restructuring and a decrease in depreciation expense of $579 000 resulting from an asset devaluation in 1997-98. NWRWA's return on asset and return on equity ratios have been affected as a result.

NWRWA's debt to equity, debt to total asset and total liabilities to equity ratios increased significantly in 1997-98, following the asset revaluation. The current ratio declined substantially in 1996-97 as a result of loans totalling $3 million being due in 1997-98. The increase in this ratio in 1998-99 is attributed to an increase in investments of $560 000.

NWRWA has been required to make tax-equivalent and dividend payments since 1997-98.[3] Fluoridation is identified as a community service obligation and is reimbursed by the State Government.

1 The abnormal revenue comprises of currency gain in retiring overseas loan and the writing down of superannuation provisions.

2 The abnormal expense comprised a $2.7 million loss on defeasance of loans and a $377 746 adjustment to the superannuation provision for redundancy payments in anticipation of NWRWA's transfer from State Government ownership to local government. Due to a debt restructure there was a $549 000 decline in financial expenses.

3 No dividend was paid in 1997-98 and 1998-99 due to after tax losses.

NORTH WEST REGIONAL WATER AUTHORITY (continued)

Table 3.12 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*[b]	*1997-98*[c]	*1998-99*[d]
Size						
Total assets	$M	95	97	89	61	61
Total revenue	$M	9	9	8	8	7
Profitability						
Operating profit before tax (includes abnormals)	$'000	33	872	-11	-2 354	1 311
Operating sales margin	%	43.6	47.8	36.2	0.4	39.3
Cost recovery	%	177.0	173.5	156.7	162.7	170.8
Return on assets	%	4.1	4.3	3.2	0.1	4.9
Return on equity	%	0.1	1.3	0	-5.4	0.6
Financial management						
Debt to equity	%	44.9	39.2	40.8	76.1	70.1
Debt to total assets	%	30.2	27.8	26.8	33.1	39.3
Total liabilities to equity	%	49.5	43.0	45.7	85.9	78.5
Interest cover	times	1.0	1.3	1.0	0	1.8
Current ratio	%	49.5	60.3	37.7	39.4	67.1
Leverage ratio	%	149.5	143.0	145.7	185.9	178.5
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	161	1 100
CSO funding	$'000	0	23 922	23 922	23 922	25 900

a North West Regional Water Authority (NWRWA) earned abnormal revenue of $517 000 representing a gain on the retirement of an overseas loan ($150 530) and a superannuation provision write down ($366 830). **b** NWRWA's assets were revalued using written-down replacement cost value, which resulted in a reduction of the asset value, by $6.7 million. **c** 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. 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 thus resulted in the value of assets declining by $26.7 million. **d** NWRWA incurred an abnormal expense of $155 000 due to an adjustment of the superannuation provision. North West Water Authority was established on 10 August 1999 as a joint authority of the Circular Head, Waratah-Wynyard, Central Coast, Devonport City, Latrobe and Kentish councils under s. 38 of the *Local Government Act 1993*. The *North West Regional Water (Arrangements) Act 1997* came into effect on 1 July 1998 and provided for the transfer of staff, property, obligations and liabilities from NWRWA to the North West Water Authority.

ESK WATER AUTHORITY — Tasmania

Esk Water Authority, trading as Esk Water, was established as a joint authority in accordance with s. 38 of the *Local Government Act 1993*. The authority commenced operation in July 1997 when the assets of its predecessor, the North Esk Scheme, were transferred. Esk Water provides bulk water supply to participating councils and other industrial and wayside users in the Launceston – Tamar Valley region.[1]

Esk Water made an operating loss before tax (including abnormals) in 1996-97 due to an abnormal expense of $2 million incurred as a result of the repayment of debt. This debt was part of a debt consolidation and restructure program instituted by the Rivers and Water Supply Commission.[2] A fall in operating and maintenance costs increased profit in 1997-98. Operating profit decreased in 1998-99 due to a reduction of $799 000 in bulk water sales resulting from reduced consumption.

Esk Water's current ratio and interest cover decreased substantially from 1995-96 to 1996-97 because loans with financial institutions increased as a result of the debt restructuring process.

Esk Water's debt to equity, debt to total asset and total liabilities to equity ratios declined sharply in 1997-98. This occurred as a result of a $2 million reduction in debt and a revaluation of all non-current assets on the basis of deprival value and a $2.5 million increment in asset values.[3] The reduction in debt increased the current ratio and interest cover in 1997-98.

In March 1999, Esk Water signed a Master Loan Facility Agreement with the Tasmanian Public Finance Corporation. The Agreement states that all debt must be guaranteed by the revenue of Esk Water and removes the need for any guarantee by the owner councils. This will result in a decline of financial expenses due to the absence of loan guarantee fees but the cost of loans could rise.[4]

Esk Water is required to make tax-equivalent and dividend payments. Currently, there is no Community Service Obligation (CSO) framework for local government, therefore there is no explicit funding of CSOs.

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1 The participating councils are the four Tamar Valley councils, Launceston City, George Town, Meander Valley and West Tamar, which are part of the joint authority.

2 The loss represents the net present value of future interest repayments for the remaining terms of loans repaid and re-financed.

3 Esk Water was able to bring forward 1998-99 debt repayment due to the deferral of capital works. This enabled debt repayment of $2 million for 1997-98.

4 Loans that were taken out prior to the Master Loan Facility Agreement were revised with terms which explicitly exclude a guarantee. At the end of 1998-99 there are no guaranteed loans.

ESK WATER AUTHORITY (continued)

Table 3.13 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*[b]
Size						
Total assets	$M	75	77	73	102	102
Total revenue	$M	7	6	6	8	7
Profitability						
Operating profit before tax (includes abnormals)	$'000	2 164	217	-1 713	1 464	824
Operating sales margin	%	66.5	40.5	3.1	30.4	21.9
Cost recovery	%	298.9	168.1	177.2	143.7	128.0
Return on assets	%	6.9	3.3	0.6	2.8	1.7
Return on equity	%	5.0	0.4	-3.0	1.3	0.6
Financial management						
Debt to equity	%	36.5	32.5	26.6	15.1	15.2
Debt to total assets	%	29.5	24.2	20.0	15.0	12.7
Total liabilities to equity	%	40.8	36.4	29.7	17.7	19.6
Interest cover	times	1.9	1.1	0.2	2.4	1.9
Current ratio	%	463.2	336.6	15.9	503.1	174.2
Leverage ratio	%	140.8	136.4	129.7	117.7	119.6
Payments to and from government						
Dividends	$'000	0	0	0	351	198
Dividend to equity ratio	%	0	0	0	0.5	0.2
Dividend payout ratio	%	0	0	0	37.7	40.8
Income tax expense	$'000	0	0	0	534	339
CSO funding	$'000	0	0	0	0	0

a North Esk Scheme's assets were transferred to the control and ownership of a joint authority, Esk Water Authority on 1 July 1997. **b** In March 1999, a Master Loan Facility Agreement was entered into with the Tasmanian Public Finance Corporation. This removes the need for any guarantee by the owner councils for loans taken out by Esk Water.

4 Urban transport

The financial performance of four urban transport Government Trading Enterprises (GTEs) are reported in this chapter (see table 4.1). These authorities vary in size and the range of services 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 1.

4.1 Sector reforms

Urban transport GTEs underwent considerable administrative and operational change over the monitoring period. These changes were largely introduced to increase their commercial focus and reduce their reliance on government contributions. However, governments generally recognise that there are social benefits in the provision of urban transport services.

The principal reform has been to separate the provision of bus, train and tram services and the competitive tendering of some of these services. The tendering process requires GTEs to compete with the private sector on the basis of a set of costing rules aimed at ensuring competitive neutrality. Even though there is no specific requirement under the National Competition Policy (NCP) agreement, urban transport GTEs discussed in this report have been made subject to tax-equivalent and dividend payments.

Governance arrangements for urban transport GTEs have been reformed to make them similar to those of other GTEs. For example, in 1995-96, the Metropolitan Transport Trust of Tasmania became a GTE subject to the *Government Business Enterprise Act 1995* and in February 1998 a State owned company subject to corporations law.

Table 4.1 **Monitored Urban Transport GTEs, 1994–95 to 1998–99**

1994–95	*1995–96*	*1996–97*	*1997–98*	*1998–99*
New South Wales				
State Transit Authority	→	→	→	State Transit Authority
South Australia				
TransAdelaide	→	→	→	TransAdelaide
Tasmania				
Metropolitan Transport Trust	→	→	Metro Tasmania Pty Ltd[a] →	Metro Tasmania Pty Ltd
Australian Capital Territory				
ACTION	→	→	→	ACTION

[a] In February 1998, the Metropolitan Transport Trust became a State owned company subjected to corporations law.

The pricing of urban transport services is determined by owner governments in all States except NSW and Tasmania — where independent pricing regulatory bodies set prices.

As part of the reform process, fare restructuring has taken place in most jurisdictions to better align fare levels with the cost of service provision. For example, on 21 July 1996 Metro Tasmania increased fares — fare increases ranged from 10 per cent to 37 per cent — to reduce its significant dependence on government funding to cover operating deficits. Fare restructuring has also been undertaken to reduce the gap in fares between jurisdictions. For example, ACTION increased bus fares in 1995-96 and 1996-97 with the aim of bridging the gap between full fares in the Australian Capital Territory and those in other jurisdictions.

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 monitoring period, partly resulting from increased competition from private operators of urban transport. The demand for urban transport services is also affected by competition from privately-owned motor vehicles, changes in fares and population.

Urban transport fares have generally increased over the monitoring period. For example, in 1998-99 the State Transit Authority (NSW) increased fares by 2.2 per cent — as recommended by the Independent Pricing and Regulatory Tribunal.

4.2 Profitability

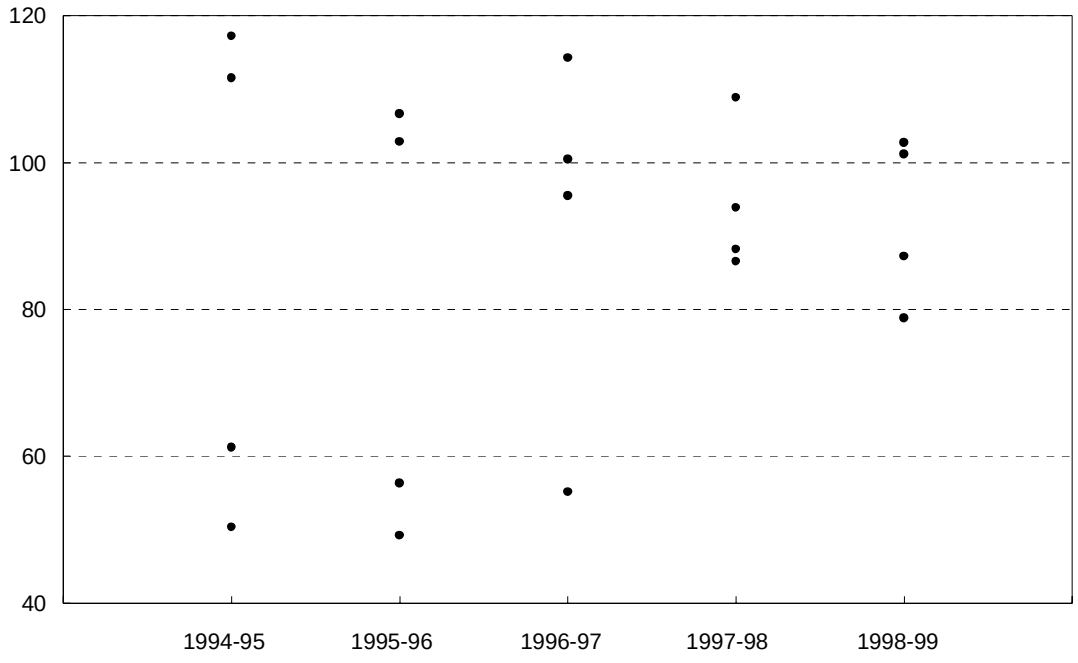
Profitability indicators provide information on how GTEs are using the assets vested in them by shareholder governments to generate earnings. For a more detailed discussion of profitability indicators see chapter 1.

Urban transport GTEs, with the exception of Metro Tasmania, have experienced declining cost recovery over the monitoring period. After 1996-97, the major factor affecting cost recovery across GTEs was the upward trend in total expenses, combined with declining or stable total revenue.

The increase in total expenses reflects higher labour and general maintenance costs, increased redundancy and depreciation expenses and the introduction of accounting for superannuation liabilities, among other things.

There was significant difference in cost recovery levels across GTEs prior to 1997-98 (see figure 4.1). This partly reflects the absence of Community Service Obligation (CSO) payments to Metro Tasmania and ACTION. The introduction of CSO payments to ACTION in 1996-97 and Metro Tasmania in 1997-98, led to a significant improvement in their cost recovery. Metro Tasmania and TransAdelaide were the only two urban transport GTEs to achieve 100 per cent cost recovery in 1998-99 — with ACTION achieving less than 80 per cent cost recovery.

Figure 4.1 **Cost recovery, 1994-95 to 1998-99 (per cent)**



Note Each data point represents the cost recovery ratio for a GTE in that financial year. Cost recovery is the ratio of revenue from operations to expenses from operations. Revenue from operations is calculated by subtracting abnormal revenue, investment income and receipts from governments to cover deficits on operations from total revenue. Expenses from operations are calculated by subtracting abnormal expenses and gross interest expense from total expenses.

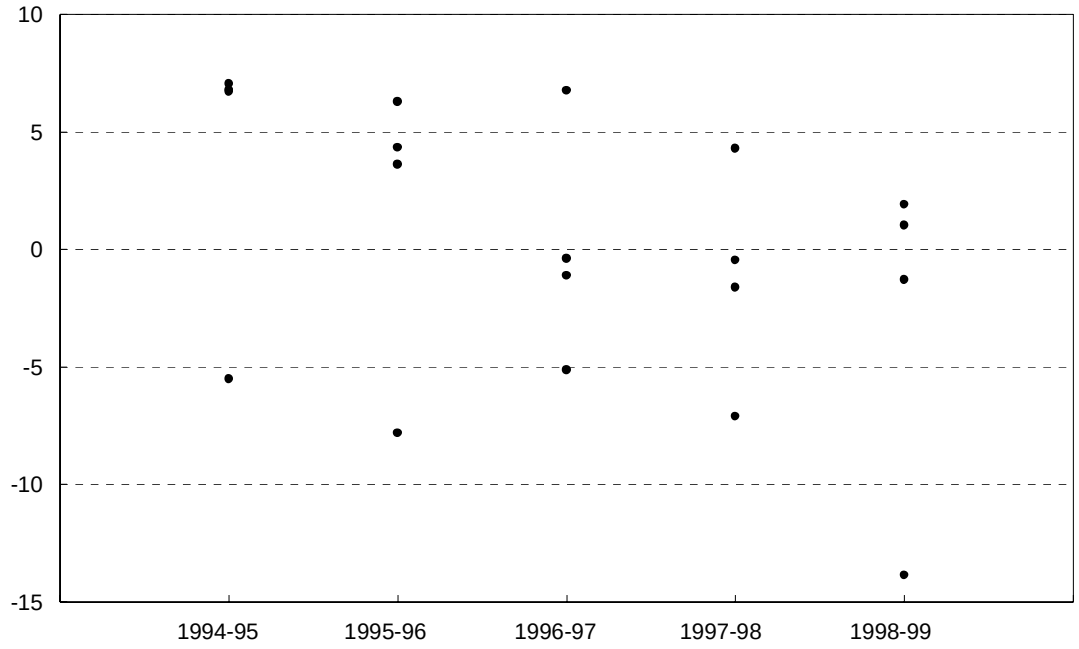
Over the monitoring period, the return on assets, like cost recovery, varied considerably across urban transport GTEs (see figure 4.2). The major factors impacting on GTEs' return on assets are changes in total revenues and total expenses. However, apart from operating profit, this performance measure 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.

TransAdelaide is the only urban transport authority to earn a positive return on assets in each year of the monitoring period. In 1998-99, only TransAdelaide and

Metro Tasmania achieved a positive return on assets. These returns are well below those required by private operators.

Like return on assets, the return on equity achieved by urban transport GTEs has varied substantially over the monitoring period. For example, the State Transit Authority's return on equity fell from 16.7 per cent in 1994-95 to -6.4 per cent in 1998-99.

Figure 4.2 **Return on assets, 1994-95 to 1998-99 (per cent)**



Note Each data point represents the return on assets ratio for a GTE 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 (including abnormals) and adding back gross interest expense. Average total assets are defined as the service potential or future economic benefits, controlled by the entity as a result of past transactions or other events (measured as the average of the value of assets at the beginning and end of the reporting period).

In 1998-99, all the monitored urban transport GTEs earned negative returns on equity, except TransAdelaide, which earned a very low return.

4.3 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 1.

Most GTEs have undertaken debt restructuring over the monitoring period, resulting in a reduction in debt levels. This restructuring includes debt for equity swaps, debt transfers to government and debt repayments. For example, in 1994-95, the transfer of assets from TransAdelaide to Transport SA involved the transfer of associated debt.

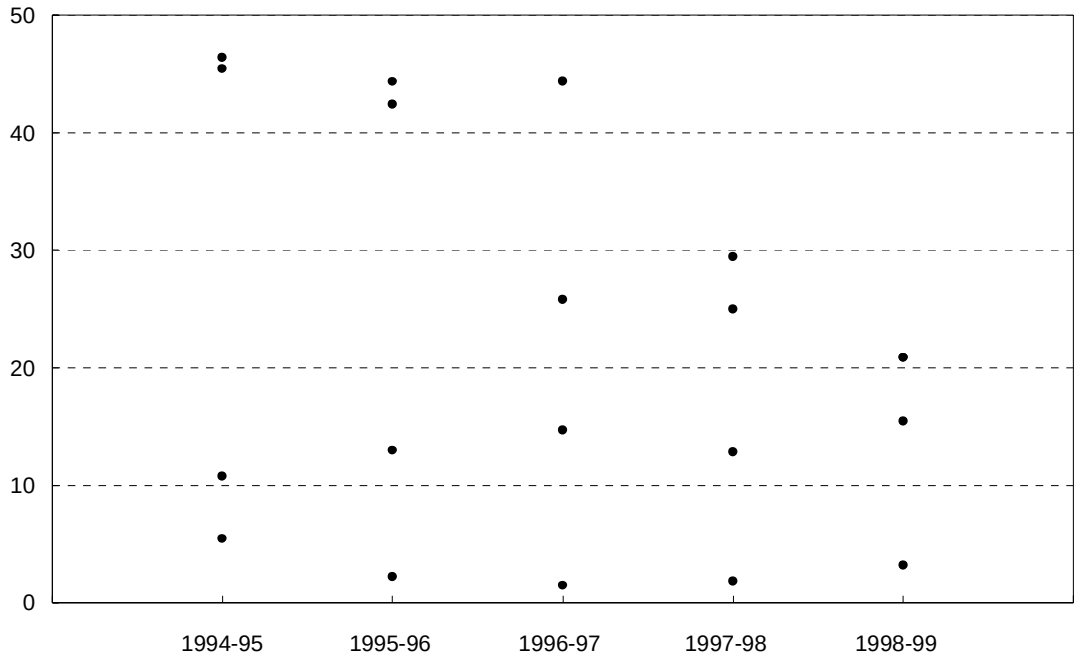
This financial restructuring changes the capital structure of the GTEs, making it difficult to assess financial management performance over time. Asset revaluations will also have an impact on performance indicators.

Many urban transport GTEs have revalued their assets over the monitoring period. Moreover, valuation procedures are inconsistent. For example, ACTION uses current valuation for some assets, such as land and building, and historical cost for others, whereas State Transit applies current valuation for all property, plant and equipment.

Over the monitoring period, the debt to total assets ratio has declined across most GTEs (see figure 4.3). This may suggest an increase in total assets acquired with the use of equity. 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.

Another measure of financial management is interest cover. In 1998-99, all urban transport authorities obtained ratios well below three. Consequently, financial commitments may have to be met from sources of funds other than earnings from time to time.

Figure 4.3 **Debt to total assets, 1994-95 to 1998-99 (per cent)**



Note Each data point represents the debt to total assets ratio for a GTE 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. Total assets are defined as the service potential or future economic benefits, controlled by the entity as a result of past transactions or other events (measured as the average of the value of assets at the beginning and end of the reporting period). In 1998-99, both ACTION and TransAdelaide had a debt to total assets ratio of 20.9 per cent.

4.4 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 1.

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 State Transit Authority (NSW) and ACTION receive explicit CSO payments, while TransAdelaide and Metro Tasmania receive payments as consolidated figures in total income.

CSO contracts across urban transport GTEs include the following common elements:

- Pricing CSO payment — reimburses authorities 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 — reimburses authorities for providing non-commercial services in excess of minimum service level requirements.
- Concession CSO payment — reimburses authorities 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.

Apart from the State Transit Authority (NSW) in 1995-96, no GTEs made tax-equivalent payments to shareholder governments over the monitoring period, reflecting the poor financial performance of urban transport GTEs. The State Transit Authority (NSW) and TransAdelaide were the only GTEs to make dividend payments over the monitoring period.

4.5 GTE performance reports

State Transit Authority (NSW)
TransAdelaide (SA)
Metro Tasmania (Tas)
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 publicly owned buses and ferry services in metropolitan Sydney and Newcastle.

Despite successive increases in total revenue, the STA continued to make operating losses between 1996-97 and 1998-99.[1] The loss incurred in 1996-97 is attributed to an abnormal expense of $5 million for the provision of unfunded superannuation liabilities. The losses incurred in 1997-98 and 1998-99 are attributed to the impact of greater traffic congestion caused by increased construction works in the inner city areas of Sydney, on patronage growth, increased labour costs, higher maintenance expenditure and the operation of unprofitable routes.[2] The operating losses have affected the return on assets and return on equity over the monitoring period.

The STA's debt to equity, debt to total asset and total liabilities to equity ratios increased and the current ratio declined over the monitoring period. The above is attributed to an increase in loans and a decrease in investment deposits with the NSW Treasury Corporation for the purchase of new buses.[3] In 1997-98, the STA rescheduled its finance lease liability for a further period of five years, resulting in a fall in current liabilities and an increase in non-current liabilities.

During 1998-99, the STA sold property at Randwick 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.

STA has an agreement with the NSW Government for the reimbursement of pricing, service and concession Community Service Obligations (CSOs).[4]

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1 The STA's total revenue increase is attributed to an increase in NSW Government contributions and the level of service provided by Sydney Buses.

2 Labour costs represent more than 60 per cent of the STA's total expenditure. On the basis of route cost and profitability analysis conducted by the STA, 64 per cent of Sydney's bus routes and 96 per cent of Newcastle's bus routes are unprofitable. A deficit of $7 million has been incurred from the ten most unprofitable routes.

3 The high level of expenditure is to maintain the average age of the bus fleet at 12 years as per the *Passenger Transport Act 1990,* and to meet anticipated demand for the Sydney Olympic Games. This purchase is financed by funds invested in NSW Treasury Corporation's "Hour Glass" facility and borrowings.

4 STA does not receive CSO payments for non-commercial services provided by Sydney Bus services.

STATE TRANSIT AUTHORITY (continued)

Table 4.1 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*[b]
Size						
Total assets	$M	363	400	379	383	369
Total revenue	$M	340	335	362	372	394
Profitability						
Operating profit before tax (includes abnormals)	$'000	19 825	10 508	-3 982	-4 501	-8 785
Operating sales margin	%	6.1	2.8	-0.9	-0.5	-1.2
Cost recovery	%	111.5	102.8	100.5	88.2	86.0
Return on assets	%	7.0	3.6	-0.4	-0.4	-1.1
Return on equity	%	16.7	4.5	-0.9	-2.3	-5.8
Financial management						
Debt to equity	%	37.2	24.4	20.7	34.8	41.8
Debt to total assets	%	5.4	2.2	1.5	1.8	3.2
Total liabilities to equity	%	182.0	134.1	134.0	141.6	157.3
Interest cover	times	4.1	4.2	-0.6	-0.6	-1.0
Current ratio	%	104.2	90.2	38.6	36.7	30.9
Leverage ratio	%	282.0	234.1	234.0	241.6	257.3
Payments to and from government						
Dividends	$'000	1 485	5 177	0	0	16 560
Dividend to equity ratio	%	1.3	3.5	0	0	11.0
Dividend payout ratio	%	7.5	77.0	0	0	-188.5
Income tax expense	$'000	0	3 783	-2 536	-875	0
CSO funding	$'000	149 300	149 500	150 467	161 658	167 837

[a]Funds generated from Sydney bus services are used to cover operating losses incurred by Newcastle services (bus and ferry) and Sydney ferry services. Capital expenditure of $46.5 million ($38.5 million for new buses) to maintain the average age of the bus fleet at 12 years as per the *Passenger Transport Act 1990* and meet anticipated demand for the Sydney Olympic Games. This expenditure was funded from investment held with and borrowing from the NSW Treasury Corporation. [b] The State Transit Authority (STA) sold the Randwick land for $20 million, and paid the net sale proceeds to the NSW Treasury as a special dividend. Fares increased by 2.2 per cent as recommended by the Independent Pricing and Regulatory Tribunal. STA entered a sale and lease buy-back arrangement for its 84 light motor vehicles with $1.8 million as sales proceed. Non-current assets were revalued using current cost basis and resulted in a reduction of $345 000 in asset value.

TRANSADELAIDE South Australia

TransAdelaide was formed in July 1994 under the *Passenger Transport Act 1994*. It assumed the operations of the former State Transport Authority, while the Passenger Transport Board (PTB) assumed the policy and planning functions. With the passing of the *TransAdelaide (Corporate Structure) Act 1998*, TransAdelaide became subject to the provisions of the *Public Corporations Act 1993*. It has two wholly owned subsidiary corporations, Hills Transit and Austrics.[1]

During 1994-95, the PTB developed an area-based competitive tendering program for the provision of urban transport services within the metropolitan region. TransAdelaide was required to compete with the private sector on the basis of costing rules aimed at ensuring competitive neutrality.

In 1995-96, TransAdelaide was awarded two contracts in its own right and a third as part of a joint venture arrangement with Australian Transit Enterprises. Following the awarding of two additional contracts to TransAdelaide in 1996-97, there was a pause in the competitive tendering of service contracts while the process was reviewed. TransAdelaide operated the remaining non-contracted services.

TransAdelaide receives the majority of its revenue (about 90 per cent) from contract payments from the PTB for the provision of bus, train and tram services. Total revenue has remained fairly constant since 1996-97 with the fall in the cost recovery ratio indicating deterioration in TransAdelaide's ability to generate revenue to cover expenses.

The sharp fall in TransAdelaide's debt to equity, debt to total asset and total liabilities to equity ratios in 1997-98 reflects an increase in the total value of TransAdelaide's assets rather than the retiring of debt.[2] The further improvement in those ratios in 1998-99 largely resulted from the transfer of debt associated with TransAdelaide's bus fleet to Transport SA.

TransAdelaide receives funding from the Department of Treasury and Finance to cover expenses incurred as a result of South Australian Government policies and practices. TransAdelaide makes tax-equivalent and dividend payments to the South Australian Government.

1 Hills Transit provides bus services to the Aldgate and Mount Barker area while Austrics is a software development company involved in the provision of computerised scheduling software.

2 Assets rose due to the upward revaluation of land and buildings and permanent way.

TRANSADELAIDE (continued)

Table 4.2 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*[a]
Size						
Total assets	$M	422	375	432[b]	656[b]	617
Total revenue	$M	217	205	191	193	193
Profitability						
Operating profit (before tax, includes abnormals)	$'000	2 558	6 549	7 760	5 186	-1 483
Operating sales margin	%	14.1	11.8	13.9	11.5	6.1
Cost recovery	%	117.2	106.6	114.2	108.9	102.7
Return on assets	%	6.7	6.3	6.8	4.3	1.9
Return on equity	%	1.6	4.5	4.5	1.6	0.2
Financial management						
Debt to equity	%	143.3	115.6	89.4	36.6	31.3
Debt to total assets	%	45.4	42.4	44.4	29.5	20.9
Total liabilities to equity	%	188.2	156.5	115.9	49.9	45.5
Interest cover	times	1.1	1.4	1.4	1.3	0.9
Current ratio	%	59.0	36.9	76.2	71.1	93.0
Leverage ratio	%	288.2	256.5	215.9	149.9	145.5
Payments to and from government						
Dividends	$'000	0	0	100	1267	0
Dividend to equity ratio	%	0	0	0.1	0.4	0
Dividend payout ratio	%	0	0	1.3	24.4	0
Income tax expense	$'000	0	0	0	0	-2 171
CSO funding	$'000	0	0	0	0	0

a As part of the South Australian Government's asset management plan, TransAdelaide's bus fleet was transferred to Transport SA resulting in a fall in total assets. Operating profit before tax (including abnormals) also declined due to a net increase in abnormal expenses associated with the asset transfer. 50 per cent of the debt associated with bus fleet assets was transferred to Transport SA. **b** TransAdelaide's assets were revalued upwards in 1996-97 and 1997-98.

METRO TASMANIA Tasmania

Metro Tasmania Pty Ltd (Metro) was incorporated on 2 February 1998 under the *Metro Tasmania Act 1997*. On the date of incorporation, the assets and liabilities of the Metropolitan Transport Trust were transferred to Metro. Metro provides urban public transport services to Hobart, Launceston and Burnie. In May 1999, Metro formed a subsidiary company, Metro Coaches (Tas) Pty Ltd to operate bus passenger transport services from Hobart to Blackman's Bay, the Channels, Campania and New Norfolk.

Over the monitoring period, Metro's performance has been affected by falling demand for urban transport services as a result of declining population and competition from motor vehicles.[1]

Operating costs were reduced in 1997-98 and 1998-99 due to the restructuring of management and administration positions, outsourcing engineering contracts and the introduction of satellite depots to reduce out-of-service running costs. The return on asset and return on equity ratios have improved accordingly.

Metro's debt to equity and total liabilities to equity ratios increased from 1996-97 to 1997-98 as a result of an increase in the provision for superannuation by $5 million.[2] Debt to equity and debt to total asset ratios increased and the current ratio decreased in 1998-99, due to a decline in non-current investment and cash on hand respectively. The funds were used to pay employees withdrawing from the State Government Retirement Benefit Funds.

Metro is not required to make tax-equivalent payments due to tax losses.

Metro entered into a Community Service Obligation (CSO) contract with the Government on 31 October 1997. CSO funding was reported explicitly in 1997-98, however from then on, it is reported as a consolidated figure within traffic operation income.

1 The greatest decline in demand for urban transport services occurred among full-fare paying adult passengers.

2 Metro's superannuation liability estimate was exceeded by $2.2 million when more employees elected to leave the State Government Retirement Benefits Fund Superannuation Scheme.

METRO TASMANIA (continued)

Table 4.3 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*[b]
Size						
Total assets	$M	63	57	56	51	37
Total revenue	$M	31	31	31	32	28
Profitability						
Operating profit before tax (includes abnormals)	$'000	-4 540	-5 651	-3 826	-1 128	-69
Operating sales margin	%	-22.6	-21.3	-16.9	-10.1	-0.7
Cost recovery	%	50.4	49.2	55.2	93.8	101.1
Return on assets	%	-5.5	-7.8	-5.1	-1.6	1.0
Return on equity	%	-12.6	-18.6	-13.0	-5.5	-0.4
Financial management						
Debt to equity	%	21.0	29.2	35.4	38.3	43.5
Debt to total assets	%	10.7	13.0	14.7	12.8	15.4
Total liabilities to equity	%	92.3	113.9	138.8	185.2	137.2
Interest cover	times	-3.5	-5.0	-3.1	-3.4	0.9
Current ratio	%	323.1	46.6	33.5	34.4	30.8
Leverage ratio	%	192.3	213.9	238.8	285.2	237.2
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	-243	-113	-561	0	0
CSO funding	$'000	0	0	0	10 904	0

a On 2 February 1998, Metropolitan Transport Trust (MTT) was incorporated under the *Metro Tasmania Act 1997* to form the Metro Tasmania Pty Ltd. The financial statistics for 1997-98 consolidate MTT's and Metro's figures. On 31 October 1997, MTT entered into a Community Service Obligations 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. 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** In May 1999 Metro, formed a subsidiary company, Metro Coaches (Tas) Pty Ltd.

ACTION — Australian Capital Territory

ACTION was established in 1977 pursuant to the *Motor Omnibus Services ACT 1955*, and is currently a division of the ACT Government's Department of Urban Services (DUS). ACTION provides urban and school bus services to the Canberra metropolitan area.

ACTION's total revenue fell over the monitoring period — increases in Community Service Obligation (CSO) payments were more than offset by decreasing passenger revenue. The deterioration in ACTION's cost recovery ratio since 1996-97 reflects ACTION's declining ability to generate sufficient revenue to cover expenses.

The improvement in ACTION's debt to equity, debt to total asset and total liabilities to equity ratios in 1996-97 resulted from the ACT Government's decision to convert $24 million of ACTION's outstanding loans to equity.

On 1 July 1998, ACTION entered into a purchaser–provider relationship with the DUS, whereby the Department purchases public transport services from ACTION. As part of this arrangement, the majority of ACTION's property was transferred to DUS.[1] Furthermore, ACTION sold its fleet of Midi buses for $6.5 million under a sale and lease buy back arrangement.[2]

ACTION entered into an explicit CSO contract in 1996-97. ACTION receives pricing, general route off peak services, concessional, school and a special needs CSO payments.[3] In order to meet its costs, ACTION also receives annual subsidies from the ACT Government.[4]

ACTION did not make any tax-equivalent or dividend payments over the monitoring period.

1 Refer to note **c** of table 3.4.

2 The five year lease agreement commencing 28 June 1998 involves the lease of 25 Midi Buses. ACTION is required to make lease payments of $975 000 per annum.

3 ACTION operates the special needs transport on a full cost recovery basis with revenue received from ACT Health Community Care, the ACT Department of Education and the Canberra Hospital.

4 ACTION received subsidies of $3 million in 1996-97, $1 million in 1997-98 and $2.3 million in 1998-99.

ACTION (continued)

Table 4.4 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*[a]	*1997-98*	*1998-99*[b]
Size						
Total assets	$M	122	117	112	101	76[c]
Total revenue	$M	71	65	65	56[d]	57
Profitability						
Operating profit (before tax, includes abnormals)	$'000	91	-1 660	-7 651	-11 015	-14 733
Operating sales margin	%	11.9	7.9	-2.0	-13.5	-21.7
Cost recovery	%	61.2	56.4	95.5	86.5	78.8
Return on assets	%	6.8	4.3	-1.1	-7.1	-13.9
Return on equity	%	0.2	-3.3	-13.2	-17.6	-28.7
Financial management						
Debt to equity	%	112.9	106.8	44.8	45.0	42.7
Debt to total assets	%	46.4	44.3	25.8	25.0	20.9
Total liabilities to equity	%	138.9	136.3	69.5	71.4	75.4
Interest cover	times	1.0	0.8	-0.2	-2.2	-5.1
Current ratio	%	58.1	52.6	47.2	45.5	27.0
Leverage ratio	%	238.9	236.3	169.5	171.4	175.4
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	35 787	36 367	39 295

a The ACT Government extinguished all of ACTION's loans since self-government (1989), converting debt of $23.9 million to equity. **b** ACTION became liable for the payment of State and Federal taxes and charges in 1998-99. **c** 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** Total revenue fell sharply between 1996-97 and 1997-98 resulting from declining fare revenue, reduced subsidy payments and no revenue from asset disposals ($1.2 million) or recoveries from redundancies ($2.4 million).

5 Railways

The financial performance of five rail Government Trading Enterprises (GTEs) is reviewed in this chapter (see table 5.1) — the NSW State Rail Authority (SRA), the Freight Rail Corporation of NSW (FreightCorp), Queensland Rail (QR), Westrail and the National Rail Corporation (NRC). Westrail and QR provide both passenger and freight services, FreightCorp and NRC provide only freight services, while the SRA provides passenger services.

Victoria's rail services are not included as they have been contracted to the private sector. TransAdelaide only provides urban passenger services and is included in chapter 4.

At the end of the 1998-99 financial year, the five GTEs examined controlled $16.2 billion worth of assets and generated $5.1 billion in revenues. QR and the SRA are the largest operators, respectively accounting for 50 per cent and 34 per cent of assets and 37 per cent and 31 per cent of revenues.

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 1.

5.1 Sector reforms

Reforms within the rail sector have been aimed at improving performance by subjecting operators to greater competitive pressures and introducing stronger financial disciplines.

Third party access regimes have been introduced, or are in the process of being introduced in each State and Territory, in accordance with National Competition Policy (NCP) agreements between the Commonwealth and State and Territory governments. Third party access to rail infrastructure (essentially the rail track) is seen as a means of increasing the scope for competition in rail services.

Table 5.1 **Monitored rail GTEs, 1994-95 to 1998-99**

1994–95	*1995–96*	*1996–97*	*1997–98*	*1998–99*
New South Wales				
State Rail Authority	State Rail Authority	State Rail Authority		State Rail Authority
		Freight Rail Corporation		Freight Rail Corporation
		Rail Access Corporation[a]		Rail Access Corporation[a]
		Rail Services Australia[a]		Rail Services Australia[a]
Queensland				
Queensland Rail				Queensland Rail
Western Australia				
Westrail				Westrail
Commonwealth				
National Rail Corporation				National Rail Corporation

Note Victoria's rail services have been contracted to the private sector and TransAdelaide provides urban passenger services and is discussed in Chapter 4. [a] Not monitored.

In NSW, the former SRA was divided into four independent business entities in July 1996 to form the SRA, the Rail Access Corporation (RAC), Rail Services Australia (RSA) and FreightCorp. These structural reforms were primarily aimed at facilitating competition through third party access to rail infrastructure.

The RAC, as the owner of rail infrastructure, is responsible for managing the State's rail infrastructure and for providing access to rail operators to the network. The RSA provides rail infrastructure maintenance services.

FreightCorp provides freight services throughout NSW and owns and maintains its own rollingstock and locomotives. SRA provides city and country passenger services and owns and maintains its own rollingstock.

In contrast with NSW, the Queensland and Western Australian Governments retained their rail authorities as integrated entities. Both rail authorities have set up business units within their corporations that are responsible for third party access issues.

In Queensland, the Network Access Unit (NAU) was established in 1995-96 within QR to deal with access issues. NAU is responsible for all dealings and negotiations with third party operators and the development of associated organisational policy.[1]

In 1998–99, Westrail was restructured to separate its track access functions from its train operating functions. Under the third party access regime, Westrail must adhere to a legislative framework which provides for other operators to negotiate track access on fair terms and conditions. These terms and conditions will be subject to independent review by a regulator.

There has been some restructuring of interstate freight operations following the establishment of the NRC. In 1991-92, the NRC was established 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 the NRC. This transfer has continued over much of the monitoring period.

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, and affect the financial ratios presented in the individual GTE performance reports.

1 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.

Most rail GTEs have set about improving the operational performance of their business. Investment programs have been developed to upgrade and renew infrastructure and new services and initiatives aimed at improving system efficiencies and attracting and retaining customers have been introduced.

Most have restructured their businesses into separate business units relating to their core services. Rail GTEs have also developed closer relations with the private sector, either through the contracting out of non-core activities or the formulation of joint ventures, such as QR's joint venture with Sea Containers Ltd to establish the Great South Pacific Express.

The revenues and costs associated with operational restructuring, such as the sale of assets or redundancy costs, are included in the calculation of some financial ratios as abnormal revenues and expenses. Hence, in some cases, financial ratios may overstate or understate the extent of changes in GTE performance.

Over the monitoring period, financial reforms have included financial restructuring, the revaluation of assets, the identification and direct funding of Community Service Obligations (CSOs), the development of dividend payment policies and the introduction of tax-equivalent regimes. Many of these reforms were aimed at establishing competitive neutrality conditions agreed to under the 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.

5.2 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.

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). In the transport of agricultural products, livestock, fertilisers and cement, rail has gone from being the dominant form of transport to, in most cases, a minor player.

Rail has maintained a dominant role in the transport of bulk commodities, such as coal and iron ore, to ports. 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. However, it makes the demand for rail transport susceptible to fluctuations in the demand for bulk commodities.

The implementation of access regimes has resulted in increased competition from other rail operators, particularly private rail operators. For example, from 1997-98, FreightCorp faced competition from other rail operators for the transport of freight on the NSW rail system.

Increased competition in freight rail services has reduced freight rates and this, with unfavourable demand conditions in commodity markets, has reduced rail freight revenues in 1997-98 and 1998-99. For example, FreightCorp's operating revenues declined by around 9 per cent between 1996-97 and 1998-99.

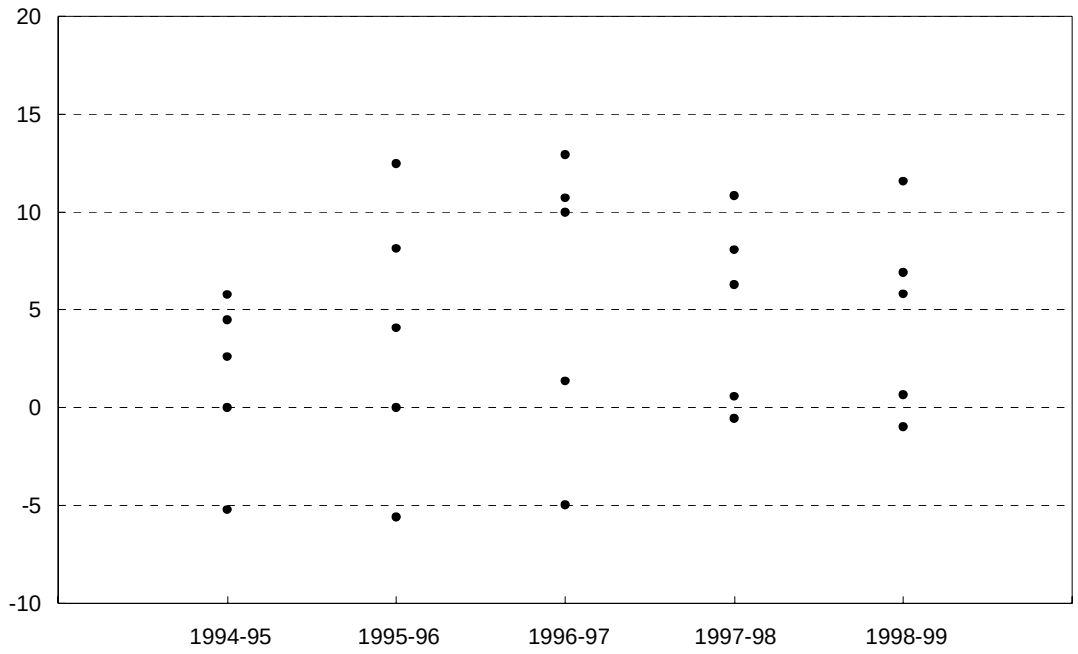
5.3 Profitability

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 1.

Profitability, in terms of return on assets, has been mixed, although there does appear to be general improvement over time (see figure 5.1).[2] QR, Westrail and FreightCorp have consistently earned returns of between 5 and 15 per cent over the monitoring period, although both QR and FreightCorp's returns declined between 1996-97 and 1998-99.

[2] Asset revaluations have a significant influence on the return on assets ratio because of their impact on asset values and operating profit (through depreciation expense). However, within the rail sector, only QR has revalued its assets over the monitoring period. It is difficult to assess the effect that this had upon asset values because revaluation coincided with corporatisation. Thus, direct comparisons with the previous year are not possible.

Figure 5.1 **Returns on assets, 1994-95 to 1998-99 (per cent)**



Note Each data point represents the return on assets ratio for a GTE 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 (including abnormals) and adding back gross interest expense. Average total assets are defined as the service potential or future economic benefits, controlled by the entity as a result of past transactions or other events (measured as the average of the value of assets at the beginning and end of the reporting period). Data points prior to 1996-97 include data for the former SRA, while data points after this date include data for both the SRA and FreightCorp.

The NRC's returns have declined continually over the period, with negative returns recorded in 1998-99. The SRA recorded negative returns on assets over much of the monitoring period. However, since the NSW rail industry was restructured in 1996-97, returns have improved with a positive return made in 1998-99.

In most cases, returns on equity within the sector parallel the returns made on assets. The exception is Westrail which was earning equity returns below zero early in the monitoring period but, by 1998-99 and following financial restructuring, Westrail earned just below 40 per cent on its equity.[3]

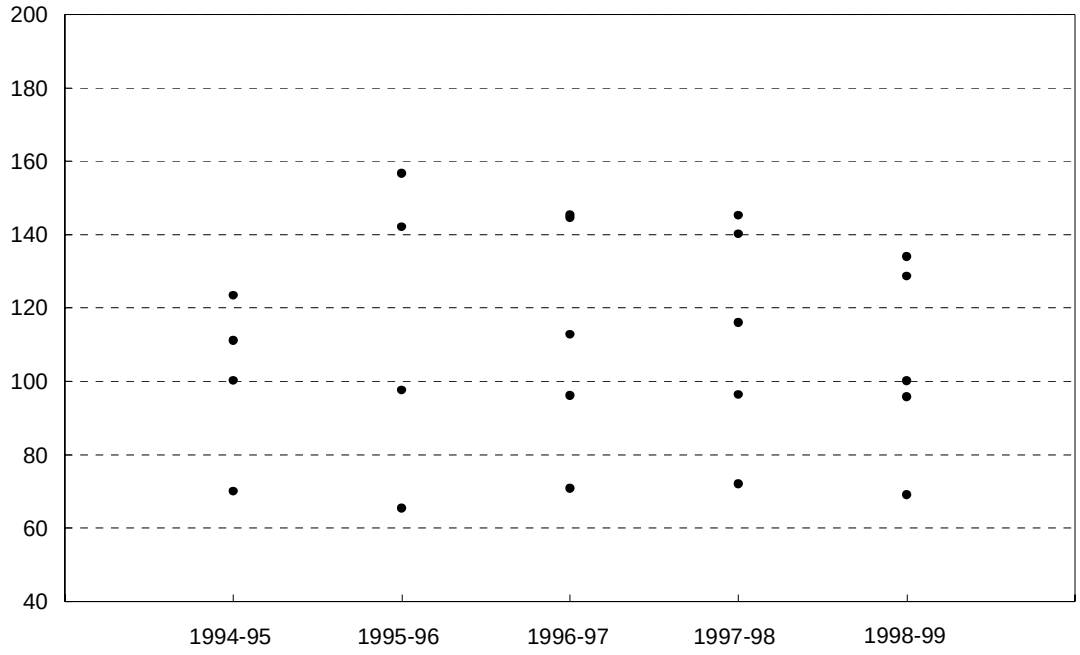
In some cases, the returns on assets and equity reflect the impact of abnormal items on operating profit. For example, in 1998-99, Westrail's return on assets ratio rose due to a contribution from abnormal revenues valued at $48 million. Similarly, FreightCorp and the SRA improved their profitability performance in 1998-99 as a

3 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.

direct result of abnormal revenue contributions worth $13 million and $51.6 million respectively.

For much of the monitoring period, most rail GTEs have more than recovered their operating costs (see figure 5.2). However, in 1998-99, cost recovery rates declined. Some of this decline is likely to be due to increased competition in the provision of freight services and depressed commodity markets which slowed revenue growth over the period.

Figure 5.2 **Cost recovery, 1994-95 to 1998-99 (per cent)**



Note Each data point represents the cost recovery ratio for a GTE in that financial year. Cost recovery is the ratio of revenue from operations to expenses from operations. Revenue from operations is calculated by subtracting abnormal revenue, investment income and receipts from governments to cover deficits on operations from total revenue. Expenses from operations are calculated by subtracting abnormal expenses and gross interest expense from total expenses. Data points prior to 1996-97 include data for the former SRA, while data points after this date include data for both the SRA and FreightCorp.

5.4 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 1.

Assessing the financial performance of the rail GTEs is complicated by the financial restructuring that has occurred within the sector. Financial restructuring introduces inconsistencies in the data across time, making comparison difficult.

In 1996-97, Westrail entered into a financial restructuring arrangement with the Western Australian Treasury. Under the agreement, State Treasury assumed responsibility for Westrail's unfunded superannuation liability, valued at around $725 million. Transferring the liability to State Treasury removed it from Westrail's balance sheet and meant that it was no longer included in the calculation of Westrail's financial ratios in subsequent financial years.

Similarly, it is difficult to make a meaningful assessment of the NRC financial management performance over this period. Between 1993 and 1996, the NRC received compensation payments from its shareholder governments to assist the NRC in rationalising inefficient functions transferred from State governments. The compensation payments are included within the data used to calculate the NRC's financial ratios.

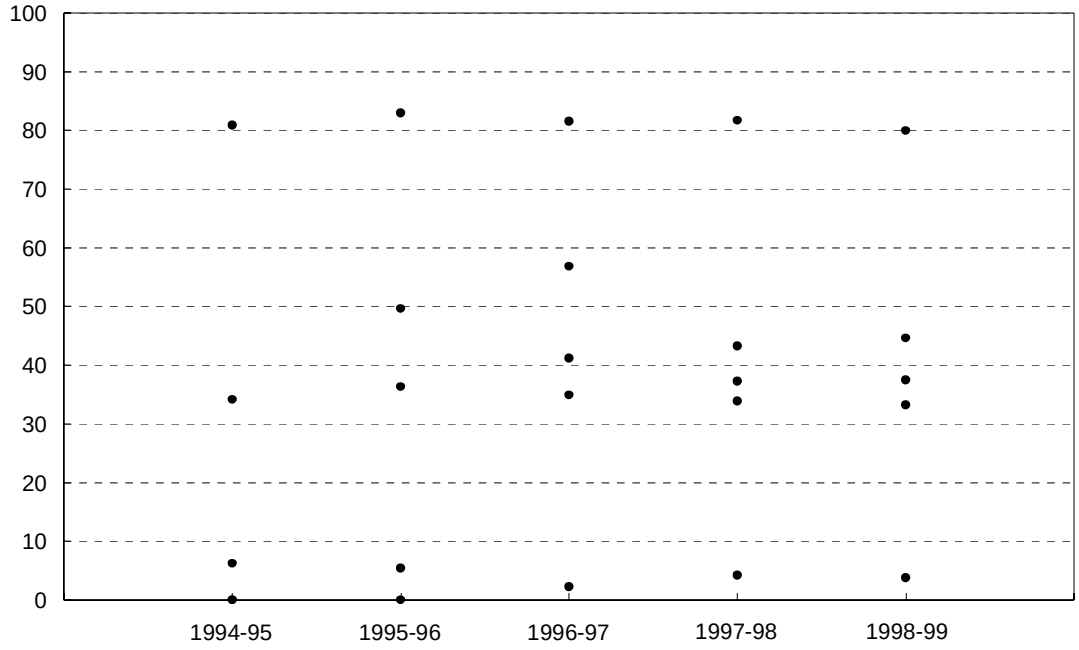
The remaining GTEs have not undertaken financial restructuring programs of this magnitude. However, some financial restructuring has occurred. In 1995-96 and 1997-98 respectively, QR and FreightCorp changed the basis upon which their debt is valued to more closely reflect market values.[4] It is unclear what effect revaluation had upon QR's financial management position as revaluation coincided with corporatisation and thus comparisons with the previous year are not possible.

In FreightCorp's case, the change in the measurement basis of borrowings resulted in abnormal losses and a corresponding increase in the carrying amount of borrowings in the balance sheets. 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 1998-99, most rail GTEs were carrying debt levels equivalent to between 30 and 50 per cent of their total assets (see figure 5.3). These GTEs have maintained this position over much of the monitoring period.

4 Previously, both entities measured their borrowings at face value.

Figure 5.3 **Debt to total assets, 1994-95 to 1998-99**

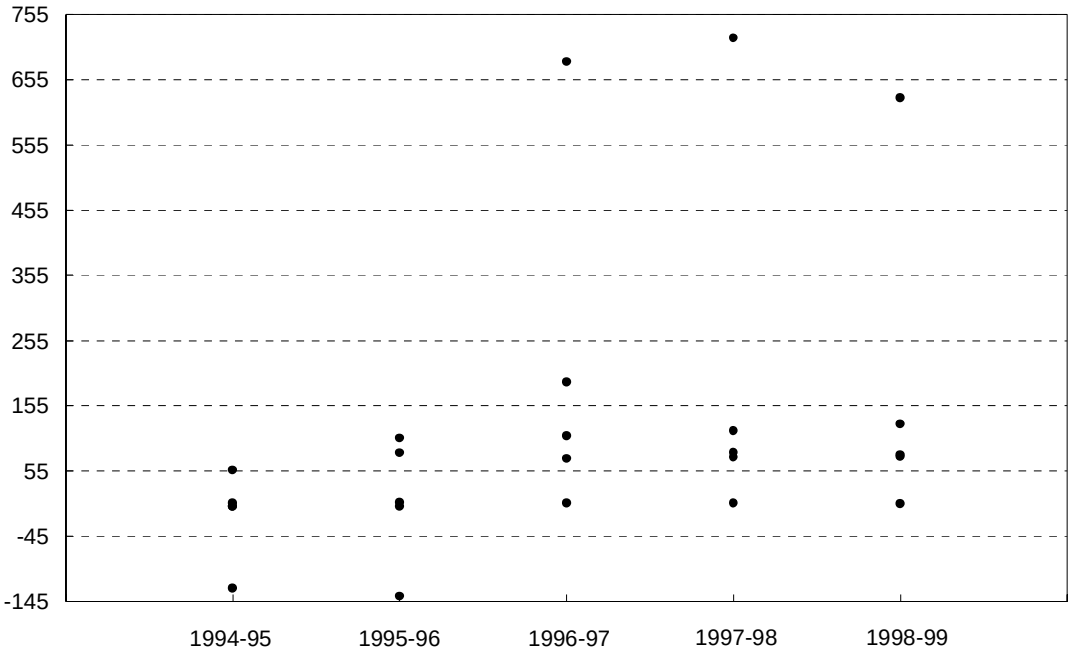


Note Each data point represents the debt to total assets ratio for a GTE in that financial year. Debt is defined to include all repayable borrowings (interest bearing and non-interest bearing), interest bearing non-repayable borrowing and finance leases. Total assets are defined as the service potential or future economic benefits, controlled by the entity as a result of past transactions or other events (measured as the average of the value of assets at the beginning and end of the reporting period). Data points prior to 1996-97 include data for the former SRA, while data points after this date include data for both the SRA and FreightCorp. In 1994-95 and 1995-96, Westrail had negative equity, and so the debt to equity ratio for these years is excluded.

An alternative measure of the level of debt financing of an entity is the debt to equity ratio. At the end of 1998-99, some rail GTEs were operating with debt to equity ratios of between 60 and 125 per cent (see figure 5.4). These GTEs have maintained this level over much of the monitoring period.

Prior to 1996-97, Westrail's debt to equity was well below zero as its debt levels exceeded its total assets. Following financial restructuring in 1996-97, Westrail has reduced its exposure to debt. However, with a debt to equity ratio over 600 per cent it remains substantially above the industry average.

Figure 5.4 **Debt to equity, 1994-95 to 1998-99 (per cent)**



Note Each data point represents the debt to equity ratio for a GTE in that financial year. Debt is defined to include all repayable borrowings (interest bearing and non-interest bearing), interest bearing non-repayable borrowing and finance leases. Average total equity is calculated by subtracting total liabilities from total assets (measured as an average at the beginning and end of the reporting period). Data points prior to 1996-97 include data for the former SRA, while data points after this date include data for both the SRA and FreightCorp. Between 1994-95 and 1995-96, Westrail had negative equity. Equity becomes negative where liabilities exceed total asset levels.

At the end of 1998-99, four of the five rail GTEs had an interest cover ratio just under 2 times (see figure 5.5). This suggests that the GTE's profits may be vulnerable to interest rate increases. The SRA recorded the largest improvement in interest cover over the period, from negative to around 2 times.

Figure 5.5 **Interest cover, 1994–95 to 1998–99 (times)**

Note Each data point represents the interest cover ratio for a GTE in that financial year. Interest cover is the ratio of earnings before interest and tax (EBIT) to gross interest expense. EBIT is calculated by subtracting total expenses from total revenue (including abnormals) and adding back gross interest expense. Gross interest expense includes finance charges on all finance leases and all debt related financial expenses. Data points prior to 1996-97 include data for the former SRA, while data points after this date include data for both the SRA and FreightCorp. Between 1994-95 and 1996-97, the SRA had a large negative interest cover, and so interest cover measure for these years is excluded. In 1994-95, Westrail had a large positive interest cover which has been excluded.

5.5 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 1.

The SRA remains the only GTE not subject to a tax-equivalent regime. This may become an issue should the implementation of access regimes raise the possibility of direct competition from third party operators.

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. The SRA and the NRC are the only rail GTEs not yet subject to a dividend payment policy.

QR has been required to make dividend payments since 1995-96 and Westrail and FreightCorp were required to make dividend payments from 1996-97. In 1998-99, state governments received $160 million in dividend payments from these three rail GTEs, with around 60 per cent of these payments being generated by QR.

Governments are also moving towards identifying, costing and explicitly funding the CSOs provided by rail GTEs. Most of the rail GTEs monitored provided CSOs over the period. CSOs included concession fares to specified a class of passenger and the provision of low volume freight services.

5.6 GTE performance reports

State Rail Authority (NSW)
Freight Rail Corporation (NSW)
Queensland Rail (Qld)
Westrail (WA)
National Rail Corporation (C'wealth)

STATE RAIL AUTHORITY OF NSW NSW

Prior to 1996-97, the State Rail Authority of NSW (SRA) provided city and country passenger rail services and freight services throughout NSW as well as interstate passenger and freight services. On 1 July 1996, SRA was vertically and horizontally separated into four smaller authorities — the SRA, the Rail Access Corporation (RAC), Rail Services Australia (RSA), and the Freight Rail Corporation (FRC) — and some of its functions were transferred to these new entities.[1] The SRA retained responsibility for the provision of city and country passenger rail services.

The SRA's first full year of operation as a separate entity was 1996-97. The SRA's assets declined in that year as some were transferred to the three new entities as part of the restructuring process. Total assets rose in 1998-99, due largely to increases in rollingstock and investments.

Following restructuring, the SRA's operating losses before tax (including abnormals) declined, with the SRA recording an operating profit in 1998-99. Higher revenues from the sale of property, plant and equipment and passenger traffic and smaller abnormal expenses contributed to the 1997-98 result, while the SRA's 1998-99 operating profit was largely a result of 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.

The contribution from abnormal revenues in 1998-99 resulted in the SRA making a positive return on its assets and equity. Its operating sales margin also became positive.

The SRA's debt to equity, debt to total asset and total liabilities to equity ratios have remained stable over the review period. However, the SRA's interest cover has increased as operating profits have improved.

1 The RAC assumed ownership of rail infrastructure from SRA and is responsible for negotiating the use of the track by rail operators and funding the upkeep of the track. The RSA assumed responsibility for maintenance of the track under contract to the RAC and also provides construction and rollingstock overhaul and repair services. FRC provides freight services throughout NSW.

STATE RAIL AUTHORITY OF NSW (continued)

Table 5.1 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	12 283	12 466	4 622[a]	4 528	5 450
Total revenue	$M	1 684	1 675	1 236	1 566[b]	1 590[c]
Profitability						
Operating profit before tax (includes abnormals)	$'000	-510 753	-746 006	-448 796	-45 384	13 530[d]
Operating sales margin	%	-29.5	-42.0	-34.6	-1.8	1.8
Cost recovery	%	70.0	65.3	70.8	72.0	69.1
Return on assets	%	-5.2	-5.6	-5.0	-0.6	0.6
Return on equity	%	-7.5	-7.5	-6.7	-1.3	0.4
Financial management						
Debt to equity	%	5.7	6.7	5.6	5.8	4.5
Debt to total assets	%	6.2	5.4	2.2	4.2	3.8
Total liabilities to equity	%	23.0	25.2	35.6	35.3	29.3
Interest cover	times	-14.7	-13.3	-19.0	-1.3	1.7
Current ratio	%	64.8	48.5	48.8	46.5	37.0
Leverage ratio	%	123.0	125.2	135.6	135.3	129.3
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	0	0	0	0	0
CSO funding	$'000	410 070[e]	421 052	507 501	495 525	483 650

a Fall in total assets due to asset divestiture associated with the restructure of SRA. **b** Higher revenues are the result of the sale of property, plant and equipment along with slightly higher passenger revenues. **c** Revenues increased due to asset disposal proceeds, higher passenger revenues, increases in NSW Government operating subsidies, interest received and other non-operating revenues. **d** Operating profit is the result of 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 tranferred from the Department of Transport. **e** The SRA's community service obligations include concession fares to specified classes of passengers and revenue shortfalls resulting from providing certain services at the request of the NSW Government.

FREIGHT RAIL CORPORATION OF NSW NSW

The Freight Rail Corporation (FreightCorp) of NSW began operating in 1996-97, following the NSW Government's restructure of the SRA. FreightCorp is a statutory State owned corporation undertaking 'above rail' freight operations.[1] It operates locomotives, wagons and other services above track. It purchases track services from the Rail Access Corporation for which it pays a charge.

FreightCorp's operating profit before tax (including abnormals) fell by 83 per cent in 1997-98. While profit was affected by an average 9 per cent decline in freight rates, the adverse operating result was largely a result of abnormal items, including restructuring costs associated with redundancies and debt. At the end of the financial year, debt was revalued at market value.

Profit performance improved in 1998-99 as abnormal expenses declined. However, FreightCorp's profit level remained below that recorded in 1996-97 as freight rates continued to decline. Freight rates fell by an average of 25 per cent between 1996-97 and 1998-99.

FreightCorp's return on assets and equity, operating sales margin and cost recovery have all decreased as profit and revenues have declined. At the same time, FreightCorp's debt to equity, debt to total asset and total liabilities to equity have fallen as debt and total liabilities have declined.

Dividend payments to the NSW Government exceeded operating profit before tax (including abnormals) in 1997-98 and were 60 per cent of operating profits in 1998-99. In both financial years, dividend payments were met out of retained earnings from the previous financial year.

FreightCorp has a Community Service Obligation (CSO) contract with the NSW Government to provide freight train services to regional areas at a non-commercial rate. The increase in CSO payments in 1997-98 reflects a corresponding increase in access charges paid by FreightCorp.

1 'Above rail' refers to the services provided using rail infrastructure. Below rail includes the track, stations, signalling and other infrastructure used for running train services.

FREIGHT RAIL CORPORATION OF NSW (continued)

Table 5.2 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*[a]	*1997-98*	*1998-99*
Size						
Total assets	$M	n.r.	n.r.	1 075	959	985
Total revenue	$M	n.r.	n.r.	832	772[b]	690[b]
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	106 304	14 158[c]	33 660[d]
Operating sales margin	%	n.r.	n.r.	15.6	7.8	9.9
Cost recovery	%	n.r.	n.r.	112.7	116.0	100.1
Return on assets	%	n.r.	n.r.	12.9	6.3	6.9
Return on equity	%	n.r.	n.r.	27.9	3.6	2.6
Financial management						
Debt to equity	%	n.r.	n.r.	191.4	83.2[e]	76.6
Debt to total assets	%	n.r.	n.r.	56.8	37.3[e]	37.4
Total liabilities to equity	%	n.r.	n.r.	261.6	110.5[e]	107.3
Interest cover	times	n.r.	n.r.	2.9	1.2 [e]	1.8
Current ratio	%	n.r.	n.r.	127.3	159.0[e]	121.4
Leverage ratio	%	n.r.	n.r.	138.2	190.5[e]	193.2
Payments to and from government						
Dividends	$'000	n.r.	n.r.	42 228	23 288	20 000
Dividend to equity ratio	%	n.r.	n.r.	14.2	6.2	4.3
Dividend payout ratio	%	n.r.	n.r.	51.0	171.6[f]	166.3[f]
Income tax expense	$'000	n.r.	n.r.	23 494	590	21631
CSO funding	$'000	n.r.	n.r.	60 618	90 000[g]	80 000

a FreightCorp began operating as a separate entity in 1996-97 following the restructure of State Rail Authority. **b** FreightCorp's freight rates have declined by an average of 25 per cent since corporatisation resulting in lower revenues. **c** Operating profits declined as a result of abnormal expenses totalling $45.9 million. These expenses are related to restructuring costs associated with redundancies and debt. Redundancy costs include provision for severance payments while debt was revalued at market value at the end of the financial year. In previous years, debt had been valued at face value after deducting any unamortised discounts. **d** Operating profits improved due to lower abnormal expenses of $13 million. **e** FreightCorp changed the measurement of its borrowings to reflect market value. **f** Dividend payouts have been funded by drawing upon retained earnings from the previous financial year. **g** The increase in community service obligation payments reflects a corresponding increase in access charges paid by FreightCorp in providing these services. **n.r.** Not relevant.

QUEENSLAND RAIL QUEENSLAND

Queensland Rail (QR) provides freight services throughout regional Queensland and operates passenger rail services in the Brisbane metropolitan area and between key regional centres. QR was corporatised in 1995.

Upon corporatisation, QR's fixed assets were revalued to reflect their market value and borrowings were brought to account at their market value. As a result, the value of total assets declined in 1995-96, although in subsequent years, total assets have increased as QR has undertaken a major capital works program, including new, rollingstock and track.

QR's operating profit before tax (including abnormals) declined between 1996-97 and 1998-99. Operating profit declined in 1997-98 due largely to a reduction in community service obligation revenues received from the Queensland Government.

Operating profit before tax (including abnormals) declined by around 45 per cent in 1998-99, largely as a result of downward pressure on freight rates. Although tonnages hauled increased, the increase in freight revenue was not enough to cover the increase in consumable expenses. As a consequence, QR's operating sales margin declined and costs were no longer being fully recovered. The return on assets and equity also declined.

QR's debt to equity and total liabilities to equity ratios rose between 1995-96 and 1998-99 and interest cover declined between 1996-97 and 1998-99 as debt levels rose. Debt has risen as a consequence of QR's capital works program. Despite increasing liabilities, QR's current ratio indicates that short-term assets are sufficient to cover its short-term debt.

QR makes dividend payments to the Queensland Government. Dividends declined in 1997-98 and 1998-99 as operating profits declined. QR pays out a significant proportion of its profits in dividends as is reflected in its dividend payout ratio.

QUEENSLAND RAIL (continued)

Table 5.3 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	7 202	5 846[b]	6 487[c]	7 031[c]	7 609[c]
Total revenue	$M	1 498[d]	1 785[d]	1 995[d]	1 896	1 902
Profitability						
Operating profit before tax (includes abnormals)	$'000	-8 159	315 895	389 020	304 609[e]	167 886[f]
Operating sales margin	%	11.4	29.6	30.8	28.7	22.2
Cost recovery	%	111.1	142.1	144.5	140.2	128.6
Return on assets	%	2.6	8.1	10.0	8.1	5.8
Return on equity	%	-0.2	6.4	11.5	7.7	4.1
Financial management						
Debt to equity	%	56.0	105.0[g]	108.5	116.5	126.9
Debt to total assets	%	34.1	36.3	41.1	43.3	44.6
Total li abilities to equity	%	78.8	158.9	177.6	180.3	195.6
Interest cover	times	1.0	2.5	2.7	2.3	1.7
Current ratio	%	52.8	81.2	77.7	106.7	134.0
Leverage ratio	%	178.8	258.9	277.6	280.3	295.6
Payments to and from government						
Dividends	$'000	0	160 611	240 345[h]	100 000	95 000
Dividend to equity ratio	%	0	5.1	10.5	4.1	3.7
Dividend payout ratio	%	0	80.0	91.3	53.4[i]	91.1
Income tax expense	$'000	0	115 246	125 893	117 301	63 656
CSO funding[j]	$'000	226 292	595 252	659 325	541 568	533 417

a Queensland Rail (QR) is corporatised. **b** Fixed assets revalued to reflect their market value. **c** Total assets increased following a major capital works program. **d** Does not include contributions from developers. **e** Profit declined as a result of a fall in community service obligation funding following a reduction in the return on assets component paid by the Queensland Government. **f** Profit was affected by downward pressure on freight rates. Although record tonnages were hauled, freight revenue did not increase enough to cover the increase in consumables. **g** Borrowings brought to account at their market value. **h** The 1996-97 dividend figure includes $36.7 million paid in that year but which relates to the 1995-96 financial year. **i** 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. **j** QR receives community service obligation payments from the Queensland Government for certain freight and passenger rail services. Contributions received in respect of passenger services are for Citytrain, Traveltrain and the Brisbane to border portion of interstate services. Contributions received in respect of freight services are for low volume routes and Q-Link operatings. QR also receives amounts for reimbursement of concessions provided to senior citizens, pensioners and students.

WESTRAIL WESTERN AUSTRALIA

Westrail provides urban and regional passenger rail services and freight rail services throughout Western Australia. Westrail'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.

In 1995-96, Westrail undertook a three year modernisation program designed to refocus the organisation on core business activities and improve its efficiency. The program included the outsourcing of non-core activities (including track maintenance and development work), workforce reductions, rationalisation of assets and restructuring of costs. The program also included investment in new locomotives and the development of a continuous improvement culture.

The first year of the modernisation program resulted in a reversal of financial performance as Westrail recorded its first operating profit before tax (including abnormals) in 1995-96. Cost reductions realised through restructuring were largely responsible for this turnaround and resulted in Westrail improving its cost recovery.

Westrail's debt to equity, debt to total asset and total liabilities to equity ratios increased in 1995-96 as borrowings increased to finance asset investment, including the acquisition of new locomotives.

In 1996-97, Westrail entered into a financial restructuring arrangement with the Western Australian Treasury aimed at furthering the implementation of competitive neutrality. Under the restructuring arrangements, State Treasury assumed Westrail's unfunded superannuation liabilities and began directly funding Westrail's community service obligations.[1] Westrail also commenced annual dividend and tax-equivalent payments to State Treasury.

State Treasury's assumption of Westrail's unfunded superannuation liability has the effect of reversing Westrail's financial management position. Westrail's negative debt to equity, total liabilities to equity and leverage ratios became positive.

Despite increasing operating profit levels in 1997-98 and 1998-99, Westrail's cost recovery decreased due to declining freight rates. Operating profits increased in both years due to abnormal revenues.

1 The financial restructuring package also included General Loan Fund repayments and a land rationalisation program with proceeds used to reduce Westrail's debt.

WESTRAIL (continued)

Table 5.4 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	1 052	1 060	1 137	1 244	1 337
Total revenue	$M	428	439	418	420	452
Profitability						
Operating profit before tax (includes abnormals)	$'000	-38 515	41 127	30 684	46 554[a]	69 023[b]
Operating sales margin	%	10.8	29.8	28.0	30.5	33.0
Cost recovery	%	123.4	156.7	145.3	145.2	133.9
Return on assets	%	4.5	12.5	10.7	10.8	11.6
Return on equity	%	5.7	-6.3	-7.8	13.9	37.7
Financial management						
Debt to equity	%	-125.1	-137.5	682.5[c]	718.6	626.9
Debt to total assets	%	80.9	82.9	81.5	81.7	79.9
Total liabilities to equity	%	-254.9	-266.5	766.5[c]	819.3	712.7
Interest cover	times	0.5	1.5	1.4	1.6	1.9
Current ratio	%	34.3	40.1	44.2	34.9	28.5
Leverage ratio	%	-154.9	-166.5	866.5[c]	919.3	812.7
Payments to and from government						
Dividends	$'000	0	0	1 508[d]	32868	44 744
Dividend to equity ratio	%	0	0	-0.6	24.7	29.8
Dividend payout ratio	%	0	0	7.6[d]	177.6	79.1
Income tax expense	$'000	0	0	10 926	28043	12 437
CSO funding	$'000	0	0	19 870[d]	19711	19 547

a Operating profit increased due to the influence of abnormal items. In 1996-97, Westrail incurred an abnormal expense totalling $11.8 million, while in 1997-98, Westrail earned abnormal revenue of $402 000. **b** Operating profit increased due to abnormal revenues of $48 million. **c** In 1996-97, State Treasury assumed Westrail's unfunded superannuation liability totalling $725 million. **d** A financial restructuring package negotiated with State Treasury introduced direct funding of Westrail's community service obligations and the introduction of a tax-equivalent regime.

NATIONAL RAIL CORPORATION — COMMONWEALTH

The Commonwealth, New South Wales, Victorian, Queensland, South Australian and Western Australian Governments established the National Rail Corporation (NRC) in 1991, with the purpose of providing interstate rail freight transport services. The agreement between these Australian governments specified a five-year establishment period for the NRC during which the company would take over all of the interstate rail freight business conducted by the five separate state-based rail authorities, including selected assets predominantly used in that business.

The NRC began operations in 1993 and, in its first five years of operation, focused on creating a modern business by process re-engineering, upgrading, replacing key assets and systems and improving relationships with customers.

In 1993, the NRC's three shareholders — the Commonwealth, New South Wales and Victorian Governments — agreed to underwrite the NRC's restructuring. The agreement committed each shareholder to cash equity injections, the transfer of selected nominated assets and the making of payments which were to compensate the NRC for any losses incurred from transferred functions. Compensation payments aimed to assist the NRC in restructuring and improving the productivity of inefficient functions, before the NRC assumed full responsibility for the business at the end of the transitional period in 1996.

Assessing the NRC's financial performance over the monitoring period is difficult because of the restructuring that was occurring. For example, company profits over the first few years of the monitoring period cannot be used as a measure of financial performance because of the payments being made by shareholder governments to the NRC.

The cessation of shareholder compensation payments in 1998 and lower freight rates reduced revenues and increased operating losses in 1997-98. As a result, NRC's return on assets and equity and cost recovery declined.

By 1998-99, the NRC had renewed its asset based, including the delivery of 120 new locomotives valued at $360 million.

NATIONAL RAIL CORPORATION (continued)

Table 5.5 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	361	846	862	897	825
Total revenue	$M	497	539	516	495	431
Profitability						
Operating profit before tax (includes abnormals)	$'000	17 836[a]	1 917[a]	-14 141[a]	-20 406[b]	-31 556
Operating sales margin	%	0.2	-2.4	-2.1	-1.5	-4.2
Cost recovery	%	100.2	97.6	96.1	96.3	95.7
Return on assets	%	5.8	4.1	1.3	0.6	-1.0
Return on equity	%	5.6	0.3	-3.6	-2.3	-9.6
Financial management						
Debt to equity	%	0	82.5	74.1	75.8	80.0
Debt to total assets	%	0	49.6	34.9	33.9	33.2
Total liabilities to equity	%	18.7	133.2	114.4	128.1	131.0
Interest cover	times	2 973.7	1.1	0.4	0.2	-0.4
Current ratio	%	612.6	377.3	211.5	121.0	103.3
Leverage ratio	%	110.9	142.1	139.9	172.8	180.8
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	2 966	912	-285	-11 434	4 480
CSO funding	$'000	0	0	0	0	0

a Profits over the first few years of the monitoring period cannot be used as a measure of financial performance because of the compensation payments being made by shareholder governments to the NRC.
b Shareholder compensation payments were reduced by $25 million and ceased entirely in February 1998.

6 Ports

Fifteen port Government Trading Enterprises (GTEs) are covered in this chapter. These authorities vary in size and the range of services they provide. Financial performance summaries including performance indicators for each authority are presented after this introduction.

The performance indicators are consistent across individual GTEs. However, care should be taken to consider changes in market environments, and timing and valuation issues relating to chosen accounting methods when making comparisons.

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 1.

6.1 Sector reforms

Individual port authorities experienced considerable structural, institutional and commercial change between 1994-95 and 1998-99 (see table 6.1). The primary aim of these reforms has been to replicate market disciplines including the establishment of clear objectives that eliminate the conflict between commercial and non-commercial objectives, which existed previously. Reform has also seen an increase in the scope for competition in the provision of port services mainly through the competitive tendering and contracting out of activities such as stevedoring, pilotage, mooring, general maintenance and ship cleaning to private operators.

The operational models adopted by individual port authorities 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.

Table 6.1 **Monitored port GTEs, 1994–95 to 1998–99**

1994–95	*1995–96*	*1996–97*	*1997–98*	*1998–99*
New South Wales				
Maritime Services Board	Newcastle Port Corporation	→	→	Newcastle Port Corporation
	Port Kembla Port Corporation	→	→	Port Kembla Port Corporation
	Sydney Ports Corporation	→	→	Sydney Ports Corporation
	Office of Marine Administration (Not Monitored)	→	→	Office of Marine Administration (Not Monitored)
	Waterways Authority (Not Monitored)	→	→	Waterways Authority (Not Monitored)
Victoria				
Port of Melbourne Authority	Melbourne Port Corporation	→	→	Melbourne Port Corporation
	Melbourne Port Services Pty Ltd (Not Monitored)	→	→	Skilled Engineering (Not Monitored)
	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 6.1 (continued) **Monitored port GTEs, 1994–95 to 1998–99**

1994–95	*1995–96*	*1996–97*	*1997–98*	*1998–99*
Western Australia				
Fremantle Port Authority	→	→	→	Fremantle Port Authority
			Bunbury Port Authority[a] →	Bunbury Port Authority
South Australia				
South Australian Ports Corporation	→	→	→	South Australian Ports Corporation
Tasmania				
Burnie Port Authority	→	Burnie Port Corporation	→	Burnie Port Corporation
Marine Board of Hobart	→	Hobart Port Corporation	→	Hobart Port Corporation
Port of Launceston	→	Port of Launceston Corporation	→	Port of Launceston Corporation
Port of Devonport Authority	→	Port of Devonport Corporation	→	Port of Devonport Corporation
Northern Territory				
Darwin Port Authority	→	→	→	Darwin Port Authority

[a] Bunbury Port Authority was not monitored prior to 1997-98.

The substantial variation in operational models adopted by individual port authority's blurs the distinction between core and non-core port services and activities.

A number of reforms have led to improved pricing and allocative mechanisms being implemented over the monitoring 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 in the types of charges levied across port authorities — for the provision of like services — still remain. Furthermore, the determination of port charges differs across jurisdictions. In some States, port charges are determined externally by independent pricing regulators, while in others, individual ports have more autonomy in setting charges.

6.2 Market environment

The level of revenue generated by port authorities is strongly linked to trade throughput. Trade throughput is susceptible to changes in both domestic and international markets. However, changing market environments do not impact on all port authorities 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 monitoring period, include:

- an increase in the average total tonnage per ship visit resulting in a reduction in the unit cost of exchanging cargo;[1]
- a fall in trade throughput resulting from a fall in demand, particularly from the Asian region in recent years; and
- a reduction in port charges and a movement towards consumption-based charging.

These changes have impacted on individual port authorities to varying degrees. An awareness of port-specific changes in market environment provides useful context for understanding changes in performance. Examples of these changes include:

- the closure of BHP Steel-making facilities in Newcastle; and
- the cessation of general cargo shipping operated by Coastal Express Line at Port Launceston.

1 Particularly towage and port authority tonnage charges.

The market environment ports operate in is dynamic and care should be given not to under- or overstate its importance. Port authorities, like any private business, should be aware of the dynamics of their individual market environment and aim to maximise their risk-adjusted return to shareholders within this environment.

Port authorities that have a diversified trade portfolio — both source and type of trade throughput — reduce the risk associated with changes in market environment. However, the extent to which a port authority can diversify its operations depends on its size, location and government policy.

6.3 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 1.

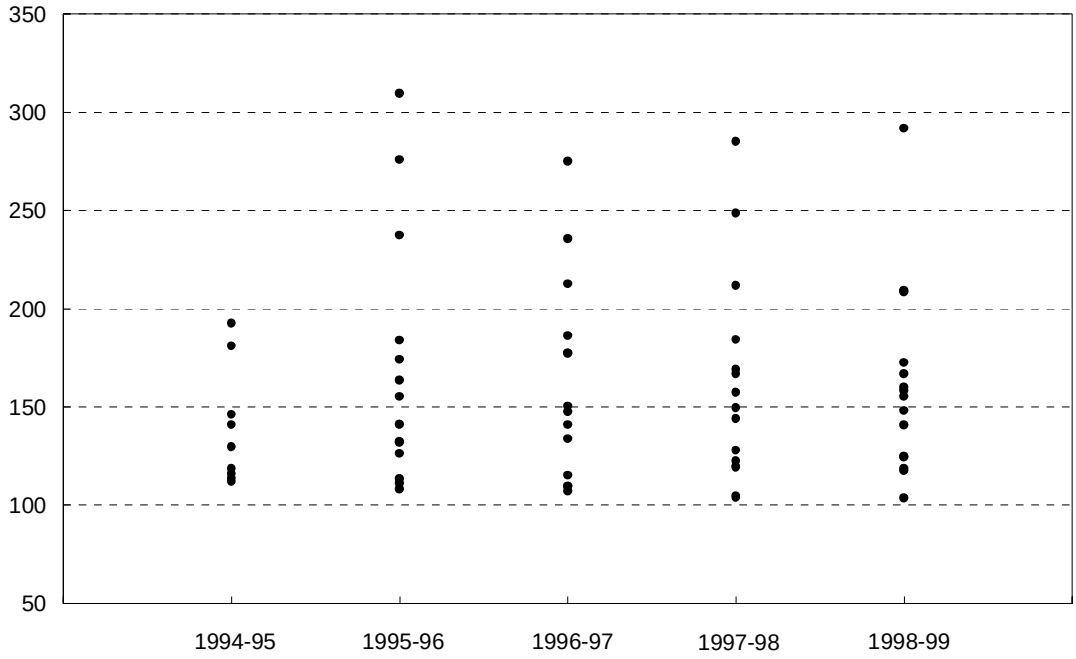
Over the monitoring period, all port authorities have recovered over 100 per cent of operating expenses (see figure 6.1). Although there is no clear industry trend in cost recovery over the monitoring period, the maintenance of cost recovery, despite reductions in port charges and a general fall in demand for Australian exports from the Asian region, indicates an improvement in the efficiency of ports in recovering costs.

Port authorities experienced substantial variation in their return on assets over the monitoring period (see figure 6.2). This variation can largely be explained by abnormal items — either through their impact on operating profit, total assets or a combination of the two.

Abnormal items include:

- Abnormal revenues — for example, interest earned from superannuation reserves not previously accounted for, asset sales, subsidies from government — inflate operating profit before tax (including abnormals) and the return on assets ratio.
- Abnormal expenses — for example, downward revaluations of non-current assets, debt re-financing, redundancy payments, losses on disposal of assets and major cyclical asset maintenance (see box 6.1) — deflate operating profit before tax (including abnormals) and the return on assets ratio.

Figure 6.1 **Cost recovery, 1994-95 to 1998-99 (per cent)**



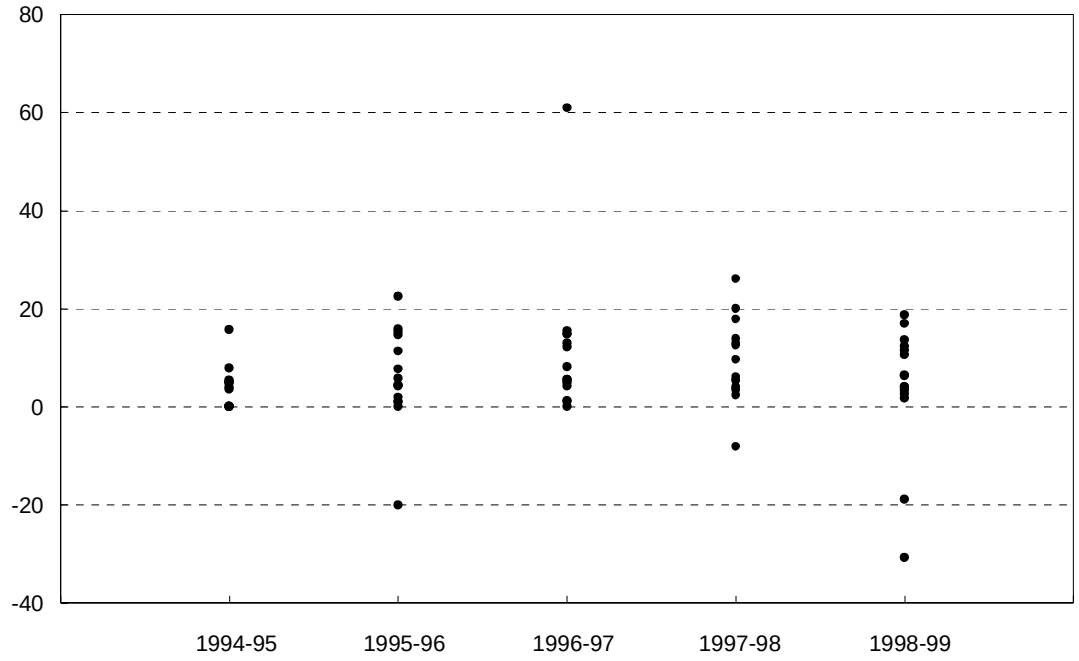
Note Each data point represents the cost recovery ratio for a GTE in that financial year. Cost recovery is the ratio of revenue from operations to expenses from operations. Revenue from operations is calculated by subtracting abnormal revenue, investment income and receipts from governments to cover deficits on operations from total revenue. Expenses from operations are calculated by subtracting abnormal expenses and gross interest expense from total expenses.

Asset revaluations account for the majority of the variation in the return on assets ratio over the monitoring period. The largest downward asset revaluation occurred at Port Kembla Port Corporation in 1998-99 — assets were revalued downward by 36 per cent. Consequently, their operating profit before tax (including abnormals) was negative, resulting in a negative return on assets. Gladstone Port Authority experienced a similar result in 1998-99. The largest upward asset revaluation occurred at Sydney Ports Corporation in 1997-98 — assets were revalued upward by 67 per cent.

The size and frequency of abnormal items in financial statements can be expected to fall as port authorities adopt competitive reforms over time, which may in part explain the clustering of ratios in the 1998-99 financial year. Two GTEs earned negative returns on assets in 1998-99. This was the result of large downward asset revaluations culminating in operating losses before tax (including abnormals).

Another measure of profitability is return on equity, which in the case of port authorities closely follows the return on assets. The Office of the Regulator-General (ORG) in Victoria has proposed a benchmark return on equity of 7.3 per cent for Melbourne Port Corporation and 6.7 per cent for the Victorian Channel Authority (ORG 2000).

Figure 6.2 **Return on assets, 1994-95 to 1998-99 (per cent)**



Note Only positive return on assets ratios were included. Each data point represents the return on assets ratio for a GTE 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 defined as the service potential or future economic benefits, controlled by the entity as a result of past transactions or other events (measured as the average of the value of assets at the beginning and end of the reporting period).

In 1998-99, only six port authorities reported a return on equity of above 7 per cent. Of these, the South Australian Ports Corporation reported a return of 18 per cent, and Newcastle Port Corporation reported a return of 11 per cent.

Box 6.1 **Major cyclical asset maintenance**

Issues relating to major non-current asset maintenance are significant to port authorities for two reasons. First, the majority of Australian port channels require dredging at regular intervals to maintain channel depth. Second, current methods for accounting for major port maintenance have a substantial impact on asset values, operating profit and therefore performance indicators.

Many port authorities account for the continued deterioration in channels by making a charge to the profit and loss statement. This charge is calculated based on the time expired since the last major maintenance cycle. In May 1999, the Urgent Issues Group of the Australian Accounting Research Foundation released Abstract 26 'Accounting for Major Cyclical Maintenance'. The amended accounting treatment requires that provisions for future maintenance must not be recognised as a liability, or as accumulated depreciation, or as a reduction in the carrying value of an asset. As a result, charges to the profit and loss statement for the future removal of accumulated siltation in channels ceased.

The change in accounting policy will result in profits being overstated in the years until the next major maintenance dredging cycle. Thereafter, the cost of major non-current cyclical maintenance will be amortised over the next cycle with corresponding reductions in profits.

Abstract 26 applies to all port authorities from 30 June 1999. Any adjustments arising from the application of Abstract 26 must be adjusted against retained profits or accumulated losses as at 1 July 1998 — see for example, the Port Kembla Port Corporation and Victorian Channel Authority 1998-99 annual reports.

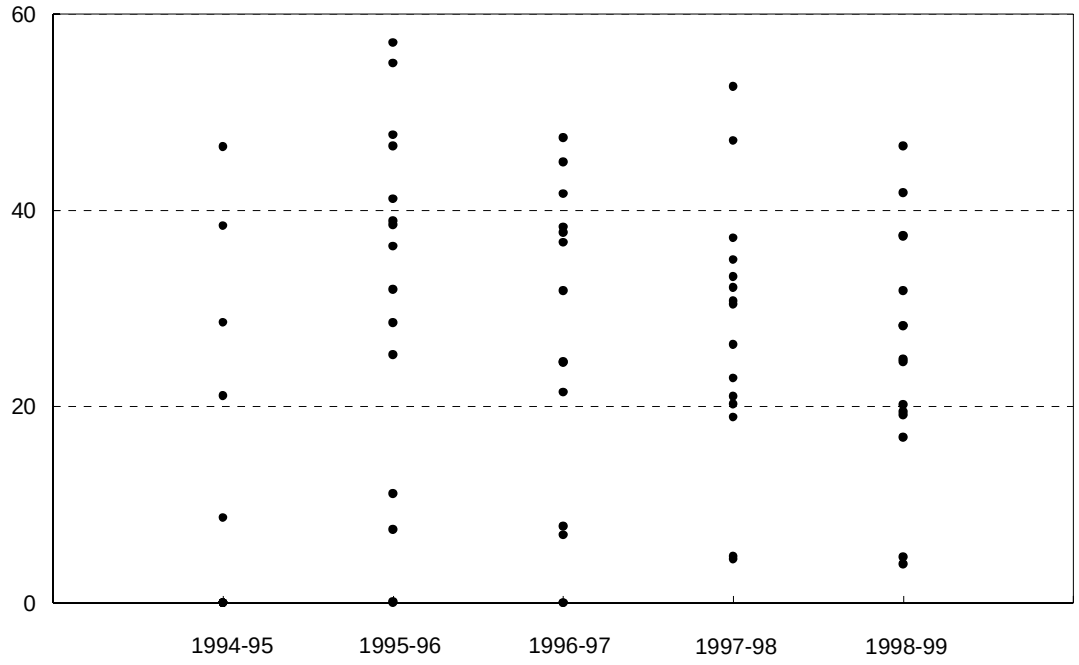
6.4 Financial management

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 1.

Over the monitoring period, port authority debt to total asset ratios 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 6.3). Asset revaluations have a large impact on this ratio. For example, over the two year period to 1998-99 Sydney Ports

Corporation's debt to total assets fell from 45 per cent to 28 per cent with no change in debt levels.[2]

Figure 6.3 **Debt to total assets, 1994-95 to 1998-99**



Note Each data point represents the debt to total assets ratio for a GTE 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. Total assets are defined as the service potential or future economic benefits, controlled by the entity as a result of past transactions or other events (measured as the average of the value of assets at the beginning and end of the reporting period).

Apart from the impact of abnormal items on the debt to total assets ratio, improvements in some port authorities' debt positions have been achieved through the retirement of debt. For example, Gladstone Port Authority achieved a 71 per cent fall in debt levels over the monitoring period.

Another measure of financial management is interest cover. In 1998-99, ten port authorities achieved ratios below three times. Consequently, there is a greater risk that financial commitments may need to be met from sources of funds other than earnings from operations.

Abnormal items have a substantial impact on this ratio. For example, Gladstone Port Authority's interest cover fell from 6.8 times in 1997-98 to -108.8 times in 1998-99 due to abnormal items.

2 Sydney Ports Corporation's assets increased by 85 per cent in value terms between 1996-97 and 1998-99.

6.5 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 1.

Owner governments require their port authorities to make tax-equivalent and dividend payments along with debt-guarantee fees. These measures were designed to encourage port authorities to act in a more commercial manner and have resulted in an increase in payments to governments. All port authorities are required to make tax-equivalent and dividend payments.

The reform process aimed to distinguish between commercial and non-commercial activities. Port authorities required to undertake non-commercial activities should receive Community Service Obligation (CSO) payments from shareholder governments equivalent to the cost of provision.

Darwin Port Authority is the only port authority to receive CSO payments. Many other port authorities are expected to undertake non-commercial activities, but do not receive CSO payments.

6.5 GTE performance reports

Newcastle Port Corporation (NSW)
Port Kembla Port Corporation (NSW)
Sydney Ports Corporation (NSW)
Melbourne Port Corporation (Vic)
Victorian Channels Authority (Vic)
Gladstone Port Authority (QLD)
Port of Brisbane Corporation (QLD)
South Australian Ports Corporation (SA)
Fremantle Port Authority (WA)
Bunbury Port Authority (WA)
Burnie Port Corporation (Tas)
Hobart Ports Corporation (Tas)
Port of Devonport Corporation (Tas)
Port of Launceston Corporation (Tas)
Darwin Port Authority (NT)

NEWCASTLE PORT CORPORATION — New South Wales

The 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*. The NPC is Australia's largest port by tonnage with a trade throughput of 78 million tonnes in 1998-99.

The NPC's operating profit remained relatively constant between 1995-96 and 1998-99. However, in 1997-98 operating profit was inflated by abnormal revenue resulting from interest earned on superannuation reserves not previously accounted for.

The value of equity significantly increased in 1996-97 and 1998-99 from:

- the reduction in borrowings from NSW Treasury Corporation and the transfer of two properties to the NPC in 1996-97;[1] and
- the 17 per cent upward revaluation of property, plant and equipment on 30 June 1999.

The 40 per cent fall in the Corporation's borrowings combined with an increase in total assets lead to a large drop in each of the debt to equity, debt to total asset, total liabilities to equity and leverage ratios.

The upward revaluation of the NPC's assets caused a sharp fall in the return on asset and return on equity ratios in 1998-99. The revised value of assets provides a better reflection of the true value placed on total assets by the NPC. However, the increase in total assets improves the Corporation's debt to equity and debt to total asset ratios without any real change in debt levels or liabilities.

The closure of BHP Steel-making facilities in Newcastle is expected to reduce total port revenue by 6 per cent in 1999-2000. The NPC aims to offset this revenue decline by increasing trade throughput in its new multi-purpose terminal currently under construction.

The NPC is required to make both tax-equivalent and dividend payments.

1 The Corporation's borrowings fell from $50 million in 1995-96 to $30 million in 1996-97. The two properties included the Australian Defence Industries site and the Forgacs site.

NEWCASTLE PORT CORPORATION (continued)

Table 6.1 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	n.r.	129	116[b]	115	132[c]
Total revenue	$M	n.r.	34	38	47[d]	40
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	12 819	12 087	18 088[d]	12 881
Operating sales margin	%	n.r.	38.8	36.9	42.8	36.8
Cost recovery	%	n.r.	163.5	150.3	157.3	158.2
Return on assets	%	n.r.	11.3	12.2	17.9	12.3[c]
Return on equity	%	n.r.	13.4	12.1	17.3	10.8[c]
Financial management						
Debt to equity	%	n.r.	83.0	45.9[e]	45.4	36.3
Debt to total assets	%	n.r.	38.9	24.5[e]	26.3	24.6
Total liabilities to equity	%	n.r.	113.3	77.9[e]	71.3	58.0
Interest cover	times	n.r.	8.3	5.3	8.1	6.8
Current ratio	%	n.r.	91.8	80.2	70.8	72.9
Leverage ratio	%	n.r.	213.3	177.9[e]	171.3	158.0
Payments to and from government						
Dividends	$'000	n.r.	5 441	8 962	10 000	9 000
Dividend to equity ratio	%	n.r.	9.0	14.3	15.1	12.0
Dividend payout ratio	%	n.r.	67.3	118.1	87.5	111.3
Income tax expense	$'000	n.r.	4 736	4 497	6 658	4 796
CSO funding	$'000	n.r.	0	0	0	0

a The Newcastle Port Corporation (NPC) was incorporated on 1 July 1995. **b** The decline in total assets in the 1996-97 financial year was due to a fall in current investments (current investments tend to be highly volatile and as such have been calculated by the NPC at a given point in time). **c** 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 asset and return on equity ratios. **d** Total revenue and operating profit were inflated by abnormal revenue resulting from interest earned ($4.7 million) from superannuation reserves not previously accounted for. **e** The Corporation's borrowings fell from $50 million in 1995-96 to $30 million in 1996-97. **n.r.** Not relevant.

PORT KEMBLA PORT CORPORATION — New South Wales

The Port Kembla Port Corporation (PKPC) was formed on 1 July 1995 as part of the corporatisation of NSW ports. The PKPC operates under the *Ports Corporatisation and Waterways Management Act 1995*.

The PKPC's total trade tonnage fell 12.6 per cent over the three year period to 1998-99. Reduced coal throughput accounted for 95 per cent of this fall.

The PKPC's total revenue fell 36 per cent between 1995-96 and 1998-99. The fall in total revenue was largely the result of a decline in port-related rental associated with reduced coal throughput and the restructure of the Corporation's rental agreement with Port Kembla Coal Terminal on 1 July 1996.[1] To assist the local coal export industry the PKPC reduced its tonnage fee at the coal terminal from $2.00 to $1.30, resulting in an $11.2 million fall in port management revenue between 1997-98 and 1998-99.[2]

The PKPC undertook a Recoverable Amounts Test (RAT) on 30 June 1999 to ensure that the carrying value of non-current assets did not exceed their recoverable amounts. The RAT revealed that property, plant and equipment were 36 per cent overvalued because of lower than expected export coal throughput between 1996 and 1999.

The PKPC is required to make both income tax-equivalent and dividend payments.

In recognition of the recent reduction in coal throughput, the PKPC is looking to diversify operations by attracting new cargoes.[3]

1 The 5 per cent reduction in scheduled charges to port users in 1996-97 may also have contributed to the fall in total revenue.

2 The Independent Pricing and Regulatory Tribunal recommended that $1.48 per tonne was a suitable rate to recover the value of the lease to the PKPC.

3 A current example of diversification is the refurbishment of the No.4 Jetty as a bulk liquid berth. Construction commenced in January 1999, and the jetty will be used mainly for the export of sulphuric acid.

PORT KEMBLA PORT CORPORATION (continued)

Table 6.2 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*	*1997-98*	*1998-99*[b]
Size						
Total assets	$M	n.r.	196	186[c,d]	182	134
Total assets	$M	n.r.	196	186[c,d]	182	134
Total revenue	$M	n.r.	44	38	39	28
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	20 087	19 535	20 908	-34 633
Operating sales margin	%	n.r.	67.7	63.6	64.5	-115.7
Cost recovery	%	n.r.	309.5	275.0	285.0	172.5
Return on assets	%	n.r.	15.3	12.9	13.9	-18.9
Return on equity	%	n.r.	13.3	12.6	13.3	-49.1
Financial management						
Debt to equity	%	n.r.	78.6	60.7	59.4	110.1
Debt to total assets	%	n.r.	38.5	31.8	32.1	37.4
Total liabilities to equity	%	n.r.	104.0	86.4[c]	82.8	149.2
Interest cover	times	n.r.	3.0	4.8	5.5	-6.4
Current ratio	%	n.r.	63.0	68.3	97.9	51.4
Leverage ratio	%	n.r.	204.0	186.4	182.8	249.2
Payments to and from government						
Dividends	$'000	n.r.	7 982	8227	13 599	9 482
Dividend to equity ratio	%	n.r.	8.3	8.4	13.6	12.4
Dividend payout ratio	%	n.r.	62.5	66.8	102.4	-25.2
Income tax expense	$'000	n.r.	7 321	7 214	7 622	2 995
CSO funding	$'000	0	0	0	0	0

a The Port Kembla Port Corporation (PKPC) commenced operations on 1 July 1995. **b** In June 1999, PKPC undertook a Recoverable Assets Test resulting in a $42.1 million downward asset revaluation. **c** The fall in total assets resulted from the sale of short term deposits ($4.5 million) and accumulated depreciation on the Port Kembla Coal Terminal ($4.6 million). **d** The PKPC retired $15 million in borrowings partly through the sale of short term deposits. **n.r.** Not relevant.

SYDNEY PORTS CORPORATION — New South Wales

The corporatisation of the ports of Sydney under the *Ports Corporatisation and Waterways Management Act 1995*, lead to the establishment of Sydney Ports Corporation (SPC) on 1 July 1995. The SPC manages the commercial ports of Sydney Harbour and Botany Bay.

Total revenue increased over the three year period to 1998-99 due to a rise in total container throughput. Although total revenue increased, the cost recovery ratio declined over the period.

The SPC achieved a 10 per cent reduction in total port charges over the two years following corporatisation. Furthermore, the SPC announced the abolition of the $10 wharfage charge on empty containers from 1 January 1999.[1]

The SPC earned a declining rate of return on assets between 1995-96 and 1998-99 as a result of an 85 per cent increase in the value of total assets. The substantial rise in the value of assets largely reflects the 30 June 1998 revaluation of property, plant and equipment.[2] In addition to the asset revaluation, the 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 improved the SPC's debt to equity and total liabilities to equity ratios without any real change in debt levels or liabilities.

The 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 The abolition of the container charge in 1999 follows a reduction from $25 to $10 in 1997. Furthermore, Sydney's pilotage charges were reduced 2.5 per cent in May 1999 as part of a new three year contract between the SPC and Sydney Sea Pilots Pty Ltd.

2 The SPC carried out a revaluation of 95 per cent of total assets using the deprival method. Assets not revalued were recorded at their historical cost.

SYDNEY PORTS CORPORATION (continued)

Table 6.3 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	n.r.	334	337	524[b]	544[c]
Total revenue	$M	n.r.	84	88	100	109
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	42 901	38 370	40 858	49 469[d]
Operating sales margin	%	n.r.	57.9	57.6	52.8	55.2
Cost recovery	%	n.r.	237.3	235.6	211.8	208.4
Return on assets	%	n.r.	15.8	15.5	12.5	11.5
Return on equity	%	n.r.	19.5	16.7	10.5	9.3
Financial management						
Debt to equity	%	n.r.	109.3	102.9	44.4	42.1
Debt to total assets	%	n.r.	47.7	44.9	35.0	28.2
Total liabilities to equity	%	n.r.	143.3	130.1	54.5	52.0
Interest cover	%	n.r.	7.2	3.8[e]	4.2	5.2
Current ratio	%	n.r.	26.2	101.5[e]	185.9	99.5
Leverage ratio	%	n.r.	243.3	230.1	154.5	152.0
Payments to and from government						
Dividends	$'000	n.r.	15 142	14 558	12 749	13 639
Dividend to equity ratio	%	n.r.	11.0	10.3	5.2	3.9
Dividend payout ratio	%	n.r.	56.5	61.3	50.0	42.2
Income tax expense	$'000	n.r.	16 080	14 619	15 359	17 177
CSO funding	$'000	n.r.	0	0	0	0

a The Sydney Port Corporation (SPC) commenced operations on 1 July 1995. **b** The sharp increase in total assets resulted largely from a revaluation of property, plant and equipment on 30 June 1998. Furthermore, the SPC purchased land at White Bay from the State Rail Authority and purchased lots 11, 12 and 13 at Port Botany from the Marine Ministerial Holding Corporation. **c** In 1998-99, the SPC purchased ten hectares of land at Port Botany. **d** The SPC received a $7.1 million capital grant from the NSW Government for the construction of a new passenger terminal at Darling Harbour. **e** The dramatic fall in interest cover (and increase in the current ratio) resulted from a 96 per cent increase in gross interest expense. During 1996-97, the SPC re-directed short term loans valued at $129 million (86 per cent of total borrowings in 1996-97) in favour of medium and long term loan options. **n.r.** Not relevant.

MELBOURNE PORT CORPORATION — Victoria

The Melbourne Port Corporation (MPC) commenced operations on 1 March 1996 under the *Ports Services Act 1995* (PSA). The Corporation is responsible for managing port land, coordinating future developments and ensuring the availability of adequate land and infrastructure to port service providers.

The MPC is subject to an average revenue cap administered by the Office of the Regulator-General in accordance with S. 50 of the PSA. In meeting the revenue cap, the Corporation was required to reduce wharfage charges by 20 per cent on 1 July 1996. In addition, it must provide an average annual reduction in charges of 10 per cent (less CPI) over the period 1997-98 to 1999-2000.[1]

The Corporation earned an operating profit before tax (including abnormals) under the revenue cap in each of the financial years to 1998-99.[2] The operating profit was achieved through a 32 per cent reduction in total expenses. The fall in expenses resulted from a general improvement in operational efficiency, reflected by an increase in the cost recovery ratio.

The MPC's return on asset and return on equity ratios have risen steadily since 1995-96 despite significant increases in asset values and revenue restrictions associated with the cap.[3] In recognition of its strong financial position the MPC was required to make a special dividend of $26 million to the Victorian Government in 1998-99.

The MPC is required to make both tax-equivalent and dividend payments to the Victorian Government.[4]

1 The MPC reduced charges by 8.5 per cent in 1997-98 and a further 6.2 per cent in 1998-99.

2 The financial statistics for 1995-96 only relate to the period 1 March 1996 to 30 June 1996.

3 Asset values increased as a result of a $50.7 million revaluation of the Corporation's land holdings in 1997-98.

4 The dividend is set at 33.3 per cent of operating profit after income tax.

MELBOURNE PORT CORPORATION (continued)

Table 6.4 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*	*1997-98*	*1998-99*[b]
Size						
Total assets	$M	n.r.	452	482	533[c]	513
Total revenue	$M	n.r.	30	81	81	83
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	14 996	28 045	37 272	46 496
Operating sales margin	%	n.r.	63.2	45.8	59.8	65.8
Cost recovery	%	n.r.	275.8	212.5	248.5	291.8
Return on assets	%	n.r.	4.2	8.1	9.6	10.5
Return on equity	%	n.r.	3.1	4.7	6.6	8.2
Financial management						
Debt to equity	%	n.r.	43.0	33.6	25.7	26.1
Debt to total assets	%	n.r.	28.5	24.5	20.2	19.1
Total liabilities to equity	%	n.r.	50.5	41.8	33.1	33.7
Interest cover	times	n.r.	4.7	3.9	4.2	6.4
Current ratio	%	n.r.	45.1	90.4	153.7	85.2[d]
Leverage ratio	%	n.r.	150.5	141.8	133.1	133.7
Payments to and from government						
Dividends	$'000	n.r.	3 185	4 227	7 987	34 074
Dividend to equity ratio	%	n.r.	1.1	1.3	2.2	8.7
Dividend payout ratio	%	n.r.	34.7	27.8	32.9	105.6
Income tax expense	$'000	n.r.	5 822	12 842	13 012	14 224
CSO funding	$'000	n.r.	0	0	0	0

a The Melbourne Port Corporation (MPC) commenced operations on 1 March 1996. Financial statistics for 1995-96 cover the period 1 March 1996 to 30 June 1996. **b** Total assets fell in 1998-99 as a result of a $26 million dividend pay out from cash reserves, the depreciation of assets and the transfer of Station Pier to the Department of Infrastructure. **c** The increase in total assets in 1997-98 largely resulted from an upward revaluation of the Corporation's land holdings ($50.7) million and the retention of operating profits ($12.8 million). **d** The large fall in the current ratio in 1998-99 reflects the payment of a $26 million special dividend to the State Government coupled with an increase in current borrowings. **n.r.** Not relevant.

VICTORIAN CHANNELS AUTHORITY — Victoria

The Victorian Channels Authority (VCA) is a statutory authority established under the *Port Services Act 1995* (PSA). The VCA commenced operations on 1 March 1996 and is responsible for safe navigation of shipping in the port waters of Melbourne, Geelong, Portland and Hastings. The authority is responsible for the provision and maintenance of navigational aids and 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 administered by the Office of the Regulator-General (ORG) in accordance with s. 50 of the PSA. The VCA has discretion in determining the structure of the tariffs, however, the ORG has the ability to reject prices if they do not comply with the average revenue cap.[1] The VCA is required to reduce channel charges by 12 per cent per annum in real terms from 1 July 1997 until 30 June 2000.[2]

The presence of a revenue cap requires the VCA to reduce expenses to maintain and increase profitability. The gradual decline in the cost recovery ratio reflects the Corporation's inability to reduce expenses to compensate for the revenue cap.

The extraordinarily high return on asset and return on equity ratios achieved in 1996-97 result from the decision to value channels at zero in the financial statements prior to 1997-98. The determination of asset values for channels was resolved through the conversion of the total costs to capital associated with the Geelong channel improvement program in 1997-98, pursuant to s. 40(d) of the PSA. The 1998-99 return on assets is extremely high compared with other Australian ports and may in part be due to the difficulty associated with valuing channel assets.

1 The 1997-98 applications made by the VCA and the Port of Geelong were rejected by the ORG and were required to be re-worked before being approved.

2 On 1 July 1997, the VCA reduced tonnage charges from $0.40 per gross tonne to $0.355 per gross tonne. Charges were further reduced to $0.294 per gross tonne from 1 July 1998. The base tariff for 1 July 1999 stands at $0.261 per gross tonne. The ORG is currently determining the price regulation to apply for the period 1 July 2000 to 30 June 2005.

VICTORIAN CHANNELS AUTHORITY (continued)

Table 6.5 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*[a]	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	n.r.	14	14	51[b]	61[c]
Total revenue	$M	n.r.	7	22	21	25
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	2 965	8 305	8 514	10 542[d]
Operating sales margin	%	n.r.	42.5	38.3	40.1	41.8
Cost recovery	%	n.r.	174.0	177.3	166.8	148.0
Return on assets	%	n.r.	22.5	61.0	26.1	18.7
Return on equity	%	n.r.	34.9	77.9	4.1	8.2
Financial management						
Debt to equity	%	n.r.	100.4	0[e]	0	0
Debt to total assets	%	n.r.	36.3	0[e]	0	0
Total liabilities to equity	%	n.r.	176.3	45.4	21.6	57.2
Interest cover	times	n.r.	23.8	53.2	0	0
Current ratio	%	n.r.	144.3	162.7	219.8	174.6
Leverage ratio	%	n.r.	276.3	145.4	121.6	157.2
Payments to and from government						
Dividends	$'000	n.r.	0[f]	1 035	3 130	3 271
Dividend to equity ratio	%	n.r.	0	14.2	12.1	8.1
Dividend payout ratio	%	n.r.	0	18.2	291.7	98.6
Income tax expense	$'000	n.r.	1 228	2617	7 441	7 225
CSO funding	$'000	n.r.	0	0	0	0

a The Victorian Channels Authority (VCA) was incorporated on 1 January 1996 and commenced operation on 1 March 1996. The financial statistics for 1995-96 cover the period 1 January 1996 to 30 June 1996. The VCA is subject to the Victorian state equivalent taxation system and Victorian wholesale sales tax-equivalent. **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 in 1998-99 resulting from additional costs associated with the dredging of the Port of Geelong ($4.3 million) and work in progress ($5.4 million). **d** Operating profit was overstated in 1998-99 due to a $3.4 million write-back in provisions for channel dredging. **e** The VCA repaid total start-up debt ($5 million). **f** The VCA was not required to make a dividend payment in 1995-96. **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. Navigation is the responsibility of Queensland Transport.

The GPA's total revenue increased between 1994-95 and 1996-97 as a result of growth in total trade throughput. The slight decline in total revenue since 1996-97 reflects the cessation of the improved harbour charge at the end of 1997.[1]

The GPA undertook a Recoverable Amounts Test (RAT) on 30 June 1999 to ensure that the carrying value of non-current assets did not exceed their recoverable amounts. This resulted in a $139.2 million write-down of non-current assets. This write-down was recorded as an abnormal item resulting in a large operating loss before tax (including abnormals) in 1998-99. The impact of the large operating loss is reflected in the negative return on asset, return on equity and interest cover ratios for 1998-99. The write-down largely related to user-funded assets, where port users provided the capital funding to construct the assets concerned.[2]

The Authority has been committed to debt reduction, achieving a 71 per cent fall over the monitoring period. As a consequence, the debt to equity, debt to total asset and total liabilities to equity ratios declined. The GPA recognises the need for diversification in its activities.[3] Given the GPA's high interest cover, the Corporation may be underutilising borrowed funds in the process of attracting new and diversified trade.[4]

The GPA is required to make both tax-equivalent and dividend payments to the Queensland Government.

1 The improved harbour charge is an amount collected annually from coal shippers to cover interest and redemption of funds borrowed for Gladstone Harbour dredging in 1981.

2 User-funded assets do not generate sufficient cash flows to support their carrying values determined under the deprival value methodology and were consequently written-down.

3 Port developments have been undertaken with the construction at Auckland Point (to provide improved facilities for handling containerised, general and breakbulk cargoes) and the construction of a bulk liquids wharf at Fisherman's Landing.

4 The GPA's 1998-99 interest cover fell with the $139.2 million write-down of assets, as a result of the RAT undertaken on 30 June 1999.

GLADSTONE PORT AUTHORITY (continued)

Table 6.6 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*[a]
Size						
Total assets	$M	431	438	452	464	358
Total revenue[b]	$M	68	77	83	81	82
Profitability						
Operating profit before tax (includes abnormals)	$'000	13 712	14 935	17 174	13 259	-127 700
Operating sales margin	%	27.0	24.3	25.2	18.4	-156.9
Cost recovery	%	140.8	132.2	133.6	122.5	117.4
Return on assets	%	5.0	4.4	4.8	3.4	-30.8
Return on equity	%	4.6	2.4	2.7	1.9	-21.8
Financial management						
Debt to equity	%	17.1	12.9	8.9	5.4	5.2
Debt to total assets	%	16.0	11.1	7.8	4.7	4.0
Total liabilities to equity	%	22.1	16.9	15.8	15.2	14.9
Interest cover	times	3.8	4.6	5.0	6.8	-108.8
Current ratio	%	67.9	69.2	109.2	110.9	118.2
Leverage ratio	%	122.1	116.9	115.8	115.2	114.9
Payments to and from government						
Dividends	$'000	4 359	2 602	2 571	3 087	0
Dividend to equity ratio	%	1.5	0.7	0.7	0.8	0
Dividend payout ratio	%	31.8	29.4	24.9	41.3	0
Income tax expense	$'000	0	6 076	6 856	5 787	-49 901
CSO funding	$'000	0	0	0	0	0

a The Gladstone Port Authority (GPA) undertook a Recoverable Amounts Test on 30 June 1999. This resulted in a $139.2 million write-down of non-current assets, and a commensurate fall in operating profit before tax (including abnormals), due to the increase in abnormal expenses. **b** The GPA's right to collect improved harbour charges under agreement with coal shippers ceased at the end of 1997. This placed significant constraints on the ability of the GPA to increase total revenue. Revenue from the improved harbour charge totalled $12.1 million in 1994-95, $13.3 million in 1995-96, $14.6 million in 1996-97 and $5.8 million in 1997-98.

PORT OF BRISBANE CORPORATION — Queensland

The Port of Brisbane Corporation (PBC) was corporatised on 1 July 1994 under the provisions of the *Government Owned Corporations Act 1993*. The Corporation manages the Port of Brisbane, the Moreton Bay boat harbours of Manly, Scarborough and Cabbage Tree Creek, along with the Gardens Point boat harbour on the Brisbane River.

The Corporation's total revenue increased by 33 per cent (including abnormal items) over the monitoring period.[1] The ability of the Corporation to generate revenue to cover expenses is reflected in its high cost recovery ratio over the monitoring period.

The PBC invested in the Brisbane Airport Corporation in 1996-97, thereby taking advantage of its cash flow and low levels of debt. The investment was entirely funded through borrowings from the Queensland Treasury resulting in a sharp increase in the debt to equity, debt to total asset and total liabilities to equity ratios.

The PBC's interest expense increased from $0.9 million in 1996-97 to $14.8 million in 1998-99. Despite the large increase in debt, the absolute level of the Corporation's interest cover combined with the increase in this ratio in 1998-99 suggest that the Corporation can easily meet periodic interest payments.

The PBC is required to make both tax-equivalent and dividend payments. The PBC is also subject to land tax and sales tax-equivalent payments from 1995-96.

1 Total revenue was inflated in 1997-98 as a result of a $4.8 million write-back of provisions for future repairs to various wharves and terminal pavings.

PORT OF BRISBANE CORPORATION (continued)

Table 6.7 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	377	404[a]	621[b]	625	658[c]
Total revenue[d]	$M	59	60	68	82	78
Profitability						
Operating profit before tax (includes abnormals)[e]	$'000	28 964	22 593	27 470[f]	16 568	26 341
Operating sales margin	%	48.0	35.8	39.7	32.5	52.2
Cost recovery	%	192.4	183.8	186.2	189.0	200.8
Return on assets	%	7.9	5.8	5.5	4.4	6.4
Return on equity	%	8.4	4.1	4.9	3.0	4.2
Financial management						
Debt to equity	%	0	0.1	48.4	46.5	48.9
Debt to total assets	%	0	0.1	37.7	30.7	31.8
Total liabilities to equity	%	6.6	7.6	55.5	51.9	57.8
Interest cover	times	0	1 130.7	32.9	2.6	2.8
Current ratio	%	107.6	126.6	101.6	81.3	81.0
Leverage ratio	%	106.6	107.6	155.5	151.9	157.8
Payments to and from government						
Dividends	$'000	9 553	5 831	7 126	4 780	15 805
Dividend to equity ratio	%	2.8	1.6	1.8	1.2	3.8
Dividend payout ratio	%	33.0	38.8	37.5	39.7	90.5
Income tax expense	$'000	0	7 563	8 454	4 514	8 884
CSO funding	$'000	0	0	0	0	0

a Total assets increased due to an upward revaluation of non-current assets and an increase in current investments. **b** Total assets increased due to a $193 million investment in the Brisbane Airport Corporation and a $30.5 million upward revaluation of non-current assets. The investment was entirely funded through borrowings from the Queensland Treasury. **c** The increase in assets largely resulted from an upward revaluation of property, plant and equipment. **d** Total revenue increased in 1996-97 and 1998-99 due to increased trade throughput, a rise in rental income and increased demand for dredging services. Total revenue also increased from a $4.9 million and $3 million write-back of provisions for future repairs to various wharves and terminal pavings, in 1997-98 and 1998-99 respectively. **e** Abnormal expenses relating to the provision for future repairs to various wharves and terminal pavings deflated operating profit before tax (including abnormals) by $4.3 million in 1995-96, $3.6 million in 1996-97, $10.4 million in 1997-98 and $3 million in 1998-99. **f** The Port of Brisbane Corporation incurred voluntary early retirement expenses of $4 million.

SOUTH AUSTRALIAN PORTS CORPORATION South Australia

The 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*. The SAPC is responsible for managing ten South Australian ports.

As part of the corporatisation process, the SAPC undertook a revaluation of non-current assets on 1 July 1995. Assets that had previously been valued at historic cost were revalued using the deprival method.[1] The large downward revaluation of assets was recorded as an abnormal expense resulting in the Corporation incurring a large operating loss before tax (including abnormals) in 1995-96.

In 1996-97, the SAPC re-financed its debt with the South Australian Financing Authority, which separated the Corporation's debt from the Common Public Sector Interest Rate debt arrangement.[2] The SAPC's debt to equity, debt to total asset and total liabilities to equity ratios have declined since 1995-96 which can in part be attributed to debt refinancing.

In 1997-98, SAPC finalised the sale of its bulk loading facilities. The sale of the facilities was undertaken with the aim of increasing the efficiency of the Corporation's operations and this may have contributed to the improvement in the cost recovery ratio in 1998-99.

From 1 July 1995, the Corporation was required to make tax-equivalent payments, dividend payments and pay land tax to the South Australian Government. The Corporation also became liable for local council rates equivalent payments as at 1 July 1998.

On 7 April 1999, the South Australian Government announced an in principle decision to sell the SAPC. The Department of Administrative and Information Services is the agency responsible for progressing the sale of the SAPC.

1 Land was revalued by the Valuer General.

2 A cost was incurred by SAPC as a result of refinancing the Corporation's debt. This was recorded as an abnormal expense in the profit and loss statement. A further debt of $20 million was repaid prior to re-financing.

SOUTH AUSTRALIAN PORTS CORPORATION (continued)

Table 6.8 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*[a]	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	192	126	109[b]	102[c]	103
Total revenue	$M	46	45	49	51[d]	42
Profitability						
Operating profit before tax (includes abnormals)	$'000	-1 073	-39 720[e]	9 897[f]	23 162[d]	15 317
Operating sales margin	%	14.3	-77.9	31.4	49.9	40.9
Cost recovery	%	180.9	155.2	177.2	154.3	166.8
Return on assets	%	3.9	-20.1	14.8	24.5	17.0
Return on equity	%	-1.0	-55.7	12.2	36.9	17.5
Financial management						
Debt to equity	%	71.8	133.0	87.6	63.7	48.6
Debt to total assets	%	37.0	41.2	38.3	33.2	28.2
Total liabilities to equity	%	80.3	156.9	111.5	85.7	72.7
Interest cover	times	0.9	-4.1	2.3	5.1	8.5
Current ratio	%	260.5	314.1	112.8	105.5	84.3
Leverage ratio	%	180.3	256.9	211.5	185.7	172.7
Payments to and from government						
Dividends	$'000	7 540	3 369	3 972	16 254[g]	5 506
Dividend to equity ratio	%	6.7	4.3	7.9	30.6	9.6
Dividend payout ratio	%	-702.7	-7.8	64.6	82.8	54.9
Income tax expense	$'000	0	3 570	3 752	3 523	5 279
CSO funding	$'000	0	0	0	0	0

a Several abnormal items were recorded in 1994-95 as a result of the establishment of the South Australian Port Corporation (SAPC) and the transfer of responsibility for non-commercial activities to the Department of Transport. **b** The large decline in total assets resulted from a $15 million fall in current assets in the form of cash and receivables. **c** Property, plant and equipment fell 11 per cent during 1997-98 resulting from a downward valuation of land assets as at 30 June 1998 coupled with accumulated depreciation for the year. **d** The higher level of revenue (and operating profit) is attributed to the sale of the Port's bulk loading plants. **e** The substantial fall in operating profit resulted from the write-down in the value of non-current assets at 30 June 1995 due to the adoption of the deprival method of asset valuation. **f** An abnormal expense of $5.7 million associated with debt re-financing arrangements with the South Australian Financing Authority reduced operating profit. **g** The SAPC paid a final dividend to the South Australian Government on 30 June 1998. Additional to that dividend the Corporation paid a special capital dividend of $11.6 million.

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 Western Australian Government in November 1995, is 'to facilitate trade in an efficient and commercial manner'. The FPA contracts out pilotage, stevedoring maintenance and fork lift training to private operators.

Between 1994-95 and 1998-99, the FPA achieved a high return on assets. Operating profit was used to retire debt and this is reflected in the improved debt to total assets ratio over the monitoring period.[1]

The FPA's return on equity, debt to equity and total liabilities to equity in 1996-97 improved with the transfer of employee entitlements (superannuation pension liabilities) to the Western Australian Government on 30 June 1997. Recent improvement in these ratios reflects the Authority's continued desire to retire debt.

In 1994-95, the FPA carried out a port pricing review, resulting in the introduction of an 'access' charge based on gross tonnage with differing rates for inner and outer harbours. The new system of charges resulted in a 9.5 per cent reduction in port pricing. Since July 1995, the FPA has undertaken periodic reductions of a range of port charges.

Total port revenue remained relatively constant over the monitoring period as reductions in port charges were offset by increases in total throughput.[2] The maintenance of the cost recovery ratio between 1995-96 and 1998-99, in the presence of falling real port charges, reflects a fall in the unit cost of throughput.

The FPA is required to make both tax-equivalent and dividend payments to the Western Australian Government.

1 The FPA's debt fell from $63.6 million in 1994-95 to $28.1 million in 1998-99.

2 Total revenue was inflated in 1997-98 due to abnormal revenue resulting from a compensation receipt for costs incurred in regard to reclamation of Port Beach land and the lease surrender on 'A' Shed at Victoria Quay.

FREMANTLE PORT AUTHORITY (continued)

Table 6.9 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*[a]	*1997-98*	*1998-99*[b]
Size						
Total assets	$M	94	104	108	112	114
Total revenue	$M	51	51	53	62[c]	55
Profitability						
Operating profit before tax (includes abnormals)	$'000	7 769	8 340	10 620	17 894[c]	13 824
Operating sales margin	%	27.0	27.1	29.0	34.6	34.3
Cost recovery	%	146.0	141.0	140.9	144.0	152.3
Return on assets	%	15.7	14.6	14.9	20.0	17.1
Return on equity	%	-32.7	-102.6	22.7	27.4	14.5
Financial management						
Debt to equity	%	-319.5	1 490.2	109.2	64.8	38.8
Debt to total assets	%	n.r.	55.0	41.7	30.4	22.3
Total liabilities to equity	%	-571.9	2 751.2	166.7	116.8	75.5
Interest cover	times	2.2	2.4	3.1	5.3	3.5
Current ratio	%	78.1	99.6	112.4	121.3	119.6
Leverage ratio	%	-471.9	2 851.2	266.7	216.8	175.5
Payments to and from government						
Dividends	$'000	0	0	0	1262	845
Dividend to equity ratio	%	0	0	0	2.7	1.5
Dividend payout ratio	%	0	0	0	10.0	10.0
Income tax expense	$'000	0	0	5 616[d]	5 270	5 377
CSO funding	$'000	0	0	0	0	0

a A number of performance indicators improved in 1996-97 as a result of the transfer of the Fremantle Port Authority's (FPA's) $25.9 million superannuation pension liability to the Western Australian Government. **b** FPA is subject to the *Port Authorities Act 1999*. **c** The FPA received $8.8 million from the Western Australian Government for costs incurred in regard to reclamation of Port Beach land and the lease surrender on 'A' Shed at Victoria Quay. **d** From 1 July 1996, the FPA was required to make tax-equivalent payments.

BUNBURY PORT AUTHORITY — Western Australia

The Bunbury Port Authority (BPA) was commercialised in October 1996 and is subject to the *Port Authorities Act 1999*. Bunbury is a bulk cargo handling port with alumina accounting for over 60 per cent of total throughput.

Although operating profit before tax (including abnormals) fell by 35 per cent between 1997-98 and 1998-99, the maintenance of the cost recovery ratio indicates no deterioration in the Authority's underlying financial performance.

In assessing the performance of the BPA, the Western Australian Minister for Transport sets an annual financial target. The target provides a measure of how efficiently the Authority is utilising its assets. In 1998-99, the target was set at 8 per cent and the actual result was 5.1 per cent.

In 1998-99, the BPA contracted out a number of port operations with the aim of increasing port efficiency and focusing the Authority's efforts on carrying out its role as a trade facilitator. Operations contracted out include stevedoring, mooring and unmooring, ship cleaning, pilotage and general maintenance.[1]

1 P&O was the successful tenderer and will operate these services from 1 July 1999. As a result of outsourcing, the BPA anticipates a reduction in its workforce from 45 to 13 by 31 July 1999.

BUNBURY PORT AUTHORITY (continued)

Table 6.10 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	n.r.	n.r.	n.r.	75	91[a]
Total revenue	$M	n.r.	n.r.	n.r.	14	14
Profitability						
Operating profit before tax (includes abnormals)	$'000	n.r.	n.r.	n.r.	2 890	1 870[b]
Operating sales margin	%	n.r.	n.r.	n.r.	31.8	22.8
Cost recovery	%	n.r.	n.r.	n.r.	149.5	155.2
Return on assets	%	n.r.	n.r.	n.r.	6.1	4.1
Return on equity	%	n.r.	n.r.	n.r.	5.4	3.1
Financial management						
Debt to equity	%	n.r.	n.r.	n.r.	32.0	24.5
Debt to total assets	%	n.r.	n.r.	n.r.	22.9	20.2
Total liabilities to equity	%	n.r.	n.r.	n.r.	39.8	33.6
Interest cover	times	n.r.	n.r.	n.r.	2.7	2.2
Current ratio	%	n.r.	n.r.	n.r.	359.4	239.1
Leverage ratio	%	n.r.	n.r.	n.r.	139.8	133.6
Payments to and from government						
Dividends	$'000	n.r.	n.r.	n.r.	332.0	190.0
Dividend to equity ratio	%	n.r.	n.r.	n.r.	0.6	0.3
Dividend payout ratio	%	n.r.	n.r.	n.r.	11.5	10.2
Income tax expense	$'000	n.r.	n.r.	n.r.	0	0
CSO funding	$'000	n.r.	n.r.	n.r.	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. **b** Operating profit before tax (including abnormals) was deflated as a result of $1.4 million redundancy payments to workers as part of the restructuring process associated with outsourcing operations to P&O. **n.r.** Not relevant.

BURNIE PORT CORPORATION — Tasmania

The Burnie Port Corporation (BPC) commenced operations on 30 July 1997 pursuant to the *Ports Companies Act 1997*. The Corporation also manages the Burnie Airport.

Abnormal items affected the BPC's operating profit before tax (including abnormals) over the monitoring period. Nevertheless, the rise in the Corporation's cost recovery ratio since 1996-97 indicates an improvement in the normal operations of the BPC.

In 1997-98, the Corporation devalued non-current assets by 14 per cent. Despite this, total assets rose in 1997-98 with the consolidation of assets pertaining to the Burnie Airport in financial statements.

The Corporation made a $2.5 million upward adjustment of retained profits on 1 July 1998 after the adoption of the principles set out in the Urgent Issues Group Abstract 26. The amended accounting treatment resulted in the provision for runway resurfacing and seaport dredging being written-off, a separate asset being recognised for seaport dredging and a review of the useful lives of the respective assets. Previously, the Corporation provided for major cyclical expenditure to airport runways and seaport dredging in advance of the expenditure.

The Corporation earned an operating profit before tax (including abnormals) in 1998-99, despite unforseen expenses associated with a violent storm in July 1998 and a $0.6 million increase in depreciation expenses, largely due to an increase in throughput.[1]

The BPC is required to make both tax-equivalent and dividend payments to the Tasmanian Government. The dividend distribution policy is determined by the directors in accordance with company rules.

1 The storm caused structural damage to the island and ocean breakwaters and No.5 and No.7 berth areas. The increase in depreciation expense resulted from the upward reassessment of the useful lives of non-current assets.

BURNIE PORT CORPORATION (continued)

Table 6.11 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*[a]	*1997-98*[b]	*1998-99*
Size						
Total assets	$M	43	43	41	44	46
Total revenue	$M	14	12	12	16	13
Profitability						
Operating profit before tax (includes abnormals)	$'000	458	-1 506	-1 523[c]	-5 393[d]	948[e]
Operating sales margin	%	13.5	2.1	2.0	-23.7	19.7
Cost recovery	%	111.9	111.0	109.3	127.9	124.3
Return on assets	%	5.1	1.0	1.0	-8.1	6.3
Return on equity	%	2.4	-7.7	-7.8	-28.9	4.8
Financial management						
Debt to equity	%	102.2	100.9	101.7	124.4	97.2
Debt to total assets	%	46.5	46.5	47.4	52.6	46.5
Total liabilities to equity	%	121.4	115.0	110.3	144.7	113.3
Interest cover	times	1.3	0.2	0.2	-1.8	1.5
Current ratio	%	267.7	113.7	175.6	228.8	195.6
Leverage ratio	%	221.4	215.0	210.3	244.7	213.3
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	0	0	0	0	0
CSO funding	$'000	0	0	0	0	0

a Wharfage charges have remained unchanged in nominal terms since July 1996. **b** Covers the 11 month period to 30 June 1998. In 1997-98 property, plant and equipment relating to the Burnie Airport was consolidated in Burnie Port Corporation's (BPC's) financial statements. **c** Operating profit was deflated by a $0.8 million loss on the disposal of a slewing crane. **d** Operating profit was deflated largely due to the adoption of the deprival method for the valuation of non-current assets. The BPC incurred numerous abnormal revenue items in 1997-98, including the amortisation of deferred revenue arising from prior period sale and lease buy back transactions, the write-back of seaport dredging and airport runway provisions and contributions by external parties to capital improvements. Abnormal expenses included the capitalisation of finance leases, a loss due to obsolescence of the Tide Bridge, devaluation of assets and redundancy payments. **e** Operating profit was deflated in 1998-99, as abnormal revenue relating to the amortisation of deferred revenue arising from prior period sale and lease buy back transactions exceeded abnormal expenses resulting from the obsolescence of the Tide Bridge and redundancy payments to former stevedoring employees.

HOBART PORTS CORPORATION — Tasmania

The Hobart Ports Corporation (HPC) was established on 30 July 1997 under the *Ports Companies Act 1997* with the stated objectives of facilitating trade for the benefit of Tasmania. King Island Ports Corporation is a wholly owned subsidiary of the HPC.

During the 1990s, the former Marine Board of Hobart diversified its activities into port-related property. The aim of diversification was to increase the returns on surplus wharves and cargo transit sheds that were being underutilised due to falling port throughput.

In the two years since corporatisation, total port throughput fell over 20 per cent by volume. The majority of the decline occurred in general cargo trade, which more than halved over the same period. Although total throughput declined in 1998-99, total revenue increased from the introduction of the Corporation's stevedoring activities to replace declining revenue streams from shipping.

Despite the changing composition of its revenue stream HPC has maintained a cost recovery ratio of over 100. This would suggest success in the management of the loss of throughput and the move into new activities.

The dramatic fall in the current ratio in 1997-98 reflects a shift in the Corporation's focus in favour of long term returns on assets. The Corporation used cash deposits and an increase in current borrowings to finance the redevelopment of Elizabeth Street Pier into a hotel and convention centre and the purchase of a 49 per cent share in Hobart International Airport Pty Ltd. The increase in the HPC's borrowings is reflected in the rise of the debt to equity, debt to total liabilities and total liabilities to equity ratios.

The HPC is required to make tax-equivalent payments to the Tasmanian Government under Part X(a) of the *Port Companies Act 1997*. Dividend payments were introduced as part of corporatisation in 1997-98.

HOBART PORTS CORPORATION (continued)

Table 6.12 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*
Size						
Total assets	$M	49	49	51	61[b]	61
Total revenue	$M	12	12	12[c]	13[d]	16[e]
Profitability						
Operating profit before tax (includes abnormals)	$'000	2 081	328[f]	1 763[c]	1 709	371
Operating sales margin	%	13.7	-4.8	11.0	13.4	6.0
Cost recovery	%	115.8	108.2	109.6	103.9	103.5
Return on assets	%	4.7	0.9	4.2	3.7	1.7
Return on equity	%	3.6	0.7	2.7	3.5	1.0
Financial management						
Debt to equity	%	9.9	8.8	8.0	23.3	22.7
Debt to total assets	%	8.7	7.4	6.9	18.9	16.8
Total liabilities to equity	%	19.4	17.5	18.1	34.3	35.0
Interest cover	times	16.3	4.1	6.6	5.9	1.5
Current ratio	%	450.1	594.4	508.2	137.3	136.0
Leverage ratio	%	119.4	117.5	118.1	134.3	135.0
Payments to and from government						
Dividends	$'000	0	0	0	160	700
Dividend to equity ratio	%	0	0	0	0.4	1.5
Dividend payout ratio	%	0	0	0	10.5	148.1
Income tax expense	$'000	609	27	610	179	-102
CSO funding	$'000	0	0	0	0	0

a Covers the 11 month period to 30 June 1998. **b** The rise in total assets resulted from an increase in the value of property, plant and equipment. **c** 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. **d** Total revenue 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 facilities on 21 May 1998. **e** Total revenue increased due to the sale of land ($0.4 million). **f** A $1.3 million abnormal expense related to redundancies deflated operating profit.

PORT OF DEVONPORT CORPORATION — Tasmania

The Port of Devonport Corporation (PDC), formerly the Port of Devonport Authority, was corporatised under the *Port Corporation Act 1997*, effective from 30 July 1997. The PDC also manages the Devonport Airport.

In 1997-98, the PDC consolidated Devonport Airport in its financial statements.[1] Consolidation had a positive impact on the Corporation's debt to total asset, debt to equity and total liabilities to equity ratios without affecting debt levels or liabilities. In fact, the Corporation's debt almost doubled between 1997-98 and 1998-99 reflected by the sharp decline in PDC's interest cover.

Although the Corporation experienced an increase in total revenue in 1998-99, the cost recovery ratio remained constant reflecting a commensurate increase in total expenses.[2] Furthermore, Devonport Airport earned an operating profit in 1997-98 of $0.3 million, which improved PDC's return on asset, return on equity and cost recovery ratios over and above that which would have occurred for the port operations alone.

The PDC is required to make both tax-equivalent and dividend payments. In 1998-99, the PDC paid a dividend to the Tasmanian Government representing 50 per cent of 1997-98 after tax profit.

1 The 1997-98 financial statistics cover the 11 month period to 30 June 1998.

2 Between 1997-98 and 1998-99, total port revenue increased by 9.2 per cent (with no real increase in port charges). In addition, total airport revenue increased 43 per cent (with a slight fall in real airport charges) and cold store revenue increased by less than 1 per cent.

PORT OF DEVONPORT CORPORATION (continued)

Table 6.13 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*
Size						
Total assets	$M	26	29	29	43[b]	45[c]
Total revenue	$M	9	9[d]	9	9	10
Profitability						
Operating profit before tax (includes abnormals)	$'000	766	1 622[e]	1 018	1 446	453[f]
Operating sales margin	%	11.8	19.5	13.1	16.0	6.5
Cost recovery	%	113.7	131.9	115.0	119.1	118.6
Return on assets	%	5.0	7.7	5.6	5.4	2.6
Return on equity	%	2.4	4.9	3.1	3.8	0.2
Financial management						
Debt to equity	%	29.3	34.6	30.2	23.8	25.3
Debt to total assets	%	21.1	25.3	21.5	21.0	19.5
Total liabilities to equity	%	36.4	43.9	42.0	34.0	33.4
Interest cover	times	2.3	4.3	2.7	3.8	1.7
Current ratio	%	345.1	470.3	455.0	480.9	454.6
Leverage ratio	%	136.4	143.9	142.0	134.0	133.4
Payments to and from government						
Dividends	$'000	0	0	0	0	440
Dividend to equity ratio	%	0	0	0	0	1.3
Dividend payout ratio	%	0	0	0	0	657.1
Income tax expense	$'000	302	665	374	442	386
CSO funding	$'000	0	0	0	0	0

a In 1997-98, the Port of Devonport Corporation (PDC) consolidated Devonport Airport in its financial statements. 1997-98 covers the 11 month period to 30 June 1998. **b** The increase in the PDC's total assets in 1997-98 is largely attributable to the addition of Devonport Airport and all related investments. **c** Total assets increased due to harbour improvements associated with a capital dredging program. **d** Total revenue includes $0.5 million from the sale of the dredge 'Port Frederick'. **e** The increase in operating revenue associated with the sale of the dredge was offset by a special payment of $0.4 million to the Tasmanian Government pursuant to the *Port of Devonport Authority Bill 1996*. **f** Abnormal expenses of $0.9 million relating to depreciation adjustments upon the reassessment of the useful life of non-current assets and the scrapping of fixed assets no longer held, reduced operating profit.

PORT OF LAUNCESTON CORPORATION — Tasmania

The Port of Launceston Corporation (PLC) was established on 30 July 1997 under the *Port Corporation Act 1997*. Upon commencement of operations, the PLC acquired the Flinders Island Ports Company (formerly the Flinders Marine Board). The PLC consolidated Flinders Island Ports Corporation in its 1997-98 financial statements. Consolidation had a minimal impact on the Corporation's performance indicators.

Between 1995-96 and 1997-98, the PLC experienced operating losses before tax (including abnormals) due to the cessation of general cargo shipping operated by Coastal Express Line, coupled with rising expenses.[1] Unforseen expenses were incurred from the oil spill associated with the grounding of the Iron Baron and redundancy payments in 1995-96 and 1997-98.

Over the monitoring period, the PLC disposed of non-current assets, thus increasing operating profits. The 1998-99 sale of properties for $0.5 million contributed to an operating profit of $0.2 million before tax (including abnormals).

The Corporation's debt has remained relatively constant over the three year period to 1998-99. The PLC's debt to equity and debt to total asset ratios combined with the Corporation's low interest cover suggest the Corporation may be susceptible to increases in interest rates.

The PLC has entered into joint arrangements with other Tasmanian ports for the provision of non-core activities. The Port of Devonport Corporation provides pilotage and other services to the Corporation, while the PLC provides communications services to shipping entering and leaving the Port of Burnie.

PLC is required to make both tax-equivalent and dividend payments to the Tasmanian Government.

1 Prior to cessation, general cargo throughput accounted for 30 per cent of total port revenue.

PORT OF LAUNCESTON CORPORATION (continued)

Table 6.14 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*[a]	*1998-99*
Size						
Total assets	$M	46	47	47	43	42
Total revenue	$M	9	9	7	7	8[b]
Profitability						
Operating profit before tax (includes abnormals)	$'000	609	-438[c]	-851	-290[d]	218
Operating sales margin	%	15.7	7.5	5.2	13.3	19.3
Cost recovery	%	118.6	113.2	107.0	118.1	123.9
Return on assets	%	3.6	1.9	1.2	2.3	3.8
Return on equity	%	1.5	-1.4	-3.0	-3.6	-0.3
Financial management						
Debt to equity	%	43.2	51.3	61.2	65.2	60.9
Debt to total assets	%	28.6	31.9	36.7	36.6	36.1
Total liabilities to equity	%	56.8	62.4	67.7	69.7	66.3
Interest cover	times	1.6	0.7	0.4	0.8	1.2
Current ratio	%	276.5	217.9	170.3	83.7	102.9
Leverage ratio	%	156.8	162.4	167.7	169.7	166.3
Payments to and from government						
Dividends	$'000	0	0	0	0	150
Dividend to equity ratio	%	0	0	0	0	0.6
Dividend payout ratio	%	0	0	0	0	-221.1
Income tax expense	$'000	165	-41	0	664	285
CSO funding	$'000	0	0	0	0	0

a The Port of Launceston Corporation consolidated Flinders Island Ports Corporation in its financial statements from 1997-98. **b** Total revenue increased in 1998-99, due largely to a 7.5 per cent increase in container throughput. The majority of the increase in throughput resulted from a 37.5 per cent increase in forestry exports. **c** Operating profit in 1995-96 was deflated by $0.3 million resulting from the retrenchment of 15 employees, combined with increased expenses due to the grounding of the Iron Baron and the associated oil spill on 10 July 1995. **d** Operating profit was deflated by $0.2 million in 1997-98 resulting from increased redundancy expenses.

DARWIN PORT AUTHORITY — Northern Territory

The Darwin Port Authority (DPA) was established under the *Darwin Port Authority Act 1983* (the Act). In October 1998, amendments to the Act provided for a commercial charter, a board of directors (to replace the Advisory Council) and a change in name to the Darwin Port Corporation.

The marked increase in the DPA's total revenue since 1996-97 largely resulted from Community Service Obligation (CSO) funding to cover debt servicing related to the East Arm Port from the Northern Territory Government. Debt servicing funding inflates the cost recovery ratio and reduces its usefulness as an indicator of the underlying performance of the Corporation.

The DPA's assets increased significantly over the monitoring period due to capital works relating to the East Arm Port.[1] Assets were also revalued using the deprival method in July 1996, resulting in the value of non-current assets increasing from $35.6 million to $50.5 million.

The rise in the debt to equity, debt to total asset and total liabilities to equity ratios in 1996-97, reflect an increase in borrowed funds for the construction of the East Arm Port. Although these ratios fell appreciably in 1997-98, this improvement resulted because of an increase in equity rather than any significant change in debt levels or total liabilities.

The DPA reported funding for CSOs in financial statements for the first time in 1996-97. The Corporation received funding to cover costs associated with the operation and management of the Stokes Hill Wharf, Wharf Precinct and Fishing Harbour Mooring Basin and wharf facilities. CSO funding was also received for debt servicing associated with the East Arm Port development and accounts for the majority of the increase in funding since 1996-97.

The DPA 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 in accordance with the Northern Territory Government's dividend policy.

1 Capital works in progress relating to the East Arm Port increased total assets by $16.7 million in 1995-96, $28.9 million in 1996-97 and $20.9 million in 1997-98.

DARWIN PORT AUTHORITY (continued)

Table 6.15 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets[a]	$M	50	67	111[b]	135	136
Total revenue	$M	10	11	14[c]	16	17
Profitability						
Operating profit before tax (includes abnormals)	$'000	1 267	1 438	-562[d]	4 040	495[e]
Operating sales margin	%	22.8	20.7	0.4	40.8	24.3
Cost recovery	%	129.5	126.1	147.3	169.0	159.9
Return on assets	%	5.4	4.3	0.5	5.4	3.3
Return on equity	%	4.1	4.5	-2.3	4.4	-1.0
Financial management						
Debt to equity	%	56.0	102.2	113.6	78.9	76.6
Debt to total assets	%	38.4	57.1	65.0	47.1	41.8
Total liabilities to equity	%	59.2	104.9	118.4	83.7	83.6
Interest cover	times	2.0	2.3	4.8	2.5	1.1
Current ratio	%	199.3	256.5	206.1	341.4	170.6
Leverage ratio	%	159.2	204.9	218.4	183.7	183.6
Payments to and from government						
Dividends	$'000	500	250	1 031	1 064	1 374
Dividend to equity ratio	%	1.6	0.8	2.5	1.7	1.9
Dividend payout ratio	%	39.5	17.4	-108.4	38.7	-178.2
Income tax expense	$'000	0	0	389	1 290	1 266
CSO funding	$'000	0	0	1 965	3 602	5 273

a Capital works in progress relating to the East Arm Port increased total assets by $16.7 million in 1995-96, $28.9 million in 1996-97 and $20.9 million in 1997-98. **b** In July 1996, the Darwin Port Authority (DPA) revalued its non-current assets using the deprival method. **c** The increase in total revenue after 1995-96 largely reflects rising community service obligation payments to DPA. **d** Operating profit before tax (including abnormals) was deflated by $4.2 million resulting from the loss on the disposal of a non-current asset. **e** Operating profit decreased due to a $2.2 million downward revaluation of assets.

7 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 1.

AIRSERVICES AUSTRALIA — Commonwealth

Airservices Australia 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 across locations, by linking charges more closely to the level and cost of providing services at individual airports.

During the monitoring period, with the exception of 1995-96, significant net abnormal expenses have deflated Airservices Australia's operating profit. The devaluation of assets, provisions for redundancies associated with staff reductions, and litigation provisions have all contributed to high net abnormal expenses — over $218 million in 1998-99.

These high abnormal expenses have resulted in the return on asset and return on equity ratios varying over the monitoring period.

Despite having low or negative operating profit over this period, Airservices Australia has been generating adequate revenue to cover expenses. The cost recovery ratio has remained constant since 1995-96 at approximately 108 per cent.

The reduction in the debt to total assets ratio of 36 per cent in 1998-99 is attributed to a 95.2 per cent decrease in current borrowings on the previous year.

A number of non-commercial activities were provided by Airservices over the monitoring period, including a telephone complaints service regarding aircraft noise, aircraft noise and flight path monitoring, provision of environmental information and aviation search and rescue functions.[2] Airservices do not appear to receive direct funding for these activities.

Airservices are required to make both tax-equivalent and dividend payments, although no dividend payments were made in 1994-95 and 1998-99.

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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 This function was transferred over to Australian Search and Rescue (AusSAR), which is managed by the Australian Maritime Safety Authority, in July 1997.

AIRSERVICES AUSTRALIA (continued)

Table 7.1 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	835	796	732	747	671
Total revenue	$M	582	580	619	607	605
Profitability						
Operating profit before tax (includes abnormals)	$'000	-46 605[a]	41 885[b]	16 963[c]	-48 012[d]	-173 178[e]
Operating sales margin	%	-5.9	9.9	4.8	-6.1	-27.2
Cost recovery	%	93.4	110.7	107.3	107.0	108.0
Return on assets	%	-3.9	7.1	4.0	-4.9	-23.1
Return on equity	%	-7.5	4.0	1.9	-9.2	-44.8
Financial management						
Debt to equity	%	36.2	43.3	41.6	49.8	48.3
Debt to total assets	%	18.9	22.9	20.6	22.7	14.5
Total liabilities to equity	%	98.3	84.0	93.5	121.7	214.3
Interest cover	times	-2.1	3.6	2.3	-3.1	-17.9
Current ratio	%	37.3	39.4	38.7	2.6	46.8
Leverage ratio	%	198.3	184.0	193.5	221.7	314.3
Payments to and from government						
Dividends	$'000	0	10 200	5 950	5 950	0
Dividend to equity ratio	%	0	2.4	1.5	1.7	0
Dividend payout ratio	%	0	59.9	76.7	-18.0	0
Income tax expense	$'000	-14 062	24 849	9 205	-15 025	-49 815
CSO funding	$'000	0	0	0	0	0

a Abnormal expenses of $61.7 million from Civil Aviation Authority Staff superannuation fund and provision for litigation. **b** Abnormal expenses of $7.1 million from revaluation decrement on airways and general technical equipment, land and civil works. **c** 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). **d** 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. **e** 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.

AUSTRALIA POST — Commonwealth

Australia Post was established in 1975 and corporatised in 1989 under the *Australian Postal Corporation Act 1989.* Its main activities are letter delivery, parcel delivery and third party agency services (receiving bill payments for other companies). Australia Post also provides retail services through the sale of postal products and postal merchandise.

Over the monitoring period, total assets and total revenue have increased steadily. Year to year profit level fluctuations can be attributed to abnormal revenues inflating profits in 1995-96 and abnormal expenses deflating profits in 1997-98. The impact of abnormal expenses and revenues is also reflected in a fluctuating return on assets ratio, which peaked at 17 per cent in 1995-96 before dropping to a low of 13.4 per cent in 1997-98.

Australia Post is subject to all taxes and pays dividends to the Commonwealth Government. Dividend payments increased over the monitoring period to a high of $219.9 million in 1996-97.

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.

Australia Post receives no financial assistance from the Government to meet these CSOs. The cost of Australia Post's CSOs was estimated at $70 million for 1998-99, based on the Government's approved costing methodology. This cost was met through cross-subsidies from within the reserved letter service.

AUSTRALIA POST (continued)

Table 7.2 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	2 217	2 382	2 589	2 736	2 854
Total revenue	$M	2 788	2 944	3 155	3 300	3 468
Profitability						
Operating profit before tax (includes abnormals)	$'000	337 600	368 000[a]	353 100	335 200[b]	373 000
Operating sales margin	%	11.9	12.5	11.5	10.3	11.0
Cost recovery	%	113.3	113.4	112.9	113.0	112.5
Return on assets	%	16.8	17.0	15.1	13.4	14.2
Return on equity	%	28.3	27.3	26.9	26.3	27.1
Financial management						
Debt to equity	%	34.0	36.1	43.0	52.2	54.7
Debt to total assets	%	13.8	13.8	14.8	16.8	19.0
Total liabilities to equity	%	157.7	170.7	202.6	218.9	194.3
Interest cover	times	19.4	16.9	16.3	17.0	15.8
Current ratio	%	90.4	76.4	87.5	90.6	87.9
Leverage ratio	%	257.7	270.7	302.6	318.9	294.3
Payments to and from government						
Dividends	$'000	120 000	142 600	219 900	215 100	148 700
Dividend to equity ratio	%	14.2	16.4	25.3	25.1	16.3
Dividend payout ratio	%	50.3	60.0	94.3	95.6	60.0
Income tax expense	$'000	98 900	130 400	119 900	110 200	125 200
CSO funding	$'000	0	0	0	0	0

a Credit resulting from an adjustment to the provision for long service leave contributed to net abnormal revenue of $23.9 million. **b** 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.

TELSTRA — Commonwealth

Telstra Corporation Limited was established in April 1993 and operates under the *Telecommunications Act 1991* and *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.

The value of total assets has increased steadily over the monitoring period. Increases in the value of property, plant and equipment, particularly communication assets, intangible assets such as patents, trademarks and licences, as well as capitalisation of software have been the main contributors to this trend. Total revenue has also increased steadily over the monitoring period, mainly attributable to new product areas such as mobile services, data services, facsimile and ISDN services.

Operating profit has increased over the monitoring period — abnormals inflated operating profit in 1995-96 as new depreciation methodology was introduced. Deflated operating profit in 1996-97 was due to the rationalisation of the broadband network and provisions for redundancies and restructuring. The impact of abnormals is also reflected in the return on asset and return on equity ratios in 1996-97. However, both ratios have improved over the monitoring period.

The debt to equity and debt to total asset ratios declined in every year monitored over the period except in 1996-97, where there was a substantial increase in both. The increase in debt in 1996-97 of 49 per cent reflects the additional borrowings undertaken for Telstra's recapitalisation in preparation for privatisation.

Telstra is subject to all taxes and pays dividends to its shareholders — the Commonwealth Government and private shareholders.[1] Dividend payouts increased over the monitoring period to a high of $424.7 million 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 does not receive Government funding for the provision of the USO.

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, outside of the monitoring period.

TELSTRA (continued)

Table 7.3 **Performance indicators 1994-95 to 1998-99**

	Units	*1994-95*	*1995-96*	*1996-97*	*1997-98*	*1998-99*
Size						
Total assets	$M	24 083	24 362	25 858	26 470	27 682
Total revenue	$M	14 081	15 239	15 983	17 302	18 218
Profitability						
Operating profit before tax (includes abnormals)	$'000	2 405 100[a]	3 446 700[b]	2 073 000[c]	4 468 000	5 320 000
Operating sales margin	%	19.9	25.4	15.6	29.2	32.1
Cost recovery	%	131.5	131.7	136.1	141.3	147.4
Return on assets	%	12.9	16.4	10.3	19.5	21.8
Return on equity	%	15.6	18.9	14.2	31.0	32.6
Financial management						
Debt to equity	%	52.4	42.3	80.3	69.7	70.1
Debt to total assets	%	27.2	22.1	31.8	29.5	26.6
Total liabilities to equity	%	105.4	92.3	160.2	138.9	168.9
Interest cover	times	5.7	7.5	5.0	8.0	10.2
Current ratio	%	87.1	87.4	70.3	52.8	44.8
Leverage ratio	%	205.4	192.3	260.2	238.9	268.9
Payments to and from government						
Dividends	$'000	944 000	1 368 000	4 146 000[d]	1 802 000	4 247 000[e]
Dividend to equity ratio	%	8.4	11.2	36.7	17.1	39.7
Dividend payout ratio	%	53.8	59.4	257.7	55.3	121.8
Income tax expense	$'000	649 600	1 144 600	464 000	1 211 000	1 832 000
CSO funding	$'000	0	0	0	0	0

a Abnormal expenses of $567.8 million from staff superannuation fund. **b** Abnormal revenue of $204.6 million received from a change in the depreciation methodology for communication assets. **c** Net abnormal expenses of $1.7 billion. This is 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 incurred in 1996-97. **d** As part of a restructuring of Telstra's capital base in preparation for privatisation, a special dividend payment of $3.2 billion was made to the Commonwealth Government. **e** Part of this would have been distributed to private shareholders.

A Participating enterprises

Table A.1 **Participating enterprises by jurisdiction, 1998-99**

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
Great Southern Energy	Electricity
Integral Energy	Electricity
NorthPower	Electricity
Hunter Water Corporation	Water
Sydney Water Corporation	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

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Table A.1 (continued) **Participating enterprises by jurisdiction, 1998-99**

GTE	*Industry Classification*
Queensland	
CS Energy	Electricity
Stanwell Corporation	Electricity
Tarong Energy	Electricity
Queensland Power Trading Corporation	Electricity
Powerlink	Electricity
Ergon Energy	Electricity
Energex	Electricity
Department of Natural Resources, State Water Projects	Water
Queensland Rail	Railways/Urban Transport
Gladstone Port Authority	Port Authorities
Port of Brisbane Authority	Port Authorities
South Australia	
South Australian Water Corporation	Water
TransAdelaide	Urban Transport
South Australian Ports Corporation	Port Authorities
Western Australia	
Western Power	Electricity
AlintaGas	Gas
Water Corporation	Water
Westrail	Railways/Urban Transport
Bunbury Port Authority	Port Authorities
Fremantle Port Authority	Port Authorities
Tasmania	
Hydro-Electric Corporation	Electricity
Aurora Energy	Electricity
Transend	Electricity
Hobart Regional Water Authority	Water
North West Regional 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 Corporation	Port Authorities
Australian Capital Territory	
ACTION	Urban Transport

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Table A.1 (continued) **Participating enterprises by jurisdiction, 1998-99**

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

B Definitions of Financial Performance Indicators

Table B.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.19	$\frac{\text{Debt}}{\text{Total equity}}$
B.06	Debt to total assets B.27 / B.19	$\frac{\text{Debt}}{\text{Total assets}}$
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 B.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	ETF 1263, ETF 1267	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.

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

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.

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