



Australian Government
Productivity Commission

Financial
Performance
of Government
Trading Enterprises
2000-01 to 2004-05

Productivity
Commission
Research Paper

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The Productivity Commission

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

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Foreword

Governments have recently sought to reinvigorate collaborative reform through a new National Reform Agenda under COAG. In part, this recommits governments to the principles contained in the Competition Principles Agreement and seeks to complete and extend national competition reform, of which government trading enterprises (GTEs) are a major focus.

Reforms undertaken since the early 1980s have led to a pronounced improvement in the financial performance of GTEs. However, there remains scope for further improvement. For example, over half the monitored GTEs continued to record rates of return below the risk-free government bond rate in 2004–05, with little change over the previous year.

With the renewed national focus on reforms and performance, the Commission is continuing its financial performance monitoring of GTEs. This will provide a baseline for measuring further improvements as the reform agenda is implemented and contributes to the Commission's role of providing information on the performance of Australian industry.

Capital management is an especially important feature of the financial performance of GTEs because of their highly capital-intensive operations. Consequently, as an adjunct to its ongoing monitoring, the Commission has commenced a program of research into issues related to the capital productivity of GTEs. This report includes the first outputs from that research.

This study was undertaken in the Economic Infrastructure Branch under the guidance of Commissioner Michael Woods. The Commission is grateful for the continuing cooperation of State and Territory Governments in the preparation of this annual series.

Gary Banks
Chairman

July 2006

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Abbreviations and explanations

Abbreviations

AAS	Australian Accounting Standard
AASB	Australian Accounting Standards Board
ABARE	Australian Bureau of Agricultural and Resource Economics
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACTEW	ACTEW Corporation Ltd
ACTION	Australian Capital Territory Internal Omnibus Network Authority
AEMC	Australian Energy Markets Commission
AEPU	Agreement Equally Proportionally Underperformed
AER	Australian Energy Regulator
AGS	Auditing Guidance Statements
AIE	Australian Inland Energy
AIEWI	Australian Inland Energy and Water Infrastructure
A-IFRS	Australian equivalents to International Accounting Standards
ANAO	Australian National Audit Office
ANRC	Australian National Railways Commission
APA	Albany Port Authority

ARA	Australasian Railway Association
ARG	Australian Railroad Group
ARIF	Australian Rail Infrastructure Foundation
ARTC	Australian Railtrack Corporation
ASA	Airservices Australia
ASIC	Australian Securities and Investment Commission
BACL	Brisbane Airport Corporation Limited
BCC	Brisbane City Council
BPA	Benchmark Pricing Agreement
BPC	Burnie Port Corporation
CCW	Cradle Coast Water
CGU	Cash Generating Unit
CHW	Central Highlands Water Authority
CoAG	Council of Australian Governments
CPA	Competition Principles Agreement
CPI	Consumer Price Index
CSO	Community Service Obligation
CWW	City West Water
DBCT	Dalrymple Bay Coal Terminal
DDSO	Digital Data Service Obligation
DOTARS	Department of Transport and Regional Services
DPA	Dampier Port Authority
DPC	Darwin Port Corporation

DPI Forestry	Department of Primary Industries (Queensland) Forestry
EBIT	Earning Before Interest and Tax
EDI	Electronic Data Interchange
ERA	Economic Regulation Authority
ESC	Essential Services Commission
ESC Act	<i>Energy Services Corporations Act 1995</i>
ETEF	Electricity Tariff Equalisation Fund
ETF	Economic Type Framework
FNSW	Forests New South Wales
FPA	Fremantle Port Authority
FPCWA	Forest Products Commission of Western Australia
FRC	Full Retail Contestability
GBE	Government Business Enterprise
GCCC	Gold Coast City Council
GFS	Government Financial Statistics
GMW	Golburn–Murray Rural Water Authority
GOC	Government Owned Corporation
GPA	Gladstone Port Authority
GPFR	General Purpose Financial Reports
GPOC	Government Prices Oversight Commission
GTE	Government Trading Enterprise
GVW	Golburn Valley Regional Water Authority
GWh	Giga (10 ⁹) watt hours

HEC	Hydro-Electric Corporation
HIA	Hobart International Airport Pty Ltd
HPC	Hobart Ports Corporation
HWC	Hunter Water Corporation
IASB	International Accounting Standards Board
ICAA	Institute of Chartered Accountants in Australia
ICRC	Independent Competition and Regulatory Commission
IPART	Independent Pricing and Regulatory Tribunal of New South Wales
KPI	Key Performance Indicator
kWh	Kilo (10^3) watt hours
MCE	Ministerial Council on Energy
MPA	Mackay Port Authority
MPC	Melbourne Port Corporation
MW	Mega (10^6) watts
MWC	Melbourne Water Corporation
MWh	Mega (10^6) watt hours
NCC	National Competition Council
NCP	National Competition Policy
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
NFPS	National Forestry Policy Statement
NPC	Newcastle Port Corporation
NRC	National Rail Corporation

NTER	National Tax Equivalent Regime
NWI	National Water Initiative
OPT	Office of Public Transport
ORG	Office of the Regulator-General
OTER	Office of the Tasmanian Energy Regulator
PAWC	Power and Water Corporation
PBC	Port of Brisbane Corporation
PCQ	Ports Corporation of Queensland
PDC	Port of Devonport Corporation
PEP	Port Enhancement Project
PHPA	Port Hedland Port Authority
PKCTL	Port Kembla Coal Terminal Limited
PKPC	Port Kembla Port Corporation
PoMC	Port of Melbourne Corporation
PPA	Power–Purchase Agreement
PTA	Public Transport Authority
PTB	Passenger Transport Board
PTE	Public Trading Enterprise
QCA	Queensland Competition Authority
QNI	Queensland–New South Wales Interconnector
QPTC	Queensland Power and Trading Corporation
QR	Queensland Rail
QTSC	Queensland Transmission and Supply Corporation

RailCorp	Rail Corporation of New South Wales
RBA	Reserve Bank of Australia
RFA	Regional Forest Agreement
RIC	Rail Infrastructure Corporation
SA Water	SA Water Corporation
SCA	Sydney Catchment Authority
SCI	Statement of Corporate Intent
SFC	Sydney Ferries Corporation
SEW	South East Water
SGARA	Self-generating and Regenerating Assets
SHTPL	Snowy Hydro Trading Pty Ltd
SMHEA	Snowy Mountains Hydro-Electric Authority
SOC	State Owned Corporation
SOC Act	<i>State Owned Corporations Act 1989</i>
SOE	State Owned Enterprise
SPC	Sydney Ports Corporation
SPS	Sydney Pilot Service Pty Ltd
SRA	State Rail Authority
STA	State Transit Authority
SVA	Shareholder Value Added
SWC	Sydney Water Corporation
TOC	Territory Owned Corporation
TPA	Townsville Port Authority

USO	Universal Service Obligation
VCA	Victorian Channels Authority
VPC	V/line Passenger Corporation
VRCA	Victorian Regional Channels Authority
WACC	Weighted Average Cost of Capital
WAGRC	Western Australian Government Railways Commission
WMW	Wimmera Mallee Rural Water Authority
YVW	Yarra Valley Water

PART A

Key points

- Government trading enterprises (GTEs) provide services in key sectors of the economy — including electricity, water, urban transport, railways, ports and forestry. In 2004-05, the 85 GTEs monitored in this report controlled assets valued at more than \$186 billion and generated \$63 billion in revenue.
- Aggregate profitability increased in the electricity, water and urban transport sectors in 2004-05 compared with the previous year. Profitability declined in the railways, forestry and ports sectors.
- Over a five year period, the profitability of the 54 GTEs (excluding Telstra) monitored continuously since 2000-01 improved, with the aggregate return on assets increasing from 6.8 per cent in 2000-01 to 8 per cent in 2005-04.
- Nearly half of the currently monitored GTEs earned less than the long-term bond rate in 2004-05. An even greater proportion failed to earn a commercial rate of return (which includes a margin for risk), suggesting impediments to improved performance remain for most GTEs.
- In total, the 85 currently monitored GTEs made dividend payments to owner-governments of almost \$4.8 billion in 2004-05 (\$2.7 billion excluding Telstra). Tax and tax-equivalent payments to governments totalled \$3.4 billion (\$1.6 billion excluding Telstra).
- The average degree of financial leverage or 'gearing' of GTEs has declined over the last ten years and is generally lower than that of private sector utilities.
 - However, there is a paucity of information that would allow the community to assess the appropriateness of GTE capital structures.
- Government ownership and government borrowing arrangements attenuate the incentives to maximise shareholder return and operational efficiency that flow from appropriate capital structures and market engagement.
- Recent equity withdrawals by governments — one means of restructuring business capital — do not appear to have significantly affected financial performance.
 - Notwithstanding this, transparency (and therefore accountability) associated with the transactions remains below private sector reporting requirements.

1 Introduction

This is the first report in a new program of government trading enterprise (GTE) financial performance monitoring. This continues work commenced in 1991 by the Productivity Commission's predecessor, the Industry Commission.

The monitoring forms part of the Commission's research into the performance of Australian industries and the progress of microeconomic reform. Reporting performance also increases transparency and, thereby, strengthens accountability. In addition, a comparable set of performance indicators can facilitate 'yardstick' competition, which is particularly important in industries where businesses do not face vigorous direct competition.

The information presented in this report covers annual financial performance and management over a period of five years, together with an analysis of the factors affecting financial performance. It is suitable for making a general assessment of financial performance within and across sectors. It cannot be used, however, for a detailed performance analysis of individual GTEs. A thorough examination of their financial statements and the market circumstances that they face is required for that purpose.

1.1 Scope

GTEs are government-owned or government-controlled entities that produce goods and services on a commercial basis by substantially or fully covering their costs. They are outside the general government sector and are also separate from government financial enterprises in the banking, insurance and related sectors.

GTEs are also commonly referred to as:

- GBEs (government business enterprises);
- GOCs (government-owned corporations);
- PTEs (public trading enterprises);
- Public corporations;
- SOCs (state-owned corporations);

-
- SOEs (state-owned enterprises); or
 - TOCs (territory-owned corporations).

These terms are often used interchangeably. In some cases, the terms have specific local and statutory relevance. For example, the term GBE in Tasmania refers to specific entities in schedule 1 of the *Government Business Enterprises Act 1995* (Tasmania), such as Forestry Tasmania and the Hydro-Electric Corporation.

This report contains a consistent set of financial performance indicators for 86 GTEs for the period 2000-01 to 2004-05 (appendix A). In 2004-05, these GTEs generated \$63 billion in revenue and controlled assets valued at \$186 billion. In aggregate, they account for around 86 per cent of the revenue generated by all government-owned businesses in Australia (ABS 2005c).

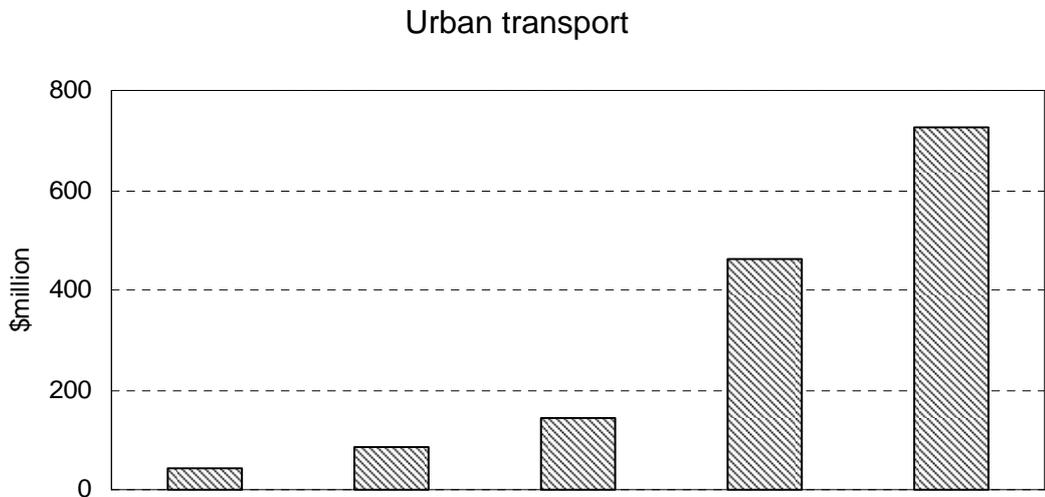
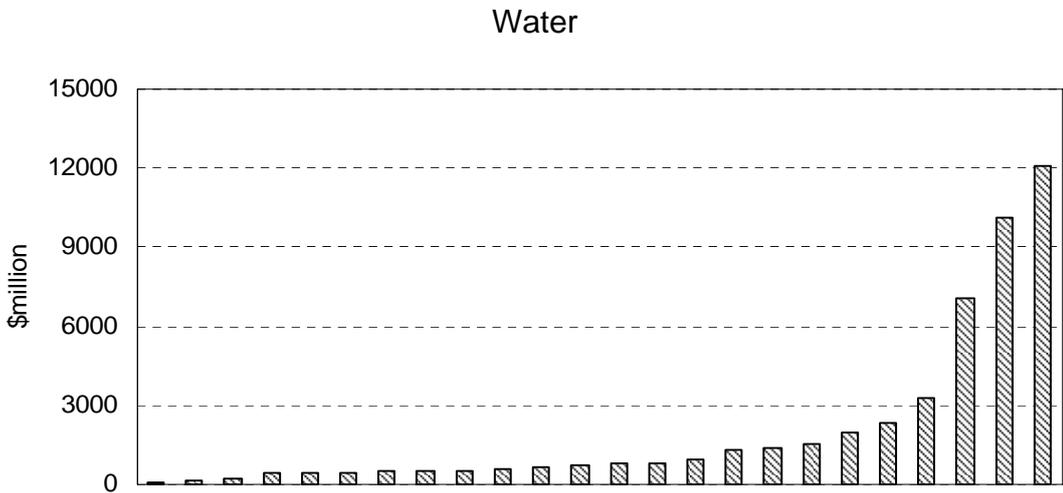
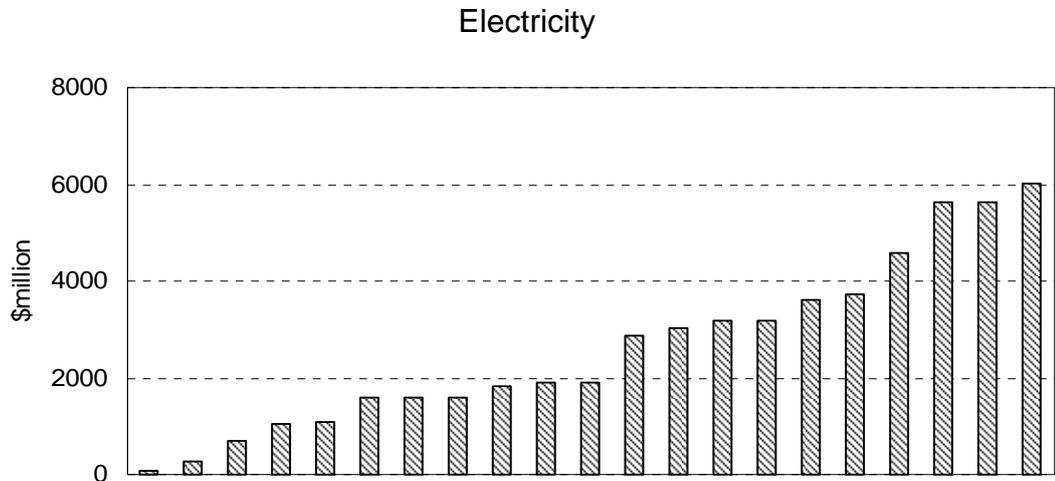
The monitored GTEs undertake a range of activities across six sectors — electricity; water, sewerage, drainage and irrigation (hereafter referred to as ‘water’); urban transport; railways; ports; and forestry. Three Australian Government trading enterprises that do not fit within these sectors — Airservices Australia, Australia Post and Telstra — are reported separately as a group.

The size of the GTEs varies substantially across and within sectors (figure 1.1). In 2004-05, the smallest in terms of asset value was the Burnie Port Authority (\$35 million) and the largest was Telstra (\$36 billion), (not shown).¹ Telstra accounted for 20 per cent of the 86 monitored GTEs’ total assets and the largest seven GTEs accounted for around 50 per cent of total assets.

The GTEs monitored represent the majority, but not all, of the GTEs currently operating in their respective sectors. Where GTEs operated over part of the reporting period, but not in 2004-05, they have not been included. These GTEs have generally been privatised or had their assets and operations transferred to other GTEs or new entities.

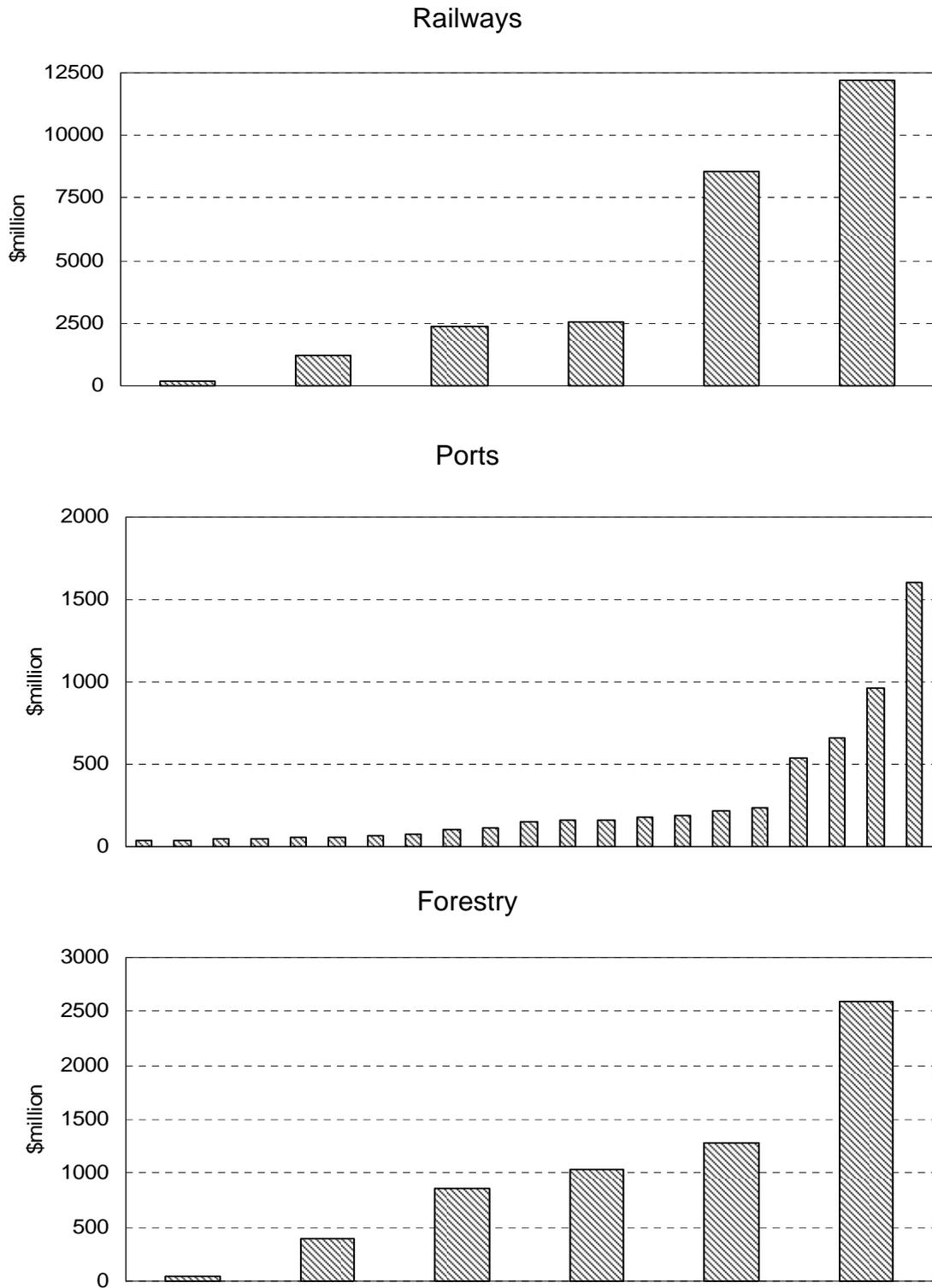
¹ Telstra is partly privatised. The Australian Government retains 51.8 per cent of issued shares.

Figure 1.1 **Assets — monitored GTEs by sector, June 2005**



(continued next page)

Figure 1.1 (continued)



Note Three Australian Government trading enterprises that do not fit within these six sectors — Australia Post (assets \$3.7 billion), Airservices Australia (\$601 million) and Telstra (\$36 billion) — are excluded from this figure.

Source: Productivity Commission estimates.

1.2 Capital management

The Commission is undertaking a new program of research into GTE capital management as part of this series of financial performance monitoring. Capital management was identified as warranting closer analysis given that most GTEs have highly capital-intensive operations, and that there has been an increase in labour productivity from past reforms. Improvements to capital productivity arguably offer the greatest scope for further gains in financial performance.

At a higher level, it must be recognised that capital management is influenced to a significant extent by the external governance of GTEs. This was examined in the last three-year program of monitoring (PC 2005a, ch. 4).

The areas covered this year are GTE capital structures and equity withdrawals.

Capital structures are examined because of their importance in influencing incentives for management to maximise shareholder returns and operational efficiency. The research into this topic also provides a framework for the consideration of other issues such as equity withdrawals.

Equity withdrawals have been the dominant instrument for capital restructuring in recent periods. They have also been controversial, and there have been claims governments have withdrawn equity to the financial detriment of GTEs and the services they provide to customers.

1.3 Report structure

For the remainder of this part of the report, Part A, an overview of the financial performance of the monitored GTEs over the last five years is presented in chapter 2.

Summaries of the data and financial performance indicators used in the report are provided in chapter 3. This chapter also includes a discussion of the prospective changes that will occur with the introduction of Australian equivalents to international financial accounting standards (A-IFRS) next year. Specifically, the effects that the changes might have on the comparability of performance indicators over time are assessed.

The findings of the research into capital structures and equity withdrawals are presented in chapters 4 and 5 respectively.

In Part B, GTE performance reports are presented by sector, with commentary on the influence of structural reforms and the market environment on performance. State and territory treasury departments were given the opportunity to review these performance reports.

2 Financial performance overview

An overview of government trading enterprise (GTE) performance at the industry level is provided in this chapter. Summaries of the financial performances of each of the 86 GTEs monitored over the period 2000-01 to 2004-05 are provided in part B of this report. Their financial performances are examined using a consistent set of financial indicators and ratios.

Information on the data and measures used in assessing performance — both at a sector level and for individual GTEs — is presented in chapter 3.

2.1 Profitability

Profitability reflects a business's capacity to generate earnings from the capital invested in its activities. Increases in the retained profits (or surpluses) add value to an owner's equity in a business. If equity holders (the community in the case of GTEs) are to obtain a full financial return on their investment, profits have to be sufficient to generate a return similar to that available from alternative investments with similar risk profiles.

The financial performance of GTEs — relative to that in previous periods and to the performance of other GTEs operating in different parts of the economy — will be affected by variations in operating conditions. Such changes in conditions can include variations in the demand for a GTE's goods and services and changes to its costs of production.

The existence of non-commercial objectives can also affect the financial performances of GTEs. The emphasis that governments place on non-commercial objectives should therefore be considered when comparing the performance of GTEs across sectors and over time. If a GTE is directed to undertake non-commercial activities without adequate funding, its financial performance will suffer — especially in sectors where community service obligation (CSO) payments would otherwise contribute a significant proportion of total revenue.

The GTEs monitored in this report generally operate in regulated industries, where prices are largely determined by independent price regulators or require ministerial approval. The influence of regulators' decisions on revenue means that their

decisions can affect the profitability of GTEs. For example, in some cases, poor operating results may reflect regulated prices being set too low, rather than being indicative of poor management by the GTEs themselves.

The valuation of assets, and their periodic revaluation, can also affect the recorded financial performance of GTEs. For example, forestry GTEs are affected annually by revaluations of growing timber assets, the effect of which is written directly into the statement of financial performance (chapter 11).

In addition, if a regulator, when determining the prices a GTE can charge for its services, assigns a different value to the assets than the value carried in the GTE's statement of financial position, measured financial performance will be affected. The Commission has also found, in some cases, differences between the asset valuation implicit in the regulator's final price determination and the regulator's stated asset valuation (PC 2002b).

In this report, the monitored profitability measures include the level of operating profit, the return on assets (and equity), and the cost recovery ratio.

Changes in GTE performance 2003-04 to 2004-05

In 2004-05, the overall financial performance of the electricity, rail and urban transport sectors generally improved, while the results for the water, forestry and ports sectors were lower overall than for the previous year (table 2.1).

Table 2.1 **Selected profitability measures, by sector in 2004-05 (2003-04)**

<i>Sector</i>	<i>Return on assets</i>		<i>Return on equity</i>		<i>Cost recovery</i>	
	per cent		per cent		per cent	
Electricity	9.0	(7.8)	7.6	(7.9)	131.8	(126.3)
Water	5.7	(5.8)	3.5	(3.6)	156.8	(162.2)
Urban transport	1.9	(0.7)	0.5	(- 1.0)	101.3	(99.5)
Railways	2.9	(- 9.9)	2.0	(- 20.2)	98.9	(41.9)
Ports	5.6	(7.2)	4.0	(5.9)	142.9	(156.0)
Forestry	0.8	(1.8)	0.2	(1.1)	105.3	(115.3)

Note Indicators are the sector-wide weighted means. Results for 2003-04 are shown in brackets.

Source: Productivity Commission estimates.

A full financial return would equate at least to the risk-free return on capital plus a margin reflecting the non-diversifiable market risk inherent in the investment.

The 10-year Commonwealth Government bond rate is widely used as the risk-free return benchmark. The average rate of return on 10-year Commonwealth

Government bonds in 2004-05 was 5.4 per cent (RBA 2006a).¹ Given the non-diversifiable risk inherent in any business activity, it is reasonable to expect that GTEs should be generating returns above the risk-free rate.²

In 2004-05, 47 per cent of monitored GTEs earned nominal pre-tax returns on assets above the 10-year bond rate. This is only marginally higher than the 45 per cent of GTEs monitored in 2003-04 that achieved a return greater than the risk-free bond rate (5.7 per cent).

In 2004-05, the proportion of monitored GTEs that provided a negative return on assets increased to 15 per cent from 11 per cent in 2003-04. Over one-third of those GTEs with a negative return, operated in the water sector.

Profitability also varied considerably between and within sectors in 2004-05 (figure 2.1).

Changes in GTE performance 2000-01 to 2004-05

Fifty-four GTEs have been monitored over the entire five-year period from 2000-01 to 2004-05.

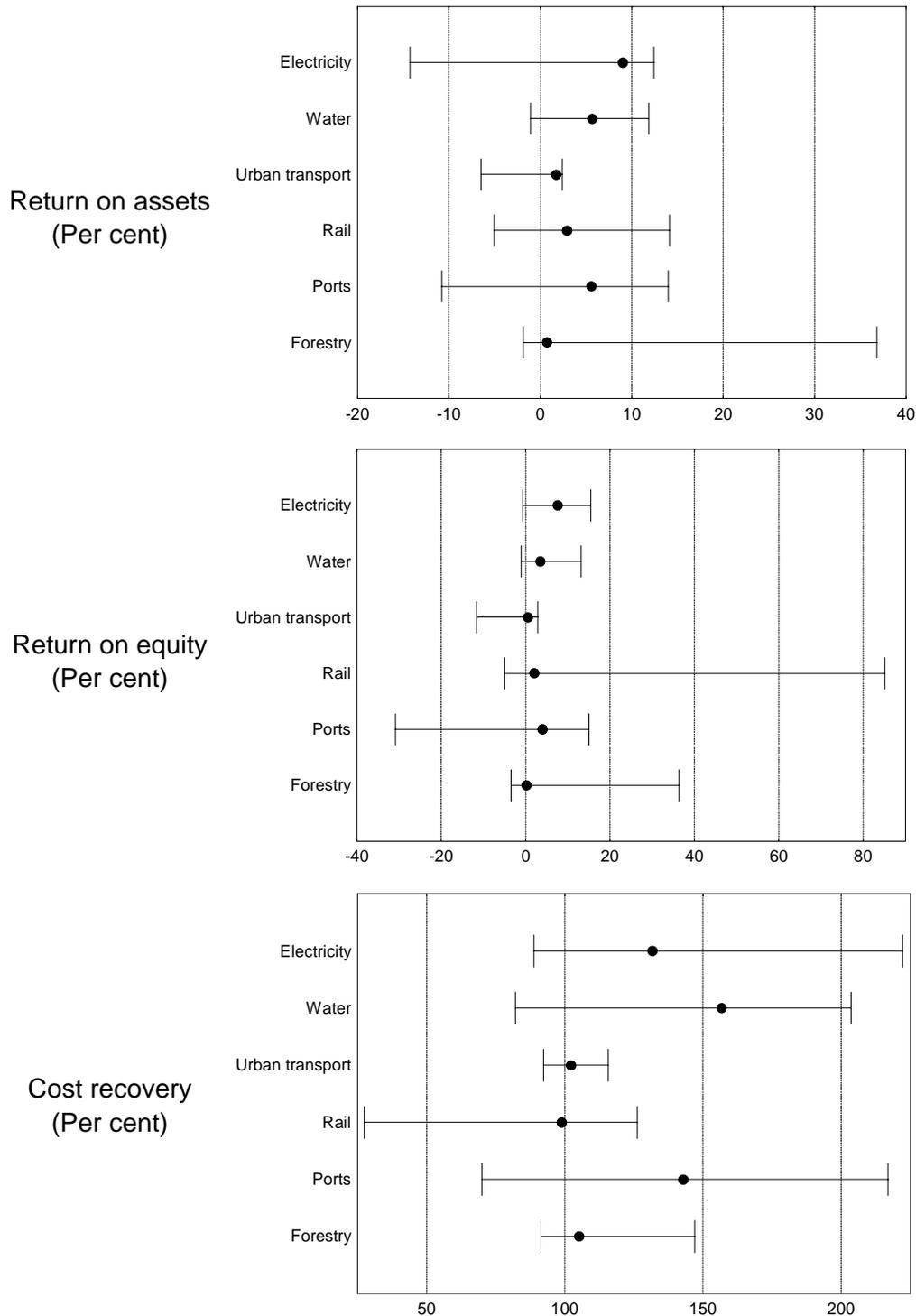
At the start of the reporting period (2000-01), 52 per cent of the 54 GTEs earned a rate of return on assets above that year's long-term bond rate (5.8 per cent).³ In 2004-05, 48 per cent of those GTEs achieved a rate of return above the risk-free rate.

¹ Based on the average daily rate over the 12 months to June 2005. The rate is usually based on the average bond rate over a specified period (12 months) rather than the 'on the day' rate at 30 June 2005, in order to minimise the effect of short-term volatility.

² Typical values estimated by regulators as an approximate overall rate of return (including an allowance for non-diversifiable risk) are somewhat higher than the risk-free rate. For example, regulators accepted a nominal post-tax return of between 6 per cent and 7 per cent for electricity distributors in New South Wales over the period February 2004 to June 2008 (IPART 2004).

³ The proportion of GTEs achieving a rate of return above the risk-free rate in 2000-01 relates to only those GTEs monitored for the entire reporting period.

Figure 2.1 Selected profitability measures, by sector in 2004-05



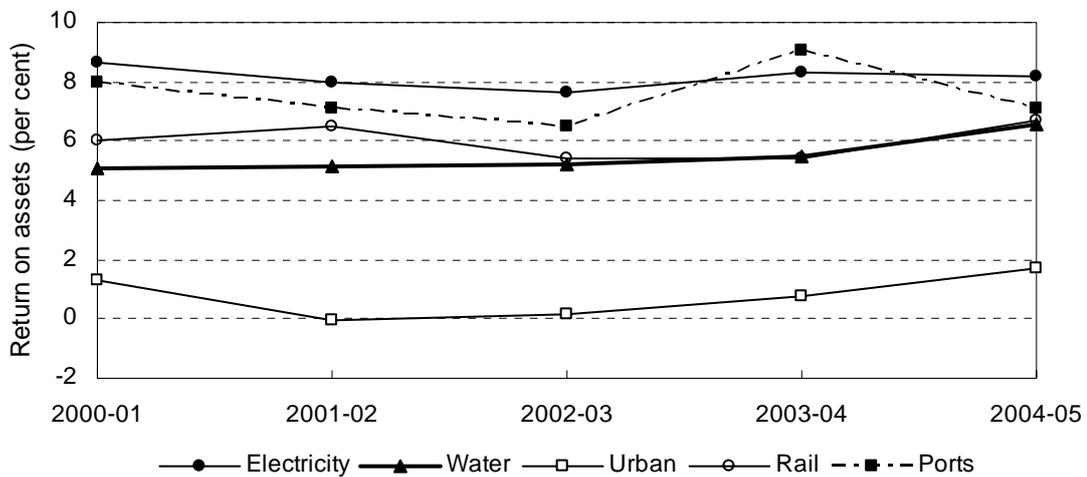
Note The dot represents the weighted mean value and the 'whiskers' represent the range of values for a given performance indicator. For example, for the electricity sector, the lowest return on assets was -14 per cent, the highest value was 12 per cent and the weighted mean return on assets was 9 per cent.

Source: Productivity Commission estimates.

Aggregate profitability of these GTEs — measured by the weighted average return on assets — increased from 10.7 per cent to 11.4 per cent between 2000-01 and 2004-05. The return on assets for all GTEs monitored over the entire reporting period, *excluding* Telstra, also increased.⁴ In 2004-05, the return was 8.0 per cent, compared to 6.8 per cent at the start of the reporting period.

The aggregate profitability increased in the water, rail and urban transport sectors in 2004-05, compared with the previous year, but fell in the electricity and ports sectors. Over the reporting period, profitability increased marginally in all sectors other than the electricity and ports sectors (figure 2.2).⁵

Figure 2.2 Profitability of GTEs, by sector



Note Return on assets is the sector-wide weighted mean of GTEs monitored for the entire reporting period, from 2000-01 to 2004-05. Forestry GTEs were only monitored from 2001-02 and therefore are not included in this graph.

Source: Productivity Commission estimates.

The electricity sector had the strongest returns of all those monitored. However, the weighted average return on assets in 2004-05 for the subset of electricity GTEs monitored over the entire reporting period was 8.2 per cent. This is a decline from 8.6 per cent in 2000-01.

⁴ Telstra is the largest GTE monitored in this report. Over the reporting period, its profits (before tax) have exceeded those generated by all other GTEs combined. Excluding Telstra from certain performance measures provides a better indication of movements in those measures during the reporting period.

⁵ GTEs in the forestry sector were only monitored from 2001-02. This sector recorded a deterioration in profitability in 2004-05 (table 2.1).

Aggregate profits of port GTEs monitored over the entire reporting period increased by 57 per cent in nominal terms (\$80 million) since 2000-01. However, the weighted average return on assets of these GTEs has declined over the reporting period because of significant upward asset revaluations in 2003-04.

2.2 Financial management

The financial management indicators in this report include the ratio of debt to assets (and debt to equity), the current ratio and the level of interest cover. Further information on these indicators is provided in chapter 3.

The average debt level of the GTEs monitored since 2000-01 increased by 3.2 per cent in real terms over the five-year monitoring period. In real terms, the electricity, water and ports sectors increased debt by 10 per cent (\$1.5 billion), 15 per cent (\$1.0 billion) and 39 per cent (\$300 million) respectively. In contrast, the urban transport and rail sectors, as well as Australia Post, Air Services Australia and Telstra have reduced real debt since 2000-01. In the case of Telstra, it was a reduction of 8.6 per cent (\$1.3 billion).

The overall increase in debt led to a corresponding increase in the weighted average debt to assets ratio for GTEs monitored over the entire reporting period. For the GTEs monitored since 2000-01 (53, excluding Telstra), the aggregate debt to assets ratio increased from 32 per cent in 2000-01 to 36 per cent in 2004-05.

Despite an overall increase in debt, more than 44 per cent of the GTEs monitored since 2000-01 decreased their nominal debt level over this period. This decline was attributable to a number of factors, including debt reduction programs, reduced capital expenditure and the partial privatisation of some businesses.

The 2004-05 weighted average debt to equity ratio for all 86 monitored GTEs has increased since 2003-04, but the ratio varied considerably between sectors — ranging from 6.5 per cent in the forestry sector to 84 per cent in the electricity sector (table 2.2). In 2004-05, 13 GTEs operated debt free.

In 2004-05, interest cover declined in most sectors, with the exceptions of the rail and urban transport sectors (table 2.2). The significant increase in the rail sector's weighted average interest cover since 2003-04 reflects increased profits rather than a decline in debt for that sector.⁶

⁶ In 2004-05, the rail sector recorded an operating profit before tax of \$420 million. This compares with a \$2.4 billion operating loss posted in 2003-04, which was primarily the result of a \$3.0 billion write down of assets.

Table 2.2 **Selected financial performance measures, by sector in 2004-05 (2003-04)**

<i>Sector</i>	<i>Debt to equity</i>	<i>Current ratio</i>	<i>Interest cover</i>
	per cent	per cent	times
Electricity	83.6 (83.9)	72.5 (71.3)	2.2 (3.0)
Water	23.0 (23.3)	54.4 (55.1)	4.6 (4.8)
Urban transport	23.4 (27.9)	58.0 (42.0)	1.4 (0.5)
Railways	29.7 (29.5)	91.8 (125.3)	2.2 (-6.8)
Ports	28.7 (30.2)	177.6 (157.1)	4.3 (5.5)
Forestry	6.5 (5.9)	139.2 (145.6)	2.4 (9.3)

Note Indicators are the sector-wide weighted means. Results for 2003-04 are shown in brackets.

Source: Productivity Commission estimates.

Financial management performance indicators also varied considerably within each sector (figure 2.3).

2.3 Government transactions

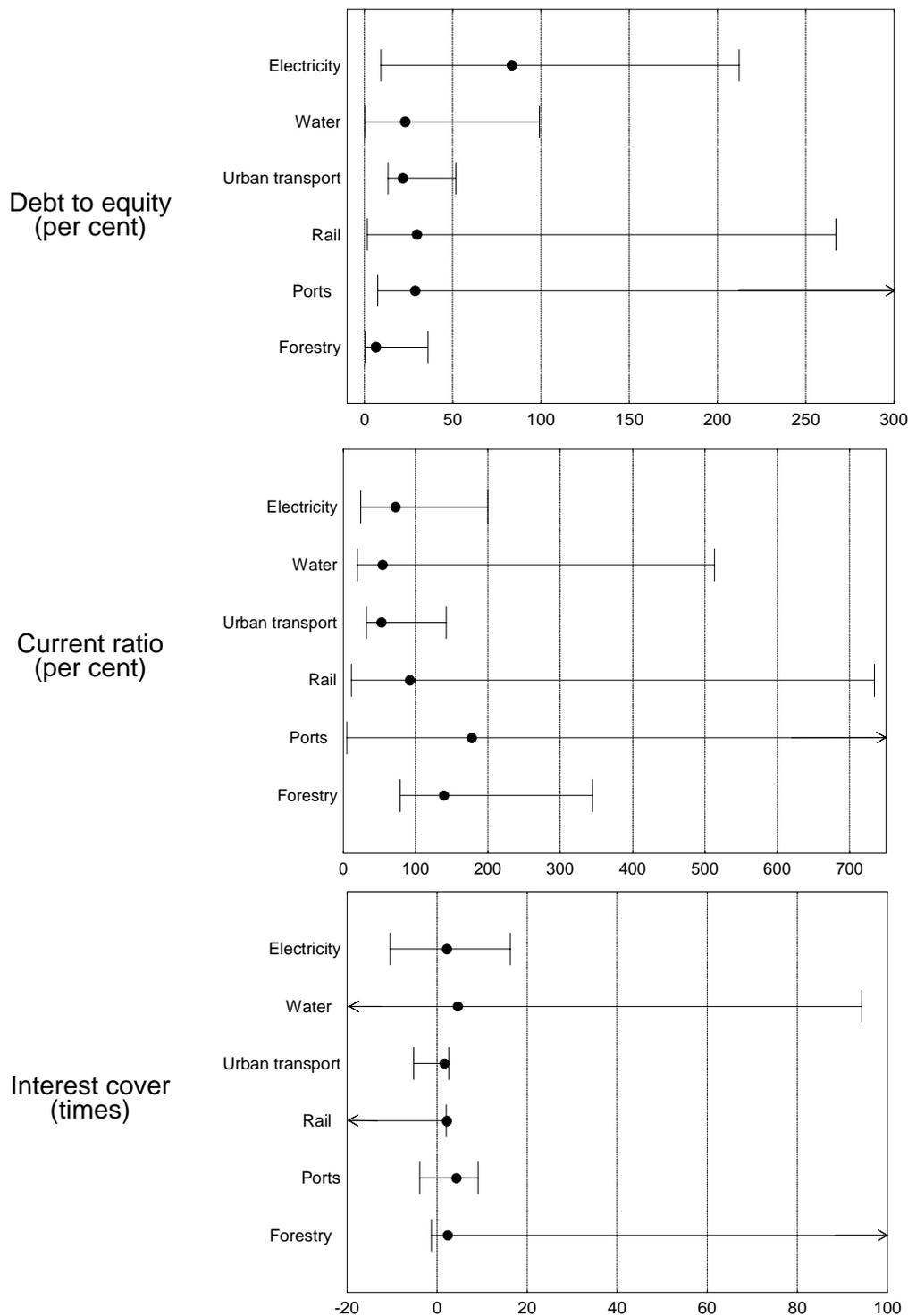
In 1995, the Council of Australian Governments endorsed the corporatisation of GTEs, as part of a range of reforms under the Competition Principles Agreement. An objective of the Agreement was to enhance the efficient allocation of resources by removing any competitive advantage that Government businesses enjoy as a result of public ownership. As part of meeting this objective, governments re-committed to tax-equivalent payments and debt guarantee fees for all significant GTEs, where the benefits outweighed the costs.

The dividend, tax-equivalent and CSO payments of GTEs are examined in the following sections. For more information, see chapter 3.

Tax-equivalent payments

Under a tax-equivalent payment regime, GTEs are required to pay tax on their operating profit at the same company tax rate as private businesses. If this were not the case, all other things being equal, a GTE would be able to earn the same after-tax commercial rate of return as its competitors with lower prices or higher operating costs.

Figure 2.3 Selected financial management indicators, by sector, 2004-05



Note The dot represents the weighted mean value and the 'whiskers' represent the range of values for a given performance indicator by sector. ^a The highest debt to equity ratio for the ports sector was 483 per cent. ^b The highest current ratio for the rail sector was 4214 per cent. ^c The lowest interest cover for the water sector was -85 times. ^d The lowest interest cover for the rail sector was -57 times. ^e The highest interest cover for the forestry sector was 135 times.

Source: Productivity Commission estimates.

Since June 2001, most state and territory government-owned entities have been subject to the National Tax Equivalent Regime (NTER).⁷ The NTER unified the tax equivalent arrangements of GTEs that were previously subject to the tax-equivalent regimes of their respective owner-governments:

The primary objective of the NTER is to promote competitive neutrality, through a uniform application of income tax laws, between the NTER entities and their privately held counterparts (ATO 2001).

In 2004-05, the 86 monitored GTEs paid almost \$3.5 billion in tax-equivalent payments to governments, of which Telstra contributed 52 per cent. The remaining GTEs each paid an average of approximately \$20 million. Total tax-equivalent payments (excluding Telstra) were 1.1 per cent (\$20 million) lower than the previous year.

Dividends

Dividend payments are a return to shareholders on the funds invested in GTEs. The payment of dividends is designed to bring GTEs into line with private sector businesses that typically distribute a proportion of their profits to shareholders.

In 2004-05, 64 GTEs made dividend payments to their owner governments, one more than in the previous year. Total dividends paid or provided for were just over \$4.9 billion. Over 40 per cent of this payment came from the Australian Government's 52 per cent share of Telstra's \$4.1 billion dividend.

Total dividends for all 86 GTEs monitored in 2004-05 increased by 10 per cent, mainly because of an increased dividend payment by Telstra. Excluding Telstra, total dividend payments fell 0.8 per cent (\$23 million) from the amount paid in 2003-04.

Dividend payments of the 53 GTEs monitored since 2000-01 (excluding Telstra) have increased by 10 per cent over the reporting period. The proportion of GTEs monitored over the period that paid, or provided for, dividends has also increased marginally, with 81 per cent providing dividends in 2000-01, and 85 per cent of GTEs providing dividends in 2004-05.

The weighted average dividend to equity ratio for all GTEs monitored was 4.8 per cent in 2004-05 compared to 4.7 per cent in 2003-04. Excluding Telstra, the dividend to equity ratio fell from 3.4 per cent in 2003-04 to 3.1 per cent in 2004-05.

⁷ Australian Government-owned entities pay income tax to the Australian Taxation Office.

Over the reporting period, several GTEs reported dividend payout ratios of over 100 per cent, especially in the electricity and ports sectors. This indicates that dividends paid or provided for exceeded operating profit (after tax) in that year. It implies that the GTE might be required to fund the dividend payment from retained earnings or by borrowing.

Some GTEs made dividend payments after reporting operating losses, resulting in negative dividend payout ratios. This can be explained by GTEs being required by their owner-governments to make pre-determined special dividends of a given amount regardless of after-tax operating profits. Negative dividend payout ratios can also occur when dividend payments during the year are based on prior year operating results.⁸

Community service obligations

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

Historically, governments have recognised these benefits through the funding of operating deficits of the relevant GTEs. However, current government policy is to make on-budget payments directly to the GTEs for the provision of certain CSOs, such as pensioner concession fares.

In 2004-05, governments paid monitored GTEs \$4.0 billion in disclosed CSO payments. In some cases, GTEs did not disclose CSO funding. Some GTEs also provide CSOs without reimbursement. For example, Forestry Tasmania did not receive CSO payments over the reporting period for the provision of public forest land management.⁹

Rail GTEs received 67 per cent of the overall CSO funding, with GTEs in the water sector receiving 14 per cent and in the electricity sector 11 per cent, in 2004-05. The urban transport sector accounted for almost all of the remaining CSO funding. As a percentage of total sector revenue, urban transport and rail sectors received the largest amount of CSO funding (40 per cent).

⁸ Under AASB 1044, dividends must be reported in the year that they are announced rather than the year that they relate to. For example, a dividend from 2004-05 profits will not be reported in the 2004-05 operating result, if it is not declared prior to 30 June 2005.

⁹ Forestry Tasmania estimated the cost of meeting these obligations at \$5.6 million for the 2004-05 financial year.

Total CSO payments to those GTEs monitored for the entire reporting period increased by 13 per cent in real terms from 2000-01 to 2004-05. Real CSO payments increased by 17 per cent in the electricity, 6 per cent in the water, 18 per cent in the urban transport and 28 per cent in the rail sectors, over the reporting period. Real CSO payments in the ports sector decreased by 76 per cent over the reporting period largely because the NSW Government ceased providing compensation payments to Port Kembla in 2003-04.¹⁰

¹⁰ The CSO payments were provided from 1999-00 to 2003-04, as compensation for the shortfall in income generated by the NSW Rental Relief Scheme for the Port Kembla Coal Terminal. Port Kembla was one of three port authorities to receive CSO payments during the reporting period.

3 Performance measures

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

In addition, an attachment outlining the implications of future reporting requirement following the adoption of Australian-equivalent International Financial Reporting Standards (A-IFRS) by most GTEs from 30 June 2006, is provided at the end of this chapter.

3.1 Data

The data used in calculating the financial performance indicators for 2000-01 to 2004-05 were taken from two sources:

- Government Finance Statistics (GFS) collection — data collected by State and Territory Treasury Departments for the Australian Bureau of Statistics (ABS); and
- General Purpose Financial Report (GPFR) — data extracted from audited GTE financial statements.

The GFS framework is based on concepts and classifications developed by the ABS in the preparation of public finance reports. The framework is based on international standards developed by the International Monetary Fund and the United Nations. The concepts used are consistent with those underlying the national accounts.

Governments also report financial information under the GPFR framework, based on accounting standards. Australian Accounting Standards used for this purpose have been developed by the Australian Accounting Standards Board (AASB). The primary purpose of the GPFR framework is to facilitate economic decision-making (including financial analysis).

GFS data were used to calculate the financial performance indicators for each GTE. However, in a small number of cases GPFR data were used because some items are

not reported separately under GFS. No GFS data were available for the Australian Government GTEs and GPFR data were therefore used.

Differences between GFS and GPFR

Financial reports under the GFS and GPFR frameworks are generally similar. Although there are minor measurement, labelling and presentation differences, there are a number of more significant differences in the treatment of transactions that GTEs undertake on a regular basis (table 3.1). Other less numerous differences arise from the treatment of foreign exchange gains and losses, swaps and derivatives, and superannuation expenses.

As a result of these differences, care is required when comparing the financial indicators in this publication with those obtained from GTE financial statements.

Table 3.1 **Differences between GFS and GPFR — selected items**

<i>Items</i>	<i>GFS</i>	<i>GPFR</i>
Gains and losses on assets	Treated as revaluations and as such are excluded from the net operating balance.	Treated as revenue and expenses and included in the net operating balance.
Distributions to owners	Distributions to owners in the form of dividends are treated as operating expenses.	Distributions are disclosed after operating results and therefore do not form part of the operating statement.
Prior-period adjustments	Operating results can be adjusted for prior-period adjustments.	Operating results reflect only items that represent revenue and expenses transactions relevant to the reporting period.

Source: SA Treasury (2001).

Gains and losses

The differing treatment of gains and losses on assets may generate inconsistencies in areas such as the profit (or loss) on the sale of assets, and revenue (or expenses) from asset revaluations. These differences can affect the reported operating profit. For example, under the GFS framework, revaluations are recorded directly in equity and have no influence on operating profit. In contrast, under the GPFR framework, changes in asset valuations may be recorded in the statement of financial performance.¹

¹ Under current accounting standards, any increase in the value of assets must be recorded in an asset revaluation reserve. The exception is any increase that reverses a downward revaluation previously recognised as an expense in the statement of financial performance, which must be recognised as revenue. A downward revaluation must be recognised as an expense. The

Differences in the approach to the timing of asset valuation also have the potential to generate inconsistencies. Revaluation of non-current assets prior to disposal is not required under the GPFR framework, whereas under the GFS framework it is. Consequently, the GPFR operating statements may contain gains or losses incurred in the disposal of the asset that are not recorded under the GFS framework.

These discrepancies between the GFS and the GPFR treatment of asset revaluations at disposal are not expected to affect indicators substantively. The majority of GTEs value their non-current assets using current valuation methodologies, ensuring minimal gains or losses on disposal.

Distributions to owners

Distributions to owners in the form of dividends and income tax-equivalent payments are regarded as operating expenses under the GFS framework. These amounts can be separately identified and are excluded from expenses in the calculation of the defined performance measures.

Prior-period adjustments

Under the GFS framework, operating results reflect only items that represent revenue and expense transactions relevant to the current period, whereas operating results in the GPFR may include prior-period adjustments.² The AASB has outlined when such differences are most likely to occur (box 3.1).

Effect of differences between GFS and GPFR

In most cases, the operating results obtained using the GFS framework match, or are almost identical to, the GPFR framework, once adjustments have been made to the GFS for dividend and tax-equivalent payments.

In a small number of cases there can be significant differences caused by the treatment of a gain or loss made on asset sales. For example, in 2001-02, TransAdelaide reported an operating loss of around \$12 million under the GPFR framework, largely due to a \$12 million loss on asset sales. Under the GFS framework, it achieved an operating profit of around \$6000.

exception is any decrement that reverses a previous revaluation increment, which must be recorded in an asset revaluation reserve.

² Under the GFS framework, prior-period items arising in the current period are allocated to the relevant prior period. Under current Australian Accounting Standards prior period items arising in the current period are allocated to the current period.

Box 3.1 **GFS differences resulting from prior-period adjustments**

Revision of estimates — Unlike GPFR, GFS data may be adjusted in the future. With GFS, adjustments may be made to prior-period operating results as a consequence of a revision to estimates.

Correction of errors — In GPFR, any error made in a prior period is corrected in the period in which the error is discovered. With GFS, prior periods are revised to take account of errors made in the relevant period.

Voluntary changes in accounting policy — In GPFR, the effects of any voluntary change in accounting policy are calculated on the basis that the new policy has always been in place. Any effects are recognised as revenue or expenses in the reporting period in which the change is made. With GFS, prior-period operating results are revised to take account of the effect of changes in the relevant period.

Change in accounting policy due to the adoption of an accounting standard — In GPFR, the adoption of accounting standards requires that a retrospective adjustment be made at the beginning of the reporting period in which the standard is first applied. With GFS, the effects of adopting a new accounting policy result in revisions to prior-period operating results.

Source: Material provided by the AASB.

Adjusting nominal values

Data presented in this report are based on nominal values — amounts denominated in terms of values at a particular point in time using ‘dollars of the day’. Where changes in real values are reported, nominal values were adjusted to their present values using price changes relating to capital investment by government businesses.³ However, there are alternative measures of price change that can be used which might result in different real values (table 3.2).

Real values were obtained by dividing nominal values for each year by the deflator that more closely reflected the underlying cost structure of GTEs. For example, the nominal revenue in 2000-01 for the Hunter Water Corporation’s revenue of \$130.6 million is divided by 0.959 (Gross fixed capital formation — public corporations) to obtain a real value of \$136.2 million. The real value using the Consumer Price Index — All Groups (Australia) deflator (0.899) would be \$145.2 million.

³ The deflator used was the implicit price deflator for gross fixed capital formation — public corporations (ABS 2005b).

Table 3.2 **Selected deflators, 2000-01 to 2004-05**

Year	Implicit price deflator			Consumer price index
	Gross fixed capital formation (public corporations)	Final consumption expenditure (other government)	Gross domestic product	All groups (Australia)
2000-01	0.959	0.872	0.882	0.899
2001-02	0.972	0.886	0.907	0.925
2002-03	0.974	0.916	0.935	0.954
2003-04	0.975	0.952	0.962	0.976
2004-05	1.000	1.000	1.000	1.000

Source: ABS (2005a; 2005b).

3.2 Performance indicators

The performances of GTEs are reported using a consistent set of financial indicators. These indicators are presented under three broad headings — profitability, financial management and transactions with government.

The indicators provide an overall picture of how a GTE is performing over time and relative to other GTEs. Generally, it is reasonable to make comparisons across GTEs in the same sector in Australia.

In some cases, intra-sectoral comparisons need to take into account the broad range of activities undertaken within a sector. For example, in the electricity sector, Western Power (WA) and Power and Water (NT) were vertically integrated during the reporting period— undertaking generation, transmission, distribution and retail activities. In contrast, other GTEs in the electricity sector generally specialise in one, or in some cases two, of these activities.⁴

Analyses of privately-owned businesses operating in similar sectors in Australia and overseas may also provide useful benchmarks, against which the performance of GTEs can be compared. However, care is required because of differences in accounting standards, including those relating to asset valuation.

Profitability

Profitability indicators provide a concise and consistent way of presenting financial information. In the absence of stock market valuations, they are an important guide

⁴ The WA Government announced in December 2005 that the vertical disaggregation of Western Power would take place from 1 April 2006. Refer to chapter 6 for further information.

to the performance of a GTE.⁵ Profitability indicators provide governments and the community with a means of evaluating how well GTEs are using the assets vested in them.

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

Listed below are the five profitability indicators used in this report. Also included is an explanation of what they represent and how they are interpreted. For derivations of these indicators, see tables 3.3 and 3.4 at the end of this section.

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

Operating sales margin — is an indicator of the surplus (not including interest and income tax) earned on sales revenue. It measures trends in operating revenue and expenses that are independent of changes in capital structure and tax regimes.

Cost recovery — is an indicator of the ability of an entity to generate adequate revenue to meet operating expenses. Investment income, receipts from government to cover operating deficits and gross interest expense are excluded. A cost recovery ratio of 100 per cent indicates that a GTE is able to meet its operating expenses from its operating revenue, excluding the cost of servicing debt.⁶

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 an entity uses the assets vested in it to produce operating profit before interest and tax. It is a useful indicator for comparing the profitability of GTEs and businesses in similar industries against a benchmark rate of return equal to the risk-adjusted weighted average cost of capital.

⁵ If a company is listed on the stock exchange, the market assessment of the value of its equity will generally be expressed through the price of its shares. Hence, expected returns are capitalised into the value of the company through movements in its share price, consistent with the cost of capital. At any particular time, the price of a company's shares encapsulates investors' views of its current and prospective financial performance.

⁶ In 1999-00, 'abnormal' revenue and expenses were also excluded from the cost recovery ratio. In 2000-01, the concept of 'abnormal items' under accounting standards was replaced by the narrower concept 'significant items'. Significant items were not excluded from the cost recovery ratio in 2000-01 because it was apparent that GTEs treated 'abnormal' and 'significant' items differently (see PC 2002a).

The return on assets is affected by changes in asset values arising from asset revaluations, transfers or sales. Some GTEs use different asset valuation methodologies, depending on the type of assets. Reported asset values may vary significantly for a given GTE over time, which reduces comparability. If assets are overvalued, GTEs might not appear to earn sufficient returns. Further, inappropriate asset valuations have implications for the efficiency of prices — because it is unlikely that those prices will properly incorporate the actual cost of capital and depreciation.

Return on equity — is an indicator of the rate of return that an entity is 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. At the end of 2004-05, the accumulated borrowings of monitored GTEs were around \$50 billion and the debt to equity ratio was 47 per cent. The capital structure of a GTE is partly determined by the financial risk associated with the use of debt finance. This risk stems from the commitment to pay interest and repay principal, irrespective of earnings. For example, a decline in operating revenue or an increase in the cost of servicing debt can result in liquidity problems if a GTE's debt is not well managed.

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

Listed below are the five financial management indicators used in this report. Also included is an explanation of what they represent and how they are interpreted. For derivations of the indicators, see tables 3.3 and 3.4 at the end of this chapter.

Debt to total assets ratio — is an indicator of the proportion of assets that are financed with borrowed capital. It gives an indication of the level of exposure to creditors and their interest in the GTE.

Debt to equity ratio — is an indicator of the risk of the entity's capital structure in terms of the amount of capital sourced from borrowing and the amount from

shareholders (governments in the case of GTEs). The greater the debt to equity ratio, the more geared the GTE.

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

Current ratio — is an indicator of an entity's ability to meet short-term liabilities by realising short-term assets. A current ratio greater than 100 per cent indicates that current assets exceed current liabilities and, if realised, their disposal would meet short-term obligations. An acceptable level for the current ratio will be related to the stability of cash flows.

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

Apart from the effect of changes in the value of assets, financial management ratios are also affected by changes in liabilities. The debt to equity ratio is affected, as equity is a residual measure obtained by deducting total liabilities from total assets. For example, an adjustment to provisions for employee entitlements would, if it leads to an increase in total liabilities, decrease equity (and vice versa), other things being equal.

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

Transactions with government

Transactions with government cover tax-equivalent and dividend payments made by GTEs to governments, and payments from governments to GTEs for community service obligations (CSOs).

Listed below are the five indicators used in this report to measure transactions with government. Also included is an explanation of what they represent and how they are interpreted. For derivations of the indicators (tables 3.3 and 3.4 at the end of this section).

Dividends — are the value of funds transferred from present and past after-tax profits of an entity to its owners. Dividends are generally reported when an adjustment is made to retained earnings (equity) in the statement of financial position (previously the balance sheet).

In some cases, governments have effected changes to the capital structure of a GTE by requiring the payment of special dividends.

Dividend payout ratio — is an indicator of the relative size of an entity's dividend payments to its profitability. It gives an indication of the share of after-tax profits that are returned to shareholders. The greater the dividend payout ratio, the higher the share of after-tax profit that is returned to shareholders. A ratio greater than 100 per cent indicates that an entity has paid a dividend that exceeds its current after-tax profits.

Dividend to equity ratio — is an indicator of the relative size an entity's dividend payments to shareholders' equity. A low dividend to equity ratio may indicate that profits are being retained by the entity to fund capital expenditure.

In some cases, comparisons of dividend ratios have to be interpreted with caution. The timing of dividend payments, declarations of dividends by boards, and ministerial approval or directions to pay dividends can result in instances where dividends reported for a financial year relate to operating results in previous years.

Typically, dividends are provided for in the year that they accrue. However, there are many cases where:

- dividends are declared and provided for in the year following the year that they accrued; and
- interim dividends for a financial year are provided in the year that they accrue and a final dividend is provided for in the subsequent year.⁷

Unless noted otherwise, dividends for the financial year were not adjusted or re-allocated to previous years to take account of changes in practices or policies. However, a note is included that indicates that an adjustment can be made to ascertain its effect on dividend payout ratios (box 3.2).

⁷ Creating a provision for a specific final dividend does not necessarily imply that the amount will eventually be paid.

Box 3.2 **Accounting standard for dividends**

A number of GTEs adopted accounting standard AASB 1044 *Provisions, Contingent Liabilities and Contingent Assets* for the first time from 1 July 2002, even though policies with similar effect had already been adopted some states. As explained below, the timing changes resulting from the application of AASB 1044 have the potential to affect some of the year to year dividend and ratio calculations used in this report.

It has been common practice for governments to announce a dividend after the end of the financial year, but before the financial statements for that year were finalised. Even though the dividends may have been announced after 30 June 2002 for example, and not actually paid until 2003-04 year, they were recognised as a liability in the financial statements for the 2001-02.

The effect of adopting AASB 1044 is to record a dividend announced after 30 June 2002 in the financial statements for the year in which the dividend is announced. In the above example, such a dividend would not now be reported in 2001-02, but be included in the financial statements for the 2002-03 year. Any amount that had been disclosed but that remains undistributed at 30 June 2003, would be recorded as a liability.

Whenever an announced dividend is paid, it is deducted from retained profits. The reported net profit in the current year is unaffected, because dividends are paid after net profit is calculated. However, AASB 1044 can affect the calculated dividend payout ratio, and any other financial ratio — where its calculation varies according to the level of current liabilities associated with dividend recognition.

Source: AASB (2001).

Changes in policies and practices by GTEs and governments over the reporting period can sometimes make comparisons difficult. For example, Victorian GTEs typically paid an interim and final dividend relating to each financial year. The interim dividend was paid during the year and the final dividend was recorded as a provision (liability) at the end of the year.

In 2000-01, following a change in accounting policy, Victorian GTEs did not provide for the final dividend because they had not yet been approved by the Treasurer. Therefore, only the interim dividend was included by these GTEs in 2000-01. From 2001-02 on, the reported dividends for Victorian GTEs included the

final dividend that was approved by the Treasurer relating to previous financial year and the interim dividend paid or provided for the financial year under review.

Income tax expense — is the value of tax-equivalent payments made to government by GTEs. Trends in the value of tax-equivalent payments do not always follow trends in pre-tax operating profit because of past tax losses, changes in tax rates and timing and other differences between accounting and taxable income.

CSO funding — is the value of payments by governments to GTEs for the specific non-commercial activities that they are directed by governments to undertake. CSO payments are reported only when separately disclosed in financial statements.

Table 3.3 Published financial performance indicators

<i>Code</i>	<i>Ratio</i>	<i>Definition</i>
B.01	Operating sales margin B.17 / (B.14 - B.33)	$\frac{\text{EBIT less investment income}}{\text{Total revenue less investment income}}$
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	$\frac{\text{Earnings before interest and tax and after abnormals (EBIT)}}{\text{Average total assets}}$
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.26	$\frac{\text{Debt}}{\text{Total equity}}$
B.06	Debt to total assets B.27 / B.19	$\frac{\text{Debt}}{\text{Average total assets}}$
B.07	Total liabilities to equity B.22 / B.26	$\frac{\text{Total liabilities}}{\text{Total equity}}$
B.08	Interest cover B.16 / B.28	$\frac{\text{EBIT}}{\text{Gross interest expense}}$
B.09	Current ratio B.21 / B.23	$\frac{\text{Current assets}}{\text{Current liabilities}}$
B.10	Leverage ratio B.13 / B.26	$\frac{\text{Total assets}}{\text{Total equity}}$
B.11	Dividend to equity ratio B.18 / B.34	$\frac{\text{Dividends paid or provided for}}{\text{Average total equity}}$
B.12	Dividend payout ratio B.18 / (B.15 - B.31)	$\frac{\text{Dividends paid or provided for}}{\text{Operating profit after tax}}$

Table 3.4 Non-published financial performance indicators

<i>Code</i>	<i>Ratio</i>	<i>GFS code</i>	<i>Definition</i>
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 abnormal and extraordinary items, ETF 19. Adjustments are made to include abnormal revenue.
B.15	Operating profit before income tax B.14 - B.25		Total revenue less total expenses. Includes abnormal items.
B.16	Earnings before interest and tax (EBIT) B.15 + B.28		Operating profit before income tax plus gross interest expense.
B.17	EBIT from operations B.16 - B.33		Operating profit before income tax plus gross interest expense less investment income.
B.18	Dividends paid or provided for		The amount included in the profit and loss statement for dividends. Includes normal and special dividends and statutory levies on profits and revenue. 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.
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.

(Continued next page)

Table 3.4 Non-published financial performance indicators, cont.

<i>Code</i>	<i>Ratio</i>	<i>GFS code</i>	<i>Definition</i>
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 revenue.
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		Revenue 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.

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

3.3 Implications of future reporting standards

Most GTEs will report in accordance with Australian-equivalent International Financial Reporting Standards (A-IFRS) for the first time on 30 June 2006. The adoption to A-IFRS is an explicit and unreserved commitment to compliance with International Financial Reporting Standards. As such, A-IFRS reporting will allow financial performance comparisons to be made between similar entities in overseas jurisdictions where international standards apply.

As noted above, Government Financial Statistics (GFS) were used as the main data source for the indicators used for this report. However, these data are supplemented to some extent with GPFER data from the GTE financial statements. Consequently, the imminent change in reporting standard can be expected to affect the comparability of financial performance and financial management indicators contained in this report with those in following years.

The impact of these differences could be mitigated to some extent in the future if the GFS framework is further harmonised with general accounting principles. Although in process, harmonisation could take several years to achieve and might not be fully achieved because of the national accounts focus of GFS.

Colin Parker, Principal, GAAP Consulting was engaged to provide advice on the effects that the change to A-IFRS reporting might have on the comparability of performance indicators over time. An extract of the Consultant's report is reproduced in attachment 3A to this chapter.

The consultant concluded that A-IFRS would significantly affect financial reports. In the case of GTEs, reporting under A-IFRS from 1 January 2005 could cause substantial changes in the recognition and measurement of assets, liabilities and equity items in the statement of financial position, as affected by standards relating to:

- financial instruments;
- investment properties
- fair value or revaluation as deemed cost;
- intangible assets; and
- income tax (tax-equivalent regimes) assets and liabilities.

The statement of financial performance will also be affected by standards relating to:

- impairment write-downs; and

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- pension accounting.

There is a substantial number of ‘minor’ technical changes to other standards, such as leases, borrowing costs, grant accounting, that will impact on individual entities. Further, transitional elections and accounting choices within individual standards could also disturb trend analysis and inter-entity comparability based on performance indicators.

The likely significance of these changes on the comparability of affected indicators was explored by the Commission. Three GTEs were selected from different industries and their current indicators were compared with those calculated using A-IFRS reported data. These GTEs were selected on the basis that they provided relatively detailed estimates of the expected impact that changing accounting standards will have on their financial statements in their 2004-05 annual reports.

For these three selected GTEs, the main sources of variation between data reported on the current (2004-05) and the future A-IFRS basis were:

- tax effect adjustments;
- treatment of defined benefits superannuation; and
- valuation of property, plant and equipment.

An indication of the magnitude of the impact that the new reporting standards could have on measures of profitability and financial management is illustrated in table 3.5.

The greatest impact on indicators appears to emanate from the increase in tax liabilities. However, changes in the treatment of superannuation benefits was also significant. These changes mainly affected equity and the after-tax operating position.

GTE A reported that changes to its defined benefits superannuation position under A-IFRS would have reduced its operating profits in 2004-05 by more than half. Further, increases in liabilities associated with changes in the treatment of tax and superannuation would have reduced total equity by 17 per cent (\$1.5 billion).

These changes would have resulted in a significant decline in profitability measures such as return on assets and return on equity. Financial management measures, such as total liabilities to equity and leverage, would also be affected.

GTE B reported a similar set of adjustments as GTE A, with tax adjustments accounting for 72 per cent of the \$570 million reduction in total equity. Adjustments to defined benefits superannuation accounted for a further 12 per cent of the reduction in total equity and 42 per cent of the total reduction in before-tax operating profits (\$46 million).

Table 3.5 Examples of the impact of A-IFRS on selected indicators

	<i>GTE A^a</i>		<i>GTE B</i>		<i>GTE C</i>	
	<i>Current</i>	<i>A-IFRS</i>	<i>Current</i>	<i>A-IFRS</i>	<i>Current</i>	<i>A-IFRS</i>
Return on assets	3.5	2.2	7.7	6.7	3.8	3.7
Return on equity	2.5	0.7	8.3	9.4	2.6	2.7
Dividend to equity ratio	1.4	1.6	3.6	4.9	0.0	0.0
Debt to equity	31.6	36.0	115.5	156.7	7.4	8.6
Total liabilities to equity	41.4	60.6	160.7	246.2	13.9	30.2
Leverage	141.4	160.5	260.7	345.5	113.91	130.15

Note All A-IFRS figures reported in this table have been estimated using data from annual reports, it is possible that adjustments do not reflect the true impact due to differences between reporting under A-IFRS and GFS reporting requirements. ^a Total assets have not been adjusted but significant increases in the liabilities has been incorporated into the estimates. Total equity measures were calculated using the GTEs' reported total equity following all adjustments for A-IFRS.

Sources: Selected Annual Reports, Productivity Commission estimates.

GTE C reduced total equity by 14 per cent (\$116 million). The adjustments to tax accounted for 82 per cent of this reduction. Operating profits after tax fell by \$1.8 million (8.3 per cent). Unlike GTEs A and B, GTE C's statements of financial position and performance were not greatly affected by changes in defined benefits superannuation liabilities.

Attachment 3A

The following is an extract from a report prepared for the Commission by Colin Parker, Principal, GAAP Consulting. The views expressed are the consultant's and not necessarily those of the Commission.

The Australian Accounting Standards Board formally agreed to adopt new Australian-equivalent International Financial Reporting Standards (A-IFRS) and interpretations at its meeting on 15 July 2004. Since that date, a number of amended standards have been issued, along with new standards based on International Financial Reporting Standards.

The standards that are currently compliant with the International Accounting Standards Board (IASB) are:

- AASB 1 'First-time Adoption of Australian International Financial Reporting Standards';
- AASB 2 'Share-based Payments';
- AASB 3 'Business Combinations';
- AASB 4 'Insurance Contracts';
- AASB 5 'Non-current Assets Held for Sale and Discontinued Operations';
- AASB 101 'Presentation of Financial Statements';
- AASB 102 'Inventories';
- AASB 107 'Cash Flow Statements';
- AASB 108 'Accounting Policies, Changes in Accounting Estimates and Errors';
- AASB 110 'Events After the Balance Sheet Date';
- AASB 111 'Construction Contracts';
- AASB 112 'Income Taxes';
- AASB 114 'Segment Reporting';
- AASB 116 'Property, Plant and Equipment';
- AASB 117 'Leases';
- AASB 118 'Revenue';
- AASB 119 'Employee Benefits';
- AASB 120 'Accounting for Government Grants and Disclosure of Government Assistance';
- AASB 121 'The Effects of Changes in Foreign Exchange Rates';

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- AASB 123 ‘Borrowing Costs’;
 - AASB 124 ‘Related Party Disclosure’;
 - AASB 127 ‘Consolidated and Separate Financial Statements’;
 - AASB 128 ‘Investments in Associates’;
 - AASB 132 ‘Financial Instruments: Disclosure and Presentation’;
 - AASB 129 ‘Financial Reporting in Hyperinflationary Economies’;
 - AASB 130 ‘Disclosures in the Financial Statements of Banks and Similar Financial Institutions’;
 - AASB 131 ‘Interests in Joint Ventures’;
 - AASB 132 ‘Financial Instruments: Presentation and Disclosure’;
 - AASB 133 ‘Earnings per Share’;
 - AASB 134 ‘Interim Financial Reporting’;
 - AASB 136 ‘Impairment of Assets’;
 - AASB 137 ‘Provisions, Contingent Liabilities and Contingent Assets’;
 - AASB 138 ‘Intangibles Assets’;
 - AASB 139 ‘Financial Instruments: Recognition and Measurement’;
 - AASB 140 ‘Investment Property’;
 - AASB 141 ‘Agriculture’; and
 - AASB 1048 ‘Interpretation and Application of Standards’ (an umbrella standard that references international and domestic interpretations).

These IASB-compliant standards are supplemented by four domestic Standards

- AASB 1004 ‘Contributions’;
- AASB 1023 ‘General Insurance Contracts’;
- AASB 1031 ‘Materiality’; and
- AASB 1038 ‘Life Insurance Contracts’.

In addition, the AASB released ‘The Framework for Preparation and Presentation of Financial Statements’ that replaces Statements of Accounting Concepts (SAC) 3 ‘Qualitative Characteristics of Financial Information’ and SAC 4 ‘Definition and Recognition of the Elements of Financial Statements’.

Disclosure on the transition to A-IFRS

AASB 1047 ‘Disclosing the Impact of Adopting AASB Equivalents to International Financial Reporting Standards’ required disclosure in the financial report of the impact of adopting Australian equivalents to IFRS for half-year and annual reporting periods ending on or after 30 June 2004. The standard ceased operation on the first-time adoption of Australian equivalents to IFRS, that is, for financial years commencing on or after 1 January 2005.

Under AASB 1047 for reporting periods ending on or after 30 June 2004, disclosure must be made of the stage of transition to IFRS, and key differences between existing accounting policies and the Australian equivalents of IFRS. There is no requirement to quantify the differences for 30 June 2004, although entities may voluntarily elect to make such disclosures.

For reporting periods ending on or after 30 June 2005, entities are required to quantify the impact on the financial statements. Where the impact is unknown or unable to be estimated reliably, a statement to that effect must be made. These disclosures are also encouraged in the financial report for reporting periods ending on or after 31 December 2004, and before 30 June 2005.

Under AASB 1 ‘First-time Adoption of Australian Equivalents to International Financial Reporting Standards’, the effect of the transition from previous standards to A-IFRS on the statement of financial position, financial performance and cash flows must be explained by means of reconciliations in the first A-IFRS financial report. These explanations must be of sufficient detail to enable an understanding of the material adjustments to the statement of financial position and cash flow statement. Further, reconciliations of the statements of financial position and performance must distinguish between accounting policy changes and the correction of errors.

Under AASB 1, the first financial report includes one year’s comparative amounts and information. Comparative information is not, however, required in respect of AASB 139 ‘Financial Instruments: Recognition and Measurement’. Entities can elect to include such comparative amounts and information if they desire.

Impact on GTE performance reporting

In measuring performance, the change to A-IFRS can be expected to cause significant disturbances to trend analysis. The new recognition and measurement requirements impact on both the statement of financial position and statement of financial performance.

Under AASB 1 ‘First-time Adoption of Australian Equivalents to International Financial Reporting Standards’, retrospective application of the A-IFRS is required. However, there are elections that each GTE may make at the date of its transition to the A-IFRS.

The elections made by GTEs can be expected to be influenced by their individual circumstances. This will lead to different outcomes unless a central agency directs otherwise. Such elections relate to:

- business combinations;
- fair value or revaluation as deemed cost;
- employee benefits (post-employment retirement plans);
- cumulative transition differences;
- assets and liabilities of subsidiaries, associates and joint ventures;
- designation of previously recognised financial instruments;
- insurance contracts;
- changes in existing decommissioning, restoration and similar liabilities included in the cost of property, plant and equipment;
- leases; and
- fair value measurements of financial assets or financial liabilities.

Individual standards also contain choices in the underlying accounting, thus also compromising inter-entity comparisons. These choices concern:

- Property, plant and equipment — after initial recognition, a choice between the cost model and the fair value model is permitted on a class of asset basis. Generally, revaluations are reflected in the asset revaluation reserve in equity;
- Employee benefits — the recognition of actuarial gains and losses in respect of defined benefit plans may be determined by any of the following: the corridor approach (greater than 10 per cent is recognised in the statement of financial performance); accelerated (any amount less than 10 per cent is recognised in the statement of financial performance), and direct to retained earnings adjustment (equity);
- Borrowing costs — expense borrowing costs or capitalise such costs to qualifying assets;
- Intangible assets — after initial recognition, a choice between the cost model and the fair value model is permitted on a class of asset basis, but only where there is an active market for those intangible assets (generally, revaluations are reflected in the asset revaluation reserve in equity); and

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- Investment property — after initial recognition, an investment property is recognised using the fair value model or the cost model. Under the fair value basis, changes in fair value are recognised in the statement of financial performance. Under the cost basis as specified in AASB 116 ‘Property, Plant and Equipment’, an investment property is measured at depreciated cost less any accumulated impairment losses.

Changes relating to specific standards

The key changes under specific standards that are likely to affect the comparability of performance indicators over time and between entities are described below.

‘Business Combinations’ (AASB 3)

Goodwill is subject to impairment testing (AASB 136 ‘Impairment of Assets’) and no longer be amortised over a maximum period of 20 years. Moreover, the identification of 29 intangible assets in the new standard should lead to more intangibles being recognised on acquisition (these assets were often previously included in goodwill).

Under the standard, a discount on acquisition is recognised as a gain in the statement of financial performance (previously recognised by reducing the fair value of non-monetary assets acquired).

Recognition of liabilities for terminating or reducing the activities of the acquiree is severely restricted. Restructuring costs will be generally expensed as incurred (previously a provision could be made as part of acquisition accounting).

‘Non-current Assets Held for Sale and Discontinued Operations’ (AASB 5)

AASB 5 is a new standard that addresses the measurement, presentation and disclosure relating to the classification of non-current assets held for sale, as disposal groups, and as discontinued operations. Assets or disposal groups that are held for sale are measured at the lower of carrying amount and fair value, less costs to sell. Assets or disposal groups held for sale are not depreciated. A non-current asset, or disposal group, acquired exclusively for subsequent disposal is classified as held for sale and measured on initial recognition at fair value less costs to sell.

'Accounting Policies, Changes in Accounting Estimates and Errors' (AASB 108)

A voluntary change of accounting policy must be accounted for retrospectively by adjusting the opening balance of retained earnings and restating comparatives (previously income or an expense item).

There is no distinction made between fundamental error and other material errors. Error correction is no longer recognised in the statement of financial performance. Error corrections are accounted for retrospectively by restating comparative information for the prior periods in which the error occurred (previously an income or an expense).

'Events After the Balance Sheet Date' (AASB 110)

The recognition of liabilities for dividends declared after the reporting date is prohibited. 'Declared' has a specific meaning, in that the dividend is appropriately authorised and no longer at the discretion of the entity. Undeclared dividends do not meet the test of a present obligation.

'Income Taxes' (AASB 112)

The new methodology for determining deferred tax requires the use of a notional tax balance sheet for comparison to the accounting balance sheet to determine temporary differences for calculating deferred-tax assets and liabilities ('balance sheet approach'). It is a more comprehensive method of recording the tax consequences of transactions recognised in the financial report. The calculation of current tax remains unchanged.

The balance sheet approach results in the recognition of additional deferred tax assets and liabilities. Circumstances where the resulting deferred tax balances from temporary differences that are not timing differences include:

- fair value changes asset revaluations, and business combinations;
- adjustments as a result of changes in accounting policies;
- foreign operations;
- convertible financial instruments; and
- investments in subsidiaries, branches, associates or interests in joint ventures.

As tax consequences follow the underlying transaction, there will be instances where tax consequences are reflected in equity (for example, in asset revaluations).

There is a lower threshold test for the recognition of deferred tax assets as ‘probable’, as opposed to ‘beyond reasonable doubt’ for timing differences and ‘virtual certainty’ for tax losses. Discounting is prohibited (previous standards were silent on discounting deferred tax assets and liabilities).

‘Property, Plant and Equipment’ (AASB 116)

The choice of a cost model or revaluation model after initial acquisition continues to be permitted. For profit-seeking entities, revaluation increments and decrements must be recognised on an individual, not a class, basis — whereas the rules for asset revaluation continue to apply to a class of assets for not-for-profit entities. For profit-seeking entities, the carrying amount of an item of property, plant and equipment may be reduced by government grants under AASB 120.

Property, plant and equipment now includes the estimated cost of dismantling and removing the asset and restoring the site (measured in accordance with AASB 137 ‘Provisions, Contingent Liabilities and Contingent Assets’). Where a condition is imposed that requires the continuing operation of an item of property, plant and equipment, the cost is recognised in the carrying amount of the item as replacement, where the recognition tests are met.

‘Leases’ (AASB 117)

The presumptive quantitative tests for leases have been removed.⁸ Greater emphasis is placed on economic substance for the classification of finance or operating leases. As a result, some lease classification decisions will change, and in particular, from operating lease to a finance lease.

‘Revenue’ (AASB 118)

An exchange or swap of goods or services must not be treated as revenue when those goods or services are similar in nature and value. Under AASB 1004 ‘Revenue’, the restrictions were much tighter. However, there will be circumstances under AASB 118 where revenue will not be recognised where it would have been under the superseded standard.

Revenue recognition has also changed where an entity has transferred significant risks and rewards associated with a sale of goods without passing control. In

⁸ Lease term 75 per cent or more of the remaining economic life, and the present value at the beginning of the lease term of the minimum lease payments equals or exceeds 90 per cent of the fair value of the leased at the inception of the lease.

addition, the entity must not retain continuing management control involvement or control over the goods sold.

In some cases, revenue recognition of items, such as contingency fees, by reference to the stage of completion of a contract from the rendering of services, would occur earlier under AASB 118 than it would under AASB 1004. Gains or losses on disposal of property, plant and equipment, and investments are recognised on a net basis, rather recognising the consideration as revenue.

‘Employee Benefits’ (AASB 119)

The recognition and measurement of post-employment benefits is required in the financial report of the sponsoring employer (previously recognition of post-employment benefits that were superannuation or medical benefits were excluded).

Three options for the recognition of actuarial gains and losses are now permitted — full recognition through the profit or loss; full recognition directly in retained earnings; and the ‘corridor’ approach:

- Under full recognition through the profit or loss approach, any systematic method that results in faster recognition of actuarial gains and losses than the ‘corridor’ approach may be adopted, provided that the same basis is applied to both gains and losses, and the basis is applied consistently.
- Under the full recognition directly in retained earnings approach, actuarial gains and losses are recognised in the period in which they are incurred. Recognition outside the profit or loss is permitted providing that all defined benefit plans and actuarial gains and losses are accounted for consistently. Such actuarial gains or losses must be presented in a statement of changes in equity titled ‘A Statement of Recognised Income and Expenses’ as per AASB 101 ‘Presentation of Financial Statement Statements’.
- Under the ‘Corridor’ approach to measuring a defined benefit liability, the portion of the actuarial gains and losses as income or expense must be recognised for amounts determined outside the corridor limits. These limits must be calculated and applied separately for each defined benefit plan. The portion of actuarial gains and losses recognised for each defined benefit plan is the excess, divided by the expected average remaining working lives of the employees participating in that plan.

'Accounting for Government Grants (AASB 120) and Contributions' (AASB 1004)

For profit-seeking entities, government grants are recognised as income on a systematic basis to match the costs they are intended to compensate. A government grant for the acquisition or construction of an asset requires that the grant be carried forward as deferred income, that is recognised as income on a systematic and rational basis over the useful life of the asset.

A government grant that becomes repayable is treated as a revision of an accounting estimate. Where the grant was for acquisition or construction of an asset, the repayment is recognised as a reduction of deferred income. In all other cases, the repayment is applied to any deferred income for that grant, and with any excess recognised as an expense.

'Borrowing Costs' (AASB 123)

A choice of accounting policy has been introduced to either capitalise borrowing costs to qualifying assets, or expense the borrowings. Previously, borrowing costs were only capitalised for qualifying assets.

Under AASB 123, borrowing costs include exchange differences from foreign currency borrowings, but only to the extent they are regarded as an adjustment of interest cost. Whereas AASB 1036 stipulates that all exchange differences arising from foreign currency borrowings, net of the effects of any hedge of the borrowings, be recorded as borrowing costs.

Under AASB 123, the amount of borrowings capitalised to qualifying assets is determined by a capitalisation rate to the expenditures on the asset. Such a rate is normally applied to the average carrying amount; whereas AASB 1036 requires the rate to be applied to the weighted average accumulated expenditures.

'Consolidated and Separate Financial Statements' (AASB 127)

A subsidiary subject to temporary control is excluded from consolidation (previously included within the ambit of AASB 1024).

'Investments in Associates' (AASB 128)

Partnerships are now included within the scope of the standard. The definition of significant influence is narrower. It is now defined as the power to participate in the financial *and* operating policy positions (previously, financial *or* operating).

AASB 1016 required that in the investor's (parent's) separate financial statements, the 'cost method' be applied (that is, cost or fair value under AASB 1041 'Revaluation of Non-Current Assets'). Whereas, AASB 128 requires the 'cost method' to be used, or AASB 139 'Financial Instruments: Recognition and Measurement' to be applied.

The 'equity method' cannot be used when the investor ceases to have significant influence. The investment is then accounted for under AASB 139 'Financial Instruments: Recognition and Measurement', unless the associate has become a subsidiary or a joint venture.

'Interests in Joint Ventures' (AASB 131)

A further test for the existence of joint control is included under this standard. Joint control only exists when strategic financial and operating decisions relating to the activity are made with the unanimous consent of the venturers. Entities that are available-for-sale investments and those suffering severe long-term restrictions that significantly impair their ability to make distributions to the venturer, are accounted for in accordance with AASB 139 'Financial Instruments: Recognition and Measurement'.

'Financial Instruments: Presentation and Disclosure' (AASB 132)

Under this standard, the classification of convertible financial instruments is likely to change from equity to debt.

'Impairment of Assets' (AASB 136)

Procedures are prescribed in AASB 136 to ensure that certain assets are carried at no more than their recoverable amounts. The requirement for recognition and measurement of an impairment loss and reversal is also specified. It is a more comprehensive standard, introducing a filter test based on impairment indicators which must be applied before more detailed calculations are undertaken. The concept of a cash generating unit (CGU) has also been introduced.

Where cash flows are used for impairment testing they are subject to discounting and discipline in their calculation. Impairment losses are more likely to be recognised sooner and at a larger amount, in comparison with the superseded standard.

The new standard applies to all assets, except for certain exemptions. The superseded standards applied to non-current assets other than non-current assets of

not-for-profit entities; to those measured at fair value and net market value; and to inventories.

The superseded standard did not identify such indicators. Under the new standard, goodwill and certain intangibles assets are tested for impairment annually, regardless of whether there is an indicator of impairment.

An asset or group of assets that has output and an active market exists, is identified as a CGU. The lowest level of aggregation of assets is that which generates largely independent cash inflows from continuing use (previously a ‘class of non-current assets’ category was the lowest level of aggregation).

The recoverable amount is the higher of an asset’s or CGU’s fair value less costs to sell, and value-in-use (previously more generic concepts were applied). Detailed rules are prescribed for cash flow projections under the value-in-use basis (previously silent on the method to be used in determining future cash flows and the discount rate).

Requirements are introduced for allocating goodwill to CGUs and for testing goodwill. A write-down order for a CGU is specified starting with the attached goodwill (previously the standard did not address impairment at CGU level, and therefore did specify a write-down order).

‘Provisions, Contingent Liabilities and Contingent Assets’ (AASB 137)

AASB 137 addresses provisions associated with the retirement or disposal of long-lived assets (previously excluded). The existence of a binding sale agreement is required for a provision for restructuring to be recognised (previously permitted to recognise a restructuring provision when a detailed plan was prepared and made public). The recognition of assets associated with provisions must be ‘virtually certain’ (previously ‘probable’).

Where provisions are discounted, the winding back of the discount is treated as a borrowing cost (previously, treated as part of the movement in provision).

‘Intangibles Assets’ (AASB 138)

Intangible assets, including those that are self-constructed, must be recognised where the recognition criteria are satisfied. Intangible assets must be identifiable, that is, separable or arise from contractual or other legal rights. Brand names, mastheads, publishing titles, customer lists, and items of similar substance, must not

be recognised as assets unless acquired. The prohibition on recognition of internally generated goodwill continues.

Expenditure on research must be recognised as an expense as incurred. An intangible asset arising in a development phase must be recognised as an asset when specified conditions are met.

Intangible assets with a finite useful life must be amortised over this life — with the residual value of such assets generally assumed to be zero. An intangible asset with an indefinite useful life is not amortised, but is subject to impairment testing. Intangible assets may be revalued, but only if there is an active market for such assets.

‘Financial Instruments: Recognition and Measurement’ (AASB 139)

All financial instruments must be recognised in the statement of financial position. All derivatives and most financial assets must be carried at fair value. Each financial asset and liability treated as ‘trading’ has changes in fair value recognised in net profit determinations. Certain gains and losses must be deferred and recognised in equity until the asset is sold (for example, available-for-sale financial assets).

For the purposes of measurement, four broad classification categories for financial instruments are specified. The categories are:

- a financial asset or liability at fair value through profit and loss (‘held-for-trading’);
- held-to-maturity investments;
- loans and receivables; or
- available-for-sale financial assets.

A financial asset or liability (including derivatives) must either be classified as held-for-trading, or designated as such on initial recognition. Financial assets and financial liabilities are initially recognised at fair value. For those financial assets and liabilities that are not ‘held-for-trading’, transaction costs are included.

Subsequently, all financial assets must be remeasured to fair value, except for held-to-maturity investments, and loans and receivables. These are carried at amortised cost using the ‘effective interest method’. These financial assets are subject to impairment testing. Investments in unlisted equity instruments with a fair value that cannot be measured reliably are measured at cost.

After acquisition, most financial liabilities are measured at the original recorded amount, less principal repayments and amortisation. Derivatives and liabilities held-for-trading are remeasured to fair value.

Hedge accounting continues to be elective, with the possibility that some entities may change their previous position. Hedge accounting can be used where four conditions are satisfied — the hedging relationship is formally designated at the inception of the hedge, it is accepted to be highly effective, the effectiveness is measurable, and it is assessed on an ongoing basis to be actually effective.

The criteria for hedging accounting are more restrictive for each of the three types of hedges — a fair value hedge, a cash-flow hedge, or a hedge of a net investment in a foreign entity.

For a fair value hedge, the gain or loss is recognised in the statement of financial performance for both the hedged item and hedging instrument. For a cash flow hedge, the gain or loss on the effective portion of the hedge is recognised directly in equity, with the ineffective portion recognised through net profit or loss. A hedge of a net investment in a foreign entity may be accounted for as either a fair value hedge or a cash flow hedge.

'Investment Property' (AASB 140)

Investment properties may be measured at cost or fair value, with fair value adjustments recognised as income (previously investment properties were measured at cost or revalued with the revaluation adjustment being recognised in equity). An investment property is property (land or building) held (by the owner or by the lessee under a finance lease) to earn rentals or capital appreciation or both, rather than for use in the production or supply of goods and services or for administrative purposes, or for sale in the ordinary course of business.

4 GTE capital structures

Key Points

- GTEs adopt lower levels of financial leverage or ‘gearing’ than their private sector counterparts. Gearing is a measure of the proportion of debt relative to total capital in a business.
- The choice of capital structure can influence financial performance, with potential benefits including improved returns for shareholder governments and greater efficiency for end-users.
- Inappropriately set capital structures and funding arrangements have the potential to reduce management incentives to maximise shareholder returns and improve efficiency.
- Capital structure choices in the private sector are influenced to a large extent by debt and equity market disciplines. Government ownership and restricted borrowing arrangements attenuate these disciplines.

Capital expenditures, such as those for plant and equipment, are financed from either debt or equity, including retained earnings out of previous profits. Overall debt levels are usually high for businesses such as GTEs, relative to businesses that operate in industries that do not require large investments in long-lived assets.

In financial terms, the level of equity in a business is the difference between the value of its assets and the claims on them. This residual amount represents shareholders’ financial interest, which in the event of liquidation only becomes available to shareholders after creditors’ claims have been paid. The holders of debt, along with other creditors, have prior claim.

A key measure of business capital structure is the ratio of debt to total capital (or to debt plus equity) — the ‘gearing ratio.’ This measure provides an indication of financial leverage, or the proportion of a business that is funded from debt.

It is widely accepted that the level of gearing in a business can influence financial performance in a number of ways. In addition to potential tax advantages, increasing the proportion of capital expenditure funded using debt can improve management incentives. However, net benefits diminish as increased debt levels begin to increase financial risks and reduce financial flexibility.

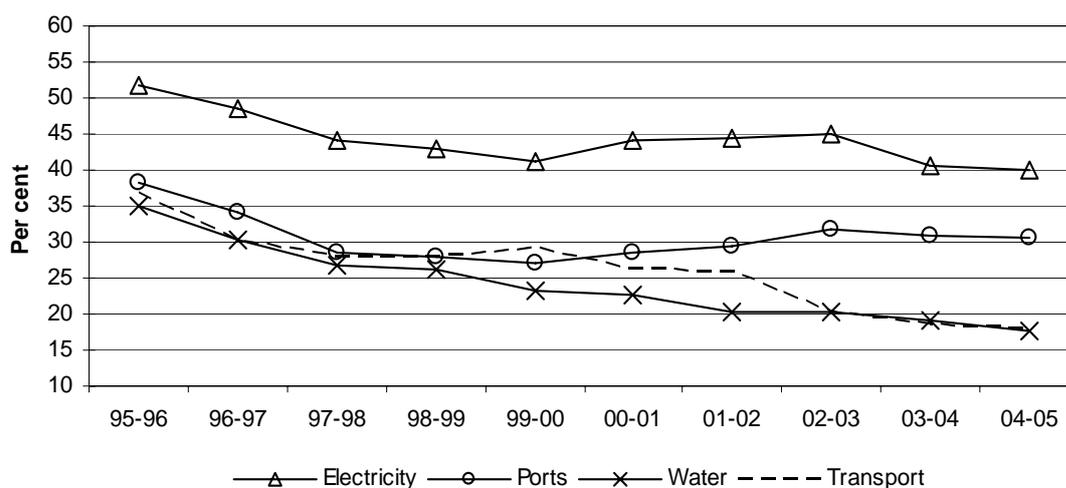
Trends in equity withdrawals among GTEs — one means of restructuring business capital — are examined in the following chapter. Recent trends in GTE capital structures, as measured by the gearing ratio, are reported in this chapter, along with the linkages between capital structure and financial performance.

4.1 Recent trends

The capital structure decisions of private sector boards and management are influenced to a large extent by debt and equity markets. State and territory GTEs and their government owners are not subject to the same market forces.

The level of gearing adopted by GTEs varies between industry sectors and across time periods. Average gearing levels have fluctuated over the last ten years in most sectors, with overall declines in all sectors (figure 4.1).¹

Figure 4.1 Average gearing ratios of GTEs, 1995-96 to 2004-05



Note Data includes GTEs that did not operate over the entire period. Figures represent the average of the gearing ratios of GTEs in each sector. The gearing ratio is the total debt divided by the sum of equity and total debt.

Data source: Productivity Commission estimates based on GFS data.

The level of average gearing remained highest over the period in the electricity sector, although it fell from over 50 per cent in 1995-96 to around 40 per cent in 2004-05. The average level of gearing in the water and urban transport sectors was also lower over the period, falling from between 35 and 40 per cent in 1995-96 to

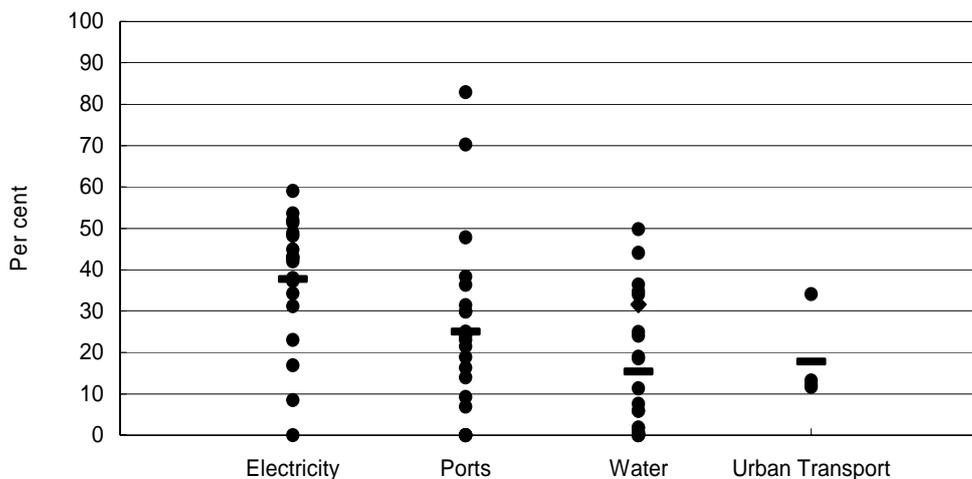
¹ The rail sector was excluded from the analysis due to the high degree of restructuring that has occurred over the time period, making comparison over time difficult. The forestry sector was excluded because gearing in the sector is negligible.

around 17 per cent in 2004-05. The average level of gearing in the ports sector started at more than 35 per cent in 1995-96, but declined to 30 per cent by 2004-05, after increasing again during the second half of the period.

The level of gearing within the ports sector was affected by upward revaluations to assets which occurred during 2003-04. The revaluations conducted by many ports in that year reflected adjustments to the market value of port assets because of increasing world demand for Australian commodity exports. At given levels of debt, such upward asset revaluations have the effect of reducing the level of gearing observed within the sector.

Substantial variation existed among the gearing ratios of individual GTEs within each sector for 2004-05 (figure 4.2). The largest degree of variation among GTEs existed within the ports and water sectors, with the standard deviation of gearing ratios exceeding the mean in each sector.

Figure 4.2 **Distribution of gearing ratios within sectors, 2004-05**



Note Data include all GTEs that were operating in 2004-05. The gearing ratio is the total debt divided by the sum of equity and total debt. Bars represent within-sector average of GTE gearing ratios.

Source: Productivity Commission estimates based on GFS data.

Within ports, three GTEs were operating with gearing ratios more than two times the average of 30 per cent in 2004-05. In the water sector, one GTE maintained a gearing ratio of around three times the average of 15 per cent, while another four GTEs were geared at more than double the average.

A possible explanation for a high degree of variation in gearing levels among port GTEs is that some ports are undertaking considerable expansion and augmentation.

For example, the Geraldton Port Authority commenced a large port enhancement project in 2000-01, which has more than doubled its level of gearing.

A higher proportion of debt is generally used to fund required capital expenditure at ports, because large expenditures typically exceed available cash flows. Retained earnings from the revenue generated would normally restore the gearing ratio over time to the level appropriate for the business and operating conditions.

Comparisons between the average gearing levels adopted by GTEs and their private sector counterparts reveal that the GTEs are structured with relatively lower levels of gearing, with the exception of the port GTEs (table 4.1). The diversity of operations of most private sector urban transport operators make any comparison with the GTEs difficult. The urban transport GTEs have therefore been excluded from the following comparison.

Gearing levels vary across different parts of the Australian electricity sector. The transmission companies surveyed have generally adopted lower gearing levels than generation and distribution companies (figure 4.3). The average gearing level of GTEs operating in each area remains lower than those of the private sector businesses represented.

Broadening the comparison to overseas electricity utilities in similar jurisdictions, the gearing levels of Australian GTEs again appear relatively low. The average gearing ratio among the Australian transmission and distribution GTEs was 47 per cent, while the average across similar US and UK businesses rated by Moody's was 56 per cent and 60 per cent in 2004, respectively (Moody's Investors Service 2005b).²

The average gearing ratio was similarly lower for water GTEs compared with privatised water businesses operating in the UK (there are no private water utilities in Australia at present). The water GTEs' average gearing ratio of 23 per cent was significantly lower than the two selected UK water utilities at 62 per cent and 89 per cent in 2004-05.

At 22 per cent, the average gearing adopted by the Australian port GTEs was significantly lower than the level adopted by UK port operator Associated British Ports Holdings (ABPH) at 37 per cent in 2005.³ Although larger in scale, the Port of Los Angeles had a similar level of gearing at 28 per cent in 2004-05.

² Moody's reported three-year average gearing ratios. These numbers represent the average gearing ratios across all financial ratings categories reported.

³ ABPH differs from the majority of the port GTEs, both in the breadth of its activities and its holdings of diversified port assets across the UK.

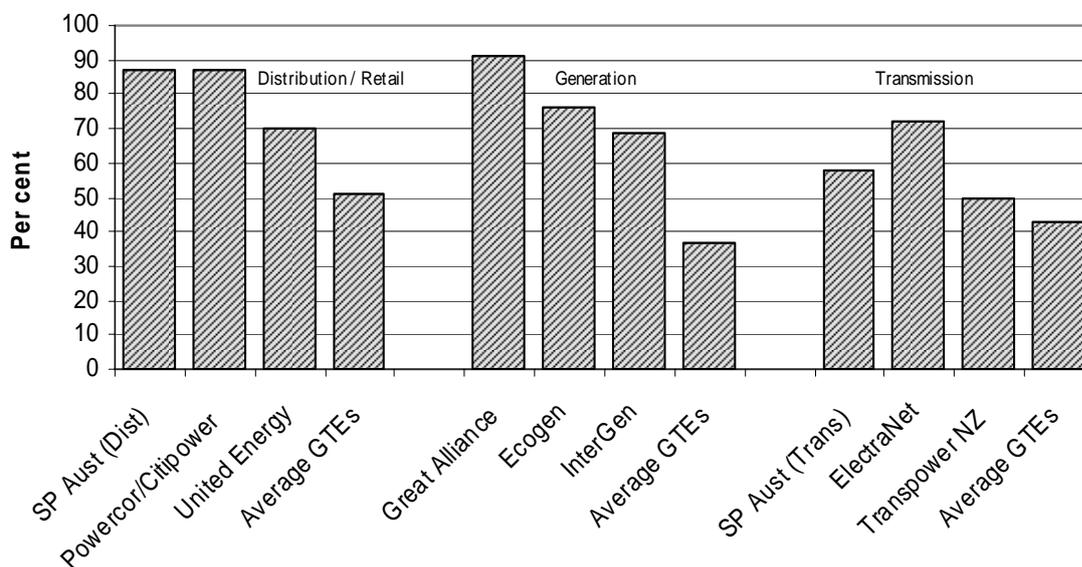
Table 4.1 Recent private sector capital structures

<i>Corporation</i>	<i>Gearing</i>
Electricity Distribution	
SP Australia Networks (Distribution) ^a	87
Powercor and Citipower ^b	87
United Energy Distribution Pty Ltd ^c	70
Electricity Generation	
Great Energy Alliance Corporation Pty Ltd (Loy Yang Generator) ^d	91
Ecogen Energy Pty Ltd (formerly AES Transpower) ^e	76
Intergen Energy Holdings (Australia) Pty Ltd ^f	69
Electricity Transmission	
SP Australia Networks (Transmission) ^g	58
Electranet Pty Ltd ^h	72
Transpower New Zealand Limited ⁱ	50
Ports / Port Authorities	
Associated British Ports Holdings ^j	37
Port of Los Angeles ^k	28
Water	
Sutton & East Surrey Water plc ^l	62
Anglian Water Service ^m	89

Note The gearing ratio is the total debt divided by the sum of equity and total debt.

^a Formerly SP Energy Pty Ltd. Figures from special purpose financial report for the financial period ending 31 August 2005. ^b Figures for Powercor and Citipower taken from the annual report of CKI/NEI Electricity Distribution Holdings (Australia) Pty Ltd, as at 31 December 2004. Powercor and Citipower are wholly owned subsidiaries of CKI/NEI. ^c As at 31 December 2003. Figures taken from Moody's Investor Service (2005c). Debt measured is senior debt. ^d As at 31 December 2004. ^e Special purpose financial report for the year ending 30 June 2005. ^f Special purpose financial report for the year ended 31 December 2004. ^g Formerly SPI Australia Holdings Pty Ltd. Figures taken from special purpose financial report for the period ending 31 August 2005. ^h For year ending June 30, 2004. Figures taken from Moody's (2005c). ⁱ Figures for the year 2004 (balance date not shown), taken from Moody's (2005c). ^j Figures as at 31 December 2005. Associated British Port Holdings PLC is a port owner and operator listed on the London Stock Exchange. ^k Figures as at the 30 June 2005. The Port of Los Angeles is a self-funding proprietary department of the City of Los Angeles, operating according to the 'landlord model.' ^l Sutton & East Surrey Water plc Financial Statements 2005, as at 31 March 2005. Sutton & East Surrey Water plc is a subsidiary of the London Stock Exchange listed East Surrey Holdings plc. The majority of debt issued is long dated and index-linked, reflecting the index-linked regulatory asset value and pricing structure. ^m Figures from the group and company balance sheets of AWG plc, as at 31 March 2005. Anglian Water is a wholly owned subsidiary of AWG plc.

Figure 4.3 Private sector and GTE gearing ratios – Australian and NZ electricity industry, 2004-05



Data source: Table 4.1.

4.2 Current GTE capital structure policies

Under the current framework, ministers undertake the role of owners of the GTEs on behalf of the community. As voting shareholders, ministers have the power to exercise broad strategic control, including the degree of gearing to be adopted in the capital structure of the GTEs.

Only the NSW Government has published the detailed criteria it uses to determine capital structures for the state's GTEs, *Capital Structure Policy for Government Businesses* (NSW Treasury 2002b) (box 4.1). There is an associated policy covering financial distributions.

Box 4.1 **NSW Treasury policy on capital structure for GTEs**

The policy is aimed at “help[ing] to ensure that government businesses operate on a commercial basis and make appropriate investment decisions.” The policy recognises that government businesses are not subject to the same debt and equity market disciplines that affect capital structure choices in the private sector.

The framework establishes surrogate mechanisms for determining an appropriate mixture of debt and equity for NSW GTEs. It outlines a number of factors that influence the choice of capital structures in the private sector and are relevant to Government businesses, including:

- the tax effects on cost of capital;
- the financial disciplines from holding debt;
- an acceptable level of financial risk, as indicated by the businesses’ individual credit rating;
- the inclusion of debt service criteria;
- the capacity to fund capital expenditure from debt and internally generated funds;
- providing sufficient flexibility for contingencies; and
- the dividend preference of the shareholder.

The policy outlines specific considerations that are necessary to ensure businesses operate on a commercial basis. Specifically, the policy points out that Government businesses would not be subject to the same levels of monitoring and discipline imposed by private sector lenders. As a result, the policy requires debt service criteria to be incorporated under the existing shareholder monitoring framework.

The policy also requires the board and shareholders of each Government business to determine an acceptable level of financial risk (of business failure), as reflected in a minimum notional credit rating. The NSW Treasury considers this necessary to ensure that GTEs are not burdened by higher debt levels. The policy requires that each business maintain a minimum notional financial rating of investment-grade.

Finally, the capital structure policy incorporates the dividend preference of the shareholder, as embodied in the *Financial Distribution Policy*. Each GTE’s capital structure must be consistent with the NSW Government’s preference for higher, more stable, dividend streams relative to capital growth. The NSW Government policy notes that a capital structure which ensures a minimum dividend constraint is also consistent with maintaining allocative efficiency between private and public sectors of the economy.

Source: NSW Treasury (2002).

Although monitored Australian Government GTEs (such as Telstra) participate directly in debt finance markets, the state-owned GTEs are required to borrow only through central borrowing authorities.⁴ The funding requirements of the GTEs are managed by the central borrowing authorities through larger pools of government debt, issued in the wholesale debt market (PC 2002a).

The GTEs' gearing is responsive to market rates of debt paid by comparable private sector businesses. This is achieved, in part, by requiring the GTEs to pay debt guarantee fees on their debt funding in addition to the rates of interest payable to the central borrowing authorities. The fees are calculated on the basis of a 'stand-alone' credit rating.⁵ Requiring the GTEs to pay debt guarantee fees also ensures competitive neutrality within the markets the GTEs are operating.

Governments have restructured the capital of GTEs by conducting equity withdrawals. This has been achieved through the use of special dividends, capital repayments and interest free loans. In a number of cases the restructuring involved increasing GTEs debt holdings, which increases the level of gearing. The restructuring is reported in more detail in the following chapter.

4.3 Optimal capital structures of GTEs

The government ownership of GTEs and the specific arrangements applying to their borrowings create additional influences on their capital structure, relative to their private sector counterparts.

Ensuring GTEs adopt appropriate capital structures has important implications for the returns shareholder governments earn on their investments, as well as for prices and quality of service provision to end-users. For GTEs subject to price regulation, it is important that governments allow them to improve profitability through capital structure adjustment to achieve an adequate rate of return under regulatory determinations.

A range of factors is considered by owners and managers in determining the optimal capital ratio for any individual business, in the context of varying market forces and operating conditions. The factors that relate the level of gearing to financial performance or shareholder value are described in the following section.

⁴ A small number of GTEs are provided with relatively minor revolving debt facilities by major Australian banks. However, these do not represent funding for capital expenditures.

⁵ The stand-alone credit ratings are normally assigned by an independent ratings agency and calculated on the basis that the GTE does not have government support. The rating reflects the credit worthiness of the GTE and provides an indication of the interest rate it would face in the market without that support.

Corporate finance theory

A widely accepted starting point in the theory of corporate finance is the Modigliani–Miller theorem (Modigliani and Miller 1958). The authors proved that, under certain conditions, the value of a business is independent of its financial structure, such as its choice of gearing or dividend policy. That is, the characteristics of financial structure, such as the split of debt and equity, only affected the way assets are divided among a business' claimants, rather than having any effect on the overall 'size of the corporate pie' (box 4.2).

Box 4.2 The Modigliani–Miller theorem

The theorem begins from the premise that two assets that generate the same cash flow must sell for the same price. If two businesses are identical, except that one holds debt and the other does not, then the value of the business with debt must be equal to the value of the other with no debt, minus the amount of debt. This follows because an investor considering buying either business could always buy the debt free business and then borrow an equivalent amount of debt, replicating the financial characteristics of the business with debt.

The value of the businesses equate because the cost of equity finance will increase as equity is replaced with debt. As debt increases, the level of financial risk increases and the returns required by equity holders increase. This offsets any reduction in the overall cost of funding and hence the value of the business is unchanged.

The theorem assumes that markets are complete, there are no taxes, bankruptcy or transactions costs (such as agency costs).

The total cost of equity for any business is therefore a linear function of the debt to equity ratio (or gearing ratio);

$$r_S = r_0 + \frac{B}{S} (r_0 - r_B)$$

r_S is the cost of equity

r_0 is the cost of capital for an all equity firm

r_B is the cost of debt

B/S is the debt-to-equity ratio.

Source: Modigliani and Miller (1958), Tirole (2006), Wikipedia definition at http://en.wikipedia.org/wiki/Modigliani-Miller_theorem (accessed 22 May 2006).

Since Modigliani and Miller's work, research into the relaxation of their initial, rather restrictive, assumptions has led to greater understanding of the links between corporate structure and business performance.⁶

A recent review of developments in the corporate structure of privatised water utilities in the UK identified a number of potential links between gearing levels and performance in the sector (DTI and HMT 2004). The main factors identified by the study are presented in box 4.3.

Tax effects

For private sector businesses, increased gearing can have the effect of reducing the Weighted Average Cost of Capital (WACC) and enhancing shareholder value because interest payments are a tax deductible expense.⁷ This provides a 'tax shield' that increases the overall returns to the equity investor relative to a business with no debt. A fall in the WACC increases shareholder value, because the WACC represents the opportunity cost of investing in similar financial assets elsewhere.⁸

With the introduction of dividend imputation in Australia in the 1980s, the 'tax shield' effect has been reduced. Imputation allows the tax paid on dividends to be utilised by shareholders as imputation credits.⁹ NSW Treasury (2002) notes that there is empirical evidence to suggest that tax benefits are not entirely offset by imputation. It contends that this is likely to be so because investors typically have different tax positions that limits the extent to which credits can be utilised.

The tax effect on the GTE capital structure choices differ from those in the private sector. Most GTEs are exempt from paying Commonwealth income tax, however they are required to make income tax equivalent payments in accordance with the National Tax Equivalent Regime (NTER). The NTER encourages the boards and management of GTEs to recognise tax as an explicit business cost, to ensure competitive neutrality within the markets they operate.

⁶ An extensive review of this literature is provided in Tirole (2006).

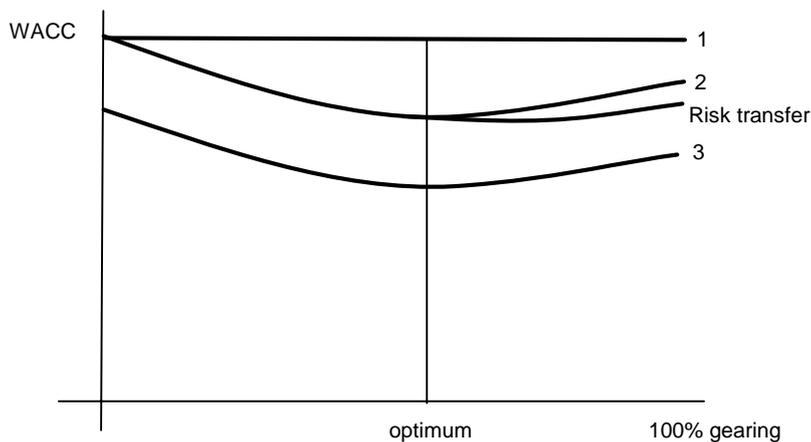
⁷ The Weighted Average Cost of Capital (WACC) is the sum of interest on debt and the required (or expected) return on equity, weighted according to their respective proportions of total capital

⁸ Shareholder value is usually estimated by using the WACC to discount the future expected cash flows arising from a financial asset, as the WACC represents the opportunity cost of those funds being invested in similar projects elsewhere. A reduction in the WACC, for example, increases the present value of a given stream of future cash flows, because a larger initial investment would be required to generate those returns for the new, lower WACC.

⁹ Returns to shareholders are therefore no longer taxed twice, reducing the relative advantage of returns to debt holders that are only taxed once.

Box 4.3 Optimal capital theory

Optimal capital theory developed out of the progressive relaxation of the stringent assumptions behind the Modigliani–Miller theorem (implying the relationship represented by line 1), allowing several explanations for varying capital structures.



Tax effects: Relaxing the assumption of no taxes results in the cost of capital falling over a certain range of gearing ratios (line 2). This suggests the optimal level of gearing corresponds to the point where the marginal benefit of the additional ‘tax shield’ (the deductibility of interest payments) equals the marginal cost of increased financial risk from gearing.

Agency and informational effects: Relaxing the assumption of no transaction costs results in the cost of capital declining from increasing the proportion of debt. Transaction costs caused by information asymmetries will fall if management incentives are improved as a result of increased gearing. This improves the value of the business and is a reinforcing factor in the shape of line 2.

Risk reduction and redistribution: Increased gearing in regulated industries can reduce business risk in the form of future adverse price determinations (regulatory error), which reduces the cost of capital further (line 3). The risk of adverse price determinations is reduced because higher gearing removes a degree of regulatory discretion when regulators are required to ensure the business’s ongoing financial viability. The reduction in discretion could also result in business risks being transferred from debt and equity holders onto consumers or tax payers. When gearing reduces the equity buffer, the business’s ability to absorb cost or revenue shocks and maintain price stability is also reduced. The impact of these shocks is more likely to be transferred onto consumers in the form of volatility in prices charged or in the UK experience, onto tax payers via government bailouts. The effective transfer of business risks away from investors results in their requiring a lower return on capital (represented by the flatter portion of line 2).

Note The Weighted Average Cost of Capital (WACC) is the sum of interest on debt and the required (or expected) return on equity, weighted according to their respective proportions of total capital.

Sources: DTI and HMT (2004), Tirole (2006).

Consequently, governments do not have the same tax deductibility motives as private sector businesses in choosing the capital structures of GTEs. Shareholder governments collect both tax equivalent payments and dividends. Capital structuring decisions in the private sector that increase shareholder returns by reducing tax payments, would not normally be expected in the capital structure policies of the GTEs.

Agency and informational effects

In general, shareholders face a principal–agent problem: managers might not always be acting in the best interests of shareholders. Without the ability to monitor decision-making or to align incentives perfectly, the potential exists for management to undertake activities that are in their or their employees’ benefit, rather than those that enhance the value of the business. This potential manifests as ‘agency costs’, usually in the form of output or profits forgone.

Such costs can be reduced by increasing the level of gearing. Increased gearing places limits on the amount of available operating cash flows, after debt financing costs have been paid. This curbs discretionary use of cash flows by management. In addition, the covenants and financial conditions (more often attached to debt financing), reduce the scope for managers to make self-interested decisions.

Although the level of operating cash flows available to GTE managers is reduced through the use of debt, the potential benefits to GTE profitability from other debt market disciplines is limited because the GTEs obtain debt financing only through state treasuries. By limiting debt financing to central borrowing authorities, the potential exists for management incentives to be less than those facing their private sector counterparts, because there is no direct interaction with wholesale debt markets.

The trading of GTE debt in wholesale markets would generally promote a higher degree of scrutiny and analysis of management strategy. Such closer interaction with debt markets or intermediaries fosters additional monitoring, which could also strengthen incentives for good management.

Incorporating debt service criteria within a government framework for shareholder monitoring, such as those incorporated in NSW Treasury policy, provides for a degree of such monitoring. State treasuries have active GTE monitoring units. However, the disciplines involved in satisfying debt markets cannot be fully replicated. Specifically, lenders who are unrelated to the shareholders can be expected to be more willing to enforce penalties for under performance.

Any systematic under performance attributable to weaker debt-market disciplines should, however, be weighed by shareholder governments against the potential

efficiencies associated with central borrowing. Economies of scale of centralised borrowing offer lower transactions costs for smaller GTEs, and in some jurisdictions the authorities provide additional debt management services. The income derived through debt guarantee fees also represents a benefit to shareholder governments under the current arrangements.

The net benefits to the GTEs from increased gearing diminish once the overall level of debt begins to increase financial risk. Difficulties can arise in meeting repayment commitments, particularly when there is cash flow volatility. More generally, the cost of additional financial risk to a business will be reflected in higher rates of interest payable on debt, determined by financial ratings assigned by independent agencies such as Standard and Poor's or Moody's (box 4.4).

The direct costs from increased gearing can also compound at higher levels of debt when a business seeks to refinance existing debt. A declining financial rating translates to higher interest rates and more restrictive covenants being sought by lenders. The need to maintain sufficient financial flexibility acts as a further constraint on the greater use of debt finance.

Risk reduction and redistribution

In addition to tax effects and agency costs, a recent joint study by the UK Department of Trade and Industry and HM Treasury (DTI and HMT 2004) revealed that an additional motivation for increased gearing could be the desire to reduce or redistribute business risks. In particular, increased gearing observed in the UK water utilities sector might reduce the utilities' exposure to future adverse regulatory outcomes.

Such exposures might be mitigated when increased gearing reduces regulatory discretion because regulators are required to ensure the ongoing viability of regulated businesses. The reduction of such future risks can reduce the current cost of capital.

It was also noted that such increased gearing could transfer cost or demand shocks onto consumers or taxpayers, by reducing the size of the equity buffer. Shocks could be felt by consumers in the form of greater volatility in charges, or by taxpayers through government 'bail-outs' in the event of financial distress. The lack of competition in the provision of natural monopoly services in the utilities sector could result in such transfers of risks to consumers or taxpayers being socially inefficient.

UK regulators have responded to the potential for socially inefficient risk reduction and redistribution, with measures aimed at mitigating regulatory risk. Among other

things, they have introduced interim determinations that pass-through some costs in the event of cost or revenue shocks. These measures have the effect of improving transparency over the distribution of certain risks between consumers and the utilities. On the other hand, licensing requirements of minimum financial ratings (particularly in the energy sector) prevent increased financial risks associated with higher gearing being transferred to consumers.

Box 4.4 Gearing and interest on debt — financial ratings

In Australia, the main independent ratings agencies are Standard and Poor’s and Moody’s Investors Service. These agencies assign financial ratings to the debt issued by borrowers. The ratings play a pivotal role in determining the rate of interest and conditions attached to each debt issue. In the case of GTEs, equivalent ratings are used to determine the debt guarantee fees paid to central borrowing authorities.

The following outlines the methodologies applying to regulated power companies in Australia.

Moody’s Investors Service

Ratings are assigned taking a forward-looking perspective, after considering a range of financial ratios (including gearing), within the context of a number of other qualitative and quantitative factors. These include the industry regulatory framework, the competitive environment and operating positions of the businesses, management strategy, risk tolerance, and the quality and stability of shareholding structure.

Moody’s provides the following expected gearing ratios for energy companies rated A and Baa, where substantial proportions of their businesses are regulated (transmission and distribution businesses). A clear relationship exists between the rating assigned and financial leverage, for a given level of business risk.

<i>Financial Rating Assigned</i>	A		Baa	
<i>Business Risk</i>	Medium	Low	Medium	Low
<i>Debt/Capitalisation (%)</i>	40-60	50-75	50-70	60-75

Standard and Poor’s

The structure of Standard and Poor’s methodology is similar to Moody’s, involving financial ratio analysis within a framework of business fundamentals, competitive and regulatory positions and evaluations of management strategies. A similar relationship holds between the rating assigned and financial ratios, for a given level of business risk. Standard and Poor’s identifies capital structure and leverage as a key driver in its assessment of financial risk, which, if higher, leads to lower financial ratings.

Sources: Moody’s Investors Service (2002), Standard and Poor’s (2005).

Regulatory benchmark capital structure

Recent regulatory decisions in the Australian electricity and gas sectors indicate that lower levels of gearing adopted by regulated GTEs imply financial ratings above the levels that regulators consider necessary to ensure ongoing financial viability.

Incentive regulation is the dominant form of regulation applied in the sectors within which the monitored GTEs operate. Price determinations are made with reference to the efficient cost of providing the service assuming a given level of gearing, among other things. This provides an incentive to enhance profits by operating more efficiently, subject usually to minimum quality standards.

In the case of the electricity sector, the efficient capital structure assumed in calculating the efficient cost is normally established from industry benchmarks, rather than one calculated as theoretically efficient. The regulated entity is at liberty to adopt the same or an alternative capital structure, presumably if doing so reduces costs and enhances profits.

The proportion of debt, or gearing ratio, assumed in recent price decisions is generally higher than the levels adopted by many GTEs in 2004-05 (table 4.2). For example, the NSW economic regulator, the Independent Pricing and Regulatory Tribunal (IPART), assumed a notional gearing ratio of 60 per cent in its most recent price determination for electricity distribution businesses (IPART 2004).

Table 4.2 **Actual gearing ratios — IPART regulated electricity distributors**

<i>GTEs covered by determination</i>	<i>Per cent gearing in 2005</i>
Energy Australia	47
Integral Energy	49
Country Energy	56

Source: IPART, 2004.

IPART claimed that the assumed gearing ratio of 60 per cent corresponds to an investment-grade financial rating (given the price determination), that allows the businesses to maintain their financial viability under both the actual and the assumed 60 per cent level of gearing.¹⁰ Their calculations indicated that the projected financial ratings for most GTEs were higher on the basis of the actual gearing adopted.

¹⁰ IPART used Standard and Poor's ratings methodology. The ratings reflected each businesses' ability to repay debt.

Risk tolerance in capital structure decisions

In the course of establishing the capital structure to be pursued, board and shareholder governments determine an acceptable level of financial risk for the businesses, among other things. Under the NSW Treasury policy on capital structure for government businesses, this involves first determining their debt capacity and conducting a business risks analysis, having regard to cash flow volatility and market competition.

The assessment includes determining the range of capital structures consistent with the maintenance of a minimum investment-grade financial rating. This minimum financial rating requirement places an upward constraint on the level of gearing the NSW GTEs can adopt, for a given debt capacity and business risk.

The independent ratings agency, Moody's Investors Service, reports that the majority of Australian utilities operate in business environments characterised by relatively low levels of risk (Moody's Investors Service 2005a). Moody's notes that Australian energy companies are able to operate with lower financial metrics (including higher gearing) compared to their global peers, for a given rating assigned.

The decisions by shareholder governments to maintain lower levels of gearing than comparable private sector businesses would generally reflect a lower tolerance for financial risk. Such a tolerance could possibly reflect a whole-of-government perspective incorporating social and environmental objectives relating to goods and services that are generally viewed as essential services. This lower tolerance can limit the potential for increased gearing to transfer business risk onto taxpayers or end-users.

There are potential costs, however, in the form of forgone profitability that could be associated with adopting risk levels that are lower than private sector investors. Such costs are manifest in the private sector for example, when businesses with low levels of gearing are bought using additional debt. These so-called 'leveraged buy-outs' reflect the potential for improved profitability from increased gearing.

The potential consequences of existing capital structures could be that profitability would be higher over time if the degree of financial risk tolerated by owner-governments increased management incentives to enhance profitability. Any such decision, however, should be taken in the context of the owner-governments' overall responsibilities to its community — including taxpayers and users of essential services. There have been cases where levels of risk have been excessive, to the cost of the community.

4.4 Further restructuring

The adoption of an appropriate capital structure is important for the financial performance of businesses operating in the private sector. In the case of GTEs, the optimal capital structure is more uncertain, because its benefits on financial performance are attenuated by public ownership and restrictive borrowing arrangements. Nevertheless, it is likely that the optimal capital structure for GTEs has less to do with tax considerations than with having the potential to improve shareholder value through improved management incentives.

The level of gearing observed across monitored GTEs appears to be lower on average than comparable private sector businesses. Scope could exist to increase the gearing adopted by certain GTEs, either via equity withdrawals or through adjustments in the ongoing funding of capital expenditures. The analysis of equity withdrawals in the following chapter suggests that this has been achieved in the past without jeopardising financial performance.

Any gains in this area are limited, however, by the inability of GTEs to participate directly in private sector debt markets. The debt market disciplines applied to the managers of private sector counterparts cannot be fully replicated by central borrowing authorities.

The natural monopoly position and non-contestability of ownership of GTEs permits governments to exercise a lower risk tolerance in capital structuring decisions, relative to the private sector. Such decisions would involve lower shareholder returns in exchange for lower risk. However, potential gains from improved management incentives toward profitability might not be realised, which would eventually be passed on to end-users.

Public acceptance of reasonable financial risk, through greater transparency in capital structure decisions that engages stakeholders, could make it possible for the GTEs to adopt capital structures reflecting a risk tolerance that is closer to that of private investors. This could be achieved by publishing guidelines as a transparent external governance initiative. Shareholding ministers would then be in a position to readily provide ex ante justification for restructuring initiatives.

5 Equity withdrawals

Key points

- During the reporting period, most equity withdrawals (by dollar value and number) occurred in 2000-01.
- Overall, there is no indication that equity withdrawals have significantly affected the financial performance of GTEs. Specifically, GTEs that were subject to equity withdrawals during the reporting period:
 - were either among the more profitable in their sector in 2004-05, or had improved their shareholder returns;
 - increased their capacity to cover interest costs; and
 - did not significantly increased their gearing ratio, with many reducing their gearing ratio.
- Equity withdrawals share similarities with 'off-market', equal-access share buybacks used by the private sector. The use of these buybacks has increased in both value and number over the reporting period.
- The transparency (and therefore accountability) associated with equity withdrawals is limited and well below the reporting requirements for similar transactions in the private sector. This particularly applies to the reporting of the rationales for equity withdrawals.
- Increased transparency would enhance the capacity of the community to assess whether equity withdrawals are in the public's long-term interest at the time that equity withdrawals are being considered.

Over the reporting period, governments have withdrawn equity from their GTEs. Most withdrawals have been made on a permanent basis, for example by the entity buying back shares from the shareholder government. In one case, equity was withdrawn on a temporary basis through an interest free loan to the government.

Equity withdrawals have a significant potential to influence the profitability and financial management of a GTE. For example, these transactions have the potential to limit GTE managements' capacity to make investment decisions regarding

infrastructure, and might even impact on the capacity to maintain or improve the quality of the services delivered to consumers.¹

The lack of information in financial statements or in governance-related documents can make it difficult to assess whether such transactions have had these effects on an individual GTE. There is also the issue of whether the withdrawn equity has been put to better uses by the shareholder government.

In the following section, the justifications for equity withdrawals, as well as their extent and value across sectors, are summarised. In subsequent sections, the financial performance of GTEs that were subject to equity withdrawals is measured against average financial performance to assess the general efficacy of equity withdrawals.²

In the final section, the use of equity withdrawals from GTEs is contrasted with the motivation, extent and reporting requirements for returning equity to shareholders in the private sector.

5.1 Equity withdrawal transactions

GTEs monitored in this report generally operate in capital intensive industries and have substantial fixed assets (PC 2002a). Further, shareholder governments have maintained a high ownership interest (equity) in these entities.

The total equity of GTEs monitored since 2000-01 (excluding Telstra) has increased by 9 per cent in real terms.³ Total assets have increased by 12 per cent as a result of asset revaluations and asset contributions in certain sectors.⁴ Some of this asset growth has been offset by increases in liabilities.

¹ Maintenance of infrastructure and measures of service delivery quality are not considered in this analysis.

² Overall average performance is based on the weighted average for all GTEs (excluding Telstra) monitored for the whole reporting period (2000-01 to 2004-05). Sector averages are based on the weighted average for GTEs in that sector which were monitored for the whole reporting period

³ Fifty-three GTEs (excluding Telstra) have been monitored for the entire reporting period. Although Telstra has returned equity to shareholders (other than the Australian Government) during the reporting period, it has been excluded from this analysis because its size and ownership structure reduces comparability of performance measures.

⁴ GTEs in the water and electricity sectors receive 'contributed assets', which are typically funded or constructed by external parties and then passed to the GTE. GTEs report contributed assets as a revenue, and in recent years contributed assets have constituted an important part of revenue growth for some GTEs. For example, in 2004-05, contributed assets accounted for 19 per cent of City West Water's total revenue.

The source of equity growth has implications for how a GTE returns equity. If a GTE is essentially returning an unrealised capital gain — such as gains generated by asset revaluations and contributed assets — it might have to increase its debt to fund the remittance, which potentially reduces the ongoing profitability and financial management of the GTE, and might lower the quality of its outputs.

This is less likely to be the case if a GTE funds an equity return from realised capital gains — such as retained earnings or gains from the sale of assets. However, returning retained earnings can reduce a GTE’s capacity to commit to new investment.

Rationales for equity withdrawals

Possible reasons for a government to withdraw equity from its GTEs include:

- to facilitate the restructuring of a GTE’s capital and debt levels, to better align the gearing level with those of similar GTEs within the sector or with similar businesses in the private sector;
- to allow governments to utilise capital in a way that maximises returns to the shareholder government. For example, a government is better placed than an individual GTE to determine how publicly-owned capital should be used to meet the state’s broader objectives;⁵
- to bolster the general government sector’s budget position, by increasing on-budget revenue at the expense of off-budget debt;⁶ and
- to realise a return from its investment, otherwise not readily realised (as the shares cannot be sold).

Over the reporting period, governments have withdrawn equity, citing many of these reasons. For example, the NSW Government withdrew just over \$3 billion from the electricity sector in 2000-01. It stated in its *Budget Papers* that:

In 2000-01, electricity sector balance sheets were restructured to move the gearing levels of electricity businesses towards those of private sector businesses.

The restructure involved the enterprises repaying equity to the General Government Sector, funded through increased debt. Proceeds of the capital restructuring were used to retire General Government Sector Debt. (NSW Government 2001, p. 3-16)

⁵ This is the underlying justification for the NSW Government’s use of the ‘modified residual approach’ for its dividend policy (NSW Treasury 2002a).

⁶ Governments can also contribute capital to GTEs to reduce a budget surplus.

Similarly, the Victorian Government requested that South East Water and City West Water return equity totaling \$100 million through ‘one-off’ additional dividends in 2002-03. The Victorian Government reasoned that these dividend payments ‘reinforce[d] the commercial focus of the businesses and ensure[d] appropriate financial ratios were maintained’ (Victorian Government 2003). As noted by the Victorian Auditor-General, ‘[t]hese additional dividends were a major contributor to the net surplus of \$236 million achieved by the General Government Sector in 2002-03’ (AGV 2003).⁷

The Queensland Government has also used equity withdrawals over the reporting period as part of capital restructuring programs (QAO 2002).

Although a government’s motives for, and the timing of, equity withdrawals can vary, it is the impact of such decisions on the ongoing financial performance of the GTE that ultimately demonstrates whether or not an equity withdrawal is detrimental to its ongoing operational performance and viability of the GTEs.

Methods of providing equity withdrawals

For GTEs, the financial mechanisms, by which equity is returned, vary. Methods of returning equity include:

- capital repayments — direct transaction which requires the entity to pay the shareholder government the proposed amount;
- debt-for-equity swaps — a transfer of an entity’s equity that is directly financed though an increase in debt;⁸
- special dividends — additional, one-off payments made by a business, unrelated to current year profits, used to return excess funds to shareholders;⁹
- share buyback — shares are repurchased from the shareholder government at a given price;¹⁰ and

⁷ In 2002-03, the Victorian Government had a target of running a budget surplus in excess of \$100 million (Victorian Government 2003). This target remains in place (Victorian Government 2006).

⁸ In the private sector, a debt-for-equity swap would require parties to exchange equity and specific debt, and not borrow from the other party, as is the case in many GTE debt-for-equity swaps with shareholder governments.

⁹ Under the *Corporations Act 2001*, ‘special dividends’ are payable only from accumulated profits or capital reserves. In relation to GTEs, the requirements for providing dividend payments vary by jurisdiction. For a summary of dividend policy by jurisdiction, see PC 2005a.

¹⁰ This is an increasingly common method of returning equity in the private sector. However, it is uncommon for GTEs to return equity in this way.

-
- interest free loans — the GTE agrees to provide an interest free loan to its shareholder government.

Alternatively, equity may be returned indirectly by GTEs providing dividends that exceed profits (after tax) over a sustained period of time. In these cases, the dividend payout ratio exceeds 100 per cent and profits are insufficient to cover dividend payments. Therefore, the GTE is required to fund the dividend payment from retained earnings, increasing the debt to equity ratio.

The *Corporations Act 2001* stipulates that dividends may only be paid out of profits. Profits include realised gains — current year's earnings or retained profits — or unrealised gains, such as asset revaluations. If dividends are to be paid from the asset revaluation reserve, revaluations must have been completed in good faith by a competent valuer, not be subject to short-term fluctuations in market circumstances and comply with the company's constitution (QAO 2003, NSW Treasury 2002a). Under the insolvency provisions of the *Corporations Act 2001*, dividends and other returns to shareholders must not result in the company trading while insolvent (Dwyer and Alston 2003).

The Task Force on Harmonisation of Public Sector Accounting (2005) noted that governments and GTEs should not report equity withdrawals as part of a dividend payment, as dividends and equity withdrawals are provided for different purposes. Dividends are provided as a signal of the entrepreneurial income generated by the business. However, equity withdrawals represent exceptional payments that in part reflect the close relationship (ownership) between a GTE and its shareholder government.

GTE experience

In order to determine the extent of GTE equity withdrawals and their implications for financial performance, a number of GTEs were selected for further analysis. Those selected were monitored in this year's report and returned a significant amount of capital to shareholder governments during the reporting period (that is between 2000-01 and 2004-05).

In total, 21 GTEs were selected — 11 from the electricity sector, six from the water sector and four from the ports sector. Of these 21 GTEs, four water GTEs and one electricity GTE were included because they have consistently reported dividend payout ratios that exceeded 100 per cent (table 5.1). Of these 21 GTEs, 15 GTEs were monitored from 2000-01.¹¹

¹¹ Overall, 53 GTEs (excluding Telstra) have been monitored for the entire reporting period.

Table 5.1 Equity returns by sector, 2000-01 to 2004-05

<i>GTE</i>	<i>Form of transfer</i>	<i>Financial year^a</i>	<i>Value of transfer^b</i>	<i>2004-05 Total closing equity</i>
			(\$ million)	(\$ million)
Electricity				
Eraring Energy ^c	Debt–equity swap	2001, 2003, 2004	3	1 157
Delta Electricity	Capital repayment	2000, 2002	500	801
Macquarie Generation	Capital repayment	2000, 2002	640	1 269
TransGrid	Capital repayment	2000, 2002	260	1 868
Energy Australia	Capital repayment	2000	1 130	2 308
Integral Energy	Capital repayment	2000, 2001	350	1 136
Country Energy	Capital repayment	2001	320	819
Powerlink	Share buyback	2000	150	1 568
Energex	Special dividends	2001, 2002	180	2 348
Hydro-Electric Corporation	High dividends		nv	1 538
Power and Water Corporation	Debt–equity swap	2002	56	649
Water				
Hunter	High dividends		nv	2 034
City West Water	Interim dividend	2002	46	411
South East Water	Interim dividend	2002	54	714
Hobart Water	High dividends		nv	146
ESK Water	High dividends		nv	111
Actew	High dividends		nv	781
Ports				
Central Queensland Port Authority ^d	Capital repayment	2001	90	434
Ports Corporation of Queensland	Capital repayment	2001, 2002, 2003	215	1 048
Cairns Port Authority	Capital repayment	2001	30	404
Townsville Port Authority	Capital repayment	2001	23	207

^a Financial year denoted by first year, for example 2000 denotes the 2000-01 financial year. ^b Values represent the sum of equity withdrawals over the period. Values have not been adjusted for inflation. ^c During the reporting period, NSW Government repurchased \$150 million of Eraring debt in 2002-03. However, in 2003-04 and 2004-05, Eraring swapped equity for \$137 million and \$16 million of debt respectively. ^d The Queensland Government withdrew equity from Gladstone Port Authority, which in 2004-05 became the Central Queensland Port Authority. **nv** No values have been estimated for equity provided when the source of the return was sustained high dividend payments.

Source: Annual reports, QAO (2002, 2003).

Some GTEs that returned equity during the reporting period were omitted from further analysis because their capital returns were insufficient to impact on financial performance significantly, or because transactions could not be explicitly identified as equity withdrawals.

There was no evidence of equity withdrawals from GTEs in the urban transit or rail sectors, Australia Post or Air Service Australia during the reporting period.¹² DPI

¹² Australia Post has provided special dividends during the reporting period. However, as its dividend payout ratio has not exceeded 100 per cent, these payments have not been considered as indirect equity withdrawals for the purposes of this assessment.

Forestry (Queensland) could have been subject to equity withdrawals. However, forestry was excluded from further analysis because the sector has not been monitored for the entire reporting period.

Telstra has returned equity to its shareholders during the reporting period by buying back shares. However, as noted previously, the Australian Government did not participate in the share buyback.

5.2 Profitability trends

Generally, a private business has to provide shareholder returns that at least meet the expected risk-adjusted returns on forgone investment opportunities if it is to attract investor capital. Measures that indicate whether GTEs are providing sufficient returns to their shareholder governments include ‘shareholder returns’, returns on equity, dividends and dividend payout ratios.¹³

Shareholder returns

Wholly government-owned GTEs do not have observable share prices to indicate a market valuation of equity.¹⁴ Shareholder returns are a measure of the implicit capital gains on the shareholder’s investment and explicit payments such as dividends and equity withdrawals. They are estimated by summing the change in the reported value of equity over the year (the implicit capital gain), dividend payments and equity withdrawals for the relevant year, and dividing it by opening total equity for the year.¹⁵

The shareholder returns of the selected GTEs that were subject to equity withdrawals during the reporting period are compared to their sector’s weighted average shareholder returns (figure 5.1).¹⁶

¹³ This analysis is focused on the impact of equity withdrawals on the affected GTEs, rather than on the associated benefits (or costs) to the shareholder governments.

¹⁴ For listed companies, the cost of attracting and retaining equity funds can be measured from the share price.

¹⁵ Dividend payments are aligned with the year that they relate to, rather than the year in which they were provided for or paid.

¹⁶ The selected GTEs are excluded from the weighted average shareholder returns of the GTEs monitored over the reporting period in each sector. The weighted average was not appreciably affected by this exclusion.

In considering shareholder returns (and other equity-based measures of financial performance), it is important to note the impact of asset revaluations on the level of equity (box 5.1).

Box 5.1 Asset valuations and equity-based measures

Macquarie Generation returned \$400 million in equity to the NSW Government in 2002-03, which was mainly funded by debt. However, equity increased overall by \$470 million.

This apparently anomalous outcome was caused by an asset revaluation. The revaluation, along with the withdrawal of equity and a decrease in operating profits before tax, had a significant impact on the comparability of key performance measures between 2001-02 and 2002-03 (see below).

Macquarie Generation — Selected performance indicators

Performance measure (per cent)	2001-02	2002-03
Return on equity	17.5	6.1
Return on assets	12.3	8.8
Debt to equity	130.0	100.7
Total liabilities to equity	207.4	143.3
Shareholder returns	17.6	133.9

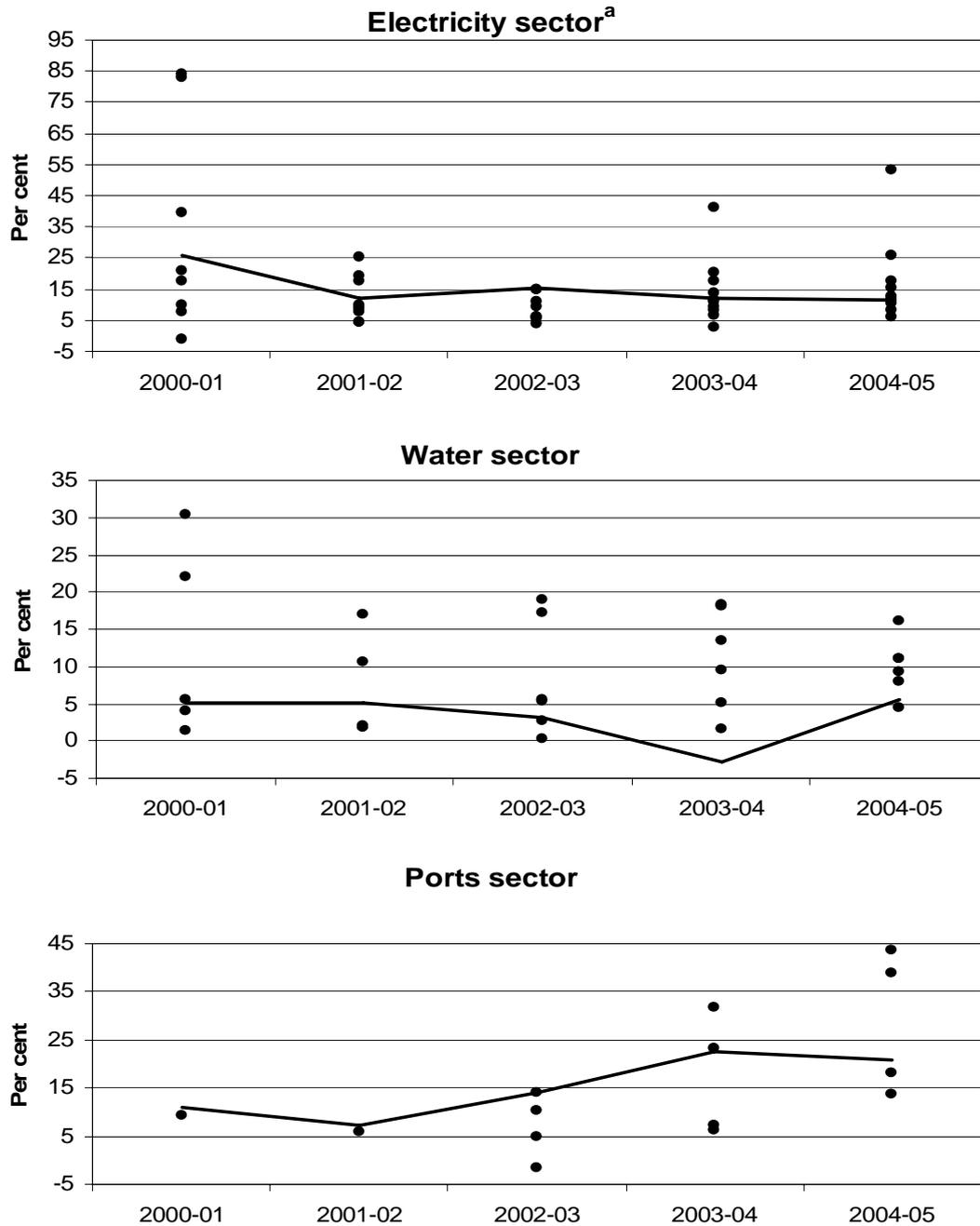
Note: Productivity Commission estimates.

Accounting standards and guidelines require businesses to measure assets at the current value or current cost of an asset, where ‘current’ refers to the value or cost in ‘today’s’ markets, having regard to changes in technology, factor price relativities and consumer demand.

Asset valuations are sensitive to the valuation methodology and the underlying assumptions used, which can give rise to significant variations in estimated asset values.

Sources: PC 2002a, PC 2005a.

Figure 5.1 Shareholder returns by sector — selected GTEs



Note The dots represent the shareholder returns of GTEs that had equity withdrawn during the reporting period. The solid line represents the sector's weighted average shareholder returns (for GTEs that operated for the entire reporting period). The number of monitored GTEs varies between years. Shareholder returns estimated by summing the change in the reported value of equity over the year (the implicit capital gain), dividend payments and equity withdrawals for the relevant year, and dividing it by opening total equity for the year. ^a For presentational purposes, the 2002-03 shareholder returns from Delta Energy (161 per cent) and Macquarie Generation (134 per cent), and Hydro-Electricity Corporation's 2004-05 shareholder return (-23.9 per cent) are not shown in the figure.

Source: Productivity Commission estimates.

Although there is variability between sectors, some trends are apparent. First, shareholder returns of the selected GTEs generally moved in accordance with their sector's weighted average. Second, the shareholder returns of the selected GTEs, particularly those in the water and electricity sectors, converged toward the weighted sector average over the reporting period.¹⁷ Third, the shareholder returns of the selected GTEs were not generally affected by equity withdrawals relative to the other GTEs in their sector.

In the electricity sector, only three of the 11 selected GTEs that had equity withdrawn during the reporting period had shareholder returns decrease by more than the decrease in the weighted sector average (50 per cent) between 2000-01 and 2004-05.

Of the three electricity GTEs to reduce shareholder returns by more than 50 per cent over the reporting period, two — Energy Australia and Integral Energy — had significant amount of equity withdrawn in 2000-01, and increased shareholder returns between 2001-02 and 2004-05. In contrast, the third GTE — Hydro-Electricity Corporation (HEC) — has had a reasonably steady fall in shareholder returns over the reporting period, with a significant decline in 2004-05, largely reflecting the impact of a \$523 million devaluation of assets.

In the water sector, only one of the selected GTEs — Hunter Water — consistently had shareholder returns below the sector weighted average, although its shareholder return increased over the reporting period.

The two selected water GTEs that experienced significant declines in shareholder returns over the reporting period were also the two that explicitly returned equity — City West Water and South East Water. The largest decrease in the shareholder returns of both these GTEs occurred between 2003-04 and 2004-05, which was largely the result of lower equity growth because capital expenditure was funded by debt. A comparison of City West Water and South East Water with Yarra Valley Water (the other metropolitan water authority in Victoria) is provided in box 5.2.

¹⁷ The proportion of GTEs that have both returned equity and provided a shareholder return within a band of 50 per cent above or below the sector weighted average has increased from two of nine in 2000-01 to seven of eleven in 2004-05. Although in 2004-05, asset revaluations by Hydro Electricity Corporation and Energex have resulted in these two firms diverging from the sector weighted sector average.

Box 5.2 Performance of selected Victorian water GTEs

In response to the Victorian Auditor-General's concerns that City West Water (CWW) and South East Water (SEW) increased debt to fund the equity withdrawals which were largely sourced from gains due to contributed assets, the Victorian Minister for Finance and Treasurer noted that the transactions have not had a negative impact on the financial conditions of the two water GTEs. The Minister and Treasurer also commented that gearing levels were below that of Victoria's third metropolitan water retailer — Yarra Valley Water (YVW).

In order to determine whether both these entities have maintained a similar level of financial performance to YVW since the equity withdrawals, selected financial indicators are reported below:

Selected Victorian Water GTEs — Selected performance indicators

Performance measures	2002-03			2003-04			2004-05		
	CWW	SEW	YVW	CWW	SEW	YVW	CWW	SEW	YVW
Shareholder returns (%)	19	17	14	18	18	7	11	11	6
Return on equity (%)	19	16	10	18	13	8	13	10	7
Debt to equity (%)	48	57	80	50	54	86	57	53	99
Gearing (%)	32	36	45	33	35	46	36	35	50
Interest cover (times)	12	8	4	9	7	3	7	5	4

Note Productivity Commission estimates.

Generally, the financial performance measures of all three water retailers have trended similarly since 2002-03. The measures relating to profitability have declined across all three GTEs, mainly because declining developer contributions reduced revenue and equity growth. Both CWW and SEW have maintained a higher return on equity than YVW. However, the rate of return on equity of the first two GTEs have converged to that of YVW since 2002-03.

All three have provided greater shareholder returns and return on equity than their sector weighted average. All three GTEs have also maintained debt-related measures above the sector weighted average, although CWW and SEW gearing levels are lower than YVW.

Although these GTEs are more heavily geared than the average for the water sector, maintaining gearing ratios at these levels does not indicate financial distress as long as the GTE can cover their cost of debt. The interest cover ratio indicates that all three GTEs can cover their interest costs (chapter 4).

Source: Productivity Commission estimates.

All selected port GTEs that returned equity also increased their shareholder returns over the reporting period. Much of this growth in shareholder returns can be attributed to growth in total assets because of upward asset revaluations and in some cases contributed assets.¹⁸

Returns on equity

In contrast to shareholder returns, which is a measure of the implicit capital gains, return on equity is a measure of the profit (after tax) that a GTE generates from the average amount of equity it holds each year.

Return on equity will also be affected by asset revaluations (as illustrated in box 5.1). Further, other factors that influence profitability, such as demand for services and increased borrowing costs, also affect the return on equity.

An equity withdrawal, if not debt financed, will generally increase the rate of return on equity because it reduces the amount of equity over which profits are shared.¹⁹

Over the reporting period, 14 of the selected 21 GTEs that had equity withdrawn increased their rate of return on equity. Of the seven GTEs to reduce their return on equity:

- three electricity GTEs had strong equity growth as a result of asset revaluations since the equity withdrawals in 2000-01;
- two water GTEs increased equity over the reporting period (despite the withdrawals) and their 2004-05 profits declined, mainly because of below average developer contributions; and
- one port GTE increased equity as a result of asset revaluations.

In 2004-05, of the 21 selected GTEs that had equity withdrawn during the reporting period:

- nine provided a return on equity in excess of their sector's weighted average return, whereas 12 did not;

¹⁸ Capital expenditure programs can have differing effects on shareholder returns. If expenditure is funded from retained earnings, a current asset becomes a non-current asset. If it is funded by debt, equity decreases. If the government provides a grant to fund the capital expenditure, equity — and therefore shareholder returns — will increase. However, if the government's contribution is reported as a capital injection, it will have a negative impact on shareholder returns.

¹⁹ Equity withdrawals can be funded from retained earnings or by the sale of assets. However, withdrawals financed by debt increase borrowing costs and might reduce profits and therefore the rate of return on equity.

- 11 provided a return on equity in excess of the weighted average return for all 53 GTEs (excluding Telstra) monitored for the entire reporting period, whereas ten did not; and
- 12 provided a return greater than the risk free bond rate of 5.4 per cent, whereas nine did not.

Of the 12 selected GTEs that provided a return on equity below their sector's weighted average, the six electricity GTEs and the three water GTEs consistently provided returns below their sector average. However, all increased their return on equity over the reporting period.

The three port GTEs that had returns below their sector weighted average in 2004-05 increased equity despite the withdrawals of equity, as a result of significant upward revaluations of assets. One port GTE — Central Queensland Port Authority — also experienced a decline in profitability (before tax) over the reporting period because of higher operating expenses associated with a merger, and increased depreciation expenses.

Dividends

The levels of dividend payments and dividend payout ratios indicate a GTE's capacity to provide current returns to shareholder governments following an equity withdrawal.²⁰ The stability and ongoing viability of dividend payments are important to governments that rely on them as a source of revenue.

In the electricity sector, the weighted sector average dividend payout ratio has declined from 99 per cent to 74 per cent over the reporting period. By 2004-05, the dividend payout ratios of the selected GTEs tended to converge towards the sector weighted average. Four NSW GTEs maintained dividend payout ratios of around 100 per cent over the reporting period (figure 5.2).²¹

Dividend payout ratios have marginally declined in the water sector over the reporting period. Most of the selected water GTEs have maintained relatively constant dividend payments (in nominal dollar terms).²² Exceptions include,

²⁰ The dividend payout ratio is defined as the ratio of dividends paid (or provided for) to after-tax operating profits.

²¹ Returning all profits after tax is consistent with the NSW Government's 'modified residual approach' for providing dividends. Under this approach, earnings that cannot be invested by the GTE to generate greater returns (residual earnings) should be returned through dividend payments (NSW Treasury 2002a).

²² Four water GTEs were selected because their dividend payout ratios consistently exceeded 100 per cent. Hunter Water consistently reported dividend ratios of well above 100 per cent,

ACTEW which retained all its 2003-04 earnings to fund capital investment and City West Water and South East Water which provided dividends that exceeded their profits (after tax) in 2002-03 to return equity to the Victorian Government.

In the ports sector, the weighted sector average dividend payout ratio declined from 77 per cent to 48 per cent over the reporting period. By 2004-05, the dividend payout ratios of the three of the four selected GTEs were around 80 per cent. However, there are no apparent trend in the movements of the dividend payout ratios of the individual GTEs over the reporting period.

5.3 Financial management trends

Most of the selected GTEs have been required to increase debt to fund equity withdrawals by shareholder governments. Therefore, the impacts of equity withdrawals on debt levels, capacity to manage debt (interest cover), and capital structure were examined.

Debt

Over the reporting period, 16 of the 21 selected GTEs that returned equity increased their total amount of debt. For 11 of the 21 GTEs, the growth in debt was below the growth in the total value of debt in their sector.

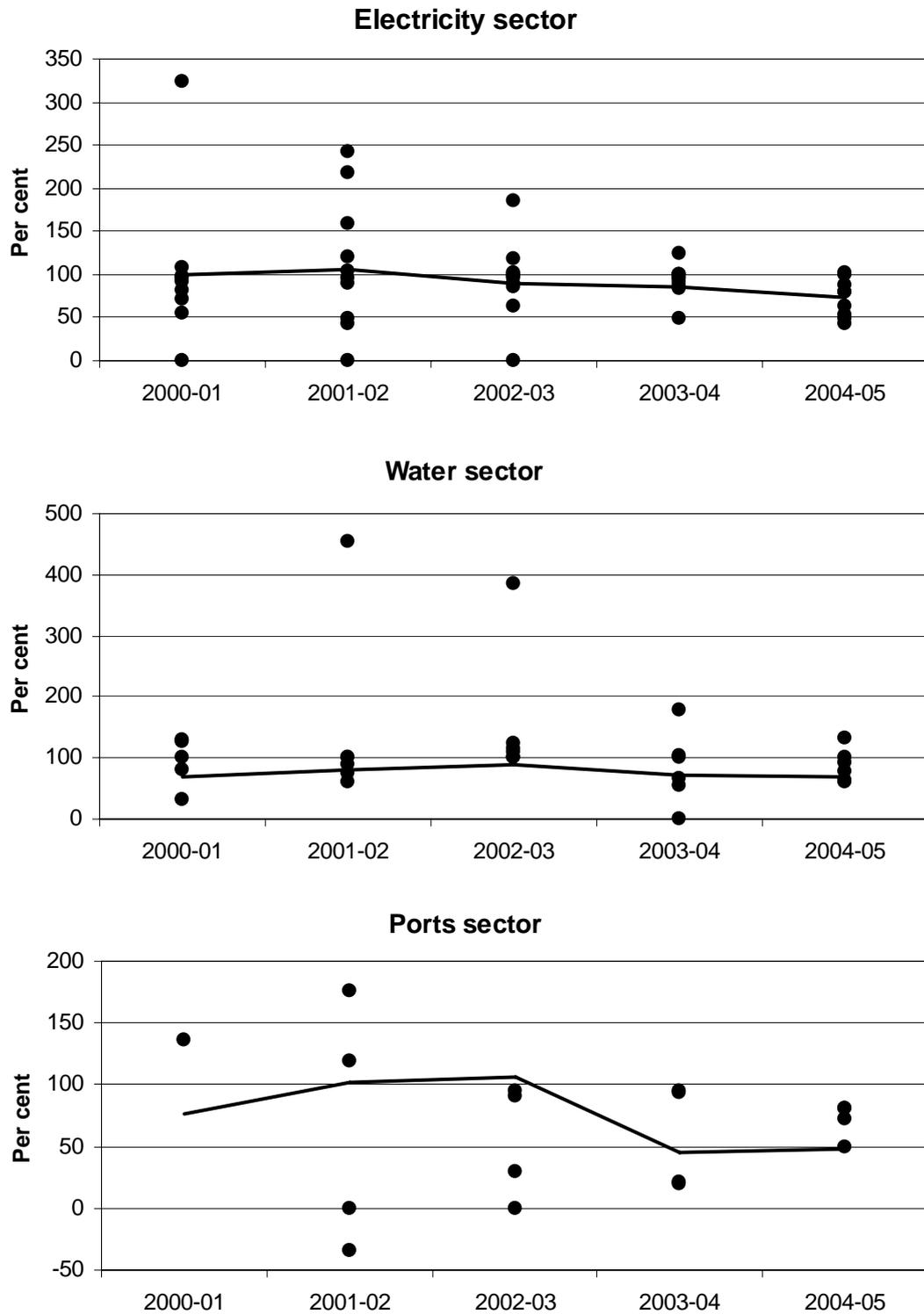
By 2004-05, the debt to equity ratios maintained by ten of the 21 selected GTEs were above the weighted average in their sector. The majority of these GTEs (six) were from the electricity sector. Three of the six electricity GTEs maintained a debt to equity ratio in excess of 100 per cent.

Interest cover

Interest cover is a measure of a GTE's capacity to meet the cost of its debt. It provides an indication of the GTE's capacity to maintain interest payments should interest rates increase or profits decline.

however, the nominal value of its dividend payments remained constant (between \$30 million and \$36 million over the reporting period).

Figure 5.2 Dividend payout ratios by sector — Selected GTEs



Note: The dots represent the dividend payout ratios of GTEs that returned equity during the reporting period. The solid line represents the sector's weighted average dividend payout ratio (for GTEs that operated for the entire reporting period). The number of monitored GTEs varies between years.

Source: Productivity Commission estimates.

Over the reporting period, 16 of the 21 selected GTEs improved their capacity to meet the cost of their debt. Of these, 13 increased their capacity to meet interest costs by more than the growth in the weighted average for their sector.

Of the five selected GTEs that reduced interest cover, four maintained interest cover in 2004-05 above the weighted average for all 53 GTEs monitored over the entire reporting period (3.5 times). The fifth, Central Queensland Port Authority, could cover its interest costs by 2.7 times. This indicates that the GTEs that have had equity withdrawn maintained their capacity to cover their borrowing costs.

In 2004-05, 13 of the 21 selected GTEs maintained an interest cover ratio in excess of the weighted average in their sector. However, only 8 GTEs maintained interest cover above the weighted average for all 53 GTEs monitored over the entire reporting period (figure 5.3).

Only two of the 11 selected electricity GTEs maintained a level of interest cover above 3.5 times. This reflects the higher debt financing of electricity GTEs relative to those in the other monitored sectors.

Gearing

As a number of equity withdrawals were justified on the grounds of aligning the capital structure of a GTE with those of other businesses in the sector or with private sector levels, the gearing ratio of GTEs following equity withdrawals was examined.²³ For a more detailed exposition on capital management and gearing ratios see chapter 4.

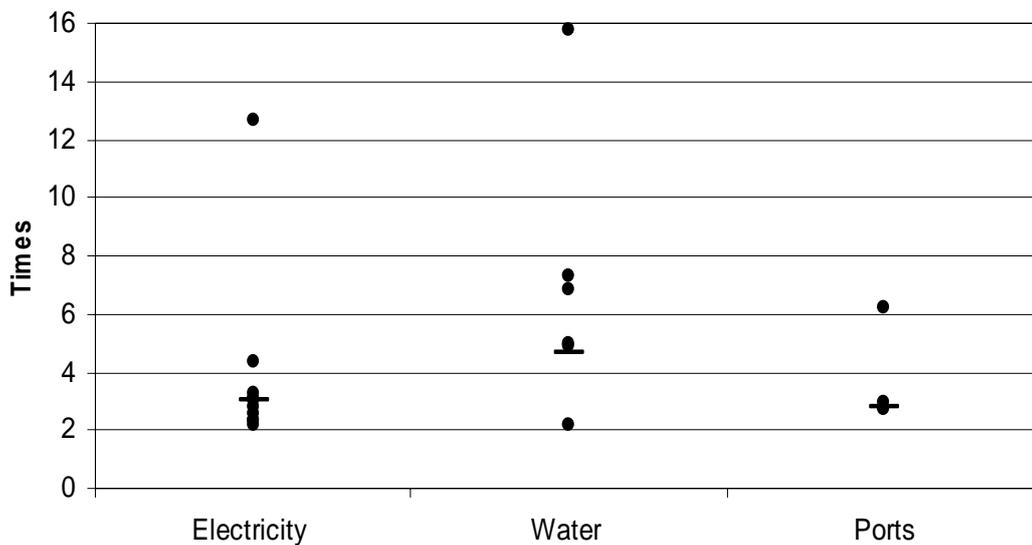
Over the reporting period, nine of the 21 selected GTEs reduced their gearing ratio. The number maintaining a gearing ratio above their sector's average remained fairly constant.²⁴ The gearing ratios of the selected GTEs are compared to their sector weighted average gearing ratio in figure 5.3.

Trends in the weighted average gearing ratio vary between the sectors. The weighted average gearing ratio increased in the water sector, but fell in the electricity and ports sectors over the reporting period. The gearing ratios of the selected GTEs have generally tracked the trend in their sector's weighted average.

²³ The gearing ratio is calculated by dividing total debt by total debt plus total equity.

²⁴ As previously noted, 15 of the 21 selected GTEs were monitored in 2000-01. Of these 15, nine GTEs (60 per cent) maintained a gearing ratio above their sector's weighted average in 2000-01. By 2004-05, 12 of the 21 selected GTEs (57 per cent) maintained gearing ratios above their sector's average.

Figure 5.3 Interest cover — selected GTEs, 2004-05



Note: Interest cover is the ratio of EBIT to gross interest expense. The dots represent the 2004-05 interest cover of GTEs that returned equity over the reporting period. The lines represent the weighted averages for the sector.

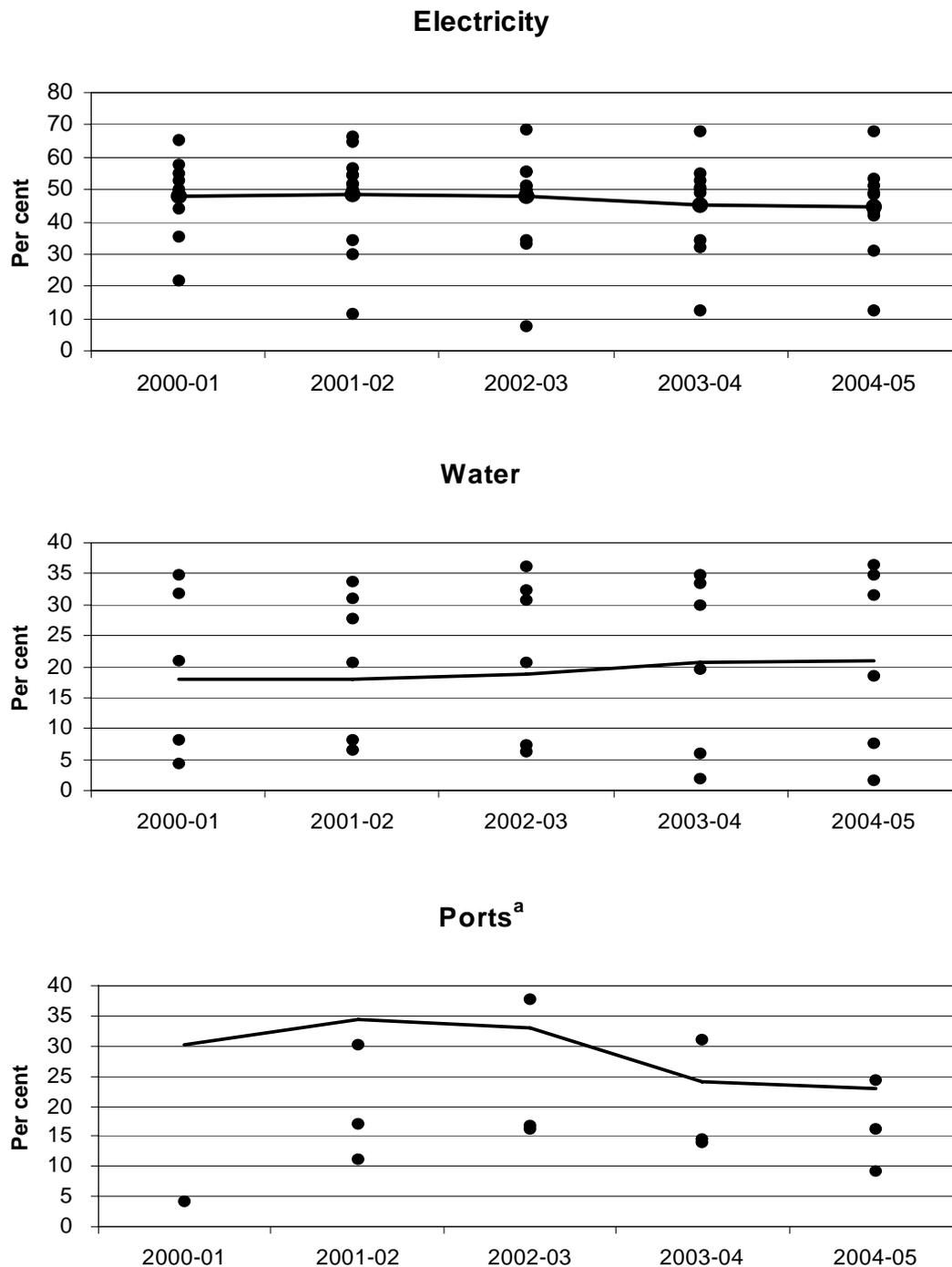
Source: Productivity Commission estimates.

By sector, the most significant movements in gearing ratios were:

- Electricity — Eraring Energy reduced its gearing ratio from 22 per cent to 13 per cent. HEC increased its gearing ratio from 35 per cent to 44 per cent, bringing it close to the weighted average for the sector (45 per cent).
- Water — Hunter Water almost doubled its gearing ratio, but at 7.5 per cent in 2004-05 it was well below the sector average. Esk Water almost eliminated debt over the reporting period.
- Ports — Central Queensland Port Authority increased its gearing ratio from 4.1 per cent to 24 per cent. However, it was as high as 37 per cent during the reporting period. The current level of gearing, which fell in the past year because of asset revaluations in 2003-04, is only marginally greater than the sector average and well below the weighted average gearing ratio for the 53 GTEs monitored for the entire reporting period. Ports Corporation of Queensland operated debt free.

Overall, the use of equity withdrawals does not appear to have significantly affected the capital structure of most GTEs involved.

Figure 5.4 Gearing ratio by sector — Selected GTEs



Note The gearing ratio is calculated by dividing total debt by total debt plus total equity. The dots represent the gearing ratios of GTEs that returned equity over the reporting period. The lines represent the weighted average gearing ratio of the sector (for GTEs that operated for the entire reporting period). ^a One GTE in the ports sector operated debt free during the reporting period.

Source: Productivity Commission estimates.

5.4 Comparisons with the private sector

A fundamental goal of corporatising government businesses was to promote efficiency by exposing them to pressures similar to those faced in the private sector. Accordingly, the motivations, extent and reporting requirements for returning equity to shareholders in the private sector are examined and compared to practices in the public sector.

Share buybacks

Private companies can return equity to shareholders via share ‘on-market’ and ‘off-market’ buybacks, capital returns and special dividends.²⁵ An ‘on market’ buyback is defined as ‘a listed corporation repurchasing shares on a prescribed financial market in the ordinary course of trading on that market’ (Section 9, *Corporations Act 2001*). In contrast, when a corporation makes an offer at an agreed price it is an ‘off-market’ share buyback.

Share buybacks are an increasingly common means of returning equity in the Australian private sector, particularly since the liberalisation of the governing regulations in 1995 (Mitchell and Watson 2004, Brown 2004). This is evidenced by the generally increasing trends in total (dollar) value and number of both ‘on-market’ and ‘off-market’ buybacks over the past fifteen years.²⁶ Possible motivations for share buybacks in the private sector are outlined in box 5.3.

Equity withdrawals from GTEs have characteristics similar to equal-access share buybacks both in the form of transaction and motivation. Key similarities are that the transaction is agreed between the parties (not reached through arbitrage) and there is little value for governments or GTEs signalling to the market.

²⁵ Off-market buybacks can take the form of an ‘equal-access’ repurchase, when an equal offer is made to all shareholders; a ‘selective’ repurchase, when the corporation repurchases shares from specified shareholders at the exclusion of others; a ‘minimum holding’ repurchase; or an acquisition for an employee share scheme (Brown and O’Day 2006).

²⁶ Between (calendar years) 1990 and 1995, 67 Australian companies engaged in share buybacks. Between 1996 and 2000, 358 companies engaged in share buybacks (Mitchell and Watson 2004). Between 2001 and 2005, 458 companies repurchased capital worth \$36 billion (RBA unpublished data, 2006).

Box 5.3 Motivations for share buybacks in the private sector

There are numerous reasons why a business may decide to reduce equity through a share buyback. Surveys also suggest that the motivation for the share buyback will influence the method used to complete the transaction.

In theory, a business may repurchase equity to:

- signal information — signal to the market that the prevailing share price undervalues the stock;
- reduce ‘free cash’ flow — return excess cash (that is, return any cash remaining after the business has exhausted investment options that have a positive net present value) to prevent wasteful investment by the company and provide investors with the capacity to use the capital more efficiently;
- leverage — change the debt to equity mix (capital structure) of the business;
- increase earnings per share — earnings per share can be increased by reducing the amount of tradeable equity and increasing (or at least maintaining) profitability following the buyback; and
- transfer wealth — if shares are undervalued when repurchased, the transaction effectively transfers wealth to ‘non-participating shareholders’ from ‘participating (selling) shareholders’.

Other explanations for engaging in share buybacks include, companies taking advantage of taxation arrangements, or buying back shares to provide employees with share options and therefore incentives for improving efficiency. These justifications are less relevant to this analysis because of governments’ ownership of GTEs.

A consistent finding of studies into what motivates managers of Australian businesses to undertake share buybacks is that on-market buybacks are used to signal that the stocks are undervalued. However, equal-access share buybacks are motivated by a desire to increase earnings per share, return excess cash and change (improve) the capital structure (Dharmawan et al. 1997; Hogan 2005; Mitchell and Watson 2004).

Since 1996, on-market share buybacks have been used by more businesses than off-market share buybacks. However, the dollar value of off-market share buybacks exceeded the dollar value of on-market repurchases (Brown 2004; Mitchell and Watson 2004;).

Source: Brown (2004); Dharmawan et al. (1997); Lamba and Ramsay (2000) Hogan (2005); Mitchell and Watson (2004);

Between 2001 and 2005, ‘off-market’ transactions were the dominant method of returning capital (by value) by the ASX 200 companies (Hogan 2005). Hogan attributed this to favourable interest rates and stockmarket conditions. Consequently, the decision of governments to engage in share buybacks for the purposes of changing capital structures is not inconsistent with private sector motivations over the reporting period.

Hogan also noted that while returning capital and increasing debt represents sound financial management during periods of low interest rates, there is an associated risk that the business might not have sufficient retained capital to manage investment should interest rates rise (or the sharemarket become more volatile). It is also possible that equity withdrawals may create a ‘wealth transfer’ between generations if governments do not appropriately invest revenue from equity withdrawals (use returns efficiently).

Conversely, appropriate equity withdrawals will enhance wealth because they allow governments to invest equity where it provides the greatest benefits to the community. This proposition is similar to the NSW Government’s view that it should manage the relationship with its businesses as if it were a holding company (box 5.4).

Box 5.4 Holding companies

The NSW Treasury (2002b) has pointed out that once capital structures have been determined, it should act like a holding company in managing its relationship with its GTEs. NSW Government’s guidelines note that in the private sector, holding companies will determine the best allocation of capital across the group, and may even require subsidiaries to remit cash on a daily basis.

To achieve the determined capital structure (and presumably alter the desired capital structure should circumstances change), it was noted that capital injections and withdrawals are appropriate means of initially achieving the agreed capital structure of GTEs.

Minimising the amount of ‘free cash’ that GTEs hold, both by withdrawing equity and by implementing the ‘modified residual approach’ for dividends, ensures that the Government can impose discipline on GTEs’ investment decisions (as a holding company would), and maximise wealth by distributing capital to projects that generate the optimal returns for the group.

Source: NSW Treasury (2002b).

Transparency

Transparency is fundamental to achieving good corporate governance of GTEs (PC 2005a). Yet, there is a vast difference between GTEs and publicly listed companies in the level of disclosure of transactions involving the return of equity.

Under the *Corporations Act 2001* (the Act) and the *ASX Listing Rules*, companies must disclose matters that are significant to investment decisions on a continuous basis. These rules capture all significant matters that occur with external parties or

within a group of companies. The Act also has additional reporting requirements associated with the return of capital. A summary of reporting requirements for equal-access share buybacks is provided in box 5.5.

Generally, the reporting of equity withdrawals from GTEs is limited in both the financial reports of individual GTEs and the budget papers of shareholder governments. For example, references to the equity withdrawals from City West Water and South East Water were limited to footnotes to the financial statements in of the GTEs' annual reports, and a paragraph in the Victorian State Budget Papers.

In 2002-03, Macquarie Generation returned contributed capital of \$400 million (equivalent to 25 per cent of its 2002-03 total equity). The 2002-03 Annual Report notes that this transaction formed part of a capital restructuring program. Also, there are no direct references to the equity withdrawal from Macquarie Generation in the 2002-03 or 2003-04 NSW Budget Papers.

In 2002-03, the Queensland Auditor General noted concerns regarding the manner in which special dividends from Energex were provided for and approved. Although the audit found that the payment from the asset revaluation reserve was legal and that due process was met, it was noted that greater documentation of dealings between the Government and its GTEs should be implemented (QAO 2003).

In contrast, when Origin Energy repurchased \$4.0 million worth (or 0.3 per cent) of ordinary shares in 2000-01, shareholders were informed of the plan at the annual general meeting, via written correspondence and the transaction was referred to throughout the 2000-01 Annual Report.

The directors of listed companies must comply with legal reporting requirements but also face incentives to inform shareholders about the value and reasons for on and off-market share buybacks. Directors need to ensure that shares are sold and that other financial objectives are met (for example, share prices increase).

Governments and GTEs do not face such financial incentives to disclose the same level of information to the community. However, the government, through the shareholding minister(s), is charged with managing the community 'owners' capital in GTEs in a manner that maximises the public interest.

Box 5.5 Legal requirements for companies engaging in equal-access share buybacks

An equal-access share buyback is defined as a transaction where all ordinary shareholders are offered a reasonable opportunity to buy back the same percentage of their ordinary shares.

The general test

Under the *Corporations Act 2001* (the Act), a company may buy back its own shares if:

- (a) the buyback does not materially prejudice the company's ability to pay its creditors; and
- (b) the company follows the procedures laid down in the Act.

This is a matter for directors to determine. However, under the Act, companies may not trade while insolvent.

Approval by shareholders

The requirements for share buybacks within the '10/12 limits' are less onerous than those over that limit. A company is within this limit if the share buyback involves 10 per cent or less of the total shares to be purchased within a twelve-month period (see subsections 257B(4) and 257B(5) of the *Corporations Act 2001*).

If a proposed share buyback is over the 10/12 limit, then it can only take place following passage of an ordinary resolution (passed with a simple majority vote of shareholders). If the proposed share buyback is within the 10/12 limit it does not require a resolution.

An equal-access buyback allows companies to devise their own timetable to suit their particular circumstances. The requirements on this are:

- a minimum of 14 days notice to shareholders and creditors must be given by lodging the buyback documents with Australian Securities and Investment Commission (ASIC);
- shareholders must receive a reasonable time to consider the buyback offer; and
- the buyback must be commenced and completed within a reasonable time of the notice being lodged with ASIC.

When a resolution is required, the company must provide an explanatory statement to shareholders at the meeting to seek approval of the buyback agreement. The statement must include 'all information known to the company that is material to the decision of how to vote on the resolution'. Further, ASIC has indicated that where a significant number of shares is involved, the statement should include advice from the independent director as to whether shareholders should vote in favour of the buyback, and an independent expert's report on the share valuation.

Source: ASIC 2006; Dwyer and Alston 2003.

As the community cannot withdraw its capital share, the importance of transparency (and accountability) in the treatment of transactions that are significant to the financial performance of the GTEs is increased. As shareholders, the community has the right to assess significant shareholder government decisions, through:

- *ex ante reporting* — which would provide the community with the government and GTE’s reasons for the transaction and the potential financial impacts;
- *transaction reporting* — which would provide information regarding the extent (value) and form of the transaction when it has been determined; and
- *ex post reporting* — which would outline the details of the transaction and any implications for the ongoing performance of the GTE (and broader implications for the state’s budget).²⁷

As noted in the previous year’s report, the publication of dividend policy statements and pre-agreed dividend payment targets are a means by which governments could address *ex ante* reporting, and provide the community with some means to assess the actions of shareholder government in their external governance of GTEs (PC 2005a).

Such reporting would allow the community to assess whether a government is acting in the public’s best interest in its dealings with a GTE. Such reporting would not place an unreasonable burden on either the GTE or shareholder government, and would be consistent with both aligning GTE reporting practices with the private sector, which is subject to continuous reporting requirements, and with principles of good corporate governance.

²⁷ This information would not necessarily be provided in the same document. For example, the GTE’s annual report could provide information on the implications of the withdrawal for that business and the state budget papers could provide information on the benefit to the state from the withdrawal.

PART B

6 Electricity

The financial performances of 21 electricity government trading enterprises (GTEs) are reported in this chapter. The GTEs vary significantly in size and the range of generation, transmission and distribution services they provide.

In 2004-05, these GTEs generated \$20 billion in revenue and controlled assets valued at \$55 billion. The group also returned just over \$2.1 billion to their respective owner-governments, through income tax-equivalent payments and dividends.

The majority (19) of the monitored GTEs operated in the National Electricity Market (NEM), a wholesale market for the supply and purchase of electricity. The two monitored GTEs not currently operating in the NEM are based in Western Australia and the Northern Territory. Tasmania entered the NEM on 29 May 2005 and began trading with other states when the Basslink interconnector became operational on 29 April 2006.

The overall performance of the electricity sector is presented in table 6.4 at the end of this overview. This is followed by performance summaries for each GTE. For a discussion of the data and the financial indicators used and some of the factors that should be considered when assessing performance, see chapter 3.

6.1 Monitored GTEs

The types of activities undertaken by the individual electricity GTEs and their involvement in ancillary services should be taken into account when comparing financial performances.

The four principal activities carried out by electricity businesses are: generation of electricity; the transmission of electricity at high voltages; the distribution of electricity at low voltages; and the retailing of electricity to customers. Of the 21 GTEs monitored, nine solely generated electricity, three transmitted electricity, six were distributors of electricity and provided retail services, and one solely traded in power supplied from privately-owned generators (table 6.1).

Table 6.1 Activities — electricity GTEs, 2004-05

<i>Electricity GTE</i>	<i>Activities</i>			
	<i>Generation</i>	<i>Transmission</i>	<i>Distribution</i>	<i>Retail</i>
<i>New South Wales</i>				
Eraring Energy	✓	X	X	X
Delta Electricity	✓	X	X	X
Macquarie Generation	✓	X	X	X
Transgrid	X	✓	X	X
Australian Inland	X	X	✓	✓
EnergyAustralia	X	✓	✓	✓
Integral Energy	X	X	✓	✓
Country Energy	X	X	✓	✓
<i>New South Wales, Victoria, Australian Government</i>				
Snowy Hydro	✓	X	X	X
<i>Queensland</i>				
CS Energy	✓	X	X	X
Stanwell Corporation	✓	X	X	X
Tarong Energy	✓	X	X	X
Enertrade ^a	✓	X	X	X
Powerlink	X	✓	X	X
Ergon	X	X	✓	✓
ENERGEX	X	X	✓	✓
<i>Western Australia</i>				
Western Power Corporation	✓	✓	✓	✓
<i>Tasmania</i>				
Hydro-Electric Corporation	✓	X	X	✓
Transend	X	✓	X	X
Aurora	X	X	✓	✓
<i>Northern Territory</i>				
Power and Water Corporation	✓	✓	✓	✓

^a Enertrade trades power from privately-owned generators into the National Electricity Market.

In 2004-05, Western Power (Western Australia) and Power and Water Corporation (Northern Territory) were the only fully integrated electricity utilities monitored — providing generation, transmission, distribution and retail services. The WA Government has recently announced that Western Power will be disaggregated into separate generation, retailing, and distribution/transmission entities (summarised in section 6.2).

In addition to providing generation, transmission, distribution or retailing services and combinations thereof, many electricity GTEs are involved in engineering

consulting services. In 2004-05, seven of the monitored GTEs also supplied gas, and two — Australian Inland and Power and Water Corporation — were involved in supplying water.

The number of GTEs monitored has changed over the reporting period (table 6.2). During 2004-05, however, there were no changes.

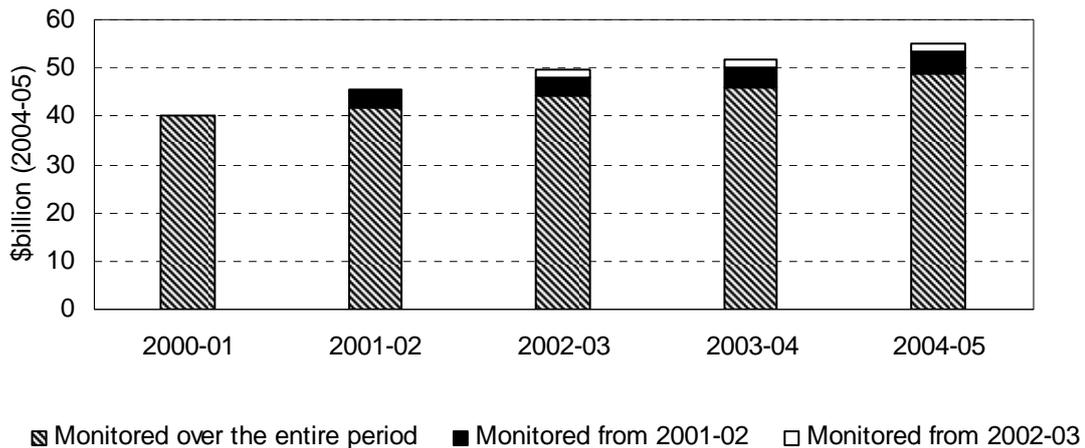
Table 6.2 Changes to monitored electricity GTEs, 2000-01 to 2004-05

<i>Period</i>	<i>Number monitored</i>	<i>Included</i>	<i>Excluded</i>
2000-01	23		
2001-02	21	Power and Water Authority, Country Energy ^a	Pacific Power, NorthPower, Advance Energy, Great Southern Energy
2002-03	21	Snowy Hydro	Snowy Mountain Hydro-Electric Authority
2003-04	21		
2004-05	21		

^a Country Energy was formed from a merger of NorthPower, Advance Energy and Great Southern Energy.

Over the reporting period, the total asset base for the monitored electricity GTEs rose in real terms from \$40 billion in 2000-01, to more than \$55 billion in 2004-05 (figure 6.1). GTEs monitored for less than the full reporting period accounted for approximately \$6 billion of this \$15 billion increase.

Figure 6.1 Sector assets — electricity GTEs, 2000-01 to 2004-05



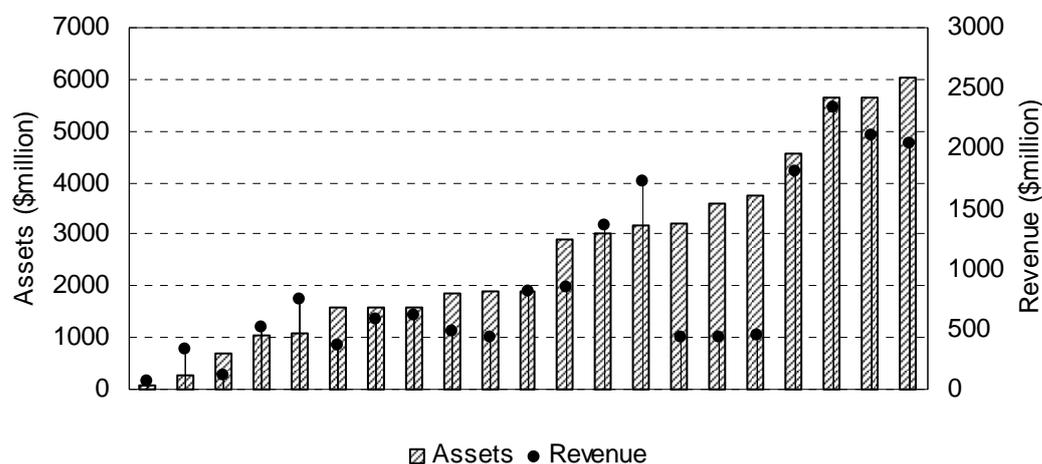
Note The value of sector assets prior to 2004-05 was converted to 2004-05 dollars using the implicit price deflator — Gross Fixed Capital Formation of Public Corporations (chapter 3).

Sources: Productivity Commission estimates.

Among electricity GTEs, the asset base of distribution GTEs grew the most in the real terms, increasing by more than \$8.0 billion over the reporting period. More than \$2.0 billion of this increase was due to the inclusion of Country Energy, first monitored in 2001-02. The value of total generation assets increased \$3.7 billion from \$16.5 billion to \$20.2 billion, of which Snowy Hydro, the GTE not included at the beginning of the period, accounted for a significant proportion (\$2.0 billion).

The size of the monitored electricity GTEs, in terms of the value of the assets controlled and revenue, varies (see figure 6.2). In 2004-05, the smallest in terms of asset value remained Australian Inland (\$164 million) and the largest was EnergyAustralia (\$6.0 billion).

Figure 6.2 **Assets and revenue — electricity GTEs, 2004-05**



Source: Productivity Commission estimates.

Structural reform

The Australian electricity supply industry originally developed on a state-by-state basis, with vertically integrated, government-owned utilities. The major driver for structural reform in the electricity industry during the 1990s was a series of inter-governmental reforms, culminating in the National Competition Policy (NCP) agreements, aimed at establishing the competitive NEM.¹ The intention behind

¹ In July 1991, governments agreed to work co-operatively to improve competitiveness in the electricity industry and the National Grid Council was established. In June 1993, six governments (Australian, NSW, Victoria, Queensland, SA and the ACT) committed to undertake reforms to establish a competitive electricity market from July 1995. At the

structural change within the electricity supply industry was to introduce competition in the generation and retail sectors by separating these competitive elements from the natural monopoly elements of transmission and distribution.²

In New South Wales, the assets of Pacific Power were successively broken up and restructured during the mid 1990s, resulting in the creation of the three separate generation businesses that are currently in operation. In distribution, 25 electricity distributors were amalgamated in 1995 to form six distribution businesses, three of which were subsequently merged in 2001 to form four distribution GTEs.³

A similar program of reform was undertaken in Queensland during the late 1990s. The assets of AUSTA Electric were used to form three generation businesses in July 1997. Around the same time, two retail GTEs were established as subsidiaries of regional distribution companies that had previously been part of the Queensland Transmission and Supply Corporation (QTSC). The transmission business of the QTSC was established as a separate corporation trading as Powerlink, along with a fourth generation GTE subsequently renamed Enertrade.⁴

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

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

No electricity GTEs exist in Victoria or South Australia as the supply of electricity was completely privatised in these states during the mid 1990s. In South Australia, electricity GTEs were progressively restructured and their assets sold or transferred

April 1995 Council of Australian Governments meeting, these reforms were extended and brought within the NCP process.

- 2 An industry is considered to be a natural monopoly if total costs of production are lower when a single firm produces the entire industry output, than when two or more firms produce the same output. It is generally accepted that electricity transmission and distribution networks exhibit natural monopoly characteristics.
- 3 Australian Inland was subsequently merged with Country Energy on 1 July 2005, which leaves three distribution businesses in total in New South Wales.
- 4 The Queensland Power Trading Corporation (QPTC) was established to assist in the transition to the new industry structure by finalising a range of financial and administrative matters arising from the restructure of the QTSC. The QPTC was also involved in trading electricity generated by a number of private sector generators. Although originally established as a transitional body, the QPTC became Queensland's fourth generation GTE in June 1999 and was renamed Enertrade.

under long-term leases to the private sector in 1999 and 2000.

In the ACT, the government-owned ACTEW Corporation Limited (ACTEW) and joint venture partner AGL, provide electricity distribution and retailing services. This public-private joint venture, ActewAGL Distribution, owns and operates the electricity distribution network in the ACT, while retailing is performed by the partnership ActewAGL Retail. Since most of ACTEW's consolidated assets and revenue are associated with the provision of water services, its financial performance is discussed in chapter 7.

6.2 Market environment

Governments have introduced reforms aimed at improving the efficiency and financial performances of electricity GTEs. The reforms have focused on the governance of GTEs, the efficiency of the production process and the competitiveness of market structures in which the GTEs operate. These reforms have implications for the financial performances of GTEs and the comparison of performances over time.

The National Electricity Market

Over the reporting period, the most significant change to the market environment was the continued development of the NEM and its associated regulatory structures, along with the introduction of user choice of electricity supplier in each jurisdiction.

The National Electricity Market Management Company (NEMMCO) manages the NEM, in accordance with the National Electricity Rules (formerly known as the Electricity Code). The NEM officially commenced operating in December 1998, although trade between the New South Wales and Victorian wholesale markets commenced in May 1997.

Tasmania is the most recent entrant to the NEM, placing management of its system under the control of NEMMCO on 29 May 2005. Active participation in the NEM began on 29 April 2006, when the Basslink interconnector became fully operational.

Although Western Australia and the Northern Territory are not party to the NEM, both jurisdictions have introduced (under commitments to NCP) choice in electricity supplier for large users of electricity. In addition, the *Electricity*

Corporation Act 1994 (WA) and Electricity Networks (Third Party Access Act (NT) provide for third-party access to the respective electricity transmission networks.⁵

The WA Government announced in December 2005 that the vertical disaggregation of Western Power would take place from 1 April 2006. Western Power has been successfully split into four independent corporations: Verve Energy (generation), Western Power (distribution and transmission), Synergy (retail) and Horizon Power (integrated regional provider)

The WA wholesale market is due to commence operation in July 2006. Market Rules governing the wholesale market were established on 1 October 2004, with a statutory corporation, the Independent Market Operator (responsible for administration and operation of the market) subsequently established on 1 December 2004.

These changes and the development of the NEM have a number of implications for GTE performance. Transmission and distribution businesses face greater regulatory scrutiny. Further, most electricity generation and retailer GTEs now face greater competition than they experienced in the past. Competition has also been facilitated in most jurisdictions by the adoption of the access provisions for distribution and transmission networks. These provisions give retailers and businesses purchasing wholesale electricity a right of access to these networks.

Recent developments in the NEM

Recent developments relating to the efficiency and competitiveness of the NEM affect the environment in which the GTEs operate. While difficult to measure at this time, recent and prospective changes in the operation of the NEM are likely to impact on the financial performances of GTEs (box 6.1).

Moves within the energy industry toward integration of generators and retailers recently, may also affect efficiency and competitiveness in the NEM. In response to businesses seeking to merge generation and retail, the ACCC has argued that this type of merger can be beneficial because of improved risk management and that it is not necessarily anti-competitive (Willet 2005a, b). Consequently, the ACCC does not currently have an objection per se to such vertical integration and some further merger activity can be expected.

⁵ Following the departure in 2001-02 of NT Power from the Northern Territory market, Power and Water Corporation is the only supplier of electricity to the vast majority of Territorians.

Box 6.1 Recent developments in the NEM

- The Council of Australian Governments (CoAG) Energy Market Review in 2002 (the Parer review) identified a number of impediments to competitive and efficient energy markets in Australia. Parer recommended new reforms to address the following problems:

- deficient governance and regulatory arrangements;
- insufficient competition in electricity generation; and
- inflexible electricity price signals for residential customers.

- In June 2004, Australian governments signed the Australian Energy Market Agreement, giving effect to the recommendations of the Ministerial Council on Energy (MCE) that stemmed from the Parer Review. The agreement includes (among other things) the creation of the Australian Energy Market Commission (AEMC) with responsibility for rule making and market development, and the Australian Energy Regulator (AER) with responsibility for market regulation (other than retail pricing) and enforcement.

After being established on 1 July 2005, the AER has taken responsibility for the economic regulation of transmission networks in the NEM. The AER will assume responsibility for the economic regulation (other than retail pricing) of the gas and electricity distribution networks in the NEM from 1 January 2007.

- Transmission capacity constraints were identified by the Parer Review as an impediment to improved competition in the NEM. The MCE recommended in December 2003 that the Regulatory Test applied by the AER to new transmission and distribution investment be revised to include the economic benefits of increased competition. The AER released a final decision on the review of the regulatory test in August 2004, which now provides for the specific inclusion of competition benefits and the appropriate definition to be used under the test.
- Parer also noted that muted price signals for electricity users tend to inhibit the development of demand management and full retail contestability in the NEM. In the context of improving energy efficiency, the Commission has recommended any roll out of 'smart metering' be subject to a comprehensive cost-benefit analysis (PC 2005d). The February CoAG 2006 communiqué commits governments to the progressive roll-out of 'smart metering' technology from 2007 where the benefits outweigh the costs for residential users.

Source: CoAG (2002; 2006), PC (2005d).

Price and environmental regulation

Most of the monitored electricity GTEs operate under some form of price regulation. The various state and national regulators and the GTEs affected are summarised in table 6.3.

In January 2001, the NSW Government commenced operation of the Electricity Tariff Equalisation Fund (EETF) to reduce the market risk faced by retail suppliers of electricity (NSW Treasury 2000).⁶ The EETF is designed to offer regulatory price protection to retail customers (who purchase less than 160 MWh per annum), while ensuring that suppliers are not exposed to unacceptable financial risk. Essentially the EETF operates to insulate NSW retailers and their customers from price movements in the NEM.⁷

All GTEs are subject to some form of environmental regulation. On 8 December 2000, the Commonwealth Parliament passed the *Renewable Energy (Electricity) Act 2000*, which established a 2 per cent renewable energy target for electricity supply in Australia. From 1 April 2001, all energy wholesalers have had to purchase increasing amounts of electricity generated from renewable sources. Most electricity generation GTEs are pursuing investment opportunities, including wind and solar power, to meet this target and also to satisfy consumer demand for 'green' energy.

6.3 Profitability

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

The majority of monitored electricity GTEs made operating profits throughout the reporting period. However, Australian Inland reported an operating loss in 2004-05, mainly attributable to increased expenses associated with its pending merger with Country Energy.

⁶ The Parer review recommended that the NSW Government should abolish the Electricity Tariff Equalisation Fund. However, the NSW Government retained the EETF for the suppliers of small, regulated retail customers (ACCC 2004, NSW Treasury 2005).

⁷ When the market price of electricity is higher than the energy cost component that retailers may recover from regulated customers, retailers withdraw the difference from the EETF, enabling them to earn a commercial return while selling at the regulated tariff. If the market price is lower, then retailers pay the difference into the fund. If the fund slips into deficit, then NSW government-owned generators are required to pay into the fund to ensure it is in balance.

Table 6.3 Current economic regulation of electricity GTEs

<i>Jurisdictional regulators</i>	<i>Regulated GTEs</i>
Distribution and retailing	
NSW – Independent Pricing and Regulatory Tribunal (IPART), Full Retail Contestability (FRC)	
<ul style="list-style-type: none"> • IPART sets Regulated Retail Tariffs for customers using <160 MWh • Tariff regulation is transitional pending development of effective retail competition (in force until June 2007). • IPART sets a revenue cap and regulates access arrangements to distribution networks as jurisdictional economic regulator under National Electricity Rules (NER). 	EnergyAustralia, Integral Energy, Country Energy, and Australian Inland (merged with Country as at 1 July 2005)
QLD – Queensland Competition Authority (QCA), FRC in July 2007	
<ul style="list-style-type: none"> • On delegation from Minister, QCA determines retail prices for non-contestable franchise customers (<100 MWh). • QCA sets a revenue cap and regulates access arrangements to distribution networks as jurisdictional economic regulator under National Electricity Rules (NER). 	Ergon, Energex
TAS – Office of the Tasmanian Energy Regulator (OTER), FRC in 2010	
<ul style="list-style-type: none"> • OTER sets retail revenue cap and performs prices oversight. 	Aurora
NT – Utilities Commission (UC), FRC	
<ul style="list-style-type: none"> • Retail prices for non-contestable customers <750 MWh subject to Treasurer's pricing order until competitive entry from other retailers. • Tranche 4 customers between 750 MWh and 2 GWh also subject to Treasurer's pricing order. • Revenue cap set by Utilities Commission on the transmission and distribution assets of Power and Water. 	Power and Water
WA – Economic Regulation Authority (ERA), FRC	
<ul style="list-style-type: none"> • Retail price cap for non-contestable customers <50 MWh, set by the Minister for Energy (uniform tariff across regions). • FRC delayed until sufficient competition develops in generation and wholesale markets. • Minister for Energy directed Western Power to cap generation capacity at 3000 MW to reduce generation market dominance. • The EAR sets a revenue cap and regulates access arrangements for both distribution and transmission networks. 	Western Power
Transmission	
All States excluding WA and NT - Australian Energy Regulator	
<ul style="list-style-type: none"> • Sets revenue caps on all transmission networks within the NEM. 	Transend (TAS), EnergyAustralia (NSW), Transgrid (NSW), and Powerlink (QLD)

Sources: IPART (2006); QCA (2006); OTER (2006); UC (2006); ERA (2006); AER (2006).

Enertrade also reported operating losses, however these have spanned most of the reporting period. Enertrade's losses were primarily due to contracts entered into prior to the commencement of the NEM. The conditions of Enertrade's purchase contracts (power-purchase agreements) — the longest of which is for 35 years — are expected to continue resulting in significant losses (Enertrade 2005).

The electricity sector as a whole has experienced substantial increases in profits since the beginning of the reporting period, with profits growing by 68 per cent in real terms (\$1.1 billion) from \$1.5 billion in 2000-01, to more than \$2.6 billion in 2004-05. For those GTEs monitored over the entire reporting period, the growth was \$678 million (43 per cent).⁸

This increase in profits is evenly attributable to the distribution and generation GTEs. The distribution GTEs experienced a collective increase in profits of 40 per cent (\$201 million) in real terms between 2000-01 and 2004-05. Generation and integrated GTEs contributed \$208 million (20 per cent) for the reporting period. The transmission GTEs experienced profit growth of \$180 million between 2000-01 and 2004-05.⁹

Over the reporting period, most electricity GTEs recovered between 100 and 150 per cent of operating costs (figure 6.4). Cost recovery is a measure of the ability of a GTE to generate adequate revenue to meet expenses. A cost recovery ratio below 100 per cent suggests that a GTE was unable to meet its operating costs even before the cost of servicing debt is taken into account.

In 2004-05, three of the five highest cost recovery ratios were recorded by transmission GTEs, with TransGrid, Powerlink and Transend all recording cost recovery ratios of over 160 per cent. Snowy Hydro recorded the highest cost recovery ratio, of almost 220 per cent, for the year.

Distribution GTEs, as a group, recorded the lowest average cost recovery ratio of 112 per cent.

⁸ In their first year monitored, Country Energy and Power and Water Corporation in 2001-02 and Snowy Hydro in 2002-03 together added \$232 million of the \$1.1 billion increase in sector profits. The subsequent profit growth of these GTEs forms part of the remaining \$847 million increase in sector profits throughout the reporting period.

⁹ The transmission GTE, TransGrid, reported a loss of \$81 million in 2000-01 that was excluded from this calculation. The loss was largely attributable to debt restructuring conducted during that year. Transgrid returned to profit in the following year and posted average profits of \$93 million per year over the remainder of the reporting period.

The return on assets for electricity GTEs as a whole fell slightly over the reporting period. Among those GTEs that have reported over the entire period, the average return on assets improved from 7.7 per cent to 10 per cent. However, the returns on assets for different groups of electricity GTEs, and individual GTEs within those groups, are quite diverse (figure 6.5). To some extent, their variability reflects the influence of restructuring expenses, asset revaluations and the continuing development of the NEM. For example, the opening up of interconnectors and the introduction of retail contestability have affected the operating results of individual GTEs at different times during the reporting period.

The variation of profitability within the sector is also reflected in the return on equity ratio. That ratio, for the sector as a whole, fell over the reporting period although this trend may have stabilised between 2003-04 and 2004-05. Individually, most of the monitored electricity GTEs have experienced variable returns on equity ratios over the reporting period.

It appears that several electricity GTEs are not achieving a sufficient return on their assets when compared to benchmark returns recommended by regulatory agencies. The Independent Pricing and Regulatory Tribunal (IPART) suggested that a nominal pre-tax return of 8.5 per cent on assets would be appropriate for electricity GTEs, taking into account the risks faced by entities operating in the sector (IPART 1998). Similarly, the Queensland Competition Authority has recommended returns for its distribution GTEs of 8.1 per cent (QCA 2001).

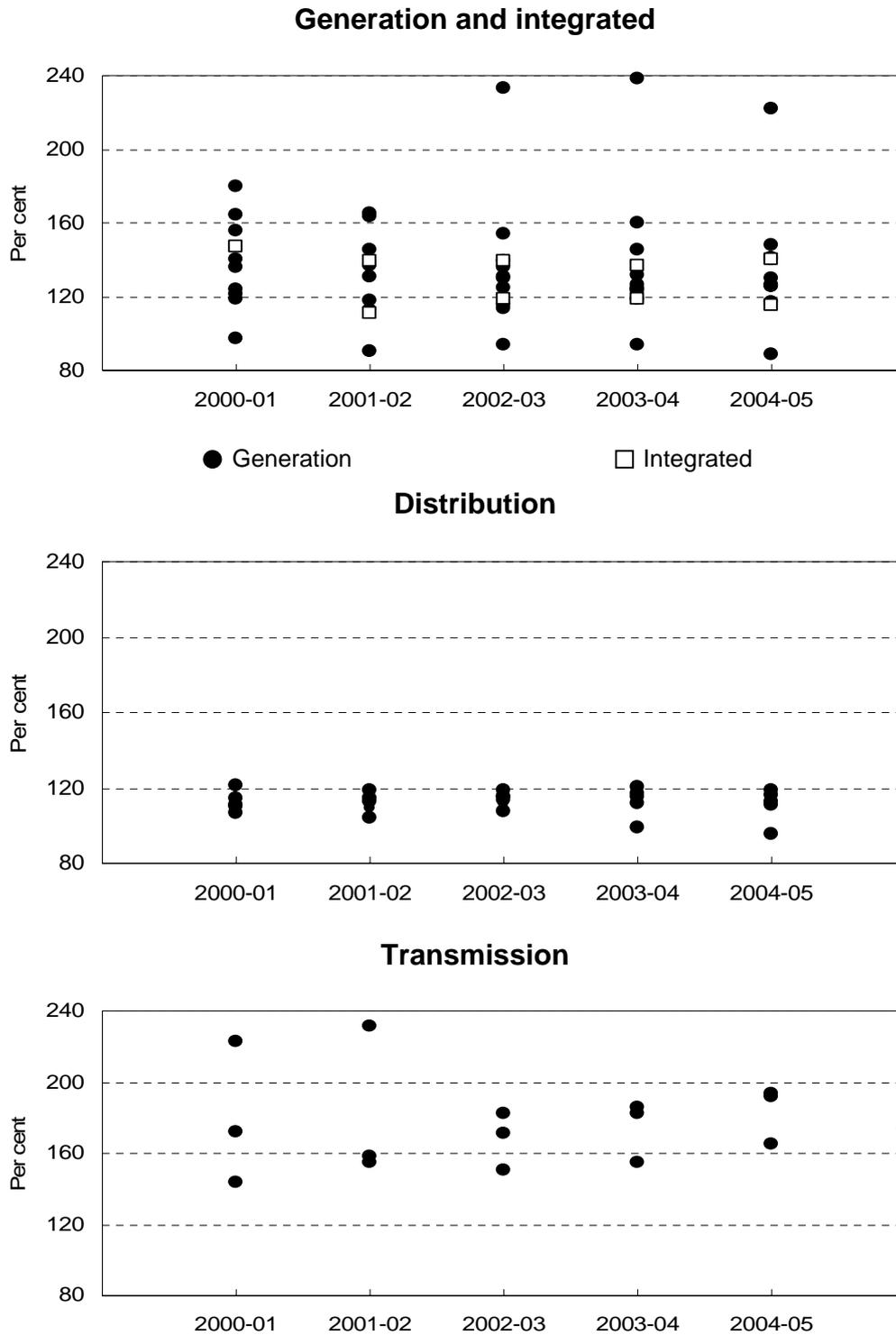
In 2004-05, only eight of the 21 monitored GTEs achieved a return on assets in excess of 8 per cent. Of the remaining 16 electricity GTEs, six failed to achieve the risk-free rate of 5.42 per cent (that is, the ten year government bond rate). The median rate of return was 7.3 per cent.

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.

Governments have, on occasion, imposed financial restructuring on their electricity GTEs. This has generally involved the transfer of both assets and liabilities to the state and territory governments, and the withdrawal of equity. Financial restructuring adds to the difficulty of comparing financial performances over time.

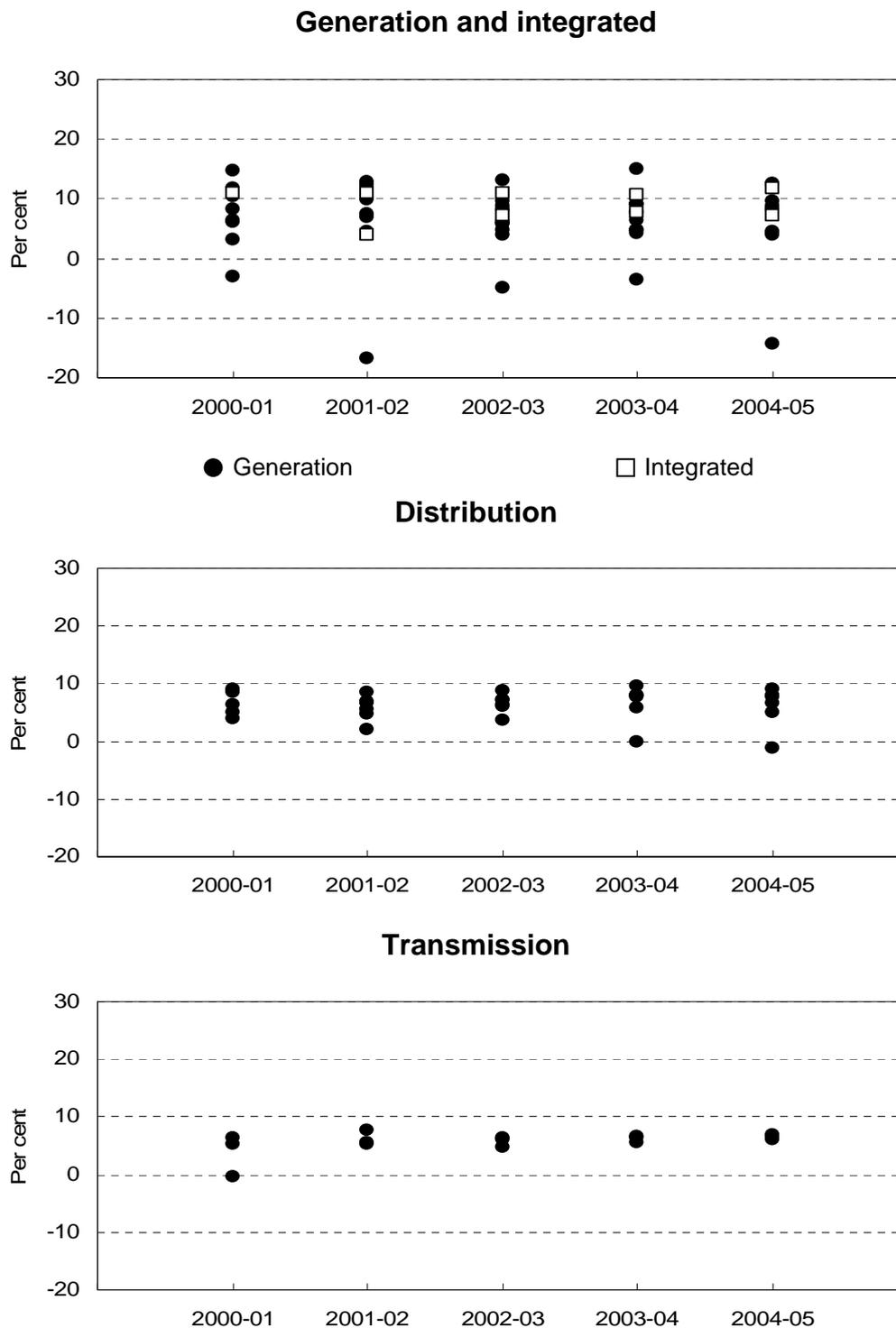
Figure 6.4 Cost recovery — electricity GTEs, 2000-01 to 2004-05



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 investment income and receipts from governments to cover deficits from total revenue. Expenses from operations is calculated by subtracting gross interest expense from total expenses.

Source: Productivity Commission estimates.

Figure 6.5 Return on assets — electricity GTEs, 2000-01 to 2004-05



Note 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 is the average of the value of assets at the beginning and end of each financial year. Where an average could not be estimated, the value of total assets at the end of the financial year was used.

Source: Productivity Commission estimates.

In New South Wales, more than \$5 billion in equity has been returned to the Government from electricity GTEs over the last decade. In 2000-01, \$3 billion in equity was returned from the New South Wales distribution GTEs — Delta Electricity, Macquarie Generation and TransGrid.

The GTEs generally increase their borrowings by a commensurate amount to pay for these transfers. Such transfers affect financial management indicators, including debt to equity, debt to total assets, interest cover and leverage ratios. For example, Eraring's debt increased by 79 per cent (\$71 million) in 2003-04 and by 10 per cent (\$16 million) in 2004-05, through non-cash equity to debt swaps conducted in each year. This has resulted in substantial increases in Eraring's debt to equity and debt to total assets ratios.

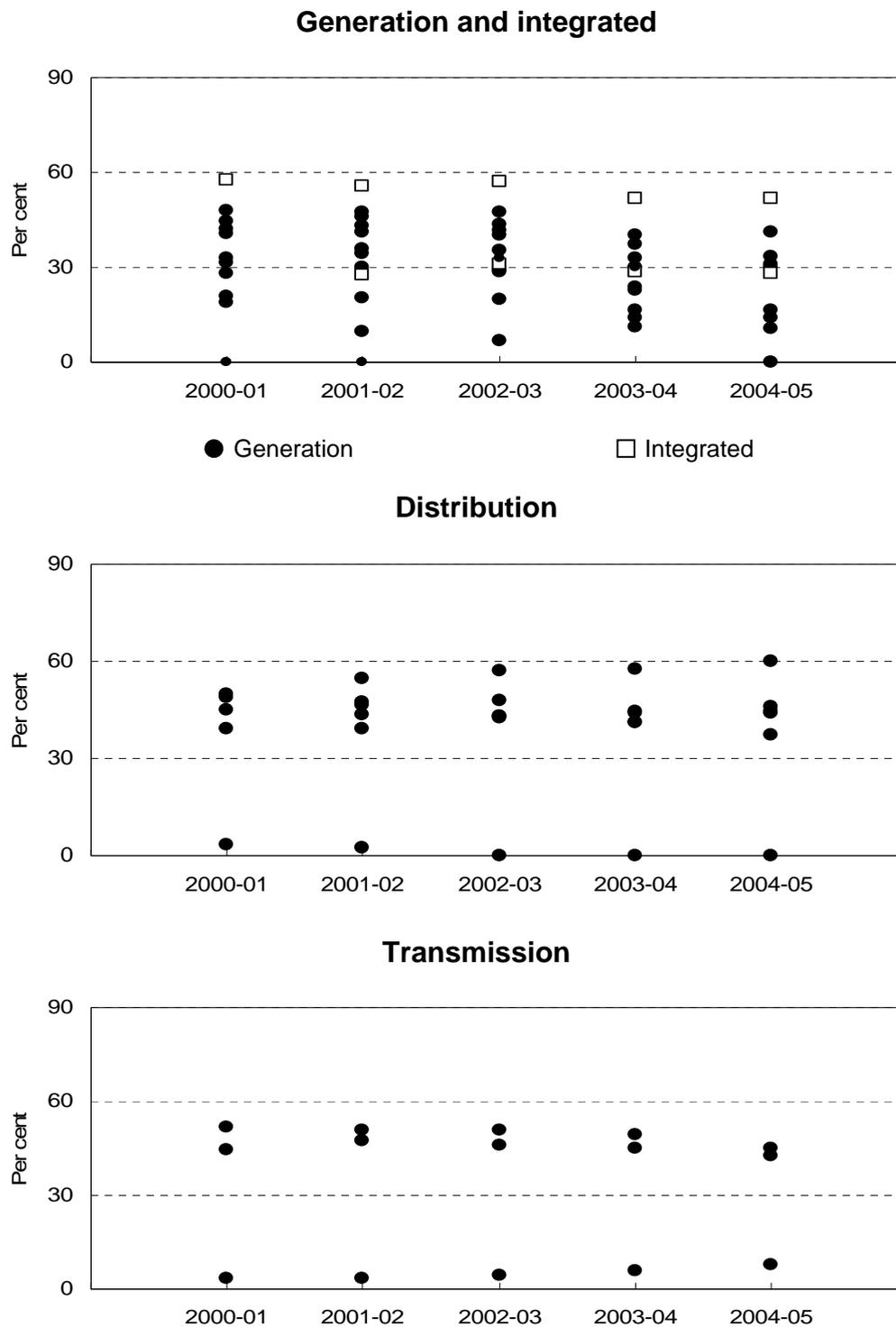
In Queensland, Powerlink has undertaken several capital restructurings since 1997 that have involved increasing debt levels. More recently, in 1999-00, an interest free loan of \$150 million was made to the Queensland Government (funded by an increase in Powerlink debt). In 2000-01, Powerlink finalised the transaction, converting the loan into an equity return by reducing the number of ordinary shares on issue by \$150 million.

A number of electricity GTEs have also reduced their debt levels through financial restructuring, which has allowed them to reduce borrowing costs. For example CS Energy's level of debt fell by 44 per cent (\$296 million) in 2003-04, facilitated by a \$260 million equity injection by the Queensland Government.

In 2004-05, the majority of electricity GTEs had debt to total asset ratios within the 30 to 60 per cent range (figure 6.6). The median debt to total assets ratio was just over 30 per cent for generation and integrated GTEs, with transmission and distribution GTEs both around 43 per cent.

In 2004-05, ten electricity GTEs had an interest cover of over three times. Only one GTE had negative interest cover. No other GTE had interest cover multiples of less than two. The margin insulating electricity GTEs from increases in interest rates or falling revenues appears to be slowly increasing for most GTEs. This suggests that in the future, these GTEs are more likely to be able to meet their debt repayment commitments out of current earnings.

Figure 6.6 Debt to total assets — electricity GTEs, 2000-01 to 2004-05



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. Average total assets is the average of the value of assets at the beginning and end of each financial year. Where an average was not available, the value of total assets at the end of the financial year was used.

Source: Productivity Commission estimates.

6.5 Financial transactions

Governments have increased the commercial focus of GTEs and facilitated 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 2.

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

Prior to 1999-00, tax-equivalent payments were based on a company tax rate of 36 per cent. Under tax-effect accounting, income tax-equivalent expenses for any year may differ from the actual amount of tax paid to the state and territory governments for that year because of permanent and timing differences. Changes in the company tax rate announced by the Australian Government in December 1999 led to the restatement of deferred tax liabilities in 1999-00.¹⁰

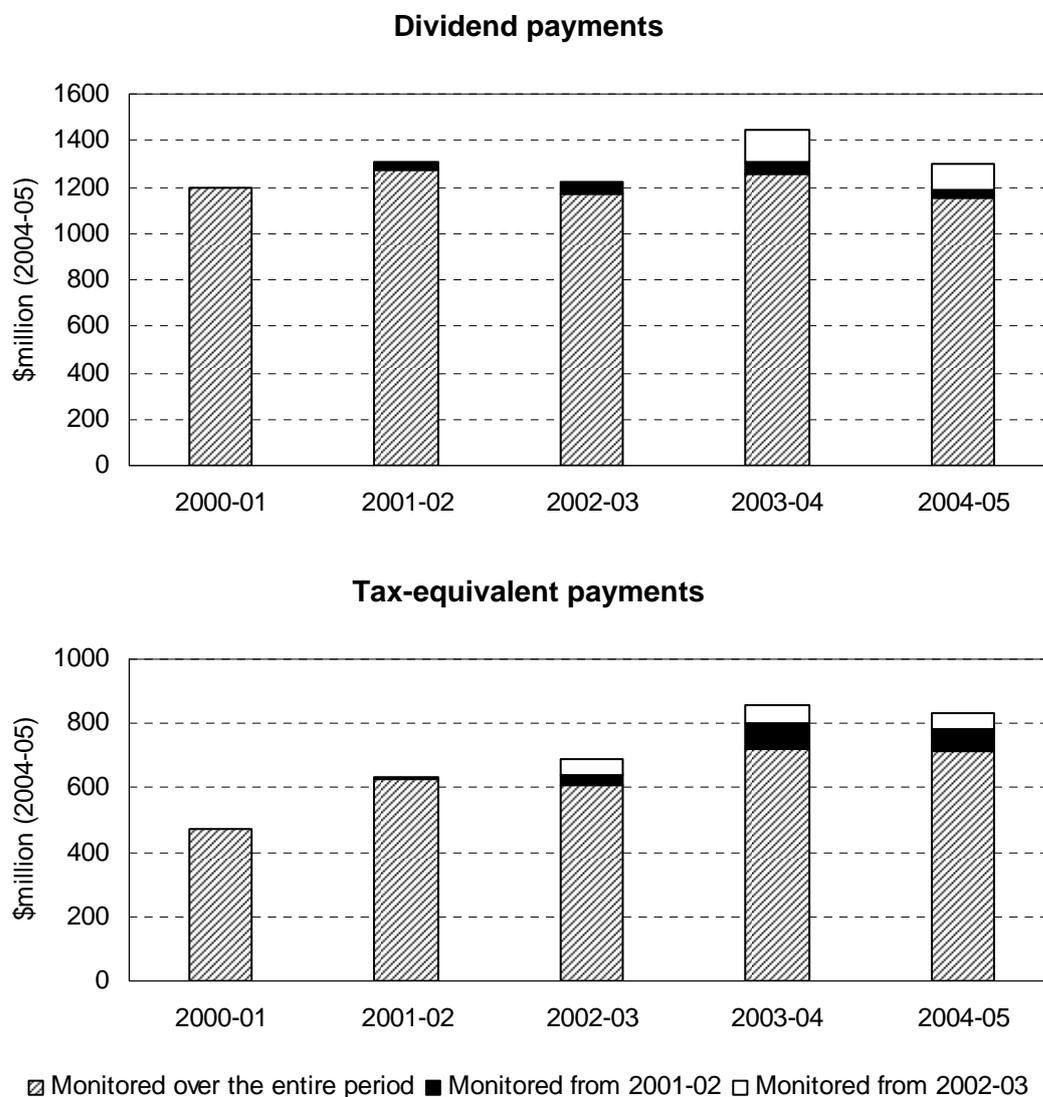
The number of electricity GTEs making tax-equivalent and dividend payments has been increasing over the reporting period and most now make such payments. The tax-equivalent and dividend payments received by owner-governments have increased on average with profit growth over the reporting period (figure 6.7).

Dividend payments represent a return on shareholder funds and their size reflects financial performance. In 2004-05, New South Wales electricity GTEs paid \$562 million in dividend payments, Queensland electricity GTEs returned \$435 million, while Western Australian and Tasmanian electricity GTEs returned \$104 million and \$68 million respectively. Power and Water Corporation returned \$20 million to the NT Government.

As part of the reform process, governments have also moved to identify, cost and fund the community service obligations (CSOs) that they imposed on electricity GTEs. CSO funding is received for the provision of rebates, concessions, the uneconomic supply of electricity to some customers and for electrical inspections.

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

Figure 6.7 **Dividend and income tax-equivalent payments — electricity GTEs, 2000-01 to 2004-05**



Note The value of dividends and tax-equivalent payments prior to 2004-05 were converted to 2004-05 dollars using the implicit price deflator — Gross Fixed Capital Formation of Public Corporations (chapter 3).

Source: Productivity Commission estimates.

In June 1999, Queensland introduced the Benchmark Pricing Agreement (BPA). The BPA is a negotiation between the Queensland Treasury and the Queensland retail GTEs — Energex and Ergon. Under the BPA, a retailer will receive a negotiated payment (CSO) if the regulated revenue from non-contestable customers is less than the cost of their energy purchases, including delivery charges. If this revenue exceeds expenses, then the GTE must pay a franchise surplus (or negative CSO) to the Queensland Treasury.

Several of the electricity GTEs received CSO funding over the reporting period. Generally, GTE retailers are subject to these CSOs, although there are some examples of CSOs being placed on generation GTEs.

In 2004-05, disclosed CSO payments to electricity GTEs amounted to over \$426 million. Approximately 73 per cent of total CSO payments were made to distribution GTEs.

ELECTRICITY

Table 6.4 Whole of sector performance indicators, 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	38 675	44 062	48 402	50 402	55 302
Total revenue	\$m	14 077	16 067	17 193	18 122	19 542
<i>Profitability</i>						
Operating profit before tax	\$m	1 639	1 827	2 012	2 547	2 616
Operating sales margin	%	19.0	18.1	18.9	20.9	24.2
Cost recovery	%	124.7	122.1	123.3	126.3	131.8
Return on assets	%	7.4	6.9	7.0	7.8	9.0
Return on equity	%	7.2	6.6	6.6	7.9	7.6
<i>Financial management</i>						
Debt to equity	%	91.5	95.2	93.3	83.9	83.6
Debt to total assets	%	42.0	41.7	41.5	38.3	38.5
Total liabilities to equity	%	128.9	133.2	131.1	123.9	127.1
Interest cover	times	2.5	2.6	2.6	3.0	2.2
Current ratio	%	77.5	77.8	71.7	71.3	72.5
Leverage ratio	%	228.9	233.2	231.1	223.8	227.1
<i>Payments to and from government</i>						
Dividends	\$m	1 162	1 277	1 079	1 402	1 257
Dividend to equity ratio	%	7.1	6.9	5.3	6.5	5.4
Dividend payout ratio	%	98.2	105.2	80.7	82.0	70.4
Income tax expense	\$m	456	614	674	837	831
CSO funding	\$m	306	391	398	403	426

6.6 GTE performance reports

Delta Electricity (NSW)

Macquarie Generation (NSW)

Eraring Energy (NSW)

TransGrid (NSW)

Australian Inland (NSW)

EnergyAustralia (NSW)

Integral Energy (NSW)

Country Energy (NSW)

CS Energy (Queensland)

Stanwell Corporation (Queensland)

Tarong Energy (Queensland)

Enertrade (Queensland)

Powerlink (Queensland)

Ergon Energy (Queensland)

Energex (Queensland)

Western Power (WA)

Hydro-Electric Corporation (Tasmania)

Aurora Energy (Tasmania)

Transend Networks (Tasmania)

Power and Water Corporation (NT)

Snowy Hydro (Australian Government)

Delta Electricity (Delta) was formed on 1 March 1996 as part of the NSW Government's restructure of the State's electricity industry. Delta operates under the *State Owned Corporations Act 1989* (SOC Act) and the *Energy Services Corporations Act 1995* (ESC Act).

Delta is an electricity generation corporation with a total capacity of 4240 MW. Delta has estimated that its production accounts for 12 per cent of total yearly supply in the National Electricity Market (NEM). While not facing direct price regulation, Delta is subject to the rules and conditions governing the NEM.

Delta recorded a pre-tax operating profit of \$180 million in 2004-05, which represents a 62 per cent increase on the previous year's operating profit of \$110 million. The result is primarily due to an 11 per cent increase in operating revenues from \$731 million in 2003-04 to \$814 million in 2004-05. Growth in operating expenses was contained at 3 per cent, increasing from \$620 million in 2003-04 to \$633 million in 2004-05. These changes were reflected in an improvement in Delta's operating sales margin from 24 per cent to 29 per cent.

The value of Delta's assets increased by \$15 million over 2004-05 to \$1.9 billion. The overall increase reflected growth in cash assets of \$20 million and other assets of \$10 million (construction works in progress). These amounts were offset by write downs in the value of property, plant and equipment totalling \$18 million.

A 10 per cent decline in Delta's debt from \$602 million to \$539 million brought about improvement in the generator's debt to equity and debt to total assets ratios. Delta's debt to equity ratio fell from 80 per cent to 72 per cent and debt to total assets declined from 33 per cent to 31 per cent. The associated reduction in interest expenses improved Delta's interest cover from 2.7 times to 4.4 times, which also improved as a result of the increased operating revenues.

Under the provisions of the SOC Act, Delta is required to make tax-equivalent and dividend payments. Dividend payments are made in accordance with the share dividend scheme, which is determined by the voting shareholders and as required by the ESC Act. In 2003-04, Delta provided for a \$120 million dividend payment — which represents 100 per cent of after-tax profit — and recorded an income tax-equivalent expense of \$57 million.

DELTA ELECTRICITY (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01 ^a	2001-02	2002-03 ^b	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	1 555	1 600	2 006	1 877	1 892
Total revenue	\$m	757	732	725	731	814
<i>Profitability</i>						
Operating profit before tax	\$'000	188 072	142 359	102 003	111 042	180 481
Operating sales margin	%	28.9	26.8	22.9	23.8	28.5
Cost recovery	%	140.6	136.6	129.7	131.2	139.8
Return on assets	%	14.8	12.7	9.5	9.1	12.4
Return on equity	%	23.2	24.3	10.3	9.3	15.4
<i>Financial management</i>						
Debt to equity	%	190.3	183.9	98.0	80.3	72.4
Debt to total assets	%	48.0	46.2	43.5	33.1	30.8
Total liabilities to equity	%	304.8	303.9	150.5	134.5	136.3
Interest cover	times	6.1	3.4	2.5	2.7	4.4
Current ratio	%	127.1	126.7	126.7	77.5	70.1
Leverage ratio	%	404.8	403.9	250.5	234.5	236.3
<i>Payments to and from government</i>						
Dividends	\$'000	119 740	85 482	113 068	74 170	123 488
Dividend to equity ratio	%	20.9	21.9	18.9	9.3	15.4
Dividend payout ratio	%	90.0	90.0	184.3	100.0	100.0
Income tax expense	\$'000	55 028	47 379	40 653	36 872	56 993
CSO funding	\$'000	0	0	0	0	0

^a Delta Electricity returned \$380 million in contributed equity to the NSW Government in 2000-01. This was paid for by additional borrowings, thereby increasing the level of debt by a commensurate amount. ^b Following the adoption of a new accounting policy regarding the valuation of physical non-current assets in 2002-03, the value of total assets increased by \$406 million. Property, plant and equipment is recognised at fair value in accordance with AASB 1041 *Revaluation of Non-Current Assets* and the *New South Wales Treasury Accounting Policy for the Valuation of Non-Current Assets at Fair Value*. Prior to 2002-03, Delta recognised property plant and equipment on a historical cost basis, except where revalued following the approval of the directors. In 2002-03, Delta's dividend included a \$50 million special payment.

Macquarie Generation (Macquarie) operates under the *State Owned Corporations Act 1989* (SOC Act) and the *Energy Services Corporations Act 1995* (ESC Act). It currently operates two coal-fired power stations — Bayswater and Liddell — with a combined generating capacity of 4640 MW.

Macquarie generates electricity for sale into the National Electricity Market (NEM) — to which it estimates its contribution is around 15 per cent of total volume. Although Macquarie does not face direct price regulation, it is subject to the rules and conditions governing the NEM.

In 2004-05, Macquarie's pre-tax operating profit increased 5 per cent (\$8 million) over the previous year to almost \$167 million. The result reflected a continuation of revenue growth over 2004-05 at 5 per cent, or \$38 million (7 per cent in 2003-04), which outpaced growth in operating expenses at 4 per cent or \$29 million. This growth was partially offset by a 15 per cent decline in total borrowing costs from \$97 million to \$83 million — the result of falling debt levels.

Macquarie continued to reduce its debt over 2004-05 as part of an ongoing debt repayment strategy. Total debt declined \$104 million, or 10 per cent, from \$1.1 billion to \$960 million. This has led to improvements in Macquarie's debt ratios, with debt to equity falling from 84 per cent to 76 per cent, and the ratio of debt to total assets from 37 per cent to 33 per cent. Combined with stronger operating revenue, the reduction in debt has also improved Macquarie's interest cover, which increased from 2.6 to 3 times.

Under the provisions of the SOC Act, Macquarie is required to make tax-equivalent and dividend payments. Dividend payments are made in accordance with the share dividend scheme, which is determined by the voting shareholders and as required by the ESC Act. In 2004-05, Macquarie provided for a \$105 million dividend payment and recorded an income tax-equivalent expense of \$61 million.

MACQUARIE GENERATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02	2002-03 ^b	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	2 065	2 127	2 828	2 905	2 882
Total revenue	\$m	808	815	761	811	848
<i>Profitability</i>						
Operating profit before tax	\$'000	143 230	181 571	100 718	158 576	166 844
Operating sales margin	%	26.4	31.4	28.4	31.2	29.0
Cost recovery	%	135.9	145.8	139.6	145.4	140.8
Return on assets	%	10.3	12.3	8.8	8.9	8.6
Return on equity	%	12.7	17.5	6.1	8.3	8.3
<i>Financial management</i>						
Debt to equity	%	135.2	130.0	100.7	83.7	75.7
Debt to total assets	%	44.5	42.9	47.2	37.0	33.2
Total liabilities to equity	%	197.2	207.4	143.3	129.0	127.1
Interest cover	times	3.0	3.4	1.8	2.6	3.0
Current ratio	%	54.3	64.3	52.4	62.0	59.4
Leverage ratio	%	297.2	307.4	243.3	229.0	227.1
<i>Payments to and from government</i>						
Dividends	\$'000	100 000	125 000	56 000	100 000	105 000
Dividend to equity ratio	%	12.2	18.0	6.0	8.2	8.3
Dividend payout ratio	%	96.5	103.0	98.9	98.8	99.6
Income tax expense	\$'000	39 597	60 257	44 081	57 335	61 423
CSO funding	\$'000	0	0	0	0	0

^a Macquarie returned \$240 million in contributed equity to the NSW Government in 2000-01. The return was paid for with additional borrowings, increasing the level of debt by a commensurate amount. ^b In 2002-03, a capital restructure and asset revaluation increment significantly affected Macquarie's financial management indicators. The debt to equity and debt to total assets ratios both fell, primarily due to the substantial increase in the valuation of Macquarie's assets. Also during 2002-03, Macquarie returned \$400 million in contributed equity to the NSW Government. The return was paid for with additional borrowings that increased the level of debt.

Eraring Energy (Eraring) commenced operations on 2 August 2000 following the transfer of generation assets, staff, rights and liabilities from Pacific Power. Eraring operates under the *State Owned Corporations Act 1989* (SOC Act) and the *Energy Services Corporations Act 1995* (ESC Act).

Eraring generates and trades electricity within the National Electricity Market (NEM). Its generation assets have a capacity of 3041 MW — the largest being the Eraring coal-fired power station which provides around 87 per cent of the company's output. In addition, the company has a wholly-owned subsidiary, Pacific Western, which until 24 March 2005 operated the Collie Power Station in Western Australia — outside the NEM — under contract to Western Power.

Eraring maintained steady revenue growth in 2004-05 at 4 per cent (5 per cent in 2003-04), increasing from \$580 million to \$602 million. In its annual report, Eraring attributes this to higher spot prices on a small number of peak trading days. Depreciation costs increased to \$54 million, up from \$47 million in 2003-04. However, falling raw materials expenses and borrowing costs offset the increase, leaving total operating expenses roughly unchanged. The higher operating revenues, therefore, translated to an improved pre-tax operating result of \$117 million, representing a 19 per cent increase from \$98 million in 2003-04.

Eraring's total assets grew by 5 per cent from \$1.5 billion to \$1.6 billion in 2004-05. Total debt was steady at \$165 million, leaving Eraring's debt to equity ratio largely unchanged at 14 per cent. Eraring's total debt increased 79 per cent to \$162 million in 2003-04, largely because of a \$137 million equity to debt swap conducted during that year. A similar transaction involving only \$16 million occurred during 2004-05. Eraring's stronger operating revenues led to an improvement in interest cover from 9 times to 13 times.

In 2004-05, Eraring returned almost \$118 million to the State Government in tax-equivalent and dividend payments (\$90 million in 2003-04)¹. Eraring received \$89 000 in community service obligation payments in 2004-05.

¹ In 2004-05, Eraring provided for more than \$82 million in dividend payments, which equated to a payout ratio greater than 100 per cent. Eraring reports that the provision for dividends in 2004-05 was increased by \$2.2 million in order to fund payments relating to workers compensation and dust disease court determinations for non-employees. The corporation noted this liability was transferred from the NSW government to Eraring upon corporatisation, with agreement that the matter to be treated as a community service obligation that would be paid for out of deductions from Eraring dividends.

ERARING ENERGY (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03 ^b	2003-0 ^c	2004-05 ^d
<i>Size</i>						
Total assets	\$m	1 319	1 327	1 385	1 523	1 592
Total revenue	\$m	463	533	553	580	602
<i>Profitability</i>						
Operating profit before tax	\$'000	36 812	48 574	58 182	98 101	117 045
Operating sales margin	%	17.6	11.3	11.8	19.0	21.1
Cost recovery	%	121.3	112.7	113.4	123.5	126.7
Return on assets	%	6.2	4.5	4.8	7.6	8.2
Return on equity	%	2.7	3.2	3.8	6.2	7.1
<i>Financial management</i>						
Debt to equity	%	28.1	12.6	8.3	14.4	14.3
Debt to total assets	%	18.9	9.9	6.7	11.1	10.6
Total liabilities to equity	%	49.0	27.7	26.1	35.3	37.5
Interest cover	times	1.8	5.2	9.2	9.0	12.6
Current ratio	%	72.2	104.2	74.7	50.2	47.4
Leverage ratio	%	149.0	127.7	126.1	135.3	137.5
<i>Payments to and from government</i>						
Dividends ^c	\$'000	19 479	36 471	35 828	60 064	82 327
Dividend to equity ratio	%	2.2	3.8	3.4	5.4	7.2
Dividend payout ratio	%	80.8	119.1	88.3	87.2	101.0
Income tax expense	\$'000	12 716	17 954	18 090	29 258	35 571
CSO funding	\$'000	125	59	110	67	89

^a In August 2001, the NSW Government agreed to repurchase \$150 million of Eraring's debt. The figures for 2001-02 have been adjusted retrospectively to allow comparability with 2002-03 figures which recognise energy sales on a gross basis. Current assets and current liabilities were adjusted upward by \$78 million. ^b In 2002-03, Eraring's debt ratios decreased with a reduction in debt (\$40 million) and an upward revaluation of non-current assets (\$55 million). ^c Eraring Energy repaid capital of \$137 million in October 2003 via a non-cash equity to debt swap. ^d Eraring Energy repaid capital of \$16 million in August 2004 via a non-cash equity to debt swap. ^e The dividend payments for 2001-02 and 2002-03 were reduced by \$4.3 million and \$4.7 million respectively. These are amounts paid for worker's compensation and dust disease court determinations for other than Eraring Energy employees. The liability was transferred from the NSW Government to Eraring Energy on corporatisation, with agreement that the matter would be treated as a Community Service Obligation (CSO) and deducted from dividends

TransGrid operates under the *State Owned Corporations Act 1989*. It was established under the *Electricity Transmission Authority Act 1994* and corporatised on 14 December 1998 under the *Energy Services Corporations Amendment (TransGrid Corporatisation) Act 1998*.

TransGrid is responsible for the planning, management and development of the NSW high voltage electricity transmission network — the largest high voltage network in Australia. It transmits power between generators and bulk distributors, some large direct customers and to interconnectors linking Victoria, South Australia and Queensland.

TransGrid's 2004-05 pre-tax operating profit result of \$116 million represents a modest improvement of 1 per cent, after improving profits by more than 50 per cent during the previous year. Slower growth in operating revenue in 2004-05, along with an increase in borrowing costs — 17 per cent, from \$88 million to \$104 million — led to the lower, more recent profit result. Other operating expenses (excluding borrowing costs) remained steady, improving Transgrid's operating sales margin from 45 per cent to 48 per cent.

The value of TransGrid's total assets expanded 10 per cent over the reporting period from \$3.4 billion to \$3.7 billion, comprising mainly property, plant and equipment, along with cash assets. Transgrid's level of debt was relatively unchanged at \$1.5 billion which led to some improvement in the company's debt ratios.

TransGrid is required to make tax-equivalent and dividend payments to the NSW Government. In 2004-05, TransGrid provided for a \$38 million dividend payment (\$70 million in 2003-04),¹ and recorded an income tax-equivalent expense of \$39 million. The reduced dividend and lower dividend payout ratio (49 per cent) caused return on equity to fall from 6.3 per cent to 4.6 per cent.

¹ The reduced dividend was determined by the Board in accordance with Transgrid's Statement of Corporate Intent 2004-05, as agreed with NSW Treasury. The latest Australian Competition and Consumer Commission revenue determination 2004-05 allows for planned capital expenditures totalling more than \$1 billion over the next four years (actual capital expenditures were \$930 million over the previous four years).

TRANSGRID (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02	2002-03 ^b	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	2 550	2 674	2 807	3 384	3 733
Total revenue	\$m	360	381	407	447	451
<i>Profitability</i>						
Operating profit before tax	\$'000	- 84 968	53 092	82 294	114 995	116 449
Operating sales margin	%	- 3.3	35.4	41.5	45.1	48.3
Cost recovery	%	172.4	154.7	171.0	182.0	193.4
Return on assets	%	- 0.4	5.2	6.2	6.5	6.1
Return on equity	%	- 9.6	2.3	4.2	6.3	4.6
<i>Financial management</i>						
Debt to equity	%	121.1	119.6	123.6	100.5	81.4
Debt to total assets	%	52.0	50.7	50.7	49.2	42.7
Total liabilities to equity	%	140.4	141.5	149.9	123.2	99.8
Interest cover	times	- 0.1	1.6	1.9	2.3	2.1
Current ratio	%	73.4	51.0	26.0	35.2	41.8
Leverage ratio	%	240.4	241.5	249.9	223.2	199.8
<i>Payments to and from government</i>						
Dividends	\$'000	0	0	46 199	70 000	38 000
Dividend to equity ratio	%	0.0	0.0	4.1	5.3	2.2
Dividend payout ratio	%	0.0	0.0	97.5	84.2	49.3
Income tax expense	\$'000	29 567	27 774	34 892	31 814	39 320
CSO funding	\$'000	0	0	0	0	0

^a TransGrid returned \$260 million of contributed equity to the NSW Government in 2000-01, as part of a capital restructure. Debt increased by a commensurate amount in that year. As part of the restructure, TransGrid incurred an expense of \$162 million due to the prepayment of its existing debt portfolio. This restructure had a significant effect on TransGrid's financial performance ratios. ^b In 2002-03, TransGrid returned \$60 million of contributed equity to the NSW Government.

Australian Inland Energy (Australian Inland) was initially established as Australian Inland Energy and Water Infrastructure (AIEWI) on 1 March 1996, a government-owned electricity distributor and retailer under the *State Owned Corporations Act 1989*. The NSW Government has since effected various consolidations among GTEs operating in regional areas. On 15 December 2000, AIEWI merged with the Broken Hill Water Board, absorbing all of the Board's infrastructure and water supply functions.

In 2002-03, AIEWI ceased to exist and was replaced by the current entity, Australian Inland. The NSW Government announced in November 2004 that Australian Inland would merge with Country Energy. Australian Inland reports the merger took effect from 1 July 2005, making 2004-05 the last financial reporting year for Australian Inland.

During 2004-05, the *Electricity Supply Act 1995* (and its regulations) and the National Electricity Rule (formerly the National Electricity Code) governed Australian Inland's electricity operations. The corporation operated under two price caps — applying to retailing and distribution prices — as determined by the Independent Pricing and Regulatory Tribunal (IPART).¹ Retail prices for customers using more than 160 MWh of electricity per annum are not regulated.

Australian Inland reported a loss of \$2 million in 2004-05, a \$2 million decline from a breakeven result in 2003-04. The result was due mainly to an increase in operating expenses of \$3 million from \$62 million to \$65 million, while total revenue remained virtually unchanged at \$63 million.

Australian Inland has received CSO payments from the NSW Government to compensate for the supply of electricity to sparsely populated areas. The value of this CSO was \$7.3 million in 2004-05.

¹ Following a 31 per cent rise in energy demand during the previous regulatory period, IPART has granted regulatory price increases to distributors and retailers. In June 2004, IPART set weighted average price caps for each distribution GTE in NSW, covering the period from 1 July 2004 to 30 June 2009. The determination provides for a real price increase equal to 14 per cent over the period, when averaged across the distribution GTEs in New South Wales. IPART's determination concerning retail price caps, to apply from 1 July 2004 to 30 June 2007, allows for nominal increases of between 5.0 and 5.8 per cent on average over the period.

AUSTRALIAN INLAND (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02	2002-03 ^b	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	154	158	158	164	164
Total revenue	\$m	52	64	71	62	63
<i>Profitability</i>						
Operating profit before tax	\$'000	4 351	3 063	5 786	7	- 1 915
Operating sales margin	%	6.5	3.9	7.1	- 1.4	- 4.4
Cost recovery	%	107.0	104.1	107.6	98.6	95.8
Return on assets	%	4.1	2.1	3.7	0.0	- 1.2
Return on equity	%	3.5	1.5	3.4	0.3	- 0.7
<i>Financial management</i>						
Debt to equity	%	2.8	2.7	0.0	0.0	0.0
Debt to total assets	%	3.3	2.3	0.0	0.0	0.0
Total liabilities to equity	%	17.4	17.4	14.7	14.2	15.1
Interest cover	times	32.5	12.9	232.4	n.r.	n.r.
Current ratio	%	166.4	175.3	226.4	207.2	199.8
Leverage ratio	%	117.4	117.4	114.7	114.2	115.1
<i>Payments to and from government</i>						
Dividends	\$'000	1 112	549	464	0	0
Dividend to equity ratio	%	1.2	0.4	0.3	0.0	0.0
Dividend payout ratio	%	34.2	26.7	10.1	0.0	0.0
Income tax expense	\$'000	1 098	1 007	1 198	- 456	-931
CSO funding ^c	\$'000	5 300	5 300	5 300	7 620	7 319

^a Australian Inland Energy merged with the Broken Hill Water Board in December 2000 and was renamed Australian Inland Energy and Water Infrastructure (AIEWI). Assets increased by \$78 million as a result of the merger. ^b In 2002-03, AIEWI was replaced by Australian Inland. ^c Australian Inland, (formerly AIEWI), receives community service obligation payments from the NSW Government to compensate for the supply of electricity to sparsely populated areas. **n.r.** Not relevant.

EnergyAustralia operates under the *State Owned Corporations Act 1989* (SOC Act) and the *Energy Services Corporations Act 1995*. The majority of EnergyAustralia's revenues are derived from distribution and retailing of electricity, operating within the framework of the *Electricity Supply Act 1995*. EnergyAustralia holds electricity and gas retail licences in New South Wales, Victoria, South Australia and the ACT. EnergyAustralia holds an electricity retail license in Queensland. The corporation also owns and operates part of the NSW transmission network.

Pre-tax operating profit increased by 5 per cent, or \$13 million, from 2003-04 to 2004-05. Revenue growth of \$294 million (11 per cent) related mainly to increased sales and delivery of energy. Total expenses grew by \$280 million (12 per cent).

The value of EnergyAustralia's assets increased by 7 per cent (\$401 million) to \$6 billion in 2004-05, attributable mainly to capital expenditure in property, plant and equipment. Total debt increased 11 per cent, or \$264 million, to \$2.7 billion. A smaller change in equity of 6.4 per cent, or \$139 million, caused the debt to equity ratio to increase from 110 per cent to 116 per cent.

EnergyAustralia is required to make tax-equivalent and dividend payments. In 2004-05, EnergyAustralia provided for an \$81 million dividend payment (down from \$164 million in 2003-04)¹ and recorded an income tax-equivalent expense of \$83 million.

The NSW Government funds EnergyAustralia for the provision of agreed community service obligations (CSOs). These include provision of rebates to pensioners and low income households, medical rebates for life support systems, and the electricity payment assistance scheme. In 2004-05 EnergyAustralia received \$33 million in CSO payments.

¹ The reduced dividend was determined by the Board in accordance with EnergyAustralia's Statement of Corporate Intent 2004-05, as agreed with NSW Treasury. It is noted that total capital expenditure in 2004-05 increased by 41 per cent (\$140 million) to \$484 million.

ENERGYAUSTRALIA (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	5 194	5 276	5 341	5 616	6 017
Total revenue	\$m	2 196	2 255	2 404	2 536	2 830
<i>Profitability</i>						
Operating profit before tax	\$'000	224 935	184 435	204 673	256 451	269 615
Operating sales margin	%	17.4	15.8	15.6	16.8	15.7
Cost recovery	%	121.0	118.8	118.5	120.2	118.6
Return on assets	%	8.6	6.9	7.1	7.8	7.7
Return on equity	%	8.9	5.3	5.8	8.2	8.3
<i>Financial management</i>						
Debt to equity	%	110.7	106.9	105.7	110.7	115.5
Debt to total assets	%	49.8	43.8	42.9	43.8	45.8
Total liabilities to equity	%	158.8	146.3	147.9	159.0	160.7
Interest cover	times	2.4	2.1	2.2	2.5	2.5
Current ratio	%	56.3	58.0	52.0	54.5	52.9
Leverage ratio	%	258.8	246.3	247.9	259.0	260.7
<i>Payments to and from government</i>						
Dividends	\$'000	92 500	47 500	106 400	163 500	81 114
Dividend to equity ratio	%	4.9	2.3	5.0	7.6	3.6
Dividend payout ratio	%	55.4	43.2	84.7	92.1	43.5
Income tax expense	\$'000	57 821	74 480	79 121	78 886	83 101
CSO funding ^b	\$'000	0	29 300	35 500	35 100	33 200

^a EnergyAustralia returned over \$1.1 billion in contributed equity to the State. The return was paid for with borrowings, increasing the level of EnergyAustralia's debt by a commensurate amount. Assets increased by \$1.5 billion, largely due to a revaluation of non-current, physical assets. ^b The NSW Government funds EnergyAustralia for the provision of agreed community service obligations relating to rebates to pensioners and low income households, medical rebates for life support systems and the electricity payment assistance scheme. These amounts were not disclosed by EnergyAustralia in its annual reports prior to 2001-02.

INTEGRAL ENERGY

New South Wales

Integral Energy (Integral) operates under the *State Owned Corporations Act 1989* and the *Energy Services Corporations Act 1995*. Integral distributes and retails electricity within the framework of the *Electricity Supply Act 1995* and the National Electricity Rules. The corporation retails electricity to residential and commercial customers in New South Wales and also participates in the National Electricity Market. Integral contracts mainly with commercial customers outside NSW.

Integral's pre-tax operating profits improved 18 per cent, or \$30 million, to \$194 million in 2004-05. The result is the third consecutive annual improvement, with operating revenue increasing \$36 million overall from \$1.32 billion to \$1.36 billion, while operating expenses remained largely unchanged at \$1.2 billion. The overall gain in operating revenue was achieved despite a \$20 million fall in electricity sales, which was offset by a \$38 million improvement in distribution network income from \$184 million to \$223 million. Other revenue from operating activities increased by \$30 million, which comprised capital contributions and 'other revenue.'

Higher operating revenues also led to a 13 per cent improvement in Integral's interest cover from 2.9 to 3.3 times. A shift in debt toward 'current' liabilities (maturing in less than 12 months) led to a decline in the current ratio from 48 per cent to 35 per cent. Integral's overall level of debt increased \$105 million (or 10 per cent) from \$1.1 billion to \$1.2 billion, slightly increasing both the debt to equity and debt to total assets ratios.

Integral is required to make tax-equivalent and dividend payments to the NSW Government. In 2004-05, Integral paid a dividend of \$114 million (\$102 million in 2003-04) and a tax-equivalent payment of \$65 million.

Integral receives funding for the provision of community service obligations (CSOs) related primarily to rebates for pensioners. In 2004-05, Integral received CSO payments totalling \$21 million.

INTEGRAL ENERGY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02 ^b	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	2 559	2 669	2 674	2 781	3 020
Total revenue	\$m	1 142	1 135	1 199	1 318	1 354
<i>Profitability</i>						
Operating profit before tax	\$'000	104 242	99 066	76 941	164 140	194 365
Operating sales margin	%	15.5	15.3	13.1	18.7	20.6
Cost recovery	%	118.3	118.0	115.1	123.0	125.9
Return on assets	%	8.2	6.9	6.1	9.2	9.6
Return on equity	%	8.8	5.9	4.2	10.1	12.8
<i>Financial management</i>						
Debt to equity	%	78.3	105.9	105.2	102.4	105.4
Debt to total assets	%	40.6	40.9	40.4	40.0	41.3
Total liabilities to equity	%	120.6	164.3	160.9	161.0	165.9
Interest cover	times	2.3	2.2	1.9	2.9	3.3
Current ratio	%	74.7	66.4	51.6	48.0	35.4
Leverage ratio	%	220.6	264.3	260.9	261.0	265.9
<i>Payments to and from customers</i>						
Dividends	\$'000	52 776	88 764	43 783	102 324	114 132
Dividend to equity ratio	%	6.3	9.3	4.3	10.1	11.2
Dividend payout ratio	%	71.8	157.7	101.9	100.0	87.9
Income tax expense	\$'000	30 721	42 793	33 986	61 817	64 590
CSO funding	\$'000	0	17 025	19 417	21 238	20 720

^a Integral Energy returned \$200 million in contributed equity to the NSW Government. The return was paid for with borrowings, increasing the level of debt by a commensurate amount. Assets were revalued upwards on 1 January 2001. The amount of community service obligation funding received by Integral Energy was not disclosed in its 2000-01 annual report. ^b Integral Energy returned \$150 million in contributed equity to the NSW Government in 2001-02. The return was paid for with borrowings, increasing the level of debt by an equivalent amount.

Country Energy was established on 1 July 2001, from the merger of three regional energy businesses: NorthPower, Advance Energy and Great Southern Energy.¹ Country Energy operates under the *State Owned Corporations Act 1989* and the *Energy Services Corporations Act 1995*. The NSW Government announced in November 2004 that the operations of Australian Inland would be merged with Country Energy. This merger took effect from 1 July 2005.

Country Energy is the largest regionally-based energy business in Australia. Its distribution network covers 72 per cent of New South Wales. Country Energy holds distribution and retail licenses in New South Wales and Victoria (for electricity and gas) and holds retail licenses in Queensland, South Australia and the ACT.²

Country Energy's pre-tax operating profit improved 7 per cent in 2004-05, increasing by \$10 million to \$150 million. A small decline in borrowing costs and an \$81 million (5 per cent) increase in total revenue outweighed a \$70 million increase in total expenses.

Total assets increased 11 per cent (\$320 million) to \$3.2 billion, largely due to an increase in the value of property, plant and equipment through investment in infrastructure.

Country Energy is required to make tax-equivalent and dividend payments. In 2004-05, it provided for an \$18 million (\$30 million in 2003-04) dividend payment and recorded an income tax-equivalent expense of \$62 million.

Country Energy receives funding for community service obligations (CSOs) from the NSW Government for pensioners, customers in caravan parks and people who rely on life support machines. In 2004-05, it received CSO payments equal to \$5.3 million, down from \$23 million in 2003-04.

¹ On 1 June 2001, NorthPower changed its name to Country Energy. On 1 July 2001, the net assets and equity of Advance Energy and Great Southern Energy were added to the net assets and equity of Country Energy.

² Country Energy also has special approval for the distribution and retailing of electricity in parts of south-west Queensland.

COUNTRY ENERGY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02^a</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m		2 450	2 639	2 866	3 188
Total revenue	\$m		1 417	1 497	1 635	1 716
<i>Profitability</i>						
Operating profit before tax	\$'000		25 112	55 439	140 710	150 977
Operating sales margin	%		8.2	10.6	15.3	15.3
Cost recovery	%		109.0	111.8	118.1	118.1
Return on assets	%		4.8	6.3	9.5	9.1
Return on equity	%		2.6	5.5	11.2	12.8
<i>Financial management</i>						
Debt to equity	%		199.5	215.7	210.6	212.3
Debt to total assets	%		54.7	57.3	57.5	60.0
Total liabilities to equity	%		264.8	290.7	296.0	289.2
Interest cover	times		1.3	1.5	2.3	2.3
Current ratio	%		42.9	51.4	47.9	47.5
Leverage ratio	%		364.8	390.7	396.0	389.2
<i>Payments to and from government</i>						
Dividends	\$'000		19 827	29 557	29 764	18 100
Dividend to equity ratio	%		3.0	4.4	4.3	2.3
Dividend payout ratio	%		111.5	80.1	38.0	18.3
Income tax expense	\$'000		7 335	18 550	62 371	52 258
CSO funding	\$'000		18 508	21 962	22 666	5 300

^a Country Energy was established on 1 July 2001, from the merger of NorthPower, Advance Energy and Great Southern Energy. **n.r.** Not relevant.

CS Energy was established on 1 July 1997, as part of the restructure of the Queensland electricity industry.¹ It is subject to the provisions of the *Government Owned Corporations Act 1993* (GOC Act) and the *Corporations Act 2001* (Cth). CS Energy operates power stations with a combined generating capacity of 2460 MW at three locations around Queensland. CS Energy generates electricity for sale within the National Electricity Market (NEM) and is subject to the National Electricity Rules (formerly the National Electricity Code).

In 2004-05, CS Energy grew its profit by 22 per cent (\$9 million) to \$50 million, but remains below a peak in 2001-02 of \$88 million. The improved profits in 2004-05 resulted from \$14 million decline (42 per cent) in borrowing costs — the result of an equity injection by the Queensland Government in late 2003-04 to reduce debt and offset otherwise declining profits.

CS Energy's debt levels increased again in 2004-05 following a large reduction in 2003-04. Total outstanding debt increased from \$384 million to \$521 million, causing the debt to equity ratio to increase from 44 per cent to 59 per cent and the debt to total assets ratio to rise from 24 per cent to 30 per cent. Lower borrowing costs led to an improvement in the generator's interest cover from 2.2 times to 3.4 times.

CS Energy is required to make tax-equivalent and dividend payments. CS Energy's dividend payment is determined in accordance with the provisions of the GOC Act.² In 2004-05, CS Energy provided for a \$29 million dividend payment and recorded an income tax-equivalent expense of \$13 million.

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

² Under the Act, the board makes a recommendation to the shareholding ministers on its proposed dividend payment. Shareholding ministers may either approve the recommendation or direct the board to pay a specified dividend.

CS ENERGY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04^d</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	1 458	1 663	1 610	1 620	1 840
Total revenue	\$m	452	494	479	475	474
<i>Profitability</i>						
Operating profit before tax	\$'000	48 734	88 045	57 608	40 865	49 829
Operating sales margin	%	19.2	23.4	19.6	16.0	14.6
Cost recovery	%	123.7	130.5	124.4	119.0	117.1
Return on assets	%	6.2	7.4	5.7	4.7	4.1
Return on equity	%	4.8	10.0	6.6	4.1	4.2
<i>Financial management</i>						
Debt to equity	%	95.6	122.8	111.6	44.1	59.3
Debt to total assets	%	41.9	47.4	41.6	23.8	30.1
Total liabilities to equity	%	139.6	175.7	164.3	86.1	109.6
Interest cover	times	2.3	4.2	2.6	2.2	3.4
Current ratio	%	81.3	113.3	81.8	105.9	75.5
Leverage ratio	%	239.6	275.7	264.3	186.1	209.6
<i>Payments to and from government</i>						
Dividends	\$'000	74 934 ^a	72 652 ^b	37 730 ^c	28 877	29 151
Dividend to equity ratio	%	12.0	12.0	6.2	3.9	3.3
Dividend payout ratio	%	251.3	119.7	95.0	95.0	80.0
Income tax expense	\$'000	18 916	27 353	17 892	10 468	13 390
CSO funding	\$'000	0	0	0	0	0

^a Dividend includes \$45.9 million attributed to 1999-00, but not provided for in that year. ^b Dividend includes \$21 million attributed to 2000-01, but not provided for in that year. ^c In 2002-03, CS Energy adopted a new accounting policy whereby a provision is made for a dividend if the dividend is declared prior to the end of the financial year. Previously a provision could be made for a dividend if it was declared after the end of the financial year but before the completion of the financial report. The effect of adopting the new accounting standard is that a \$51 million dividend previously attributed to 2001-02, has been recognised in the 2002-03 financial statement. This adjustment is not included in the figure recorded in this year's report to avoid double counting. ^d In 2003-04, CS Energy's level of debt was reduced through a \$260 million equity injection by the Queensland Government.

Stanwell Corporation (Stanwell) was established on 1 July 1997, as part of the restructure of the Queensland electricity industry. It is subject to the provisions of the *Government Owned Corporations Act 1993* (GOC Act) and the *Corporations Act 2001* (Cth).¹ Stanwell generates electricity for sale into the National Electricity Market (NEM).

Stanwell operates the Stanwell coal-fired station and several gas, bio-mass, hydro and wind generation plants with a combined generating capacity in excess of 1640 MW.

Stanwell's pre-tax operating profit declined 21 per cent (\$13 million) in 2004-05 \$48 million. Total revenue grew modestly from \$360 million to \$370 million because of lower prices in the spot market for electricity, while total expenses increased 11 per cent (\$34 million) to \$333 million. The generator noted the higher expenses were due to increased fuel costs during the year, influenced by higher coal export prices.

In 2004-05, total assets increased by 6 per cent (\$100 million) and was accompanied by a 12 per cent (\$28 million) fall in total debt, which reduced the debt to total assets ratio from 14.3 per cent to 12.7 per cent. Despite the decline in debt levels, Stanwell's borrowing costs increased during the year, reducing its interest cover from 5.3 to 4.4 times. A rise in the level of current assets improved Stanwell's current ratio from 87 per cent to 139 per cent.

Stanwell is required to make tax-equivalent and dividend payments. Stanwell's dividend payments are determined in accordance with the provisions of the GOC Act.² In 2004-05, Stanwell provided for a \$24 million dividend payment and recorded an income tax-equivalent expense of \$9.7 million.

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

² Under the Act, the Board makes a recommendation to the shareholding ministers on its proposed dividend payment. Shareholding ministers may either approve the recommendation or direct the Board to pay a specified dividend.

STANWELL CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	1 660	1 666	1 693	1 590	1 650
Total revenue	\$m	416	361	373	360	370
<i>Profitability</i>						
Operating profit before tax	\$'000	138 608	77 864	59 430	61 237	48 437
Operating sales margin	%	38.9	26.5	20.7	20.2	16.7
Cost recovery	%	163.8	136.0	126.1	125.2	120.1
Return on assets	%	9.7	5.8	4.7	4.6	3.9
Return on equity	%	9.4	5.3	4.1	4.0	3.8
<i>Financial management</i>						
Debt to equity	%	34.0	33.6	33.1	23.2	20.3
Debt to total assets	%	20.9	20.3	19.9	14.3	12.7
Total liabilities to equity	%	61.0	65.7	68.0	57.4	62.8
Interest cover	times	6.7	5.2	4.1	5.3	4.4
Current ratio	%	65.1	85.8	116.3	86.5	139.1
Leverage ratio	%	161.0	165.7	168.0	157.4	162.8
<i>Payments to and from government</i>						
Dividends	\$'000	98 097 ^a	71 020 ^b	39 479	38 691	23 564
Dividend to equity ratio	%	9.5	7.0	3.9	3.8	2.3
Dividend payout ratio	%	101.4	130.6	95.0	95.0	60.8
Income tax expense	\$'000	41 831	23 477	17 866	20 508	9 671
CSO funding	\$'000	0	0	0	0	0

^a Dividend includes \$26 million attributed to 1999-00 but not provided for in that year. ^b Dividend includes \$19 million attributed to 2000-01 but not provided for in that year. Also included is a final dividend of \$52 million attributed to 2001-02.

Tarong Energy (Tarong) was established on 1 July 1997, as part of the restructure of the Queensland electricity industry. It is subject to the provisions of the *Government Owned Corporations Act 1993* (GOC Act) and the *Corporations Act 2001* (Cth).¹ Tarong generates electricity for sale into the National Electricity Market. Tarong owned and operated the SA gas supplier, Terra Gas Trader (TGT) for part of the year, until divesting its interest on 12 February 2005.

Tarong operates power stations (two coal-fired, one gas turbine, one hydro and one wind) with a combined generating capacity of 2395 MW. Under a joint-venture agreement with Tokyo Electric Power Company (TEPCO) and Mitsui Co. Ltd, Tarong also owns a 50 per cent interest in the Tarong North Power Station.

Tarong's pre tax operating profit declined \$10 million over the previous year to \$114 million. The result reflected a \$100 million fall in total revenue against a \$91 million decline in operating expenses. A majority of the decline in revenue (\$87 million) and expenses occurred due to the sale of TGT in February 2005. A write down of \$2 million, the recoverable amount of the interest in TGT, was conducted immediately prior to its sale, which also impacted on Tarong's pre-tax operating result.²

The value of Tarong's assets remained largely unchanged at \$1.6 billion. The level of current assets declined relative to current liabilities, reducing Tarong's current ratio from 54 per cent to 41.2 per cent. Total debt declined 12 per cent (\$35 million) to \$260 million, leading to a reduction in the corporation's debt to total assets ratio. Along with an increase in equity, the reduced debt levels also caused a decline in Tarong's debt to equity ratio from 35 per cent to 30 per cent.

Tarong is required to make tax-equivalent and dividend payments. Its dividend payment is determined in accordance with the provisions of the GOC Act.³ In 2004-05, Tarong provided for a dividend payment of almost \$64 million and recorded an income tax-equivalent expense of \$34 million.

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

² The write down to recoverable amount meant there was no loss arising from the sale of TGT.

³ Under the Act, the Board makes a recommendation to the shareholding ministers on its proposed dividend payment, which the shareholding ministers may either approve or direct the Board to pay a specified dividend

TARONG ENERGY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02 ^b	2002-03	2003-04 ^c	2004-05 ^d
<i>Size</i>						
Total assets	\$m	1 604	1 874	1 957	1 598	1 614
Total revenue	\$m	562	602	611	606	505
<i>Profitability</i>						
Operating profit before tax	\$'000	136 186	137 702	115 643	123 371	113 700
Operating sales margin	%	27.9	23.6	19.8	23.1	25.9
Cost recovery	%	138.8	130.9	124.7	130.1	134.9
Return on assets	%	10.5	8.2	6.4	8.1	8.3
Return on equity	%	10.7	11.3	9.5	10.1	9.2
<i>Financial management</i>						
Debt to equity	%	48.7	70.5	79.5	34.5	29.9
Debt to total assets	%	28.1	34.4	35.4	16.6	16.2
Total liabilities to equity	%	84.3	121.0	129.6	86.6	85.0
Interest cover	times	7.0	27.1	18.1	6.8	7.0
Current ratio	%	57.0	67.2	24.9	54.2	41.2
Leverage ratio	%	184.3	221.0	229.6	186.6	185.0
<i>Payments to and from government</i>						
Dividends	\$'000	102 515	129 711	76 562	81 608	63 680
Dividend to equity ratio	%	11.7	15.1	9.0	9.6	7.4
Dividend payout ratio	%	109.7	133.7	95.0	95.0	80.0
Income tax expense	\$'000	42 759	40 715	35 052	37 469	34 100
CSO funding	\$'000	0	0	0	0	0

^a Tarong Energy acquired South Australian-based Terra Gas Trader on 31 October 2000, increasing Tarong Energy's asset base, revenue and expenses. The 2000-01 dividend includes \$38 million that was attributed to 1999-00 but not provided for in that year. Also includes a proposed final dividend of \$64 million attributed to 2000-01. ^b Dividend includes \$37.5 million that was attributed to 2000-01 but was not provided for in that year.

^c Under a joint-venture agreement which came into effect on 6 August 2003, TEPCO and Mitsui acquired a 50 per cent interest in Tarong North Power Station. Proceeds from the sale of non-current assets associated with the joint venture-agreement were used to fund a reduction in Tarong's level of debt in 2003-04.

^d Tarong's revenue and expenses declined during 2004-05 due to the sale of its interest in the South Australian gas supplier Terra Gas Trader on 12 February 2005.

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

Enertrade's primary role is as wholesale trader of power-purchase agreements (PPAs) assigned to it as part of the industry restructure in 1997.¹ However, it is now seeking to expand its business activities to include the construction, ownership and operation of energy assets. Enertrade now owns and operates a 53 Megawatt natural gas fired electricity generator at Barcaldine and its associated gas pipeline. It also now owns and operates the North Queensland Gas Pipeline.

Since 1 July 2002, Enertrade has made provision for estimated future losses related to its legacy PPAs — originally totalling \$486 million in 2002-03. The carrying amount of the provision is revised annually to the best estimate as at the reporting date.²

In 2004-05, Enertrade recorded a pre-tax operating loss of \$55 million, an increase from the \$21 million loss posted in 2003-04. The increased loss was primarily the result of a smaller devaluation of the provision for onerous contracts in 2004-05, which creates a smaller (positive) effect on the operating result when compared to 2003-04. In addition, purchases of energy at \$490 million, which increased 6 per cent (\$28 million) over the previous year, exceeded energy sales revenue of \$390 million, which increased by \$21 million over the previous year.

The value of Enertrade's assets declined 40 per cent (\$180 million) in 2004-05, the majority of the fall reflecting reduced holdings of cash. No dividend or tax-equivalent payments have been made since 2000-01 because of pre-tax operating losses.

¹ A number of Enertrade's long-term PPAs, constitute onerous contracts and are expected to result in significant future losses. The agreements commit Enertrade to purchasing power at fixed prices over the terms of the respective agreements and selling it into the NEM at prevailing (currently lower) pool prices. The longest of these contracts is for a term of 35 years, which extends to 2029.

² The estimate depends on future changes in the market prices for electricity and the prevailing interest rates. The provision is recorded as a liability in the statement of financial position and the annual revision is recognised in expenses in the statement of financial performance.

ENERTRADE (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03^a</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	273	265	413	446	267
Total revenue	\$m	625	472	434	356	446
<i>Profitability</i>						
Operating profit before tax	\$'000	- 14 332	- 48 997	- 21 350	- 20 907	- 55 237
Operating sales margin	%	- 2.7	- 10.7	- 6.3	- 7.6	- 12.6
Cost recovery	%	97.4	90.4	94.1	92.9	88.8
Return on assets	%	- 3.1	- 16.7	- 5.0	- 3.8	- 14.3
Return on equity	%	- 16.5	- 65.2	n.r. ^b	n.r. ^b	n.r. ^b
<i>Financial management</i>						
Debt to equity	%	95.1	196.5	- 64.0	- 172.3	0.0
Debt to total assets	%	33.0	35.8	28.4	22.4	0.0
Total liabilities to equity	%	169.8	440.1	- 374.8	- 898.0	- 421.4
Interest cover	times	- 1.7	- 11.1	- 4.0	- 3.5	- 10.4
Current ratio	%	269.9	164.6	330.2	248.0	104.6
Leverage ratio	%	269.8	540.1	- 274.8	- 798.0	- 321.4
<i>Payments to and from government</i>						
Dividends	\$'000	0	0	0	0	0
Dividend to equity ratio	%	0.0	0.0	0.0	0.0	0.0
Dividend payout ratio	%	0.0	0.0	0.0	0.0	0.0
Income tax expense	\$'000	2 123	0	0	0	0
CSO funding	\$'000	0	0	0	0	0

^a In 2002-03, the Queensland Government injected \$300 million of contributed equity into Enertrade. In 2002-03, Enertrade had negative equity, largely as a result of a provision for onerous contracts related to power purchasing agreements. ^b Liabilities exceeded assets. n.r. Not relevant.

Powerlink was established on 1 July 1997 as part of a restructure of the Queensland electricity industry. It is subject to the provisions of the *Government Owned Corporations Act 1993* (GOC Act) and the *Corporations Act 2001* (Cwlth). Powerlink owns and controls the Queensland high voltage transmission network and operates in the National Electricity Market (NEM).

Powerlink has minority equity interests in ElectraNet Pty Ltd, a provider of electricity transmission services in South Australia, and Electranet Transmission Services Pty Ltd — a provider of asset management services.

Powerlink achieved 9 per cent growth in revenue for the year, increasing from \$425 million to \$463 million. The majority of the increase in revenue stemmed from its transmission network, where the corporation reported continued increases in electricity demand, particularly in South-East Queensland. This growth was underpinned by the profile of Powerlink's current regulated revenue cap set by the ACCC. Total expenses also grew 9 per cent from \$290 million to \$320 million, allowing Powerlink to post an improved profit result of \$150 million — a 9 per cent (\$12 million) improvement on the previous year's result.

Assets increased by 5 per cent (\$170 million) to \$3.3 billion 2004-05, mainly through an increase in the value of property, plant and equipment. Asset additions of \$197 million and upward revaluations totalling \$72 million, more than offset depreciation of \$117 million.

Under the provisions of the GOC Act, Powerlink is required to make tax-equivalent and dividend payments. Under the Act, the Board makes a recommendation to the shareholding ministers on its proposed dividend payment. Shareholding ministers may either approve the recommendation or direct the Board to pay a specified dividend. In 2004-05, Powerlink provided for an \$81 million dividend payment and recorded an income tax-equivalent expense of \$43 million.

POWERLINK (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	2 588	2 821	3 052	3 201	3 372
Total revenue	\$m	339	362	385	425	463
<i>Profitability</i>						
Operating profit before tax	\$'000	112 611	101 271	112 016	135 426	147 150
Operating sales margin	%	56.9	45.2	46.2	47.8	47.4
Cost recovery	%	231.8	182.5	185.9	191.7	190.3
Return on assets	%	7.6	6.2	6.3	6.7	6.9
Return on equity	%	15.4	6.2	5.7	6.5	6.8
<i>Financial management</i>						
Debt to equity	%	101.1	99.9	97.1	96.5	93.2
Debt to total assets	%	44.5	47.2	46.0	45.2	44.4
Total liabilities to equity	%	128.9	120.6	119.3	118.6	115.1
Interest cover	times	2.3	2.5	2.6	2.8	2.8
Current ratio	%	42.0	67.8	73.0	59.0	75.2
Leverage ratio	%	228.9	220.6	219.3	218.6	215.1
<i>Payments to and from government</i>						
Dividends	\$'000	165 644	70 545	72 855	87 924	81 240
Dividend to equity ratio	%	14.2	5.9	5.5	6.2	5.4
Dividend payout ratio	%	92.3	95.0	95.0	95.0	78.6
Income tax expense	\$'000	- 66 940	27 012	35 330	42 870	43 838
CSO funding	\$'000	0	0	0	0	0

^a Powerlink received an income tax benefit of almost \$67 million. This was primarily due to the Cross-Border Lease entered into during the year, which reduced tax-equivalent payments by \$113 million. The Queensland Government reduced its equity stake by \$150 million, completing a debt for equity swap which commenced in 1999-00.

The Ergon Energy Group (Ergon) comprises Ergon Energy Corporation Ltd, a regulated electricity distributor, and Ergon Energy Pty Ltd, an energy retailer. The group was established on 30 June 1999, through the amalgamation of six regional distribution corporations and their retail subsidiary, Ergon Energy Pty Ltd.¹ Ergon is subject to the provisions of the *Government Owned Corporations Act 1993* (GOC Act) and the *Corporations Act 2001* (Cwlth).²

Ergon's pre-tax operating profit improved by 16 per cent (\$19 million) in 2004-05 with a 35 per cent (\$543 million) increase in revenue that the corporation reports was buoyed by its retail business. Total expenses increased 37 per cent (\$520 million) the majority of which was comprised of a \$410 million increase in network charges and electricity purchases.

Ergon's assets grew by more than 46 per cent (\$1.8 billion) in 2004-05 from \$3.9 to \$5.6 billion. The majority of the increase consisted of additions to property, plant and equipment totalling \$1.3 billion. Ergon reported the spending was part of an extensive capital investment program of over \$6 billion from 1999 to 2010, aimed at improving network reliability. The corporation also noted significant customer initiated works in response to population growth. Total debt increased 19 per cent (\$282 million) from \$1.4 to \$1.7 billion.

Ergon is required to make tax-equivalent and dividend payments. In 2004-05, Ergon paid \$82 million in dividend payments (\$87 million in 2003-04) and \$44 million in tax-equivalent payments (\$36 million in 2003-04).

Ergon receives community service obligation (CSO) payments to cover any shortfall incurred in supplying electricity to non-contestable customers at gazetted tariffs. Ergon received \$218 million in CSO payments in 2004-02.

¹ The six regional distribution corporations were the Far North Queensland Electricity Corporation, North Queensland Electricity Corporation, Mackay Electricity Corporation, Capricornia Electricity Corporation, Wide Bay-Burnett Electricity Corporation and South-West Queensland Electricity Corporation. The retail subsidiary, Ergon Energy Pty Ltd, was formed in February 1998, following the merger of Northern Electricity Retail Corporation and Central Electricity Retail Corporation.

² The Queensland Government announced in April 2006 its intention to sell the contestable retail operations of Ergon by the end of 2006.

ERGON ENERGY CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	3 211	3 392	3 423	3 852	5 642
Total revenue	\$m	1 418	1 442	1 499	1 555	2 098
<i>Profitability</i>						
Operating profit before tax	\$'000	89 262	116 155	126 913	128 392	147 338
Operating sales margin	%	10.5	12.7	13.5	13.5	11.1
Cost recovery	%	110.6	114.6	115.5	115.6	112.5
Return on assets	%	5.1	5.7	6.0	5.9	5.1
Return on equity	%	6.2	6.0	7.1	5.7	5.0
<i>Financial management</i>						
Debt to equity	%	81.6	88.2	98.1	85.1	74.3
Debt to total assets	%	39.0	39.4	42.6	41.0	37.3
Total liabilities to equity	%	124.2	130.3	131.5	120.1	136.5
Interest cover	times	2.4	2.6	2.6	2.5	2.6
Current ratio	%	112.9	139.6	136.5	155.4	152.2
Leverage ratio	%	224.2	230.3	231.5	220.1	236.5
<i>Payments to and from government</i>						
Dividends	\$'000	69 305	73 702	119 311 ^a	87 413	82 111
Dividend to equity ratio	%	5.5	5.1	8.1	5.4	4.0
Dividend payout ratio	%	89.1	85.1	113.4	95.0	80.0
Income tax expense	\$'000	11 505	29 506	21 736	36 377	44 696
CSO funding	\$'000	232 354	188 456	191 798	223 596	217 656

^a Dividend includes a \$20 million special dividend payment.

ENERGEX was formed on 1 July 1997, following the incorporation of the South-East Queensland Electricity Corporation and its wholly-owned subsidiary, Southern Electricity Retail Corporation. It is subject to the provisions of the *Government Owned Corporations Act 1993* and the *Corporations Act 2001 (Cth)*¹.

ENERGEX distributes and retails electricity and gas in Queensland via two wholly-owned subsidiary companies, ENERGEX Retail and Allgas Energy.

Operating profits (before tax) declined 5 per cent (\$13 million) in 2004-05. This was attributable to a 4 per cent (\$80 million) increase in total expenses, associated with increased capital expenditure and interest costs during the year. ENERGEX reported the increased capital expenditure was undertaken in order to cater for higher demand and improve network reliability.

The value of ENERGEX's assets increased by more than 25 per cent (\$1.2 billion) in 2004-05, which was the result of both capital expenditure and a \$710 million revaluation of the electricity network. The revaluation was conducted during 2004-05 in conjunction with a Queensland Competition Authority determination on pricing of distribution services. The revaluation, plus a \$290 million increase in debt levels, led to a large decline in the debt to equity ratio from 122 per cent to 96 per cent. The ratio of total liabilities to equity also declined from 180 per cent to 140 per cent.

ENERGEX is required to make tax-equivalent and dividend payments. Under the GOC Act, the Board makes a recommendation to the shareholding ministers on its proposed dividend payment. Shareholding ministers may either approve the recommendation or direct the Board to pay a specified dividend. In 2004-05, ENERGEX provided for a \$120 million dividend payment and recorded an income tax-equivalent expense of \$84 million.

ENERGEX receives community service obligation payments to cover any financial shortfall incurred in supplying electricity to its non-contestable customers at gazetted tariffs, as well as for the payment and administration of pensioner rebates. These payments amounted to \$35 million in 2004-05.

¹ The Queensland Government announced in April 2006 its intention to sell the retail operations of ENERGEX. The government indicated it expects the trade sale to be completed by the end of 2006.

ENERGEX (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02 ^b	2002-03 ^c	2003-04	2004-05 ^d
<i>Size</i>						
Total assets	\$m	3 708	3 902	4 241	4 489	5 636
Total revenue	\$m	1 908	1 950	2 142	2 278	2 345
<i>Profitability</i>						
Operating profit before tax	\$'000	116 096	170 443	186 469	239 069	226 278
Operating sales margin	%	11.0	12.4	13.4	14.8	14.2
Cost recovery	%	109.7	114.2	115.5	117.4	116.2
Return on assets	%	6.3	6.6	7.2	7.9	6.7
Return on equity	%	6.8	6.5	8.8	9.7	7.3
<i>Financial management</i>						
Debt to equity	%	97.2	119.4	123.6	121.6	95.7
Debt to total assets	%	44.9	47.6	48.0	44.7	44.4
Total liabilities to equity	%	131.1	157.2	168.1	179.6	140.0
Interest cover	times	2.1	3.2	2.7	3.3	3.0
Current ratio	%	125.8	137.8	147.3	133.3	144.1
Leverage ratio	%	231.1	257.2	268.1	279.6	240.0
<i>Payments to and from government</i>						
Dividends	\$'000	102 520	246 319	158 909	147 500	115 641
Dividend to equity ratio	%	7.3	15.8	10.3	9.3	5.9
Dividend payout ratio	%	107.1	243.0	117.1	95.0	79.9
Income tax expense	\$'000	20 381	69 060	50 780	83 800	81 569
CSO funding	\$'000	24 626	27 419	29 600	32 500	34 508

^a ENERGEX revalued its supply system, upon adoption of AASB 1041, resulting in a revaluation increment of \$495 million to non-current assets. Includes expenses of \$12 million relating to redundancy restructuring and development costs. Dividend includes an \$8.2 million payment attributed to 1999-00 but not provided for in that year. Also includes a proposed final dividend of \$94 million attributed to 2000-01. ^b Includes expenses of \$27 million relating to a write down of investments, and redundancy and restructuring costs. Dividends include a \$150 million special dividend. ^c Dividends include a \$30 million special dividend. ^d Assets were revalued by \$714 million.

Western Power is a government-owned corporation established under the *Electricity Corporation Act 1994*. Western Power owns four major and 24 smaller power stations with a total capacity of 3500 MW — 56 per cent of WA's total generation capacity.¹ Western Power is also involved in the transmission, distribution and retailing of electricity to residential and industrial (commercial) customers.²

The WA Government announced in December 2005 that the vertical disaggregation of Western Power would take place from 1 April 2006. Western Power has been successfully split into four independent corporations: Verve Energy (generation), Western Power (distribution and transmission), Synergy (retail) and Horizon Power (integrated regional provider).

In 2004-05, Western Power's pre-tax operating profit declined 20 per cent (\$76 million) to \$300 million, reflecting a rise in total expenses of more than 13 per cent (\$190 million) that exceeded a 5.0 per cent (\$110 million) increase in revenue. Increased electricity demand provided solid growth in electricity sales. However, increased fuel prices (compared to the previous year) as well as the use of more expensive peak capacity, inflated operating costs over the year.

Western Power's debt levels have remained high during the reporting period, as reflected in its debt to equity and debt to total assets ratios. Debt to equity fell slightly in 2004-05, the result of a 5.0 per cent (\$120 million) increase in total debt outstanding that was proportionally smaller than a 7.0 per cent (\$110 million) increase in total equity.³ There was a slight increase in Western Power's debt to total assets ratio.

Western Power makes dividend and income tax-equivalent payments to the State Government. In 2004-05, Western Power provided for a \$106 million dividend payment and recorded an income tax-equivalent expense of \$75 million.

Western Power received an entitlement of \$43 million for the performance of community service obligations in 2004-05.

¹ Western Power operates and maintains all but one of its own generation assets, the Collie Power station, which since 24 March 2005 is operated and maintained by a private company.

² Western Power's customers are supplied through two major interconnected systems — one in the South-West corner of Western Australia and the other in the Pilbara to the North. Western Power also operates 28 separate systems in remote parts of the State.

³ The increase in total equity comprised of a \$100 million increase in retained profits and a \$7 million increase in contributed equity from the WA Government.

WESTERN POWER (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01^a</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	4 180	4 231	4 407	4 583	4 828
Total revenue	\$m	1 597	1 623	1 725	1 802	1 913
<i>Profitability</i>						
Operating profit before tax	\$'000	289 138	302 697	319 979	375 183	298 845
Operating sales margin	%	28.1	28.1	26.9	29.0	23.3
Cost recovery	%	139.2	139.1	136.8	140.6	130.2
Return on assets	%	11.0	10.9	10.8	11.6	9.5
Return on equity	%	15.3	15.6	15.0	17.0	13.6
<i>Financial management</i>						
Debt to equity	%	188.7	160.3	162.2	145.2	144.3
Debt to total assets	%	57.5	55.5	57.0	51.7	52.1
Total liabilities to equity	%	233.7	190.8	190.5	186.1	184.2
Interest cover	times	2.8	3.0	3.2	3.5	3.0
Current ratio	%	133.5	117.6	112.4	110.7	120.5
Leverage ratio	%	333.7	290.8	290.5	286.1	284.2
<i>Payments to and from government</i>						
Dividends	\$'000	94 100	116 972	114 050	103 513	105 783
Dividend to equity ratio	%	7.5	8.6	7.7	6.6	6.4
Dividend payout ratio	%	49.3	55.3	51.1	39.0	47.3
Income tax expense	\$'000	98 121	91 342	96 901	109 604	75 141
CSO funding	\$'000	28 700	31 400	33 500	34 700	42 700

^a The dividend payment in 2000-01 was comprised of a \$47 million interim dividend, paid on 29 June 2001 and provision for a \$47 million dividend, paid during December 2001.

The Hydro-Electric Corporation (HEC), trading as Hydro Tasmania (HT), operates under the *Hydro-Electric Corporation Act 1995* and is subject to the provisions of the *Government Business Enterprises Act 1995*. On 1 July 1998, the HEC was disaggregated into three separate businesses — the HEC, Aurora Energy and Transend Networks. The HEC retained responsibility for electricity generation on mainland Tasmania and for generation, distribution and retailing on the Bass Strait Islands.¹

The HEC's pre-tax operating profit improved 38 per cent (\$27 million) to \$99 million in 2004-05, the result of a \$10 million increase in revenue and a \$17 million decline in total expenses.

The value of the HEC's assets declined 13 per cent (\$350 million) in 2004-05, partly reflecting a \$600 million devaluation of generation assets. The devaluation resulted from the incorporation of lower real electricity prices into the fair value of those assets. The devaluation and a 13 per cent (\$130 million) increase in total outstanding debt, caused both the debt to equity and debt to total assets ratios to also increase. The devaluation also caused the HEC's leverage ratio to increase, reflecting the larger proportionate fall in total equity than the decrease in total assets.

The HEC's current ratio increased from 24 per cent to 134 per cent as a result of a \$110 million increase in current assets (money market deposits). The deposit is required in fulfilment of conditions under the HEC's Australian Financial Services Licence, gained during 2004-05.² The deposit is funded using a credit facility that is reported as a non-current liability.

The HEC is required to make tax-equivalent and dividend payments to the Tasmanian Government. In 2004-05, a \$40 million dividend was paid, including an \$8 million special dividend. An income tax-equivalent expense of \$36 million was recorded.

Throughout the reporting period, the HEC received community service obligation (CSO) payments for the provision of concessional arrangements to customers living on the Bass Strait Islands. In 2004-05, CSO payments amounted to \$6 million.

¹ Delivery of services to the Bass Strait Islands has been contracted to Aurora Energy.

² The licence authorises the HEC to carry on financial services business, including dealings in financial derivatives.

HYDRO-ELECTRIC CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02	2002-03 ^b	2003-04 ^c	2004-05
<i>Size</i>						
Total assets	\$m	3 342	3 515	3 568	3 598	3 248
Total revenue	\$m	332	371	397	439	449
<i>Profitability</i>						
Operating profit before tax	\$'000	46 284	60 056	68 100	71 981	99 196
Operating sales margin	%	40.2	36.0	38.0	32.9	38.1
Cost recovery	%	165.2	154.3	159.6	148.4	161.6
Return on assets	%	4.1	3.9	4.3	4.0	5.1
Return on equity	%	0.8	1.4	1.7	1.7	3.5
<i>Financial management</i>						
Debt to equity	%	55.0	52.1	50.2	52.1	78.8
Debt to total assets	%	31.5	30.2	29.3	30.2	35.4
Total liabilities to equity	%	77.2	76.8	72.9	73.5	111.3
Interest cover	times	1.5	1.8	1.8	2.0	2.3
Current ratio	%	27.6	32.5	25.9	24.4	133.6
Leverage ratio	%	177.2	176.8	172.9	173.5	211.3
<i>Payments to and from government</i>						
Dividends	\$'000	49 230	60 503	40 000	40 000	40 000
Dividend to equity ratio	%	2.7	3.1	2.0	1.9	2.2
Dividend payout ratio ^d	%	323.4	217.6	118.9	113.3	63.3
Income tax expense	\$'000	31 060	32 252	34 453	36 661	35 986
CSO funding	\$'000	4 914	5 356	5 238	4 748	6 030

^a Includes debt restructuring expenses relating to the repurchase of loans (\$6.8 million) and the termination of interest rate swaps (\$670 000). Includes an abnormal income tax item (\$22.5 million) relating to the restatement of deferred tax balances due to a change in the income tax rate. Includes an asset revaluation increase of \$74 million. ^b In 2002-03, the Hydro-Electric Corporation changed its policy regarding dividend payments in accordance with accounting standard AASB 1044 *Provisions, Contingent Liabilities and Contingent Assets*. Under this standard, dividends are recognised at the time they are declared, determined or publicly recommended. In August 2003, the HEC Board proposed a dividend payment of \$43 million, including a \$26 million special dividend. This dividend payment is reported for 2003-04. ^c The HEC Board proposed a dividend of \$40 million for 2003-04, including a special dividend of \$17.4 million. This dividend payment will be included in the 2004-05 annual report. ^d Dividends prior to 2004-05 have been adjusted to take account of changes in practices or policies during the reporting period.

Aurora Energy Pty Ltd (Aurora) was established on 1 July 1998, following the disaggregation of the Hydro-Electric Corporation (HEC).¹ Aurora is incorporated under the *Corporations Act 2001* (Cth), pursuant to the *Electricity Companies Act 1997*.

Aurora is mainland Tasmania's only electricity distribution and retail company. It also holds electricity retail licences in New South Wales and Victoria.²

Aurora reported a 13 per cent increase (\$6 million) in pre-tax operating profit to \$52 million in 2004-05. The result reflects a 13 per cent increase (\$86 million) in total revenue that outpaced growth in expenses. Total expenses increased \$80 million to \$697 million.

Aurora's profit result was also aided by a \$9.2 million asset revaluation of unbilled energy sales. The change also led to a significant increase in Aurora's current ratio from 73 per cent to 130 per cent. The current ratio was also boosted by an increase in Aurora's holdings of money market deposits, required under the entity's recently issued Australian Financial Services licence.

Aurora is required to make dividend and tax-equivalent payments to the Tasmanian Government. In 2004-05, Aurora provided for a \$12 million dividend payment and recorded an income tax-equivalent expense of \$19 million.

Aurora receives community service obligation (CSO) payments for providing pensioners with discounted electricity. In 2004-05, Aurora received \$12 million in CSO payments.

¹ Prior to disaggregation, the HEC had sole responsibility for the generation, transmission and sale of electricity in Tasmania. Transend Networks now owns and operates Tasmania's electricity transmission assets and Aurora conducts electricity distribution and retailing. Aurora also delivers services on Bass Strait Islands under sub-contract for the HEC.

² Since disaggregation, Aurora has broadened its range of products and services. In 2001-02, it entered into an alliance with Signature Security Group for the purpose of marketing security products. This followed the establishment of a telecommunications joint-venture (TasTel) in 2000-01, and the formation of a subsidiary company — EziKey — to market its bill paying system. Aurora Gas Pty Ltd was formed as a wholly-owned subsidiary in February 2002 to participate in the Tasmanian gas supply tendering process.

AURORA ENERGY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04^a</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	792	836	864	923	1 072
Total revenue	\$m	572	587	631	663	749
<i>Profitability</i>						
Operating profit before tax	\$'000	37 002	40 139	46 761	45 648	51 610
Operating sales margin	%	12.3	11.6	11.8	10.7	10.1
Cost recovery	%	114.0	113.1	113.4	112.0	111.2
Return on assets	%	9.2	8.4	8.9	8.1	7.9
Return on equity	%	8.0	11.1	9.0	7.7	8.3
<i>Financial management</i>						
Debt to equity	%	143.9	127.0	107.9	97.4	108.1
Debt to total assets	%	48.6	46.4	43.1	41.0	43.8
Total liabilities to equity	%	201.0	180.8	154.7	145.6	165.2
Interest cover	times	2.1	2.4	2.6	2.7	2.9
Current ratio	%	55.2	80.3	88.6	72.7	128.9
Leverage ratio	%	301.0	280.8	254.7	245.6	265.2
<i>Payments to and from government</i>						
Dividends ^a	\$'000	10 244	12 567	14 954	13 942	11 997
Dividend to equity ratio	%	4.1	4.5	4.7	3.9	3.1
Dividend payout ratio	%	50.8	40.5	52.0	50.8	37.0
Income tax expense	\$'000	16 856	9 082	17 995	18 225	19 225
CSO funding	\$'000	9 727	9 745	13 005	11 319	11 513

^a Prior year dividends have been adjusted to take account of changes in practices or policies during the reporting period.

Transend Networks (Transend) was established on 1 July 1998, following the disaggregation of the Hydro-Electric Corporation (HEC).¹ Transend is incorporated under the *Corporations Act 2001* (Cth), pursuant to the *Electricity Companies Act 1997*.

Transend owns and operates the high voltage electricity transmission system in Tasmania, which includes almost 3500 km of overhead transmission lines, 45 substations and 9 switching stations. Following commencement of the National Electricity Market in Tasmania on 29 May 2005, Transend handed over its responsibilities for the security of the system to the National Electricity Market Management Company Limited.

During 2004-05, Transend undertook capital expenditure of \$75 million to prepare for the commencement of operations of the Basslink interconnector, which commenced operations on 29 April 2006, as well as to increase security and reliability in the network.

In 2004-05, the value of Transend's assets increased by 7 per cent (\$49 million) to \$698 million. Transend's total debt increased 51 per cent (\$18 million) from \$35 million to \$53 million, the majority of which consisted of non-current borrowings.

Transend's pre-tax operating profit was 37 per cent (\$12 million) higher in 2004-05 compared to the previous financial year, increasing to \$44 million. This was the net result of a 23 per cent (\$22 million) rise in revenue and a 15 per cent (\$10 million) rise in expenses.

Transend's debt to equity and debt to total asset ratios both increased in 2004-05, to 9.2 per cent and 7.9 per cent, respectively. The corporation's overall level of debt remains low however, when compared to other electricity GTEs.

Transend is required to make dividend and tax-equivalent payments to the Tasmanian Government. In relation to 2004-05, Transend declared a \$14 million dividend and recorded an income tax-equivalent expense of \$16 million.

¹ Prior to disaggregation, the HEC had sole responsibility for the generation, transmission and sale of electricity in Tasmania. Transend Networks owns and operates Tasmania's electricity transmission assets and Aurora Energy conducts electricity distribution and retailing.

TRANSEND NETWORKS (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02^a</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	464	593	604	649	698
Total revenue	\$m	78	81	83	97	119
<i>Profitability</i>						
Operating profit before tax	\$'000	22 407	28 637	27 155	32 199	44 089
Operating sales margin	%	30.6	36.7	33.7	35.3	39.5
Cost recovery	%	144.0	158.1	150.8	154.6	165.4
Return on assets	%	5.3	5.6	4.7	5.5	7.0
Return on equity	%	2.6	4.3	3.1	3.7	5.0
<i>Financial management</i>						
Debt to equity	%	3.9	3.3	4.9	6.4	9.2
Debt to total assets	%	3.5	3.3	4.3	5.6	7.9
Total liabilities to equity	%	17.4	13.3	15.6	17.6	22.0
Interest cover	times	16.4	25.8	28.7	16.7	16.2
Current ratio	%	35.8	39.8	62.9	33.2	26.6
Leverage ratio	%	117.4	113.3	115.6	117.6	122.0
<i>Payments to and from government</i>						
Dividends ^b	\$'000	10 091	9 837	8 183	9 924	13 766
Dividend to equity ratio	%	2.6	2.1	1.6	1.8	2.5
Dividend payout ratio	%	100.2	50.0	50.0	49.9	48.7
Income tax expense	\$'000	12 341	8 963	10 789	12 327	15 833
CSO funding	\$'000	0	0	0	0	0

^a Includes an asset revaluation increase of \$118 million. ^b Dividends prior to 2004-05 have been adjusted to take account of changes in practices or policies during the reporting period.

Power and Water Corporation (PWC) was established on 1 July 2002, following the corporatisation of the Power and Water Authority (PAWA).¹ PWC operates under the *Government Owned Corporations Act 2001* (GOC). PWC generates, transmits, distributes and retails electricity throughout the Northern Territory, as well as providing water and sewerage services.

PWC owns and operates the three separate grid systems operating in the Northern Territory — Darwin–Katherine, Alice Springs and Tenant Creek.

PWC's pre-tax operating profit declined 11 per cent (\$6 million) in 2004-05. The change can be attributed to increased wages and raw materials costs, arising out of a new Enterprise Bargaining Agreement, as well as higher global oil prices. The increased operating expenses were not wholly offset by 12 per cent growth (\$58 million) in sales and services revenue.

In 2004-05, PWC provided for a \$19 million dividend payment and recorded an income tax-equivalent expense of \$14 million. PWC is required to declare a dividend and make tax-equivalent payments to the NT Government under the GOC.

PWC receives CSO payments from the NT Government. In 2004-05, these amounted to \$52 million for pensioner concessions, geographic equalisation, Government price freeze policy and Tranche 4 electricity reforms.²

¹ PAWA was established under the *Power and Water Authority Act* in 1987.

² Tranche 4 reforms relate to the introduction of retail contestability in the Northern Territory. More information about NT Government regulation in this sector is provided at the start of this chapter.

POWER AND WATER CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	Units	2001-02 ^a	2002-03 ^b	2003-04	2004-05
<i>Size</i>					
Total assets	\$m	1 013	1 043	1 051	1 056
Total revenue	\$m	390	448	480	538
<i>Profitability</i>					
Operating profit before tax	\$'000	18 560	45 772	55 046	48 938
Operating sales margin	%	9.6	15.5	16.0	13.5
Cost recovery	%	110.6	118.4	119.1	115.6
Return on assets	%	4.0	7.1	7.7	7.0
Return on equity	%	2.8	5.1	6.5	5.4
<i>Financial management</i>					
Debt to equity	%	42.5	52.0	47.1	44.9
Debt to total assets	%	27.7	30.9	28.3	27.9
Total liabilities to equity	%	53.3	70.9	66.8	61.5
Interest cover	times	1.9	2.7	3.2	2.9
Current ratio	%	138.9	133.1	97.8	69.5
Leverage ratio	%	153.3	170.9	166.8	161.5
<i>Payments to and from government</i>					
Dividends	\$'000	9 227	20 000	20 046	18 900
Dividend to equity ratio	%	1.4	3.1	3.2	2.9
Dividend payout ratio	%	49.7	62.3	49.8	54.4
Income tax expense	\$'000	0	13 672	14 818	14 164
CSO funding	\$'000	58 814	42 241	44 145	52 039

^a The Power and Water Corporation (PWC) was included in this report for the first time in 2001-02. It was established in 1987 under the *Power and Water Authority Act*. ^b In 2002-03, the PWC repaid \$56 million in equity to the NT Government. The equity withdrawal was funded from debt, increasing interest-bearing liabilities and decreasing equity by commensurate amounts.

Snowy Hydro Limited (Snowy Hydro) commenced operations on 28 June 2002, when it assumed responsibility for the assets and liabilities of the Snowy Mountains Hydro-Electric Authority (SMHEA), under the *Snowy Corporatisation Act 1997*.¹ Snowy Hydro operates under the *Corporations Act 2001* (Cwlth) and is jointly owned by the Australian Government, NSW and Victorian Governments.²

Snowy Hydro controls the Snowy Mountains Scheme — dual-purpose infrastructure that enables hydro-electric generation and irrigation — which consists of seven power stations and 16 dams mainly in the Kosciusko National Park. During 2004-05, Snowy Hydro also acquired a 100 per cent interest in energy retailer, Red Energy, currently operating in the Victorian market.

Snowy Hydro generated 4320 GWh of electricity for sale into the National Electricity Market in 2004-05, representing approximately 2.4 per cent of total traded volume.

Snowy Hydro's pre-tax operating profit declined by 7.0 per cent (\$32 million) in 2004-05 to \$199 million. The decline is attributable to a 5.0 per cent increase in total expenses (\$10 million) against a 1.0 per cent (\$5 million) decline in total revenue.

Snowy Hydro is required to make dividend and tax-equivalent payments. In 2004-05, Snowy Hydro provided for a \$110 million dividend payment and recorded an income tax-equivalent expense of \$51 million.

¹ The SMHEA was abolished on 27 June 2002. Prior to its abolition, the SMHEA sold its transmission assets to TransGrid and paid the balance owing for Commonwealth Government advances it received to construct the Snowy Mountains Scheme. The Australian Government assumed any future liability in respect of Inscribed Stock, previously issued by the SMHEA.

² Shareholdings in Snowy Hydro are NSW (58 per cent), Victorian (29 per cent) and Australian (13 per cent) Governments.

SNOWY HYDRO (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01	2001-02	2002-03 ^a	2003-04	2004-05
<i>Size</i>						
Total assets	\$m			1 680	1 691	1 891
Total revenue	\$m			386	430	425
<i>Profitability</i>						
Operating profit before tax	\$'000			182 546	214 544	198 637
Operating sales margin	%			57.0	58.1	55.0
Cost recovery	%			232.7	238.4	222.3
Return on assets	%			13.2	14.8	12.4
Return on equity	%			13.9	16.4	14.7
<i>Financial management</i>						
Debt to equity	%			58.5	52.6	61.3
Debt to total assets	%			33.0	30.1	32.6
Total liabilities to equity	%			77.2	74.9	88.3
Interest cover	times			5.7	6.9	6.6
Current ratio	%			66.0	69.5	60.1
Leverage ratio	%			177.2	174.9	188.3
<i>Payments to and from government</i>						
Dividends	\$'000			0	140 000 ^b	110 000
Dividend to equity ratio	%			0.0	14.5	11.0
Dividend payout ratio	%			0.0	88.1	74.6
Income tax expense	\$'000			50 875	55 681	51 116
CSO funding	\$'000			0	0	0

^a 2002-03 is the first year that Snowy Hydro was included in this report. It was established under the *Snowy Corporatisation Act 1997*. ^b The \$140 million dividend for 2003-04 includes an unfranked cash dividend of \$70 million paid on 12 September 2003 and another fully franked cash dividend of \$70 million paid on 2 February 2004.

7 Water, sewerage, drainage and irrigation

The financial performances of 24 water, sewerage, drainage and irrigation (referred to hereafter as water) government trading enterprises (GTEs) are reported in this chapter. In 2004-05, these GTEs generated over \$6 billion in revenue and controlled assets valued at over \$48 billion.

The monitored water GTEs vary in size and the range of services they provide. Several carry out all the activities involved in the supply of water and the disposal of stormwater and sewage. Others provide only a limited range of these services.

The GTEs monitored include those that provide services to major urban, regional and rural areas.

Financial performance summaries, including performance indicators for the water sector and each water GTE, are presented in this chapter. The performance indicators are consistent across individual GTEs. However, when making comparisons, care should be taken to consider differences in market environments and issues relating to the valuation of assets.

A discussion of the data, performance indicators used and some of the factors that should be considered when assessing performance is provided in chapter 3.

7.1 Monitored GTEs

The activities of the monitored water GTEs are shown in table 7.1. Some also have interests in other areas. For example, ACTEW Corporation of the ACT has a joint venture interest with the private sector for the supply of gas and electricity.

Table 7.1 Activities — water GTEs, 2004-05

<i>Water GTE</i>	<i>Jurisdiction</i>	<i>Activity</i>				
		Catchment management	Bulk water	Reticulation	Wastewater treatment	Irrigation supply ^a
Sydney Catchment Authority	NSW	✓	✓	✗	✗	✗
Sydney Water	NSW	✗	✗	✓	✓	✗
Hunter Water	NSW	✓	✓	✓	✓	✗
Melbourne Water	Victoria	✓	✓	✓	✓	✓
City West Water	Victoria	✗	✗	✓	✗	✗
South East Water	Victoria	✗	✗	✓	✗	✗
Yarra Valley Water	Victoria	✗	✗	✓	✗	✗
Barwon Water	Victoria	✓	✓	✓	✓	✗
Coliban Water	Victoria	✗	✓	✓	✓	✗
Goulburn Valley Water	Victoria	✗	✓	✓	✓	✗
Gippsland Water	Victoria	✗	✓	✓	✓	✗
Central Highlands Water	Victoria	✗	✓	✓	✓	✗
Southern Rural Water	Victoria	✗	✓	✗	✗	✓
Lower Murray Water	Victoria	✗	✗	✓	✓	✓
Grampians Wimmera Mallee Rural Water	Victoria	✗	✓	✓	✓	✓
Goulburn–Murray Rural Water	Victoria	✗	✓	✗	✗	✓
Sunwater	Queensland	✗	✓	✗	✗	✓
SA Water	SA	✗	✓	✓	✓	✓
Water Corporation	WA	✓	✓	✓	✓	✓
Hobart Water	Tasmania	✗	✓	✗	✗	✓
Cradle Coast Water	Tasmania	✗	✓	✗	✗	✓
Esk Water	Tasmania	✗	✓	✗	✗	✓
ACTEW Corporation	ACT	✓	✓	✓	✓	✗

^a Not including wastewater sales for irrigation purposes.

The set of monitored water GTEs does not include local government service providers. In some cases, the revenues generated by these providers can be substantial. For example, in 2004-05, the water operations of the Brisbane City Council and Gold Coast City Council generated revenue of over \$500 million and \$200 million respectively (BCC 2005, GCCC 2005).

The Commission has expanded the number of monitored water GTEs over the reporting period.

Six regional and rural Victorian GTEs — Coliban Water, Goulburn Valley Water, Gippsland Water, Central Highlands Water, Southern Rural Water and Goulburn-Murray Rural Water — and one from the ACT — ACTEW — have been monitored since 2001-02. Of the Victorian GTEs, four provide water and sewerage services to households and businesses in regional Victoria¹, and the other two are mainly involved in the storage of bulk water and its sale to irrigators in regional Victoria. The ACTEW Corporation is a vertically integrated water and electricity distribution GTE operating predominantly in the ACT.

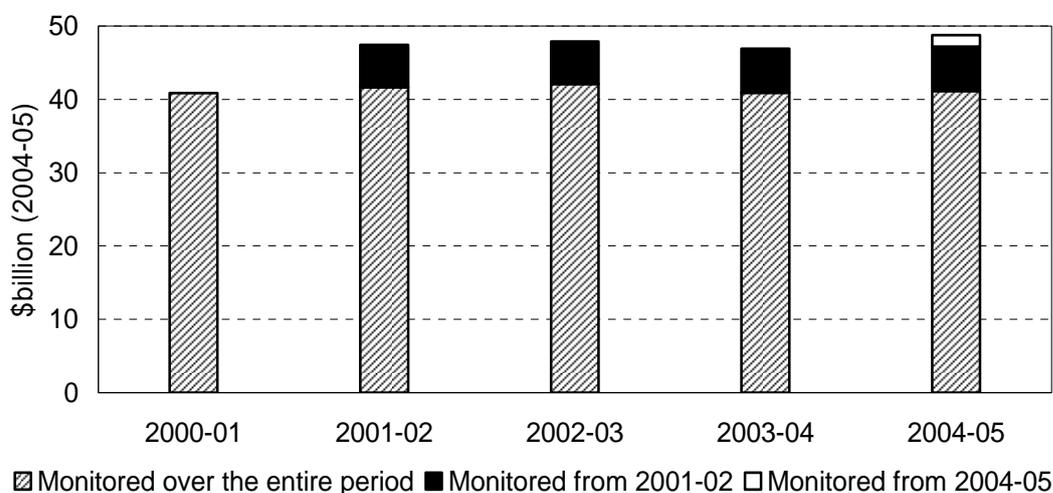
In 2004-05, the financial performances of Grampians Wimmera Mallee Water (Victoria) and Lower Murray Water (Victoria) are reported for the first time.

On 1 July 2004, Wimmera Mallee Water (rural water authority) merged with Grampians Water (regional urban water authority) to form Grampians Wimmera Mallee Water. Sunraysia Rural Water Authority was also merged with Lower Murray Water (regional urban water authority), to trade as Lower Murray Water. Previous GTE reports monitored the financial performance of Wimmera Mallee Water and Sunraysia Rural Water Authority between 2001-02 and 2003-04.

The change in total assets of monitored water GTEs over the reporting period, measured in 2004-05 dollars, is shown in figure 7.1. The total assets of water GTEs monitored for the entire period increased by 1 per cent. The total assets of water GTEs monitored since 2001-02 increased by 4 per cent. The total assets of the three GTEs included for the first time in 2004-05, increased assets in the water sector by \$1.1 billion.

¹ After Barwon Water — which has been monitored for the entire reporting period — Coliban Water, Goulburn Valley Water, Gippsland Water and Central Highlands Water are the four largest regional urban water authorities by historical population served (VWIA 2005).

Figure 7.1 Sector assets — water GTEs



Note In 2001-02, an additional seven water GTEs were monitored. In 2004-05, a further two GTEs are monitored. The value of sector assets prior to 2004-05 was converted to 2004-05 dollars using the implicit price deflator — Gross Fixed Capital Formation for Public Corporations (chapter 3).

Source: Productivity Commission estimates.

The size of the water GTEs — in terms of the value of the assets controlled and revenue earned — varies substantially (figure 7.2). In 2004-05, the smallest water GTE monitored in terms of asset value and revenue was Cradle Coast Water (\$65 million in assets and \$8.6 million in revenue). The largest water GTE monitored in terms of both assets and revenues was the Sydney Water Corporation (Sydney Water) (\$12 billion in assets and \$1.4 billion in revenue).²

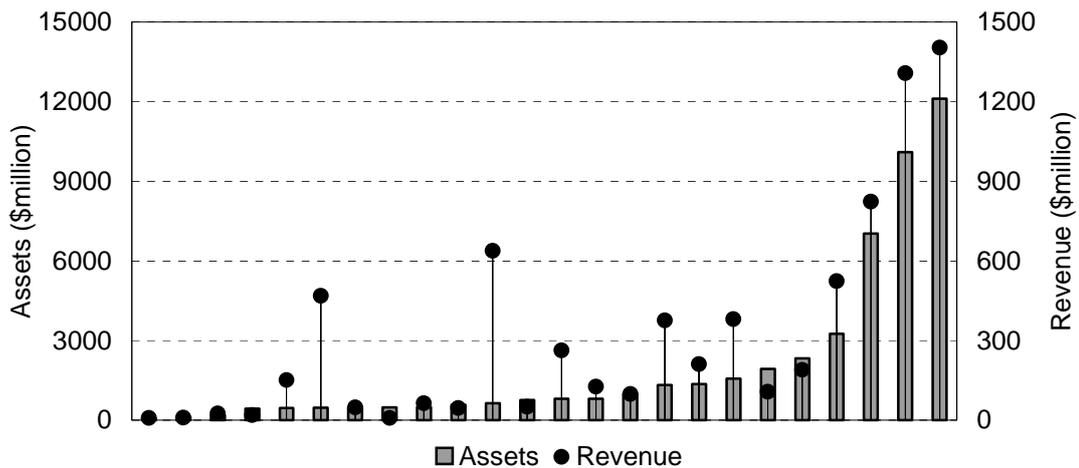
The regulatory framework for the monitored water GTEs differs across jurisdictions. Most monitored water GTEs operate under licences that specify standards for water quality and supply reliability and cover the extraction of water from rivers and underground systems.

There are also jurisdictional differences in governance. These include the different emphases on commercial objectives by boards and governments compared to other objectives, such as compliance with the principles of ecologically sustainable development.

² Sydney Water is the second largest GTE monitored in this report. The largest is Telstra.

The prices charged by New South Wales, Victorian (metropolitan) and ACT water GTEs are regulated by independent bodies.³ The prices charged by Victorian regional urban and rural water authorities were set by the GTE boards and approved by the minister.⁴ Prices for a small number of the remaining monitored water GTEs are set directly by government.

Figure 7.2 **Assets and revenue — water GTEs, 2004-05**



Source: Productivity Commission estimates.

7.2 Market environment

Changes in the operating environment — obligations and objectives, demand and supply conditions, and regulated charges — of water GTEs can affect their financial performance. Further, weather conditions and water restrictions impact on the availability of, and demand for, water.

³ The Independent Pricing and Regulatory Tribunal regulates prices for New South Wales water GTEs, the Independent Competition and Regulatory Commission regulates ACTEW Corporation’s prices and the Essential Services Commission (ESC) regulates prices for metropolitan water GTEs in Victoria.

⁴ On 1 July 2005, ESC price determinations took effect for regional urban water authorities. The ESC expects that price determinations for rural water authorities will take effect from 1 July 2006.

Sector-wide reforms

Water industry reforms have been aimed at improving efficiency and financial performance by making the GTEs more commercially focused.

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

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

In June 2004, CoAG agreed to the National Water Initiative (NWI).⁵ The objective of NWI is to optimise economic, social and environmental outcomes by improving the national consistency of markets and regulatory and planning frameworks for managing Australia's surface and groundwater resources (CoAG 2004). Key elements of the NWI include:

- continued implementation of full cost recovery pricing for water in both urban and rural sectors;
- the use of independent bodies to set or review prices or price setting processes, and to publicly review and report on pricing and cost recovery arrangements;
- greater consistency in pricing policies across sectors and jurisdictions, so as to facilitate the trade of entitlements; and
- better management of urban water demand, by reviewing temporary water restrictions and encouraging innovations to promote urban water efficiency.

As part of the NWI, CoAG agreed to establish the National Water Commission, which will assess and report back to CoAG on the progress of governments in implementing the NWI.

⁵ All Australian governments are now signatories to the agreement, although the Governments of Tasmania and Western Australia did not initially sign the agreement in 2004.

Organisational changes

Some GTEs have privatised or outsourced business activities for commercial reasons. For example, SA Water contracted out the management and operation of the water supply for the Adelaide metropolitan area to a private company for a period of 15 years in 1996. Coliban Water contracts out a range of activities to the private sector including operations and maintenance, revenue collection, technical and laboratory operations, and information technology management. Coliban Water also has several water treatment plants constructed under public-private partnerships.

Other GTEs have been restructured for governance reasons. For example, the Sydney Catchment Authority (SCA) was established in 1999 as a result of a 1998 review of the detection of the parasites *Cryptosporidium* and *Giardia* in Sydney's drinking water. The SCA was made responsible for the management and protection of Sydney's water supply catchments, dams, raw water transfer pipelines and canals, and associated infrastructure. This infrastructure had previously been managed by Sydney Water.

Water demand and supply

Since all the monitored water GTEs charge volumetric rates for water use, their financial performance is directly related to the amount of water they distribute. This depends on both the demand for water and the GTEs' ability to supply enough water to meet this demand.

The demand for water is determined primarily by factors such as population, industry composition and activity. However, demand is also affected by weather conditions. For example, SA Water supplied Adelaide with 526 million litres of water per day in 2000-01 (a year with a prolonged hot summer) compared to 454 million litres per day during 2004-05 (SA Water 2005).

For many GTEs, the amount of water they are able to supply in any year is strictly limited, and dependent on current and previous seasonal conditions. Indeed, the performance of several GTEs was adversely affected by the drought in 2003-04 because of limited water availability. For example, in October 2003, SA Water implemented permanent water restrictions.⁶

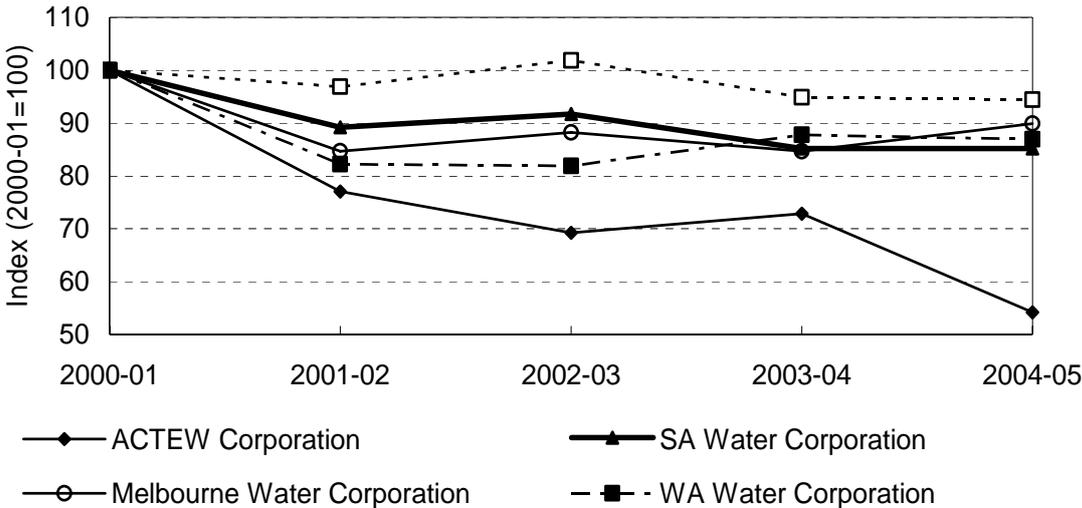
⁶ The Victorian Government implemented similar water restrictions in Melbourne from 1 March 2005.

Responses by governments and GTEs to conserve water include restrictions on consumption by specific customers and general restrictions applying to specific activities. For example, in September 2001, the WA Government restricted the use of sprinklers by households and businesses to two days per week (Water Corporation 2002).

Many GTEs have environmental objectives included in their governing legislation. Demand management measures can be useful in meeting objectives such as improving environmental flows.

Over the reporting period, the volume of water supplied by water GTEs varied year to year (see figure 7.3 for selected GTEs). Water restrictions and water conservation efforts appear to have had a significant impact on water sales. Overall, aggregate urban water consumption in Australia declined by 15 per cent between 2000-01 and 2004-05 (WSAA 2005).

Figure 7.3 Water sales — selected urban water GTEs



Source: WSAA (2005).

Customer charges

Historically, water and sewerage charges were based on property values, accompanied by a free allowance of water that could be consumed without any usage charge. Property-based charges rarely reflected the cost of providing water and sewerage services, and sometimes resulted in cross-subsidisation between customers (PC 2002b).

All monitored water GTEs now have usage-based charges for water supply services, typically comprising a fixed access charge and a volumetric charge based on water

use.⁷ The access charge is intended to reflect the fixed costs of supplying a customer including billing, system maintenance and environmental costs. The volumetric charge is intended to reflect the variable cost of supplying water. In some cases, usage-based charges are in the form of inclining block tariffs, implemented partly as a demand management initiative.

Two GTEs — Water Corporation and SA Water — continue to use property-based charges for sewerage services.

In 2004-05, the Victorian Government introduced an inclining block tariff for domestic water users in Melbourne. From 1 October 2004, households paid 75 cents per kilolitre for the first 440 litres used per day, 88 cents per kilolitre for water used between 440 and 880 litres per day, and \$1.30 per kilolitre for water used above 880 litres per day. In line with the NWI, customers will receive ‘smart bills’ which provide details of the charges and water usage information.

GTEs that earn a significant share of total revenue from the volumetric component of usage-based charges have greater exposure to changes in the demand for water.

Governments also use water charges to collect revenue for water-related initiatives. For example, from 1 October 2003, SA Water customers were required to pay the ‘Save the Murray Levy’, which the SA Government uses to fund its contribution to an agreement with the NSW, Victorian, ACT and Australian Governments to commit \$500 million over five years to improving the health of the River Murray.

From 1 October 2004, Victorian metropolitan and regional urban water authorities were required to make environmental contributions under the *Water Industry Act 1994*. Between 2004 and 2008, these water authorities will contribute approximately \$225 million to fund environmental renewal projects around the State. Each GTE’s annual contribution is specified in the Act. In 2004, affected water authorities were permitted to, and did, increase their water charges by 5 per cent to cover their contribution.

Customer growth

Revenue volatility is also affected by the inclusion of developer and customer contributions as revenue. Developer and customer contributions entail payments to GTEs to finance new infrastructure. Alternatively, developers may be required to

⁷ Usage-based charges were first introduced in 1982 by the Hunter District Water Board (now the Hunter Water Corporation) under the late Dr John Paterson, AO (1982-84).

construct or install infrastructure assets themselves, which are then transferred to the responsible GTE at no cost.

The level of developer contributions that water GTEs receive each year is affected by the level of building activity.⁸ For example, in 2004-05, the total value of building work completed in South Australia increased by 11 per cent (ABS 2006) and the value of developer contributions received by SA Water increased by 60 per cent (SA Water 2005). In contrast, the total value of building work completed in New South Wales decreased by 6 per cent (ABS 2006), and the value of developer contributions received by Sydney Water decreased by 12 per cent (Sydney Water 2005).

Changes in the level of developer and customer contributions affect some water GTEs more than others. For example, Goulburn Valley Water's developer charges and contributions accounted for around 23 per cent of its total revenue in 2004-05. In contrast, developer charges and contributions accounts for less than 6 per cent of ACTEW Corporation's total revenue in 2004-05, and are not required at all by the Tasmanian GTEs.

7.3 Profitability

Profitability indicators provide information on how well GTEs are using the assets vested in them by shareholder governments to generate earnings. However, the diverse range of activities of the entities has to be taken into account when comparing indicators across GTEs.

Under the NWI, metropolitan water GTEs are expected to achieve upper bound pricing by 2008, while rural systems are expected to achieve lower bound cost recovery and, where practicable, move towards the upper bound (CoAG 2004).

Lower bound cost recovery pricing includes operational, maintenance and administrative costs, externalities, taxes or tax-equivalent payments, dividends, provisions for the cost of asset consumption and interest costs on debt. Upper bound — full cost recovery — pricing also encompasses the total opportunity cost of the GTE's investment in assets (calculated using a weighted average cost of capital).⁹

⁸ The total level of residential building activity declined by 27 per cent in 2000-01, then increased by 23 per cent in 2001-02, 17 per cent in 2002-03, and 5 per cent in 2003-04, but fell by 1 per cent in 2004-05.

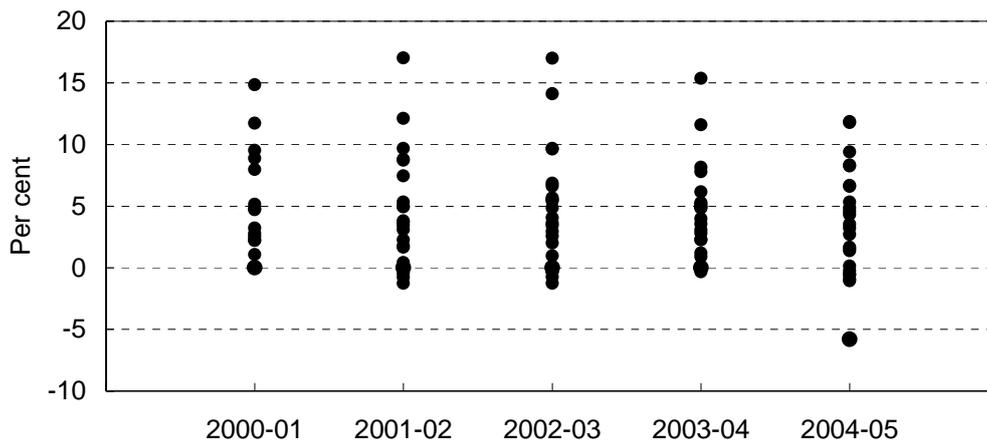
⁹ Governments first made the commitment to use cost recovery bands to set prices in 1998 (PC 2005a).

Overall, the operating profit of water GTEs was relatively stable during the reporting period. Total sector operating profit before tax was \$1.8 billion in 2004-05.

The return on assets for the sector overall decreased by 3 per cent over the reporting period, as growth in the assets exceeded growth in profitability in the sector. However, there was a wide range of variation across GTEs in each financial year over the reporting period (figure 7.4).

In 2004-05, seven of the eight monitored GTEs that generated a return on assets greater than the risk-free rate¹⁰ predominately earned revenue from providing water services to urban centres.¹¹ The five monitored GTEs that generated negative returns on assets service regional and rural areas.¹² The Grampians Wimmera Mallee Water had the lowest return on assets in 2004-05.

Figure 7.4 Return on assets — water GTEs



Note Seven water GTEs were included in 2001-02 and a further two have been included in 2004-05. 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 and adding back gross interest expense. Average total assets is the average of the value of assets at the beginning and end of each financial year. Where an average was not available, the value of total assets at the end of the financial year was used.

Source: Productivity Commission estimates.

¹⁰ In 2004-05, the risk-free rate for 10 year Australian Government bonds was 5.4 per cent.

¹¹ The eight GTEs are Melbourne Water Corporation, City West Water, South East Water, Yarra Valley Water, Sun Water, SA Water, Water Corporation and ACTEW Corporation. Of this group, Sun Water is the only GTE that predominantly services rural customers.

¹² The five GTEs are Coliban Water, Southern Rural Water, Lower Murray Water, Grampians Wimmera Mallee Water and Goulburn–Murray Water.

The rural water GTEs, such as Southern Rural Water, Lower Murray Water, Grampians Wimmera Mallee Water and Goulburn–Murray Water, do not set prices to be profitable (box 7.1).

In 2004-05, the five monitored water GTEs that generated a negative return on assets did not recover their recurrent costs. Over the reporting period, the capacity of most monitored water GTEs to recover costs has declined, with Sun Water being the notable exception, having increased its cost recovery ratio by 40 per cent.

Setting charges that do not cover costs, including the cost of capital, has implications for incentives, particularly when considering future investment decisions within the sector and across the economy. Under the full corporatisation model, the intention is to subject GTEs to the same capital market disciplines as the private sector.

There are distinct differences in the profitability of water GTEs operating in metropolitan and non-metropolitan areas in Victoria.¹³ The aggregated return on assets for metropolitan water GTEs in 2004-05 was around 9 per cent, compared to a return on assets of less than 1 per cent for regional urban and rural water GTEs. Victorian rural water GTEs use the renewals annuity approach to determine water charges, but use accounting depreciation in reporting operating results (box 7.1).¹⁴

As noted in box 7.1, using the renewals annuity approach to set prices results in lower prices and decreased profitability, contributing to the Victorian rural GTEs reporting a negative return on assets in 2004-05.

Another ratio used to measure profitability is return on equity — the rate of earnings on the capital provided by shareholder governments. Although the returns on equity for most water GTEs were stable during the reporting period, only five GTEs achieved a return greater than the risk-free rate in 2004-05.

¹³ The metropolitan water GTEs are City West Water, Yarra Valley Water, South East Water and the Melbourne Water Corporation. The other monitored water GTEs from Victoria are regional urban or rural water authorities.

¹⁴ From 1 January 2004, the ESC took responsibility for regulating all Victorian water authorities. It is currently in the process of determining price paths for the rural water authorities, which it expects to take effect from 1 July 2006.

Box 7.1 Renewals annuity pricing

Charges for rural water GTEs in Victoria during 2004-05 were based on providing adequate funding to maintain the condition of existing channels, pipelines and structures using the renewals annuity concept. This involved setting aside funds for known future asset replacement and rehabilitation. It is an alternative to setting prices based on the consumption of existing fixed assets using an accounting measure of depreciation.

A renewals-based pricing approach is consistent with the minimum full cost recovery requirements of National Competition Policy agreements for the water sector — 'to recover the operational, maintenance and administrative costs, externalities, taxes or tax-equivalents (not including income tax), the interest cost on debt, dividends (if any) and provision for future asset refurbishment and replacement' (NCC 2003b).

To calculate a renewals annuity, a GTE identifies those assets that will reach the end of their life in the renewals period. It estimates the costs of replacing these assets and calculates the annual cash requirement to meet these costs.

The effect on the operating result using this approach can be derived by substituting accounting depreciation with a renewals charge (see below for a renewals reconciliation for Goulburn Murray Water in 2004-05).

Renewals reconciliation — Goulburn Murray Water, 2004-05

	(\$'000)
Net operating result (accounting depreciation based)	- 11 410
Add back accounting depreciation	30 806
Less renewals annuity	17 959
Net operating result (renewals-based)	1 437

The renewals annuity charge is typically less than the equivalent accounting depreciation expense. Therefore, other things being equal, a GTE's net operating result at prices set under the renewals-based approach is generally worse than it would be if prices provided for accounting depreciation. A comparison of Southern Rural Water's operating position over the reporting period, under the accounting depreciation and renewals-based approach is provided below:

Renewals reconciliation — Southern Rural Water, 2000-01 to 2004-05

Year	Net operating result (\$'000)	Net operating result (renewals-based) (\$'000)
2000-01	528	3 409
2001-02	- 5 536	167
2002-03	- 3 234	944
2003-04	- 1 404	2 001
2004-05	- 1 437	5 504

Sources: GMW (2005); SRW (2005).

7.4 Financial management

Financial management indicators provide information about the capital structure of GTEs and their ability to meet the cost of servicing debt and other liabilities as they fall due.

Debt levels of monitored water GTEs increased in nominal terms from \$6.6 billion in 2000-01 to around \$8.4 billion in 2004-05. Twelve of the 23 monitored GTEs increased borrowings over the reporting period, however, more than 80 per cent of the growth in debt can be attributed to three water GTEs.¹⁵ For the sector, the increase in debt has been offset by growth in total assets, which has resulted in the debt to asset ratios remaining relatively stable over the reporting period (figure 7.5).

Movements in the debt to asset ratios of the monitored GTEs varied over the reporting period. The debt to asset ratio of 12 water GTEs increased over the reporting period, for eight GTEs it declined, while the other three (smaller) GTEs operated debt free.

Asset revaluations affected the debt to total assets ratios of some water GTEs over the reporting period. For example, Sydney Water's assets decreased by \$2.6 billion in 2003-04, following a revaluation of systems assets and easements. This downward revaluation contributed to the debt to total assets ratio increasing from 17 per cent in 2002-03 to 20 per cent in 2003-04.¹⁶

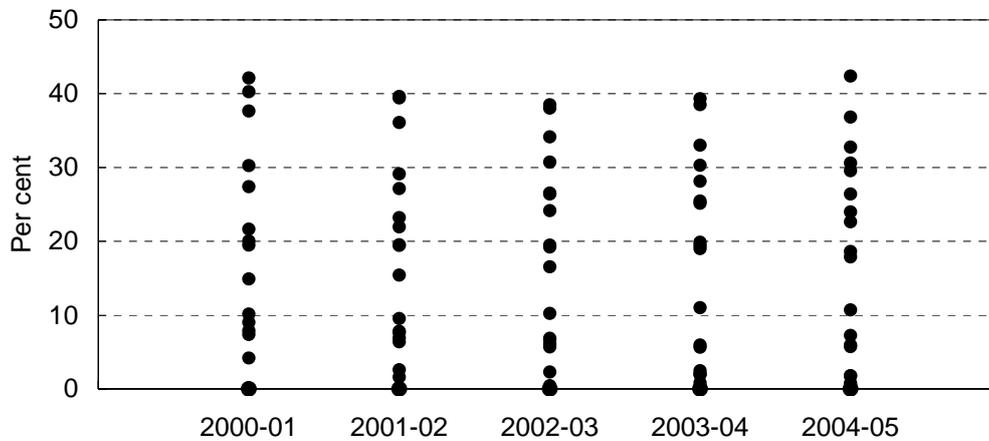
Interest cover — which measures the capacity of a GTE to meet periodic interest payments out of current earnings — for the sector in 2004-05 was 4.6 times. Interest cover remained largely unchanged over the reporting period.

The ability of water GTEs to meet short-term liabilities, as indicated by the current ratio, has remained largely unchanged since 2000-01. Although most water GTEs had current ratios below 100 per cent during the reporting period, the reasonably stable cash flows that are generally a feature of the water sector suggest that low current ratios can be sustained.

¹⁵ The three GTEs are Sydney Water, Water Corporation and Yarra Valley Water. In total, these three GTEs hold 53 per cent of debt in the water sector.

¹⁶ In 2004-05, Sydney Water's debt to asset ratio increased to 23 per cent, despite an upward revaluation of system assets, because it borrowed \$160 million to fund capital investment.

Figure 7.5 Debt to total assets — water GTEs



Note Seven water GTEs were included in 2001-02, and a further two were included in 2004-05. Three GTEs operated debt free from 2001-02 to 2004-05. Debt is defined to include all repayable borrowings (interest bearing and non-interest bearing), interest bearing non-repayable borrowings and finance leases. Average total assets is the average of the value of assets at the beginning and end of each financial year. Where an average was not available, the value of total assets at the end of the financial year was used.

Source: Productivity Commission estimates.

7.5 Transactions with government

As part of the reform process, governments have sought to give GTEs a greater commercial focus and facilitate competitive neutrality by exposing them to capital market disciplines and regulations similar to those faced by private sector businesses.

Dividends

The dividend payable by each GTE depends on the dividend policy of its owner government. In 2004-05, 12 of monitored water GTEs had dividend payout ratios above 50 per cent and, of these, two reported dividend payout ratios of 100 per cent or more. One GTE — Southern Rural Water — made a dividend payment despite recording an operating loss.

All seven of the GTEs that did not report a dividend payment in 2004-05 were Victorian regional urban or rural water authorities.

Tax-equivalent payments

The introduction of tax-equivalent regimes differed across GTEs. However, since 2002-03, all water GTEs are subject to tax-equivalent payments under the National Tax Equivalent Regime.

Over the reporting period, the total amount of income tax paid to owner governments, in real terms, grew by 8 per cent (figure 7.6). However, the year to year levels of income tax (and dividends) paid varied. In aggregate, year-to-year movements in income tax payments have not been closely aligned with movements in operating profit before tax. This is because factors such as asset revaluations influence the amount of tax individual GTEs are required to pay.

For example, in 2003-04, Sydney Water's operating profit before tax increased by 40 per cent, however, its income tax expense decreased from \$93 million in 2002-03 to \$36 million in 2003-04, primarily because a revaluation of assets reduced its income tax liability.

In 2004-05, income tax payments from the water sector totalled \$530 million, 3 per cent more than in 2003-04. Seventeen GTEs were required to make income tax-equivalent payments to their shareholder governments. Of these, ten increased income tax payments. The WA and Victorian Governments were the major recipients, receiving 35 per cent and 27 per cent of all income tax-equivalent payments made by water GTEs respectively.

CSOs

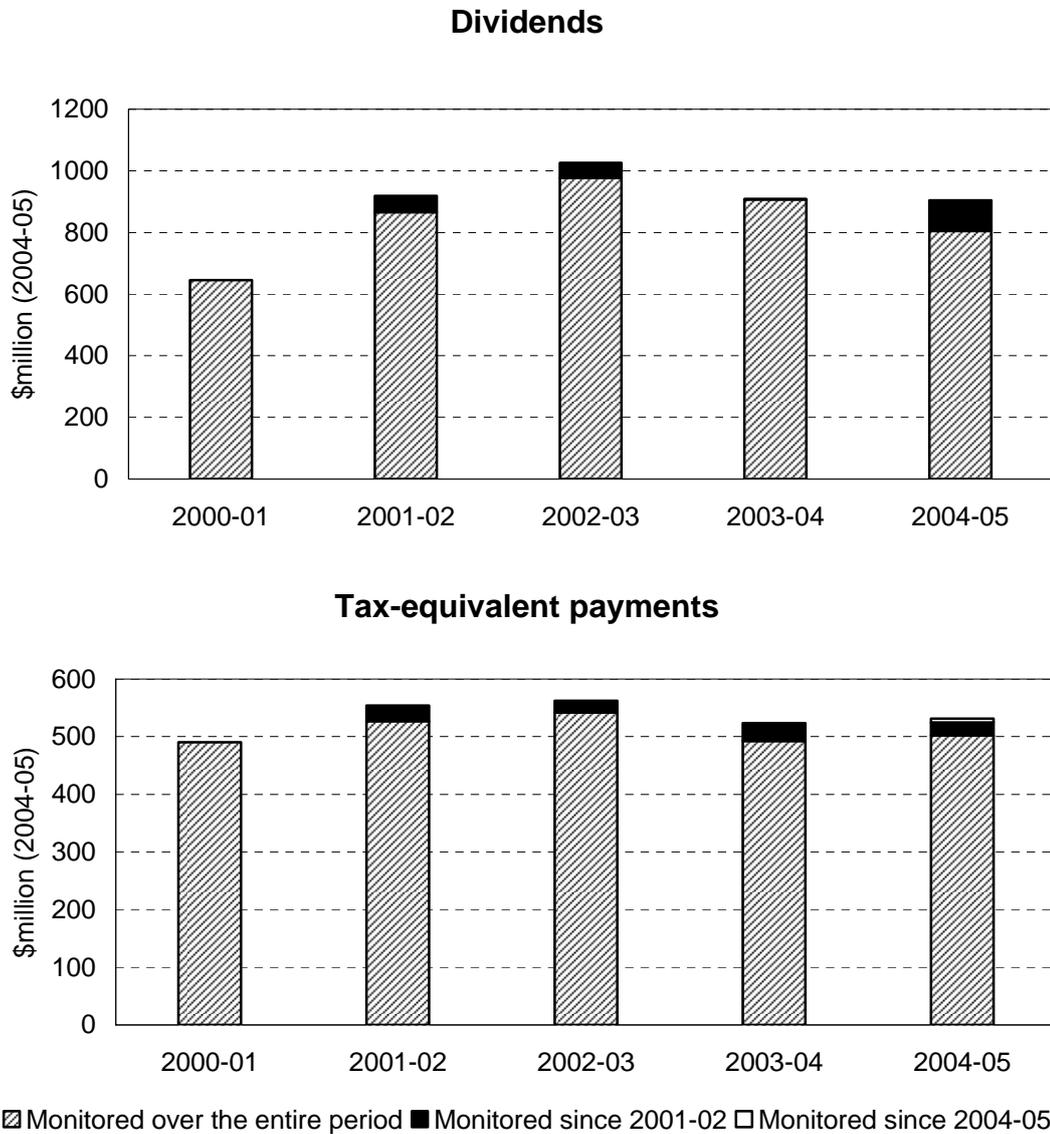
CSOs provided by some water GTEs include concessions, the supply of services below the cost of provision and upgrading sewerage infrastructure. In 2004-05, 18 water GTEs received funding for CSOs totalling almost \$570 million.¹⁷ CSO payments to Water Corporation accounted for more than half of the CSO payments made to the water sector and 22 per cent of its total revenue.

In 2004-05, most Victorian water GTEs reported an increase in CSO payments. This reflects the Victorian Government decision to extend and increase concession entitlements. In 2004-05, health care card holders also became eligible for concessions on water volume charges. In addition, the maximum annual cap was increased from 1 October 2004, to compensate concessional water users for

¹⁷ Several Victorian GTEs disclose CSO payments in their annual reports, but do not report the amount separately in the financial statements.

expected price increases following changes to the tariff structure. The maximum cap will also be indexed every year to help maintain its real value (ESC 2006).

Figure 7.6 **Dividend and income tax-equivalent payments — water GTEs**



Note Seven water GTEs were included in 2001-02. A further two GTEs have been included in 2004-05. The value of dividend and tax-equivalent payments prior to 2004-05 were converted to 2004-05 dollars using the implicit price deflator — Gross Fixed Capital Formation of Public Corporations (chapter 3).

Source: Productivity Commission estimates.

WATER

Whole of sector performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02	2002-03	2003-04 ^a	2004-05
<i>Size</i>						
Total assets	\$m	39 169	46 104	46 632	45 721	48 295
Total revenue	\$m	4 861	5 505	5 793	5 878	6 305
<i>Profitability</i>						
Operating profit before tax	\$'000	1 478 064	1 616 333	1 681 772	1 818 421	1 818 312
Operating sales margin	%	39.2	37.7	37.1	38.8	36.5
Cost recovery	%	165.3	159.9	158.4	162.2	156.8
Return on assets	%	5.8	5.3	5.4	5.8	5.7
Return on equity	%	3.2	2.9	3.0	3.6	3.5
<i>Financial management</i>						
Debt to equity	%	21.9	20.0	21.0	23.3	23.0
Debt to total assets	%	20.3	18.2	18.7	20.2	20.5
Total liabilities to equity	%	29.3	28.1	29.6	32.7	32.7
Interest cover	times	4.4	4.4	4.4	4.7	4.6
Current ratio	%	59.2	70.4	61.3	54.1	54.4
Leverage ratio	%	129.3	128.1	129.6	132.7	132.7
<i>Payments to and from government</i>						
Dividends	\$'000	618 691	893 073	999 071	885 170	898 956
Dividend to equity ratio	%	2.1	2.4	2.7	2.4	2.4
Dividend payout ratio	%	61.4	82.8	88.1	69.8	69.5
Income tax expense	\$'000	470 004	538 048	547 270	510 042	524 604
CSO funding ^b	\$'000	409 156	485 675	506 780	527 537	556 172

^a 2003-04 revenue, operating profit before tax and profitability measures have been revised. A \$40 million diminution in ACTEW's investment in TransACT was reported as a negative revenue. However, under GFS reporting requirements, this transaction should not impact on the operating result. ^b CSO payments between 2002-03 and 2004-05 have been revised to include CSO payments not previously reported to a number of Victorian GTEs.

7.6 GTE performance reports

Sydney Catchment Authority (NSW)
Sydney Water Corporation (NSW)
Hunter Water Corporation (NSW)
Melbourne Water Corporation (Victoria)
City West Water (Victoria)
South East Water (Victoria)
Yarra Valley Water (Victoria)
Barwon Regional Water Authority (Victoria)
Coliban Water (Victoria)
Goulburn Valley Water (Victoria)
Central Gippsland Water (Victoria)
Central Highlands Water (Victoria)
Southern Rural Water (Victoria)
Lower Murray Water (Victoria)
Grampians Wimmera Mallee Water (Victoria)
Goulburn–Murray Water (Victoria)
Sunwater (Queensland)
SA Water Corporation (SA)
Water Corporation (WA)
Hobart Regional Water Authority (Tasmania)
Cradle Coast Water (Tasmania)
Esk Water Authority (Tasmania)
ACTEW Corporation (ACT)

The Sydney Catchment Authority (SCA) was established by the *Sydney Water Catchment Management Act 1998* to provide, construct, operate, manage and maintain efficient systems for the supply of bulk water. The SCA's activities are carried out under an operating licence granted by the Governor and a Water Management Licence issued by the Department of Land and Water Conservation.¹

Catchment management and protection is a key function of the SCA and it has regulatory enforcement powers aimed at reducing threats to water quality. In 2004-05, SCA focussed on improving its drought management strategies, implementing the Government's Metropolitan Water Plan and enhancing asset management frameworks.

Charges for bulk water and other services are determined by the Independent Pricing and Regulatory Tribunal (IPART). Under a determination made in September 2000, real charges did not change between 2000-01 and 2004-05.² Bulk water sales to Sydney Water Corporation (SWC) accounted for around 96 per cent of total revenue.³

SCA increased total assets by \$61 million in 2004-05, primarily through upward revaluations of facility assets. However, current assets fell by \$17 million because SCA funded its capital investment program from internal cash assets. As current liabilities increased because some long-term loans reached maturity, the current ratio also increased.

Over the reporting period, operating profit before tax decreased by 62 per cent to \$22 million. SCA attributes this to the ongoing drought and water restrictions reducing water sales and increasing pumping costs. Consequently, the return on assets has more than halved since 2001-02.

The funding arrangements for SCA's non-commercial activities, such as managing a range of heritage items including old dams and weirs, walking tracks and bridges, are not reported in the financial statements.⁴

¹ The operating licence places obligations on SCA with respect to customer service, system performance and environmental performance.

² On 2 September 2005, IPART released its final determination of the SCA's prices to apply from 1 October 2005 to 30 June 2009.

³ Responsibility for managing catchments, dams and their associated infrastructure was transferred from SWC to the SCA in July 1999.

⁴ The SCA is required to provide these services under its operating licence.

SYDNEY CATCHMENT AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	736	746	711	736	806
Total revenue	\$m	123	124	120	131	126
<i>Profitability</i>						
Operating profit before tax	\$'000	59 880	47 436	26 650	28 266	22 362
Operating sales margin	%	56.5	46.6	31.8	30.9	27.7
Cost recovery	%	230.0	187.3	146.7	144.7	138.4
Return on assets	%	9.5	8.0	5.3	5.7	4.6
Return on equity	%	7.5	5.9	3.1	3.9	3.1
<i>Financial management</i>						
Debt to equity	%	30.9	30.1	32.0	34.9	33.2
Debt to total assets	%	21.8	21.6	21.9	24.1	24.0
Total liabilities to equity	%	41.5	40.0	42.2	47.2	43.9
Interest cover	times	6.8	5.1	3.2	3.2	2.7
Current ratio	%	92.7	70.4	40.0	55.8	33.3
Leverage ratio	%	141.5	140.0	142.2	147.2	143.9
<i>Payments to and from government</i>						
Dividends	\$'000	17 600	30 500	18 877	18 354	15 811
Dividend to equity ratio	%	3.3	5.9	3.8	3.7	3.0
Dividend payout ratio	%	56.5	189.5	97.0	97.0	97.0
Income tax expense	\$'000	16 278	10 555	8 805	7 101	6 062
CSO funding	\$'000	n.p.	n.p.	n.p.	n.p.	n.p.

^a Includes a downward revaluation of some land (\$6.9 million), land transfers to the Sydney Water Corporation (\$11.7 million) and the National Parks and Wildlife Service (\$5.6 million). **n.p.** Not published.

Sydney Water Corporation (Sydney Water) operates under the *State Owned Corporations Act 1991* and the *Sydney Water Act 1994*.¹ SWC supplies drinking water and provides wastewater services and some stormwater services to a population of around 4.2 million in Sydney, the Blue Mountains and Illawarra under an operating licence granted by the Governor.²

Sydney Water's charges are regulated by the NSW Independent Pricing and Regulatory Tribunal (IPART). IPART issued a price determination in May 2003, setting charges for the following two years, providing an overall price adjustment marginally above the CPI for each of those years.³

Total assets increased by around \$293 million, largely due to a revaluation of system assets during 2004-05. Total liabilities also increased by \$192 million as Sydney Water borrowed an additional \$158 million to fund capital investment and incurred payables of \$38 million under the Rouse Hill Infrastructure Agreement.⁴ These changes have resulted in both the debt to equity and debt to total assets ratios increasing, maintaining the trend over the reporting period.

In 2004-05, operating profit before tax decreased by \$36 million to \$270 million. While revenue increased by \$7 million, expenses also grew by 4 per cent (\$42 million), with increases in employee-related costs and service expenses.

In 2004-05, Sydney Water received CSOs payments for providing pensioner rebates (\$70 million), property exemptions (\$9 million) and the Blue Mountain Septic Pump-out subsidy (\$1 million). This accounted for 6 per cent of Sydney Water's total revenue.

¹ The enactment of the *Water Legislation Amendment (Drinking Water and Corporate Structure) Act 1998* changed the status of SWC from a 'company' State Owned Corporation (SOC) to a 'statutory' SOC. The change gave the responsible Minister greater power to make directions and access information, among other things.

² The operating licence places obligations on SWC with respect to customer service, system performance and environmental performance. A new licence became effective on 1 July 2005.

³ In September 2005, IPART released its final determination for Sydney Water's prices, effective from 1 October 2005. IPART is also responsible for conducting annual audits of Sydney Water's compliance with its licence.

⁴ Under the Rouse Hill Infrastructure Agreement, SWC operates a major recycling scheme at Rouse Hill (providing more than 1300 ML of recycled water to more than 15 000 homes).

SYDNEY WATER CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01 ^a	2001-02 ^b	2002-03 ^c	2003-04 ^d	2004-05
<i>Size</i>						
Total assets	\$m	13 471	14 253	13 856	11 827	12 120
Total revenue	\$m	1 431	1 492	1 450	1 397	1 403
<i>Profitability</i>						
Operating profit before tax	\$'000	283 510	334 548	218 761	305 921	270 106
Operating sales margin	%	29.4	31.6	24.8	32.7	30.1
Cost recovery	%	145.3	146.2	132.9	148.6	143.0
Return on assets	%	3.2	3.4	2.6	3.6	3.5
Return on equity	%	1.5	1.6	1.1	2.8	2.5
<i>Financial management</i>						
Debt to equity	%	18.1	18.8	21.8	30.1	31.6
Debt to total assets	%	14.9	15.4	16.6	19.9	22.6
Total liabilities to equity	%	23.2	25.7	29.6	39.6	41.4
Interest cover	times	3.0	3.4	2.5	3.0	2.8
Current ratio	%	59.5	51.2	43.7	42.5	40.9
Leverage ratio	%	123.2	125.7	129.6	139.6	141.4
<i>Payments to and from government</i>						
Dividends	\$'000	53 353	110 000	115 000	115 000	120 000
Dividend to equity ratio	%	0.5	1.0	1.0	1.2	1.4
Dividend payout ratio	%	32.7	60.1	91.5	42.7	55.8
Income tax expense	\$'000	120 292	151 460	93 110	36 404	55 025
CSO funding	\$'000	73 300	78 343	79 661	79 095	79 079

^a Includes expenses relating to superannuation adjustments (\$56 million), redundancy (\$8 million) and the repayment of excess government contributions for sewerage backlog projects (\$36 million). Includes a revaluation increment of \$168 million relating to system and property assets. ^b Includes a \$101 million expense relating to superannuation adjustments and a revaluation increment of \$334 million to system assets. ^c Includes expenses relating to superannuation adjustments (\$82 million), the write-off of the Customer Information Billing System project costs (\$51 million), the South Western Suburbs Ocean Outfall Scheme (\$30 million) and a revaluation decrement of \$698 million to system assets and easements. ^d Includes a \$106 million expense relating to superannuation adjustments and a revaluation decrement of around \$2580 million to system assets and easements.

Hunter Water Corporation (HWC) operates under the *State Owned Corporations Act 1989* and the *Hunter Water Act 1991*.¹ HWC provides water, wastewater and drainage services to almost half a million people living in the Newcastle, Lake Macquarie, Maitland, Cessnock and Port Stephens areas, under an operating licence.² Hunter Water Australia Pty Ltd, a wholly-owned subsidiary of HWC, provides water treatment, engineering, surveying and laboratory services to HWC and external clients.

HWC's charges are regulated by the NSW Independent Pricing and Regulatory Tribunal (IPART) using a CPI-X pricing regime.³ In 2004-05, there was an overall price increase of 0.5 per cent above the rate of inflation.

In 2004-05, HWC's operating profit before tax increased by 54 per cent (\$22 million). Total revenue grew by 23 per cent mainly because of increases in developer contributions (\$15 million) and revenue from the sale of non-current assets (\$8 million). Expenses increased by \$14 million.

The current ratio fell by 44 per cent in 2004-05, mainly because HWC reduced its cash assets by \$15 million, and increased its current interest bearing liabilities by \$38 million. The increase in debt had an impact on the debt to equity and debt to total assets ratios, which increased by 28 per cent and 29 per cent respectively.

HWC is subject to dividend and tax-equivalents payments. In 2004-05, HWC paid a \$34 million dividend, down from \$36 million in 2003-04. The dividend payout ratio also decreased from 178 per cent to 79 per cent over the same period. This is the first year since 1999-00 that dividends have not exceeded operating profit after tax.

The NSW Government funds HWC to provide tariff rebates to pensioners and for exempt properties such as churches. In 2004-05, these CSO payments accounted for 5 per cent (\$10 million) of HWC's total revenue.

¹ The enactment of the *Water Legislation Amendment (Drinking Water and Corporate Structure) Act 1998* changed the status of HWC from a 'company' State Owned Corporation (SOC) to a 'statutory' SOC. The change gave the responsible Minister greater power to make directions and access information, among other things.

² The operating licence, as granted by the Governor, places obligations on HWC with respect to customer service, system performance and environmental performance.

³ IPART issued a price determination in May 2003, which set charges for the following two years and provided an overall price adjustment marginally above the CPI for each of those years. IPART is also responsible for conducting annual audits of HWC's compliance with its licence.

HUNTER WATER CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01^a</i>	<i>2001-02^b</i>	<i>2002-03</i>	<i>2003-04^c</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	2 017	2 095	2 179	2 246	2 333
Total revenue	\$m	131	133	147	154	190
<i>Profitability</i>						
Operating profit before tax	\$'000	36 420	26 254	34 026	41 479	63 841
Operating sales margin	%	32.4	24.4	27.9	32.1	38.5
Cost recovery	%	140.9	125.8	132.1	139.8	155.8
Return on assets	%	2.2	1.7	2.0	2.3	3.2
Return on equity	%	1.3	0.4	0.5	1.0	2.1
<i>Financial management</i>						
Debt to equity	%	4.5	7.1	6.8	6.3	8.2
Debt to total assets	%	4.2	6.4	6.1	5.6	7.2
Total liabilities to equity	%	9.0	12.8	13.6	13.5	14.7
Interest cover	times	5.8	4.2	4.8	5.5	7.3
Current ratio	%	116.5	151.6	75.0	76.2	42.7
Leverage ratio	%	109.0	112.8	113.6	113.5	114.7
<i>Payments to and from government</i>						
Dividends	\$'000	30 000	31 110	38 000	36000	33 800
Dividend to equity ratio	%	1.6	1.7	2.0	1.8	1.7
Dividend payout ratio	%	126.4	452.7	386.4	178.4	78.6
Income tax expense	\$'000	12 677	19 382	24 191	21301	20 819
CSO funding	\$'000	8 463	8 550	9 261	9043	9 668

^a Includes an asset revaluation increment of \$54.3 million relating to water and sewerage assets, and an expense of \$1.6 million for an increase in superannuation liability. ^b Includes an expense of \$13.4 million as a result of an adjustment to superannuation liabilities and a revaluation increment of \$26.8 million relating to sewers. ^c Includes an asset revaluation increment of \$67.9 million relating to water and sewerage assets and an expense of \$1.6 million for an increase in superannuation liability.

Melbourne Water Corporation (MWC) operates under the *Melbourne Water Corporation Act 1992* and the *State Owned Enterprises Act 1992*. MWC's activities include water catchment management, wholesale water supply, sewage treatment and stormwater and drainage management. Its main customers are the three retail water GTEs in Melbourne¹, however services are also provided to other water authorities, local councils and land developers.

In 2004-05, the Victorian Government had set water charges under the *Melbourne Metropolitan Water, Wastewater and Drainage Services Pricing Order 2001*. In 2004-05, metropolitan water and sewerage charges increased by the rate of inflation.²

Operating profit before tax increased by \$9.2 million (5 per cent) in 2004-05. Higher revenue from water, sewage and drainage services more than compensated for reduced revenue from developer contributions and increased expenses.

Assets increased by \$131 million over 2004-05, driven by \$182 million of capital expenditure, an increase of \$31 million from the previous year. Unlike 2003-04, this expenditure was not debt financed, with MWC reducing debt by \$14 million.

MWC is required to make dividend and tax-equivalents payments. In 2004-05, dividend payments were reduced by 57 per cent, as interim and final dividends for the financial year had not been determined by 30 June 2005.

MWC was not subject to CSOs over the reporting period.

¹ Sale of bulk water and sewage services to the metropolitan retail water GTEs constitutes the majority of MWC's business. MWC also relies on these GTEs for billing and collection of its drainage services charges.

² On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. Under these arrangements, the ESC has determined that water, sewage and drainage prices will increase, on average, by just over 2.2 per cent above the inflation rate from 2005-06 to 2007-08.

MELBOURNE WATER CORPORATION (continued)

Performance indicators 1999-00 to 2003-04

	<i>Units</i>	<i>2000-01^a</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	2 954	2 995	3 051	3 132	3 263
Total revenue	\$m	461	477	506	501	524
<i>Profitability</i>						
Operating profit before tax	\$'000	178 094	185 811	218 425	179 462	188 621
Operating sales margin	%	56.0	54.9	57.8	50.3	50.9
Cost recovery	%	226.5	221.8	236.8	201.4	203.6
Return on assets	%	8.9	8.8	9.7	8.2	8.3
Return on equity	%	10.4	9.9	11.1	8.8	8.7
<i>Financial management</i>						
Debt to equity	%	93.0	88.3	83.2	84.5	78.8
Debt to total assets	%	42.1	39.4	38.0	38.5	36.8
Total liabilities to equity	%	124.4	125.5	120.9	122.2	118.5
Interest cover	times	3.2	3.4	3.9	3.5	3.4
Current ratio	%	16.9	19.0	16.6	12.0	19.3
Leverage ratio	%	224.4	225.5	220.9	222.2	218.5
<i>Payments to and from government</i>						
Dividends ^b	\$'000	58 300	98 942	99 400	95 700	41 300 ^c
Dividend to equity ratio	%	4.7	7.5	7.3	6.9	2.8
Dividend payout ratio	%	45.2	76.0	66.3	77.6	32.9
Income tax expense	\$'000	49 066	55 555	68 472	56 089	62 920
CSO funding	\$'000	0	0	0	0	0

^a Includes a \$59.1 million increase in the value of Crown land assets that was previously unrecognised. ^b A change in accounting policy in 2000-01 resulted in a final dividend not being provided for because it was not yet announced by the shareholding ministers. From 2001-02 to 2003-04, the dividend included the final dividend from the previous year's operating results and the current year's interim dividend. Under AASB 1044, dividends are recognised in the financial year in which they are announced (chapter 3). ^c Only the 2003-04 final dividend was recognised, as 2004-05 interim and final dividends had not been recognised by 30 June 2005.

City West Water (CWW) commenced operations on 1 January 1995. CWW is incorporated under the *Corporations Act 2001* (Cwlth) and operates subject to a licence issued under the *Water Industry Act 1994*. It provides water, sewerage and trade waste services to approximately 290 000 residential, commercial and industrial customers in Melbourne's central business district, and its inner and western suburbs.

In 2004-05, Victorian Government set water charges under the *Melbourne Metropolitan Water, Wastewater and Drainage Services Pricing Order 2001*.¹ Regulated prices increased by 2.23 per cent on 1 July 2004, and 5.0 per cent on 1 October 2004. The second increase was to provide for legislated environmental contributions.²

Operating profits before tax fell by \$20 million (21 per cent) in 2004-05. A reduction in developer contributions counteracted the positive impact of higher sales revenue on total revenue. Environmental contributions (\$7.5 million) and service charge refunds (\$3.5 million), which were not incurred in 2003-04, contributed to the \$24 million increase in total expenses.

In 2004-05, assets and liabilities increased by \$66 million and \$54 million respectively, mainly because of increased capital expenditure funded by borrowing. Consequently, the return on assets and return on equity ratios fell, while the debt to equity and debt to total assets ratios rose.

CWW is required to make dividend and tax-equivalents payments. In 2004-05, the dividend payment remained unchanged from the previous year and tax-equivalents payments fell.

CWW is reimbursed for the value of concessions provided to pensioners and others, and for the administration of the concession schemes. In 2004-05, CSO payments accounted for 4 per cent of total revenue.

¹ On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. Under these arrangements, from 1 July 2005, CWW will set prices and service standards in accordance with its ESC approved three year water plan.

² Under the *Water Industries (Environmental Contributions) Act 2004*, water authorities are required to make environmental contributions to the Government, to fund various water-related initiatives that promote sustainable water management and address adverse environmental outcomes from water use.

CITY WEST WATER (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02 ^b	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	641	660	686	735	802
Total revenue	\$m	228	243	261	260	264
<i>Profitability</i>						
Operating profit before tax	\$'000	82 340	100 070	104 800	97 697	77 385
Operating sales margin	%	41.2	45.4	43.7	42.1	34.4
Cost recovery	%	170.2	183.1	177.7	172.6	152.3
Return on assets	%	14.8	17.0	17.0	15.4	11.8
Return on equity	%	19.4	19.4	19.0	17.6	13.2
<i>Financial management</i>						
Debt to equity	%	46.7	38.6	47.9	50.1	57.2
Debt to total assets	%	27.4	23.2	26.5	28.1	30.6
Total liabilities to equity	%	72.3	68.8	84.0	84.3	95.2
Interest cover	times	8.1	10.5	12.0	9.5	6.8
Current ratio	%	56.1	69.7	55.7	44.0	58.2
Leverage ratio	%	172.3	168.8	184.0	184.3	195.2
<i>Payments to and from government</i>						
Dividends	\$'000	22 350	54 750	90 800	41 600	41 600
Dividend to equity ratio	%	6.4	14.4	23.8	10.8	10.3
Dividend payout ratio	%	33.0	74.0	124.8	61.4	78.0
Income tax expense	\$'000	14 574	26 036	32 072	29 926	24 024
CSO funding	\$'000	n.p.	8 837	8 977	9 030	10 001

^a A change in accounting policy in 2000-01 resulted in a final dividend not being provided because it was not yet announced by the shareholding ministers. From 2001-02, the dividends include the final dividend from the previous year's operating results and the current year's interim dividend. Under AASB 1044, dividends are now recognised in the financial year in which they are announced (chapter 3). ^b CSO payments were first recorded in the 2002-03 financial report. **n.p.** Not published.

South East Water (SEW) is incorporated under the *Corporations Act 2001* (Cwlth) and operates subject to a licence issued under the *Water Industry Act 1994*. SEW provides water supply and sewerage services to 1.3 million customers in the southern and eastern suburbs of Melbourne.

In 2004-05, the Victorian Government set water charges under the *Melbourne Metropolitan Water, Wastewater and Drainage Services Pricing Order 2001*.¹ Regulated prices increased by 2.23 per cent on 1 July 2004, and 5.0 per cent on 1 October 2004. The second increase was to provide for legislated environmental contributions.²

Operating profits before tax fell by \$23 million (21 per cent) in 2004-05. Reductions in developer contributions and trade waste revenue tempered the positive impact of higher sales revenue on total revenue. Environmental contributions (\$11 million) and service charge refunds (\$4.4 million), which were not incurred in 2003-04, contributed to a \$25 million increase in total expenses.

In 2004-05, assets and liabilities increased by \$64 million and \$30 million respectively, mainly because of increased capital expenditure partially funded by borrowing. Consequently, the return on assets and return on equity ratios fell, while the debt to equity and debt to total assets ratios rose.

SEW is required to make dividend and tax-equivalents payments. In 2004-05, the dividend payment decreased because both the interim dividend for 2004-05 and final dividend for 2003-04 (paid in 2004-05) were lower than the corresponding dividends paid in 2003-04.

SEW is reimbursed for the value of concessions provided to pensioners and others, and for the administration of the concession schemes. In 2004-05, CSO payments accounted for 5 per cent of total revenue.

¹ On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. Under these arrangements, from 1 July 2005, SEW will set prices and service standards in accordance with its ESC approved three year water plan.

² Under the *Water Industries (Environmental Contributions) Act 2004*, water authorities are required to make environmental contributions to the Government, to fund various water-related initiatives that promote sustainable water management and address adverse environmental outcomes from water use.

SOUTH EAST WATER (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02	2002-03	2003-04	2004-05 ^a
<i>Size</i>						
Total assets	\$m	1 070	1 105	1 160	1 255	1 319
Total revenue	\$m	329	343	387	373	376
<i>Profitability</i>						
Operating profit before tax	\$'000	103 587	111 989	139 545	118 877	96 249
Operating sales margin	%	37.7	38.4	41.2	37.5	32.1
Cost recovery	%	160.6	162.4	170.2	160.0	147.4
Return on assets	%	11.7	12.1	14.1	11.6	9.4
Return on equity	%	14.7	12.7	15.7	12.8	9.6
<i>Financial management</i>						
Debt to equity	%	53.2	51.2	56.7	53.7	53.3
Debt to total assets	%	30.2	29.1	30.7	30.3	29.6
Total liabilities to equity	%	77.6	78.6	88.9	84.4	84.7
Interest cover	times	6.0	6.7	8.1	6.6	4.9
Current ratio	%	64.4	77.7	42.8	37.8	54.0
Leverage ratio	%	177.6	178.6	188.9	184.4	184.7
<i>Payments to and from government</i>						
Dividends ^b	\$'000	33 000	62 300	102 200	54 400	34 800
Dividend to equity ratio	%	5.7	10.2	16.6	8.4	5.0
Dividend payout ratio	%	39.1	80.3	105.5	65.9	51.8
Income tax expense	\$'000	19 169	34 434	42 636	36 326	29 082
CSO funding ^c	\$'000	n.p.	13 827	16 435	17 148	19 231

^a A change in accounting policy in 2004-05, which has resulted in borrowings which mature within 12 months of the reporting date, and where SEW has an agreement to refinance in place, have been reclassified from current to non-current interest bearing liabilities. Given this, the 2004-05 current ratio is not comparable with previous years. ^b A change in accounting policy in 2000-01 resulted in a final dividend not being provided for because it was not yet announced by the shareholding ministers. From 2001-02 to 2003-04, the dividend included the final dividend from the previous year's operating results and the current year's interim dividend. Under AASB 1044, dividends are now recognised in the financial year in which they are announced (see chapter 3). ^c This is the first GTE report to include SEW's CSO payments. SEW's annual reports provides comparable information on CSO payments back to 2001-02, but SEW does not report CSO payments separately in its financial statements. **n.p.** Not published.

Yarra Valley Water (YVW) is incorporated under the *Corporations Act 2001* (Cwlth) and operates subject to a licence issued under the *Water Industry Act 1994*. It provides retail water supply and sewerage services, as well as the collection of tradewaste to more than 1.5 million people in the eastern and northern suburbs of Melbourne.

In 2004-05, the Victorian Government set water charges under the *Melbourne Metropolitan Water, Wastewater and Drainage Services Pricing Order 2001*.¹ Regulated prices increased by 2.23 per cent on 1 July 2004, and 5.0 per cent on 1 October 2004. The second increase was to provide for legislated environmental contributions.²

Operating profit before tax fell \$14 million (19 per cent) in 2004-05. Total revenue increased by \$28 million, because of increased sales revenue and developer contributions. However, total expenses increased by \$43 million, because of environmental contributions (\$13 million), service charge refunds (\$10 million) and legal settlement costs, which were not incurred in 2003-04.

In 2004-05, assets and liabilities increased by \$128 million and \$42 million respectively, mainly because of increased capital expenditure and associated borrowings. As a result, the return on assets and return on equity ratios fell, while the debt to equity and debt to total assets ratios rose.

Timing differences resulted in YVW's current interest bearing liabilities falling by \$59 million in 2004-05. This caused the current ratio to increase from 26 per cent to 57 per cent.

In 2004-05, the dividend YVW paid to the Government decreased by \$4.3 million to \$44 million. However, the dividend payout ratio exceeded 100 per cent, because as it includes final dividend payments for 2003-04.

YVW is reimbursed for the value of concessions provided to pensioners and others. In 2004-05, CSO payments accounted for 6 per cent of total revenue.

¹ On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. Under these arrangements, from 1 July 2005, YVW will set prices and service standards in accordance with its ESC approved three year water plan.

² Under the *Water Industries (Environmental Contributions) Act 2004*, water authorities are required to make environmental contributions to the Government, to fund various water-related initiatives that promote sustainable water management and address adverse environmental outcomes from water use.

YARRA VALLEY WATER (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	1 263	1 296	1 356	1 430	1 558
Total revenue	\$m	342	336	370	353	381
<i>Profitability</i>						
Operating profit before tax	\$'000	86 165	78 988	94 724	75 595	61 129
Operating sales margin	%	34.7	33.2	34.4	30.7	26.1
Cost recovery	%	153.0	149.7	152.5	144.4	135.3
Return on assets	%	9.5	8.7	9.6	7.8	6.7
Return on equity	%	11.9	9.6	10.3	8.2	6.6
<i>Financial management</i>						
Debt to equity	%	82.6	82.6	80.3	85.7	99.1
Debt to total assets	%	40.3	39.6	38.5	39.3	42.4
Total liabilities to equity	%	107.7	111.1	113.3	123.5	143.7
Interest cover	times	3.6	3.4	4.0	3.3	2.6
Current ratio	%	37.0	46.6	45.3	25.5	56.7
Leverage ratio	%	207.7	211.1	213.3	223.5	243.7
<i>Payments to and from government</i>						
Dividends ^a	\$'000	23 614	52 693	60 400	48 400	44 100
Dividend to equity ratio	%	4.1	8.6	9.7	7.6	6.9
Dividend payout ratio	%	34.3	89.5	93.7	92.2	105.0
Income tax expense	\$'000	17 285	20 136	30 290	23 121	19 124
CSO funding ^b	\$'000	n.p.	18 726	19 227	20 278	21 142

^a A change in accounting policy in 2000-01 resulted in a final dividend not being provided for because it was not yet announced by the shareholding ministers. Consistent with AASB 1044, from 2001-02 onwards, dividends are recognised in the financial year in which they are announced (chapter 3). Therefore, between 2001-02 and 2004-05, dividend included the final dividend from the previous year's operating results and the current year's interim dividend. ^b YVW's CSO payments have not been reported in previous years. YVW's annual reports provide comparable information on CSO payments back to 2001-02, however, these figures are not reported separately in the financial statement. **n.p.** Not published.

Barwon Regional Water Authority (Barwon Water) was established under the *Water Act 1989*. Barwon Water provides water and sewerage services to nearly 260 000 residents in Geelong and surrounding areas, making it Victoria's largest regional urban water authority.

In April 2004, the Barwon Water Board approved a 6.3 per cent increase in the water use component of its tariff, and declared that the water service charge to remain at the 2003-04 level.¹ This change was intended to give customers more control over their expenditure on water.

Operating profit before tax fell \$11 million (49 per cent) in 2004-05. Total revenue decreased by \$3.1 million, as growth in sales revenue was more than offset by the fall in revenue from the sale of assets. Total expenses increased by \$7.9 million.

In 2004-05, assets and liabilities increased by \$18 million and \$8.7 million respectively. Assets increased because of Barwon Water's continued investment in capital works. Although investments increased, debt remained constant and borrowing costs declined marginally. Growth in liabilities was primarily attributable to increases in payables and provisions for deferred tax liabilities.

For the first time during the reporting period, Barwon Water made a dividend payment to the Government. Dividend payments are based on a share of the previous year's profit, however, the payment of a dividend requires consultation between the Board, the relevant portfolio Minister and the Treasurer. In 2004-05, it was determined that Barwon Water provide a dividend of \$1 million.

Barwon Water is reimbursed for the value of concessions provided to pensioners and others, and for the administration of the concession schemes. In 2004-05, CSO payments accounted for 4.7 per cent of total revenue.²

¹ On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. From 1 July 2005, Barwon Water will set prices and service standards in accordance with its ESC approved three year water plan. Prices will increase by 5.3 per cent plus CPI in 2005-06, and Barwon Water will continue to utilise a two part pricing structure over the next three years.

² CSO payments are disclosed in Barwon Water's Annual Report but are not separately identified in the financial statements.

BARWON REGIONAL WATER AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02^a</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	847	880	904	963	981
Total revenue	\$m	71	81	95	101	98
<i>Profitability</i>						
Operating profit before tax	\$'000	4 359	10 841	22 030	22 245	11 236
Operating sales margin	%	12.7	18.7	27.4	25.8	15.1
Cost recovery	%	114.3	123.0	137.7	134.7	117.8
Return on assets	%	1.1	1.8	2.9	2.8	1.5
Return on equity	%	0.6	1.4	1.9	1.9	0.9
<i>Financial management</i>						
Debt to equity	%	8.1	7.5	7.3	6.4	6.3
Debt to total assets	%	7.4	6.9	6.7	6.0	5.7
Total liabilities to equity	%	10.2	9.6	10.5	10.2	11.1
Interest cover	times	1.9	3.5	6.4	6.6	4.0
Current ratio	%	111.9	122.1	119.2	130.8	91.0
Leverage ratio	%	110.2	109.6	110.5	110.2	111.1
<i>Payments to and from government</i>						
Dividends	\$'000	0	0	0	0	1 014
Dividend to equity ratio	%	0.0	0.0	0.0	0.0	0.1
Dividend payout ratio	%	0.0	0.0	0.0	0.0	13.0
Income tax expense	\$'000	0	0	6 679	6 344	3 461
CSO funding ^b	\$'000	0	4 064	4 528	4 111	4 691

^a Includes a revaluation increment of \$25.4 million relating mainly to water distribution assets. ^b CSO payments have been taken from Barwon Water's 2004-05 Annual Report, CSO payments are reported but are not separately identified in the financial statements.

Coliban Regional Water Authority (Coliban Water) was established on 1 July 1992 under the *Water Act 1989*. It provides water and sewerage services to around 64 000 customers in northern central Victoria.

The Coliban Water Board set charges subject to ministerial approval. In 2004-05, water charges increased by the rate of inflation plus 5 per cent.¹

Coliban Water reported an operating loss before tax of \$6.5 million in 2004-05. Total expenses increased by 19 per cent in 2004-05 (3 per cent in 2003-04), because of increased payments for contracted water treatment services², and higher depreciation expense associated with a revaluation of infrastructure assets. Growth in expenses more than offset the increases in sales revenue (\$3.0 million) and developer contributions (\$1.4 million).

In 2004-05, total assets increased by \$105 million (16 per cent), largely because of a revaluation of infrastructure assets at their 'deprival' value. However, current assets fell by 12 million, with Coliban Water using cash assets to fund capital works. Since 2000-01, the current ratio has declined from over 1000 per cent to 400 per cent.

Coliban Water is subject to dividend and tax-equivalent payments. In 2004-05, no dividend or income tax was paid or provided for, reflecting Coliban Water's financial position.³

The State Government reimbursed Coliban Water \$2.6 million for concessions provided to pensioners and rebates to non-profit organisations. In 2004-05, CSO payments increased by 21 per cent, following the Government's decision to increase the cap and extend concessions to healthcare cardholders.

¹ On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. Under these arrangements, from 1 July 2005, Coliban Water will set prices and service standards in accordance with its ESC approved three year water plan.

² Coliban Water contracts out a range of activities to the private sector and has several water treatment plants constructed under public-private sector partnerships. Contract payments for assets under public-private sector partnerships comprise fixed and variable components to be made by Coliban Water over a 25 year contract period. Coliban Water estimated that the present value, at 30 June 2005, of future contract payments is \$141 million.

³ Coliban Water expects to remain in a tax loss position for some time and thus is unlikely to incur tax-equivalent payments in the near future.

COLIBAN REGIONAL WATER AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m		640	652	648	753
Total revenue	\$m		31	44	47	50
<i>Profitability</i>						
Operating profit before tax	\$'000		- 4 913	- 2 041	- 675	- 6 535
Operating sales margin	%		- 32.7	- 13.5	- 7.6	- 18.8
Cost recovery	%		75.4	88.1	92.9	84.2
Return on assets	%		- 0.8	- 0.3	- 0.1	- 0.9
Return on equity	%		- 0.8	- 0.3	- 0.1	- 0.9
<i>Financial management</i>						
Debt to equity ^b	%		0.0	0.0	0.0	0.0
Debt to total assets ^b	%		0.0	0.0	0.0	0.0
Total liabilities to equity	%		1.4	2.1	1.5	1.7
Interest cover	times		n.r.	n.r.	n.r.	n.r.
Current ratio	%		1 021.0	595.3	672.7	399.3
Leverage ratio	%		101.4	102.1	101.5	101.7
<i>Payments to and from government</i>						
Dividends	\$'000		3 760	0	0	0
Dividend to equity ratio	%		0.6	0	0.0	0.0
Dividend payout ratio	%		- 76.5	0	0.0	0.0
Income tax expense	\$'000		0	0	0	0
CSO funding ^c	\$'000		2 128	2 213	2 165	2 616

^a 2001-02 was the first year that Coliban Water was included in this report. It was established in July 1992 under the *Water Act 1989*. ^b Coliban Water operates debt free, with capital expenditure funded from retained earnings and government grants. ^c Coliban Water CSO payments are taken from the 2004-05 Annual Report, however, these payments are not reported separately in the financial statements. **n.r.** Not relevant

Goulburn Valley Regional Water Authority (GVW) was established in March 1994 under the *Water Act 1989*. It provides water and sewerage services to a population of more than 100 000 in northern central Victoria, including the major towns of Seymour, Euroa and Shepparton.

The GVW Board set charges subject to ministerial approval. In 2004-05, average water charges increased by 5.4 per cent.¹

Operating profit before tax fell by 44 per cent to \$5.3 million in 2004-05. Total expenses increased by \$5.5 million, mainly because of increases in sewage treatment and pumping costs and water treatment costs. This exceeded the increase in total revenue (\$1.3 million).

In 2004-05, assets and liabilities increased by \$22 million and \$17 million respectively, because GVW's ongoing infrastructure investment program is predominantly funded by new borrowings. As a result, the return on assets and return on equity ratios fell, while the debt to equity and debt to total assets ratios rose significantly.²

GVW is subject to tax-equivalents and dividend payments. In 2004-05, GVW did not make a taxable income, therefore no tax-equivalents payment was realised or recorded in the financial statements and the Treasurer determined that no dividend was payable.³

GVW is reimbursed for the value of concessions provided to pensioners and others, and for the administration of the concession schemes. In 2004-05 CSO payments increased by 14 per cent, following the Government's decision to increase the cap on water concessions from 1 October 2004.

¹ On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. Under these arrangements, from 1 July 2005, GVW will set prices and service standards in accordance with its ESC approved three year water plan.

² GVW reports that borrowings are budgeted to reach \$52 million over the next three years to fund its ongoing capital program.

³ GVW considers it unlikely that operating profits will be sufficient in the foreseeable future, to offset income tax deductions associated with the tax depreciation of assets. This is due to higher (accelerated) tax depreciation rates compared to accounting depreciation rates.

GOULBURN VALLEY REGIONAL WATER AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02^a</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m		430	448	457	479
Total revenue	\$m		40	50	46	47
<i>Profitability</i>						
Operating profit before tax	\$'000		8 751	15 000	9 448	5 320
Operating sales margin	%		21.1	29.6	20.5	12.2
Cost recovery	%		126.8	142.1	124.6	113.3
Return on assets	%		2.3	3.6	2.3	1.4
Return on equity	%		2.1	3.6	2.2	1.2
<i>Financial management</i>						
Debt to equity	%		2.7	2.3	2.6	6.3
Debt to total assets	%		2.6	2.3	2.5	6.0
Total liabilities to equity	%		4.3	4.6	4.5	8.3
Interest cover	times		10.0	19.3	13.4	5.5
Current ratio	%		441.4	125.3	126.4	107.8
Leverage ratio	%		104.3	104.6	104.5	108.3
<i>Payments to and from government</i>						
Dividends	\$'000		0	0	0	0
Dividend to equity ratio	%		0.0	0.0	0.0	0.0
Dividend payout ratio	%		0.0	0.0	0.0	0.0
Income tax expense	\$'000		0	0	0	0
CSO funding ^b	\$'000		0	1 687	1 697	1 941

^a 2001-02 was the first year that Goulburn Valley Water was included in this report. It was established in March 1994 under the *Water Act 1989*. ^b This is the first report to provide GVW's reported CSO payments. GVW's annual reports provide comparable information on CSO payments back to 2002-03.

Central Gippsland Water Authority (Gippsland Water) operates under the *Water Act 1989*. It provides water and sewerage services to over 130 000 people in 41 towns in the Traralgon area.

The Gippsland Water Board set charges subject to ministerial approval.¹ On 1 July 2004, residential fixed and variable water charges were increased by 2.3 per cent and 30 per cent respectively. On 1 October 2005, prices were increased a second time to provide for legislated environmental contributions.²

Sales revenue from domestic customers and businesses accounted for 42 per cent and 33 per cent of total revenue respectively. Of this sales revenue, 60 per cent was from property-based charges with the remainder from usage-based charges.

In 2004-05, Gippsland Water's operating profit before tax increased by 43 per cent, to \$8.2 million. Revenue from water service charges increased by \$5.7 million and continued high levels of property development resulted in a \$3.0 million increase in contributed assets. However, total expenses also increased by \$6.9 million, primarily because of increased supplier costs.

Over the reporting period, Gippsland Water increased the returns it generated from its assets. Even so, in 2004-05, the return on assets of 1.1 per cent was below the risk free rate of 5.4 per cent.

Gippsland Water's current ratio has decreased over the reporting period, as Gippsland Water used liquid assets to fund capital works.

In 2004-05, Gippsland Water did not make tax-equivalent payment because it did not generate a taxable income.³

The State Government reimbursed Gippsland Water \$2.4 million in 2004-05 for concessions including pensioner rebate and health care card schemes, water for fire-fighting purposes, and student education programs.

¹ On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. Under these arrangements, from 1 July 2005, Gippsland Water will set prices and service standards in accordance with its ESC approved three year water plan.

² Under the *Water Industries (Environmental Contributions) Act 2004*, water authorities are required to make environmental contributions to the Government.

³ Gippsland Water considers it unlikely that operating profits will be sufficient in the foreseeable future, to offset income tax deductions associated with the tax depreciation of assets. This is due to higher (accelerated) tax depreciation rates compared to accounting depreciation rates.

CENTRAL GIPPSLAND WATER AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m		480	479	487	498
Total revenue	\$m		45	46	54	63
<i>Profitability</i>						
Operating profit before tax	\$'000		1 062	- 1 404	5 743	8 208
Operating sales margin	%		0.7	- 5.0	9.0	11.6
Cost recovery	%		100.7	95.2	109.9	113.1
Return on assets	%		0.2	- 0.3	1.2	1.7
Return on equity	%		0.2	- 0.3	1.2	1.7
<i>Financial management</i>						
Debt to equity ^b	%		0.0	0.0	0.0	0.0
Debt to total assets ^b	%		0.0	0.0	0.0	0.0
Total liabilities to equity	%		1.1	1.3	2.1	2.7
Interest cover	times		n.r.	n.r.	n.r.	n.p.
Current ratio ^c	%		547.4	541.7	355.2	281.5
Leverage ratio	%		101.1	101.3	102.1	102.7
<i>Payments to and from government</i>						
Dividends	\$'000		0	0	0	0
Dividend to equity ratio	%		0.0	0.0	0.0	0.0
Dividend payout ratio	%		0.0	0.0	0.0	0.0
Income tax expense	\$'000		0	0	0	0
CSO funding ^c	\$'000		1 912 ^d	1 968	2 071	2 384

^a 2001-02 was the first year that the Central Gippsland Water Authority (Gippsland Water) was included in this report. It was established in July 1994 under the *Water Act 1989*. ^b Gippsland Water operates debt free, with capital expenditure funded from retained earnings and government grants during the reporting period. ^c Gippsland Water's relatively high current ratio reflects its large holdings of liquid investments. ^d CSO payments were not disclosed separately in Gippsland Water's financial reports in 2001-02. This figure was obtained from the 2002-03 annual report. **n.r.** Not relevant.

Central Highlands Water Authority (CHW) operates under the *Water Act 1989*. It provides water and sewerage services to a population of 113 000 in Ballarat and surrounding areas.

CHW entered into a public-private sector agreement with Thames Water Ballarat on 12 April 1999. The contract requires CHW Water to pay an annual charge comprising both fixed and variable components for 25 years, after which ownership of the water treatment facility will transfer to CHW.¹

The CHW Board set charges subject to ministerial approval.²

Operating profit before tax fell \$4.2 million (87 per cent) in 2004-05. Growth in operating revenues were insufficient to offset the negative impacts of the write down of assets and environmental contributions.³

CHW has maintained a current ratio of more than 450 per cent over the reporting period, with cash investments (\$18 million) and receivables (\$10 million) exceeding current liabilities (\$6 million). CHW has also reduced debt over the reporting period, consequently, the debt to equity and debt to assets ratios have declined.

In 2004-05, CHW paid \$2.6 million in tax-equivalents payments which includes a \$256 000 payment associated with its 2004-05 operating position, and a \$2.3 million payment associated with 2003-04.

CHW is reimbursed for the value of concessions provided to pensioners and others, as well as for the administration of the concession schemes. In 2004-05, CSO payments accounted for 4.9 per cent of total revenue.

¹ At 30 June 2004, Central Highlands Water estimated that the present value of the contract payments was \$96 million, using a discount rate of 10 per cent. The payment obligation is subject to the future performance of Thames Water and, as such, is an Agreement Equally Proportionally Underperformed (AEPUs) under accounting standard AASB 1044. AEPUs are not required to be recognised in the statement of financial position.

² On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. Under these arrangements, from 1 July 2005, CHW will set prices and service standards in accordance with its ESC approved three year water plan.

³ Under the *Water Industries (Environmental Contributions) Act 2004*, water authorities are required to make environmental contributions (equal to 5 per cent of revenue in 2003-04) to the Government, to fund various water-related initiatives that promote sustainable water management and address adverse environmental outcomes from water use.

CENTRAL HIGHLANDS WATER AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03 ^b	2003-04 ^c	2004-05
<i>Size</i>						
Total assets	\$m		570	569	578	579
Total revenue	\$m		40	46	49	46
<i>Profitability</i>						
Operating profit before tax	\$'000		1 230	4 806	4 900	654
Operating sales margin	%		2.6	9.1	8.2	- 0.8
Cost recovery	%		102.7	110.0	108.9	99.2
Return on assets	%		0.4	1.0	0.9	0.1
Return on equity	%		0.2	0.9	0.9	- 0.3
<i>Financial management</i>						
Debt to equity	%		1.6	0.4	0.2	0.1
Debt to total assets	%		1.6	0.4	0.2	0.1
Total liabilities to equity	%		3.0	2.2	2.5	2.5
Interest cover	times		2.1	7.2	26.1	8.9
Current ratio	%		529.1	529.1	486.9	460.6
Leverage ratio	%		103.0	102.2	102.5	102.5
<i>Payments to and from government</i>						
Dividends	\$'000		516	0	0	0
Dividend to equity ratio	%		0.1	0.0	0.0	0.0
Dividend payout ratio	%		42.0	0.0	0.0	0.0
Income tax expense	\$'000		0	0	0	2 581
CSO funding	\$'000		2025	2 010	2 079	2 251

^a 2001-02 was the first year that the Central Highlands Water Authority was included in this report. It was established in July 1994 under the *Water Act 1989*. ^b Includes amendments to total liabilities due to the incorrect treatment of deferred tax liabilities by GFS. This has resulted in amendments to total liabilities to equity ratio and leverage ratio previously reported. ^c Includes amendments to total liabilities due to the incorrect treatment of deferred tax liabilities by GFS. This has resulted in amendments to total liabilities to equity ratio and leverage ratio previously reported.

GIPPSLAND AND SOUTHERN RURAL WATER AUTHORITY Victoria

Gippsland and Southern Rural Water Authority (Southern Rural Water) was established on 1 July 1995 under the *Water Act 1989*.

Southern Rural Water provides irrigation water to over 9000 customers in three districts and administers over 8400 licences, managing the taking and use of water from rivers, streams and groundwater sources in southern Victoria. It also manages several water storage dams that provide water to irrigators, urban water authorities and several power generators.

The Southern Rural Water Board set water charges subject to ministerial approval, using the renewals annuity concept (box 7.1) to set charges that would provide adequate funding to maintain the condition of the required network of channels, pipelines and structures.¹ In 2003-04, Southern Rural Water commenced to increase prices under a three year price path. In 2004-05, Southern Rural Water's prices rose to meet cost recovery requirements.²

Southern Rural Water recorded an operating loss of \$1.1 million in 2004-05, however, operating losses have decreased by \$4.4 million since 2001-02. Despite the losses, the Victorian Government has required Southern Rural Water to make dividend payments and to fund a range of community programs and Government initiatives from a 4 per cent "Rate of Return" on headworks assets used to store bulk water entitlements. In 2004-05, Southern Rural Water spent almost \$2 million to meet this obligation.³

Southern Rural Water receives CSO payments for the provision of concessions to pensioners (\$2.4 million). In addition, it receives grants from the Government for programs including salinity projects, state water assessment, groundwater investigations and water resource management (\$2.1 million).⁴ In total, these payments accounted for 23 per cent of Southern Rural Water's revenue in 2004-05.

¹ On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. Under these arrangements, from 1 July 2006, Southern Rural Water will set prices and service standards in accordance with its ESC approved water plan.

² Southern Rural Water used this price path in developing its water plan for the ESC.

³ From 1 July 2005, the Victorian Government will no longer require rural water authorities to generate a 4 per cent rate return on assets to fund dividends and other water-related activities (DSE 2004).

⁴ Southern Rural Water also manages recreation facilities at Blue Rock, Cowwarr, Glenmaggie, Melton, Merrimu and Pykes Creek Reservoir. It is not reimbursed by the Government for the associated expenses.

GIPPSLAND AND SOUTHERN RURAL WATER AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m		440	435	435	438
Total revenue	\$m		14	18	19	20
<i>Profitability</i>						
Operating profit before tax	\$'000		- 5 536	- 3 234	- 1 404	- 1 079
Operating sales margin	%		- 43.2	- 19.6	- 8.5	- 6.8
Cost recovery	%		69.8	83.6	92.2	93.6
Return on assets	%		- 1.3	- 0.7	- 0.3	- 0.2
Return on equity	%		- 1.3	- 0.7	- 0.3	- 0.3
<i>Financial management</i>						
Debt to equity ^b	%		0.0	0.0	0.0	0.0
Debt to total assets ^b	%		0.0	0.0	0.0	0.0
Total liabilities to equity	%		1.1	0.9	1.0	1.3
Interest cover	times		n.r.	n.r.	n.r.	n.r.
Current ratio	%		309.1	257.0	274.4	269.8
Leverage ratio	%		101.1	100.9	101.0	101.3
<i>Payments to and from government</i>						
Dividends	\$'000		418	418	418	380
Dividend to equity ratio	%		0.1	0.1	0.1	0.1
Dividend payout ratio	%		- 7.6	- 12.9	- 29.8	- 35.2
Income tax expense	\$'000		0	0	0	0
CSO funding ^c	\$'000		1 341	1 209	2 171	2 428

^a 2001-02 was the first year that the Gippsland and Southern Rural Water Authority (Southern Rural Water) was included in this report. It was established in July 1995 under the *Water Act 1989*. ^b Southern Rural Water operates debt free, with capital expenditure funded from retained earnings and government grants. **n.r.** Not relevant. ^c CSO funding figures are based on the amount provided to Southern Rural Water for providing concessions to pensioners.

Lower Murray Urban and Rural Water Authority (LMW) was established on 1 July 2004 under the *Water Act 1989*. LMW was formed by the merger of the Lower Murray Regional Water Authority's urban water and wastewater business with Sunraysia Rural Water Authority rural water business.

LMW provides urban water and wastewater services, river quality water for irrigation, stock and gardens, and collection and disposal of irrigation drainage across its region, North-Western Victoria.¹

LWM's revenue is split between its rural services (40 per cent), water supply services (34 per cent) and wastewater services (26 per cent). Fixed water charges generate 68 per cent of LWM's revenue from rural services, compared to 37 per cent for regional urban water supply.

In 2004-05, LMW reported an operating loss before tax of \$2.7 million. LMW attributes the loss to the impact of the revaluation of the combined assets of the merged entity on its depreciation expense. An independent valuer increased LWM's asset valuation by 68 per cent, which increased depreciation expense by \$6 million.

LMW's has a current ratio of more than 510 per cent, with cash investments (\$19 million) and receivables (\$5.0 million) exceeding current liabilities (\$5.3 million). LMW also maintains a low level of debt by funding capital works from current assets, consequently, the debt to equity and debt to assets ratios are both less than 1 per cent. As LMW operated at a loss, its interest cover ratio was negative, even though its borrowing costs were \$31 000.

In 2004-05, LMW received \$1.2 million for CSOs relating to the provision of concessions to pensioners. CSO payments accounted for 3.1 per cent of total revenue.

¹ The LMW Board set water charges in 2004-05, subject to ministerial approval. Rural water charges were calculated using the renewals annuity concept (box 7.1). On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. Under these arrangements, from 1 July 2006, LMW will set prices and service standards in accordance with its ESC approved 2006-07 to 2007-08 water plan.

LOWER MURRAY WATER (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05^a</i>
<i>Size</i>						
Total assets	\$m					468
Total revenue	\$m					39
<i>Profitability</i>						
Operating profit before tax	\$'000					- 2 653
Operating sales margin	%					- 10.7
Cost recovery	%					90.3
Return on assets	%					- 0.6
Return on equity	%					- 1.0
<i>Financial management</i>						
Debt to equity	%					0.1
Debt to total assets	%					0.1
Total liabilities to equity	%					3.1
Interest cover	times					- 84.6
Current ratio	%					513.3
Leverage ratio	%					103.1
<i>Payments to and from government</i>						
Dividends	\$'000					0
Dividend to equity ratio	%					0.0
Dividend payout ratio	%					0.0
Income tax expense	\$'000					1 791
CSO funding	\$'000					1 195

^a On 1 July 2004, Sunraysia Water and Lower Murray Water merged, and commenced trading as Lower Murray Water.

Grampians Wimmera Mallee Rural Water Authority (GWMW) was established on 1 July 2004 under the *Water Act 1989*. GWMW was formed following the merger of Grampians Water and Wimmera Mallee Water and has assumed all the functions previously undertaken by these entities. GWMW supplies both urban and rural water services to central western Victoria and is responsible for the Wimmera Mallee Pipeline Project.

The GWMW Board set water charges in 2004-05, subject to ministerial approval. Rural water charges are calculated using the renewals annuity concept (box 7.1).¹

In 2004-05, GWMW reported an operating loss of \$7.0 million. GWMW attributes its operating position to the impact of drought conditions, which reduced sales revenue and increasing expenditure associated with monitoring and treating water more intensively. However, GWMW reported a \$415 000 net benefit associated with the merger.

GWMW is subject to tax-equivalent payments. In 2004-05, no income tax was paid reflecting GWMW's financial position.

In 2004-05, GWMW received \$1.7 million for CSOs relating to the provision of concessions to pensioners. CSO payments accounted for 4.7 per cent of total revenue.

¹ On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. Under these arrangements, from 1 July 2006, GWMW will set prices and service standards in accordance with its ESC approved water plan.

GRAMPIANS WIMMERA MALLEE WATER (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05^a</i>
<i>Size</i>						
Total assets	\$m					638
Total revenue	\$m					33
<i>Profitability</i>						
Operating profit before tax	\$'000					- 6 959
Operating sales margin	%					- 21.8
Cost recovery	%					82.1
Return on assets	%					- 1.1
Return on equity	%					- 1.1
<i>Financial management</i>						
Debt to equity	%					0.5
Debt to total assets	%					0.5
Total liabilities to equity	%					1.5
Interest cover	times					- 41.3
Current ratio	%					229.1
Leverage ratio	%					101.5
<i>Payments to and from government</i>						
Dividends	\$'000					0
Dividend to equity ratio	%					0.0
Dividend payout ratio	%					0.0
Income tax expense	\$'000					0
CSO funding	\$'000					1 699

^a GWMW was established on 1 July 2004, following the merger of Grampians Water and Wimmera Mallee Water.

Goulburn–Murray Rural Water Authority (GMW) was established on 1 July 1994 under the *Water Act 1989*. GMW is responsible for the supply, storage and delivery of water to irrigators and regional urban water authorities over an area of 68 000 square kilometres in northern Victoria. It is also responsible for the management and operation of several facilities for the Murray–Darling Basin Commission.

The GMW Board set water charges, subject to ministerial approval, using the renewals annuity concept (box 7.1).¹ In 2004-05, prices increased by 8 per cent.

In 2004-05, GMW reported an operating loss before tax of \$11 million. Although, revenue from water and drainage charges increased, total revenue declined largely because grants as from the Government fell by \$9.4 million.² An increase in GMW's depreciation expense accounted for almost half (42 per cent) of the 7.9 per cent (\$9.0 million) increase in total expenses.

GMW is subject to dividend and tax-equivalent payments. However, due to its operating position, neither was paid in 2004-05.

During 2004-05, GMW reported payment for the \$53 000 provision of concessions to pensioners.³ GMW also received \$8.8 million in Government grants for its salinity program, the national landcare program, the water saving program and other works.

¹ On 1 January 2004, the Essential Services Commission (ESC) became responsible for regulating pricing and service standards of all Victorian water authorities. Under these arrangements, from 1 July 2006, GMW will set prices and service standards in accordance with its ESC approved water plan.

² In 2003-04, GMW received one-off \$10 million to fund a 'small meter outlet program'. However, the matching expenditure did not commence until 2004-05.

³ This figure is taken from the GMW's 2004-05 Annual Report, however the CSO payment is not disclosed separately in the financial statements.

GOULBURN–MURRAY RURAL WATER AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03	2003-04 ^b	2004-05
<i>Size</i>						
Total assets	\$m		1 738	1 719	1 902	1 939
Total revenue	\$m		103	93	113	107
<i>Profitability</i>						
Operating profit before tax	\$'000		- 7 526	- 21 608	2 086 ^c	- 11 411
Operating sales margin	%		- 8.7	- 24.5	1.3	- 10.0
Cost recovery	%		92.0	80.3	101.3	n.p.
Return on assets	%		- 0.4	- 1.3	0.1	- 0.5
Return on equity	%		- 0.4	- 1.3	0.1	- 0.6
<i>Financial management</i>						
Debt to equity ^d	%		0.0	0.0	0.8	0.8
Debt to total assets ^d	%		0.0	0.0	0.8	0.8
Total liabilities to equity	%		2.0	2.2	2.9	3.1
Interest cover	times		n.r.	n.r.	n.r.	- 8.6
Current ratio	%		200.1	83.0	147.5	157.0
Leverage ratio	%		102.0	102.2	102.9	103.1
<i>Payments to and from government</i>						
Dividends	\$'000		0	0	0	0
Dividend to equity ratio	%		0.0	0.0	0.0	0.0
Dividend payout ratio	%		0.0	0.0	0.0	0.0
Income tax expense	\$'000		0	0	0	0
CSO funding ^e	\$'000		n.p.	31.	37	53

^a 2001-02 was the first year that the Goulburn–Murray Water Authority was included in this report. It was established in July 1994 under the *Water Act 1989*. ^b Includes a revaluation increment of \$157 million in infrastructure. ^c Profits inflated by a 'one-off' government grant of \$10 million received in 2003-04, however, the matching expenditure will not commence until 2004-05. ^d GMW operated debt free, with capital expenditure funded from retained earnings and government grants until 2003-04. A \$20 million loan from Victoria Treasury for 20 years at a fixed interest rate of 6.34 per cent was taken in July 2003. ^e GMW discloses concession payments in its Annual Report, but does not report them separately in the financial statements. n.r. Not relevant. n.p. Not published.

Sunwater was established under the *Government Owned Corporations Act 1993* on 1 October 2000, assuming the roles and responsibilities of State Water Projects.¹ Sunwater owns and operates bulk water storage and distribution infrastructure and supplies irrigators, industrial and urban bulk water customers.

Charges for rural customers were determined by Sunwater's shareholding ministers. A price direction in October 2000 set a price path of between five and seven years for most of Sunwater's service areas.²

Operating profit before tax increased by \$30 million (155 per cent) in 2004-05, reportedly because of a \$34 million gain from the revaluation of non-current assets. This significant increase in profits had a positive impact on Sunwater's return on assets and return on equity ratios. However, excluding revaluations, operating profits (before tax) would have fallen in 2004-05 because expenditure growth exceeded revenue growth by \$3.1 million.

Following the substantial reduction of debt in 2003-04, Sunwater's borrowing costs fell by \$1.2 million in 2004-05. As profits also increased, Sunwater's interest cover increased to 94 per cent (12 per cent in 2003-04). In contrast, the current ratio decreased as cash assets were to fund capital works and payables increased.

Sunwater is subject to dividend and tax equivalence payments. In 2004-05, dividends paid fell by 91 per cent (from \$4 million in 2003-04). However, total dividends attributable to the 2004-05 financial year will be \$3.2 million, compared to total dividends attributable to the 2003-04 financial year of \$4.2 million.³

Sunwater received CSO funding from the State Government for shortfalls in revenue from providing water to rural water users, costs to comply with new governing legislation and payment for new rural water assets or extensions to existing schemes built for reasons other than commercial return.⁴ As a share of total revenue, CSO payments have declined from 17 per cent in 2000-01 to 4 per cent in 2004-05.

¹ Sunwater wholly-owns Eungella Water Pipeline Pty Ltd and North-West Queensland Water Pipeline Pty Ltd.

² 2004-05 pricing arrangements were extended for 1 year, with the next 5 year irrigation price paths to take effect from 1 July 2006.

³ Total dividends include interim dividends paid during the relevant financial year and final dividends, which were not declared until the following financial year.

⁴ Sunwater does not receive CSO payments for its provision and maintenance of recreational facilities.

SUNWATER (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01 ^a	2001-02 ^b	2002-03 ^c	2003-04 ^d	2004-05
<i>Size</i>						
Total assets	\$m	312	360	457	392	458
Total revenue	\$m	92	113	110	109	151
<i>Profitability</i>						
Operating profit before tax	\$'000	4 656	30 359	26 102	19 541	49 894
Operating sales margin	%	4.5	27.1	23.2	16.5	31.7
Cost recovery	%	104.8	137.2	130.2	119.8	146.4
Return on assets	%	2.2	9.7	6.9	5.0	11.9
Return on equity	%	1.9	11.1	7.5	3.7	12.4
<i>Financial management</i>						
Debt to equity	%	11.1	8.6	5.9	2.5	1.9
Debt to total assets	%	10.2	7.6	5.7	2.0	1.8
Total liabilities to equity	%	25.0	20.3	16.0	15.4	14.0
Interest cover	Times	4.2	15.0	14.6	12.0	94.3
Current ratio	%	268.2	344.8	407.9	467.0	301.1
Leverage ratio	%	125.0	120.3	116.0	115.4	114.0
<i>Payments to and from government</i>						
Dividends	\$'000	0	0	4 127 ^e	4 000	373 ^f
Dividend to equity ratio	%	0.0	0.0	1.2	1.1	0.1
Dividend payout ratio	%	0.0	0.0	19.5	29.5	0.8
Income tax expense	\$'000	1 869	4 219	4 890	5 976	3 859
CSO funding	\$'000	15 368	15 368	9 494	8 663	6 097

^a Includes the operations of Sunwater from October 2000 to June 2001. State Water Projects' revenues and expenses for the period July 2000 to September 2000 were combined with Sunwater to obtain results for the full financial year. Include a \$23.3 million revaluation increment to water infrastructure assets. ^b Includes a \$33.8 million revaluation increment relating to water infrastructure assets. ^c Includes a \$82.5 million revaluation increment relating to water infrastructure assets. ^d Includes a revaluation decrement of \$69.8 million relating to water infrastructure assets. ^e Includes a final dividend payment of \$600 000 for 2001-02 and an interim dividend of \$3.6 million for 2002-03. ^f No provision for the final dividend was made in the 2004-05, as such the final dividend for 2004-05, which was declared in August 2005, has not been included in

SA Water Corporation (SA Water) was established under the *South Australian Water Corporation Act 1994* and operates subject to the *Public Corporations Act 1993*. SA Water provides water and wastewater services to 1.4 million customers in both metropolitan and country areas of SA.

SA Water's metropolitan water and sewerage operations generated 63 per cent of revenue and accounted for 61 per cent of its assets in 2004-05.¹ Country operations generated 31 per cent of revenue and accounted for 37 per cent of assets.² Charges for water and sewerage services are set by the Minister for Administrative Services after consultation with SA Water. In 2004-05, urban water tariffs were increased by 3.5 per cent on average.³

In 2004-05, SA Water's operating profit before tax increased by 8 per cent (\$21 million), because of strong growth in developer contributions (\$26 million increase) and revenue from rates and charges (\$20 million increase). However, growth across a range of expenses, including depreciation, employee costs, operational contracts, and service and supply costs offset some of the revenue gains.

Total assets increased by \$192 million (3 per cent) in 2004-05, mainly because of an asset revaluation increment of \$160 million. However, SA Water reports that it decreased capital expenditure by 35 per cent to \$122 million due to the completion of expenditure on its environmental program and metropolitan wastewater treatment plant.

SA Water is subject to dividend and tax equivalence payments. In 2004-05, dividends paid fell by 11 per cent (\$18 million) and tax equivalence payments increased by 4 per cent (\$3.8 million).

SA Water receives CSO payments relating to the provision of water and wastewater services in country areas, the administration of a pensioner concession scheme, and the provision of water and wastewater concessions to exempt properties, such as charities.

¹ SA Water directly operates and maintains its non-metropolitan water assets, however it contracts United Water to maintain and operate its metropolitan water and waste water assets.

² Other operating activities, such as work with the Murray Darling Basin Commission, the Australian Water Quality Centre, engineering workshops and water industry business development, account for the balance of revenue and assets.

³ This increase is consistent with the Adelaide consumer price index, excluding electricity price increases.

SOUTH AUSTRALIAN WATER CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02	2002-03	2003-04 ^a	2004-05 ^b
<i>Size</i>						
Total assets ^c	\$m	6 059	6 212	6 562	6 843	7 034
Total revenue	\$m	604	629	701	733	823
<i>Profitability</i>						
Operating profit before tax	\$'000	200 539	215 368	264 081	267 309	288 205
Operating sales margin	%	47.9	48.2	49.5	47.2	44.9
Cost recovery	%	190.5	191.5	196.2	182.8	181.3
Return on assets	%	4.8	4.9	5.4	5.2	5.3
Return on equity	%	2.9	3.2	3.8	3.4	3.6
<i>Financial management</i>						
Debt to equity	%	25.9	24.7	23.9	24.4	23.4
Debt to total assets	%	20.0	19.5	19.2	19.4	18.6
Total liabilities to equity	%	29.5	28.8	27.7	28.3	27.1
Interest cover	Times	3.2	3.5	4.2	4.4	4.6
Current ratio	%	97.3	97.0	75.3	76.1	72.8
Leverage ratio	%	129.5	128.8	127.7	128.3	127.1
<i>Payments to and from government</i>						
Dividends	\$'000	135 470	137 175	164 845	174 110	155 189
Dividend to equity ratio	%	2.9	2.9	3.3	3.3	2.9
Dividend payout ratio	%	100.6	89.0	86.8	96.9	78.8
Income tax expense	\$'000	65 827	61 161	74 233	87 544	91 337
CSO funding	\$'000	86 104	90 358	91 706	101 556	103 440

^a Includes a special dividend of \$10 million. ^b Revenue and expenses reported in GFS data are \$47 million greater than the amounts reported in SA Water 2004-05 Annual Report. Part of this variation reflects SA Water's decision not to report the collection of the Murray River Levy, (\$19 million) as it is passed straight through to the SA Government. ^c Asset revaluations in each year of the reporting period resulted in an increase in the value of assets by \$9.5 million (2000-01), \$130 million (2001-02), \$322 million (2002-03), \$188 million (2003-04) and \$159 million (2004-05).

The Water Corporation was established on 1 January 1996 under the *Water Corporation Act 1995*. The Water Corporation provides public water supply, sewerage and drainage services and bulk water to almost 2 million people across urban and regional Western Australia.

The Water Corporation operates under a 25 year licence issued under the *Water Services Licensing Act 1995*. On 1 January 2004, the Economic Regulation Authority (ERA) assumed responsibility for the licensing regime of service providers and for conducting reviews of various industry issues, including water pricing.¹

The Government remains responsible for setting water prices. In 2004-05, no changes were made to prices.²

The Water Corporation's total assets grew by \$155 million to \$10.1 billion, mainly because of additions to capital assets in the water treatment and distribution network. Total liabilities increased by \$45 million (3 percent) due to increases in current liabilities, including tax liabilities and employee benefit provisions. As the increase in current liabilities exceeded the growth in current assets, the Water Corporation's current ratio fell by 12 per cent in 2004-05.

In 2004-05, operating profit before tax increased by 9 per cent to \$605 million with total revenue and total expenditure growing by \$100 million and \$50 million respectively. Increases in sales revenue (\$42 million), CSO contributions (up \$20 million) and developer contributions (\$28 million) contributed to total revenue growth.

Over the reporting period, the Water Corporation received CSO payments for costs incurred in providing country services, pensioner concessions and a program to eliminate septic tanks to protect groundwater, waterways and public health. In 2004-05, CSO payments accounted for 22 per cent of the Water Corporation's total revenue.

¹ On 30 November 2005, the West Australian Treasurer released the ERA's review of urban water and wastewater prices. The ERA is currently conducting a review of country water and wastewater prices.

² All capital cities CPI is used as the determine the rate of inflation for pricing purposes.

WATER CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	9 457	9 579	9 713	9 939	10 094
Total revenue	\$m	1 012	1 042	1 104	1 208	1 308
<i>Profitability</i>						
Operating profit before tax	\$'000	445 083	422 851	469 015	554 474	605 034
Operating sales margin	%	47.0	45.1	48.0	49.9	50.3
Cost recovery	%	188.8	182.1	192.3	199.6	199.1
Return on assets	%	5.1	5.0	5.5	6.2	6.6
Return on equity	%	3.6	3.6	4.0	4.7	5.0
<i>Financial management</i>						
Debt to equity	%	10.4	11.1	12.0	13.0	12.7
Debt to total assets	%	9.1	9.6	10.2	11.0	10.7
Total liabilities to equity	%	16.3	17.2	17.7	19.1	19.4
Interest cover	Times	14.5	9.5	8.5	11.8	11.8
Current ratio	%	51.2	33.9	46.1	29.8	26.3
Leverage ratio	%	116.3	117.2	117.7	119.1	119.4
<i>Payments to and from government</i>						
Dividends	\$'000	240 753	259 811	255 293	291 545	311 477
Dividend to equity ratio	%	3.0	3.2	3.1	3.5	3.7
Dividend payout ratio	%	82.0	87.9	77.8	75.4	73.9
Income tax expense	\$'000	151 575	127 260	140 971	168 034	183 531
CSO funding	\$'000	225 890	240 197	258 403	268 393	288 253

The Hobart Regional Water Authority, trading as Hobart Water, was established as a Joint Authority under the *Local Government Act 1993*. Hobart Water commenced operations on 1 January 1997 following the transfer of assets, property rights and liabilities from its predecessor, the Hobart Regional Water Board. Hobart Water provides bulk water supplies to its owner-councils.¹

Maximum charges for bulk water are determined by the Minister for Local Government on recommendations by the Government Prices Oversight Commission.² In 2004-05, nominal charges reportedly increased by 5.9 per cent.

In 2004-05, Hobart Water's operating profit before tax increased by \$1.1 million (28 per cent). Strong growth in bulk water sales revenue, which accounts for 87 per cent of Hobart Water's total revenue, contributed to this result.

Hobart Water's total assets increased by \$11 million (6 per cent), in 2004-05. This growth resulted from revaluations and additions to infrastructure assets (\$6.2 million) and an increase in cash assets (\$4.1 million). The combination of increased operating profits and growth in net assets resulted in Hobart Water's return on equity ratio growing by 15 per cent.

In 2004-05, Hobart Water's tax-equivalence payments increased by 39 per cent, which is consistent with the improved operating profits before tax.

Hobart Water was not subject to CSOs over the reporting period.

¹ The councils that comprise the Joint Authority are Brighton Council, Clarence City Council, Derwent Valley Council, Glenorchy City Council, Hobart City Council, Kingborough Council, Sorell Council and Southern Midlands Council.

² Under the *Government Prices Oversight Act 1995*, the recommendations may take the form of maximum revenues, maximum prices, pricing principles or a combination of these.

HOBART REGIONAL WATER AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05^a

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	169	171	169	180	191
Total revenue	\$m	20	20	24	24	26
<i>Profitability</i>						
Operating profit before tax	\$'000	2 535	3 272	3 420	3 802	4 857
Operating sales margin	%	23.5	26.6	27.7	28.2	29.0
Cost recovery	%	130.7	136.3	138.3	139.2	140.9
Return on assets	%	2.8	3.8	4.9	4.9	4.9
Return on equity	%	1.5	1.9	2.4	2.1	2.4
<i>Financial management</i>						
Debt to equity	%	26.3	26.2	26.2	24.4	22.8
Debt to total assets	%	19.5	19.5	19.5	19.0	17.9
Total liabilities to equity	%	34.1	35.2	33.5	32.1	31.2
Interest cover	Times	2.2	2.0	1.7	1.8	2.2
Current ratio	%	26.9	51.6	60.4	80.2	114.1
Leverage ratio	%	134.1	135.2	133.5	132.1	131.2
<i>Payments to and from government</i>						
Dividends	\$'000	2 400	2 100	0 ^b	3 000	2 800
Dividend to equity ratio	%	1.9	1.7	0.0	2.3	2.0
Dividend payout ratio	%	129.0	88.2	0.0	109.7	83.0
Income tax expense	\$'000	675	892	407	1 068	1 485
CSO funding	\$'000	0	0	0	0	0

^a All results taken from General Purpose Financial Report data because of the unavailability of Government Financial Statistics data (see chapter 3). ^b A change in accounting policy to meet the requirements of AASB 1044 meant that no dividend was recognised in 2002-03 (chapter 3).

Cradle Coast Water (CCW) was established as a Joint Authority on 10 August 1999 under the *Local Government Act 1993*.¹ CCW collects, treats and supplies bulk drinking water to its joint owning councils — Circular Head, Central Coast, Waratah-Wynyard, Devonport City, Latrobe and Kentish.

Maximum charges for bulk water are determined by the Minister for Local Government on recommendations by the Government Prices Oversight Commission.² In 2004-05, the average price of bulk water was reduced by 2 per cent.

Operating profit before tax increased by \$230 000 (18 per cent). Total revenue grew by 6 per cent, because both bulk water sales and revenue from the provision of contracted services increased.³ However, CCW's expenditure also grew by 4 per cent, due to increased maintenance, depreciation and external contract costs.

In 2004-05, CCW's current assets decreased by 29 per cent due to a reduction in investments. As current debt levels increased by 96 per cent (\$1 million), CCW's current ratio declined to 49 per cent in 2004-05. However, a reduction in total debt has resulted in other indicators of financial management, such as its debt to equity and debt to total assets ratios decreasing.

CCW is subject to dividend and tax-equivalence payments. In 2004-05, tax equivalence payments increased by 95 per cent because of CCW's improved operating result and a reduction in its deductible depreciation-revaluation decrement.

CCW had not receive CSO payments since 2001-02. Prior to 2001-02, fluoridation was identified as a CSO and reimbursed by the Government.

¹ Cradle Coast Water initially traded under the name 'North West Water Authority' (NWWA). On 1 July 2000, the NWWA adopted the trading name of Cradle Coast Water, which became its legal trading name on 12 December 2001.

² Under the *Government Prices Oversight Act 1995*, the recommendations can take the form of maximum revenues, maximum prices, pricing principles, or a combination of these.

³ Contracted services are reported as including the sale of irrigation water and 'Fluoridisation Works' provided under an agreement with the Tasmanian Government.

CRADLE COAST WATER (continued)

Performance indicators 2000-01 to 2004-05^a

	Units	2000-01	2001-02	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	61	61	64	65	65
Total revenue	\$m	8	8	8	8	9
<i>Profitability</i>						
Operating profit before tax	\$'000	1 390	856	1 190	1 259	1 488
Operating sales margin	%	34.7	28.3	30.9	30.2	31.3
Cost recovery	%	153.3	139.5	144.8	143.3	145.6
Return on assets	%	4.7	3.7	4.1	4.0	4.3
Return on equity	%	3.7	2.2	3.0	2.8	3.0
<i>Financial management</i>						
Debt to equity	%	63.0	60.2	53.2	51.7	51.5
Debt to total assets	%	37.7	36.1	34.2	33.0	32.7
Total liabilities to equity	%	69.6	66.8	59.4	58.0	56.9
Interest cover	Time s	2.0	1.6	1.9	2.0	2.1
Current ratio	%	121.4	97.8	92.6	84.0	48.9
Leverage ratio	%	169.6	166.8	159.4	158.0	156.9
<i>Payments to and from government</i>						
Dividends	\$'000	514	428	0 ^a	595	629
Dividend to equity ratio	%	1.5	1.2	0.0	1.5	1.5
Dividend payout ratio	%	40.0	53.1	0.0	52.4	50.4
Income tax expense	\$'000	104	49	39	123	241
CSO funding	\$'000	31	0	0	0	0

^a All results taken from General Purpose Financial Report data because of the unavailability of Government Financial Statistics data (chapter 3). ^b A change in accounting policy to meet the requirements of AASB 1044 meant that no dividend was recognised in 2002-03 (see chapter 3).

The Esk Water Authority, trading as Esk Water, was established as a Joint Authority under the *Local Government Act 1993*. Esk Water commenced operations in July 1997, following the transfer of assets from its predecessors, the North Esk Scheme, West Tamar Scheme and the Launceston City Council. Esk Water provides bulk water supply to councils and industrial users in the Launceston–Tamar Valley region.¹

Maximum charges for bulk water are determined by the Minister for Local Government on recommendations by the Government Prices Oversight Commission.² Esk Water utilises a two-part tariff structure, which was implemented in 2001-02. The variable component of the price was reduced by 12 per cent during 2003-04.

In 2004-05, operating profit before tax increased by 10 per cent, to \$2.9 million. Revenue growth from increased sales and reduced borrowing costs contributed to this result.

A revaluation of non-current assets resulted in Esk Water's total assets increasing by \$15 million (14 per cent) to \$121 million. This revaluation, in conjunction with a fall in earnings before interest and tax, resulted in decreases in both the return on assets and return on equity ratios.

In 2004-05, the current ratio fell by more than 50 per cent because a \$2 million loan became a current liability.³ However, as total debt did not change and equity increased, the debt to equity ratio decreased.

Esk Water is subject to dividend and tax-equivalence payments. In 2004-05, dividend payments fell by 19 per cent. However, dividends paid in 2003-04 were enhanced by Esk Water's strong operating performance in 2002-03.

Esk Water was not subject to CSOs over the reporting period.

¹ Participant councils in the Joint Authority include Launceston City, George Town, Meander Valley and West Tamar. On inception, Esk Water received equity from the State Government (88 per cent), Launceston City Council (11 per cent) and Meander Valley Council (1 per cent).

² Under the Government Prices Oversight Act 1995, the recommendations can take the form of maximum revenues, maximum prices, pricing principles, or a combination of these.

³ In line with accounting principles, this loan was reported as a current liability in 2004-05, because it matures within the next financial year.

ESK WATER AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05^a

	Units	2000-01 ^b	2001-02	2002-03 ^c	2003-04 ^d	2004-05 ^e
<i>Size</i>						
Total assets	\$m	102	103	100	106	121
Total revenue	\$m	8	9	9	10	10
<i>Profitability</i>						
Operating profit before tax	\$'000	1 950	2 546	2 926	2 619	2 872
Operating sales margin	%	30.5	34.9	35.5	30.8	30.1
Cost recovery	%	144.0	153.5	155.1	144.5	143.1
Return on assets	%	2.5	3.1	3.4	3.1	2.7
Return on equity	%	1.5	1.9	2.3	1.9	1.8
<i>Financial management</i>						
Debt to equity	%	8.9	8.9	8.0	2.1	1.8
Debt to total assets	%	7.9	7.8	6.9	1.9	1.8
Total liabilities to equity	%	13.9	14.9	14.4	8.8	8.8
Interest cover	Times	4.2	5.2	6.3	5.7	15.8
Current ratio	%	175.6	205.0	124.4	526.0	248.2
Leverage ratio	%	113.9	114.9	114.4	108.8	108.8
<i>Payments to and from government</i>						
Dividends	\$'000	1 337	1 683	2 011	2 048	1 662
Dividend to equity ratio	%	1.5	1.9	2.3	2.2	1.6
Dividend payout ratio	%	100.0	100.7	100.0	115.1	87.5
Income tax expense	\$'000	613	875	914	839	972
CSO funding	\$'000	0	0	0	0	0

^a All results taken from General Purpose Financial Report data because of the unavailability of Government Financial Statistics data (see chapter 3). ^b A revaluation resulted in an increase of \$3.3 million in the value of pipes and other fixed assets. ^c Includes an asset revaluation decrement of \$3 million. ^d Includes an asset revaluation increment of \$10 million. ^e Includes an asset revaluation increment of \$14 million.

ACTEW Corporation (ACTEW) provides water and sewerage services to over 130 000 domestic and commercial customers in the ACT and Queanbeyan. ACTEW was established in 1995 and operates in accordance with the *Territory Owned Corporations Act 1990*. ActewAGL — a joint venture with privately-owned energy company AGL — provides gas and electricity services and manages ACTEW Corporation's water and sewerage assets under contract.

ACTEW owns a 50 per cent interest in ActewAGL.¹ In addition, ACTEW holds a 25 per cent interest in TransACT Communications Pty Ltd, a broadband communications provider in the Canberra area.

The ACT Independent Competition and Regulatory Commission (ICRC) sets prices for water and sewerage services, and for both electricity and gas distribution network services. A four year price path of CPI plus 2.5 per cent for water and CPI plus 1 per cent for wastewater, was determined by the ICRC and commenced on 1 July 2004.

ACTEW's operating profit before tax increased by \$7.5 million (9.1 per cent) in 2004-05. This is mainly attributable to the growth in sales revenue of \$10 million following the price increases. Operational expenses increased by \$3.1 million mainly as a result of drought conditions and increased water abstraction charges.

In 2004-05, total equity fell by \$23 million mainly as a result of a \$32 million (5.8 per cent) increase in total liabilities. As operating profits increased, ACTEW's return on assets and return on equity ratios increased by 5.4 per cent and 37 per cent respectively. However, as debt and interest expenses also increased, ACTEW's debt to equity ratio increased and interest cover fell.

ACTEW is subject to dividends and tax-equivalent payments. In 2004-05, ACTEW paid a dividend of \$94 million. In 2003-04, interim and final dividends were postponed to assist ACTEW finance capital expenditure projects. In 2003-04, ACTEW also commenced reporting under a tax consolidation regime, the associated adjustments increased its tax-equivalent payment in that year. In 2004-05, the tax-equivalent payment fell by \$12 million.

¹ ActewAGL's operations are included in ACTEW Corporation's financial results using the 'equity accounting' method. Under this method, ACTEW recognised its initial investment in ActewAGL as an asset, and adjusts the value of the investment to reflect its share of profits (losses) in ActewAGL each year. In 2004-05, ActewAGL reported assets of \$885 million and revenue of \$568 million.

ACTEW CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02^a</i>	<i>2002-03</i>	<i>2003-04^b</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m		1 326	1 334	1 354	1 363
Total revenue	\$m		185	191	194	212
<i>Profitability</i>						
Operating profit before tax	\$'000		72 862	62 942	82 022	89 487
Operating sales margin	%		53.2	45.3	53.4	52.2
Cost recovery	%		203.8	174.6	204.6	200.2
Return on assets	%		7.5	6.6	7.8	8.2
Return on equity	%		5.9	5.5	6.5	9.0
<i>Financial management</i>						
Debt to equity	%		45.2	44.4	42.6	45.8
Debt to total assets	%		27.2	26.4	25.5	26.3
Total liabilities to equity	%		66.5	68.5	68.4	74.5
Interest cover	times		3.8	3.5	4.6	5.0
Current ratio	%		104.7	136.7	145.3	75.9
Leverage ratio	%		166.5	168.5	168.4	174.5
<i>Payments to and from government</i>						
Dividends	\$'000		46 887	47 700	0 ^c	94 021 ^d
Dividend to equity ratio	%		5.9	6.0	0.0	11.9
Dividend payout ratio	%		100.1	110.0	0.0	132.1
Income tax expense	\$'000		26 034	19 561	29 846	18 291
CSO funding	\$'000		0	0	0	0

^a 2001-02 was the first year that ACTEW Corporation was included in the water sector. It commenced operations as a water business in July 1995. ^b In 2003-04, operating profits before tax have been revised upwards by \$40 million. Last year, a \$40 million diminution in ACTEW's investment in TransACT was reported as a negative revenue. However, under GFS reporting requirements, this transaction should not impact on the operating result. Profitability measures and the interest cover ratio have been revised as a result of this correction. ^c The dividend payment for 2003-04 was postponed to 2004-05. ^d Includes a closing balance of \$22.5 million not paid in 2004-05.

8 Urban transport

The financial performances of five urban transport government trading enterprises (GTEs) are covered in this chapter. At the end of 2004-05, they controlled \$1.5 billion in assets and generated around \$810 million in revenue. These urban transport GTEs vary in size and the range of services they provide.

Financial performance summaries, including performance indicators for each individual GTE and a summary of performance indicators for the sector as a whole, are presented after this introduction. The performance indicators are consistent across individual GTEs. However, when making comparisons, care should be taken to consider differences in the nature and scale of the businesses, their market environments and issues relating to the valuation of their assets.

The financial indicators used and some of the factors that should be considered when assessing performance are discussed in chapter 3.

8.1 Monitored GTEs

The selected GTEs vary in the range of services they provide, their size and their corporate structure. The primary activity of most of the urban transport GTEs is the provision of bus services (table 8.1). State Transit Authority (STA) of New South Wales, Sydney Ferries Corporation (SFC) and TransAdelaide operate other modes of transport. STA and SFC operate passenger ferries, and TransAdelaide operates passenger rail and tram services and is also responsible for the management of the metropolitan rail network.

Urban transport services are also provided by Queensland Rail and the WA Government Railways Commission, as a part of their broader rail operations. The performance of these GTEs is reported in chapter 9.

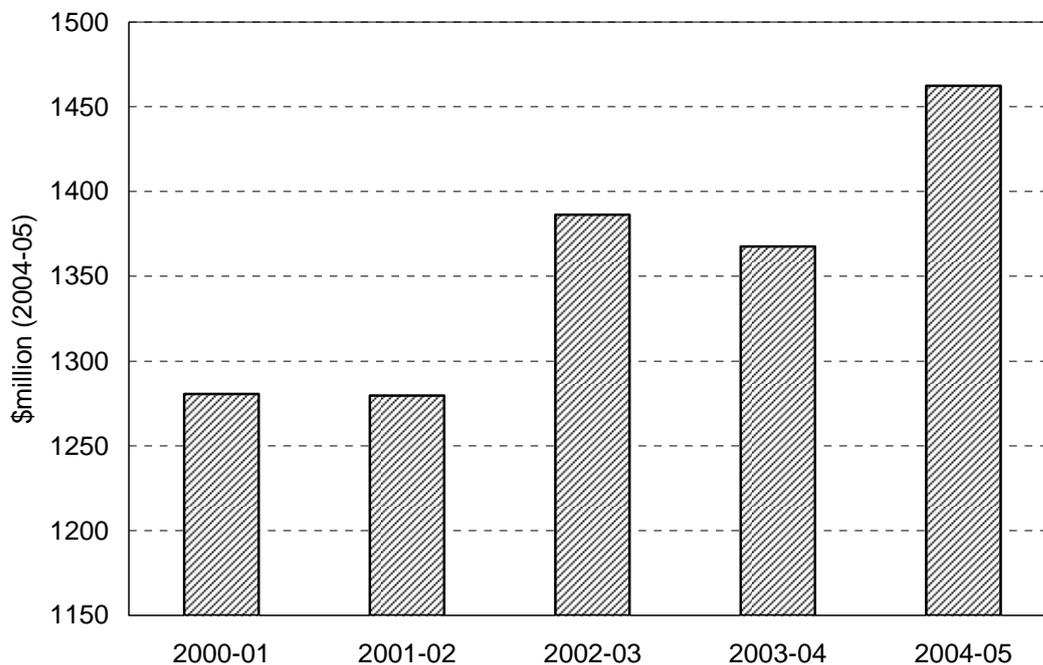
Table 8.1 Activities — monitored urban transport GTEs, 2004-05

	<i>Bus</i>	<i>Ferry</i>	<i>Tram</i>	<i>Train</i>
State Transit Authority (NSW)	✓	✓	x	x
Sydney Ferries Corporation	x	✓ ^a	x	x
TransAdelaide ^b	x ^c	x	✓	✓
Metro Tasmania	✓	x	x	x
ACTION	✓	x	x	x

^a Sydney Ferries Corporation was established as a separate entity from State Transit Authority as at 1 July 2004. ^b In addition to its passenger transport activities, TransAdelaide is the infrastructure manager for the Adelaide metropolitan rail network. ^c TransAdelaide does not operate bus services in its own right. However, it has a joint-venture operation that provides bus services in the Adelaide Hills.

Over the reporting period, total assets of the reported GTEs grew by around \$180 million (14 per cent) in real terms (figure 8.1). A large increase in total assets in 2002-03 was largely attributable to a \$137 million asset revaluation increment recorded by STA.

Figure 8.1 Sector assets — urban transport GTEs

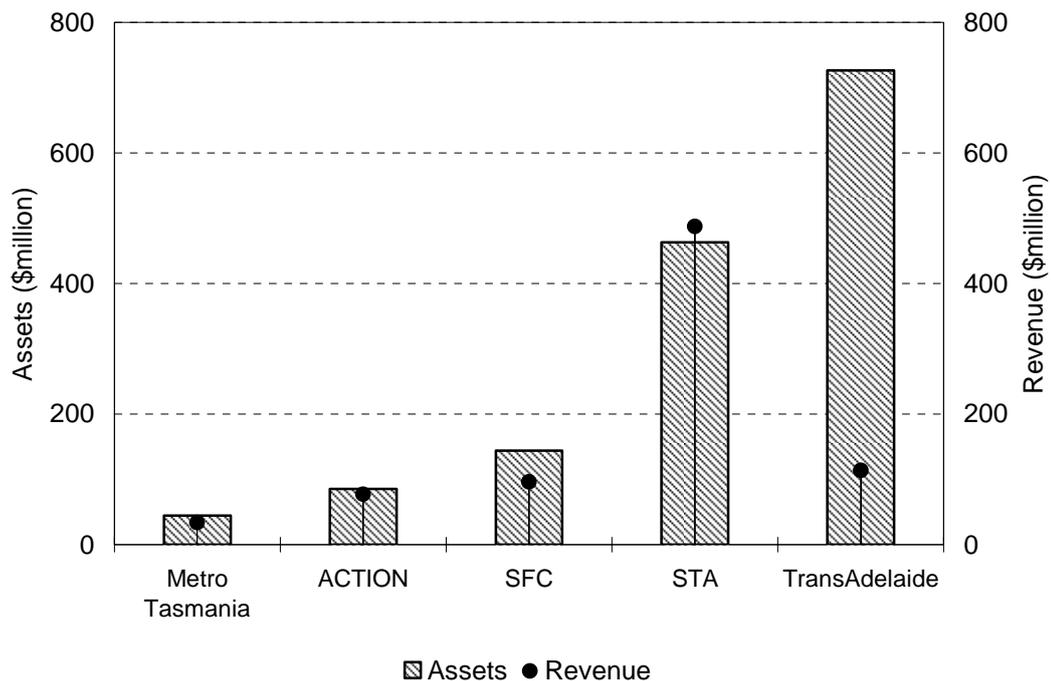


Note The value of sector assets were converted to 2004-05 dollars using the implicit price deflator — Gross Fixed Capital Formation for Public Corporations (chapter 3).

Source: Productivity Commission estimates.

In 2004-05, TransAdelaide controlled 50 per cent of the aggregate assets, while STA accounted for a further 32 per cent. Of the \$810 million of revenue generated by the five GTEs in 2004-05, STA accounted for approximately 60 per cent (figure 8.2). The large size of TransAdelaide's asset base relative to its revenue reflects the high valuation of rail infrastructure assets vis a vis buses and ferries for the other urban transport GTEs.

Figure 8.2 **Assets and revenue — urban transport GTEs, 2004-05**



Source: Productivity Commission estimates.

8.2 Market environment

The patronage and financial performances of urban transport GTEs are significantly affected by the market environment in which they operate. Travel demand and revenue depend on a number of factors, including competition from private operators of urban transport, the cost of alternative methods of transport, including those incurred with driving and parking privately-owned motor vehicles, as well as changes in fares and urban demographics.

In 2004-05, patronage decreased for the sector as a whole. STA, SFC, Metro Tasmania and ACTION recorded a decline in patronage of 0.3 per cent, 4.2 per cent, 1.1 per cent and 0.4 per cent, respectively. TransAdelaide also

experienced a decline in passenger numbers of 0.6 per cent, with tram and train boardings decreasing 2.9 per cent and 0.2 per cent, respectively.

Urban transport services were provided almost exclusively by governments prior to the 1990s. The rationale for government intervention in the provision of urban transport services included the benefits of service coordination and system-wide ticketing, limited competition, the existence of positive externalities and the provision of access to the disadvantaged.

Microeconomic reform has been aimed at introducing institutional and regulatory changes in order to reduce the reliance of service providers on government subsidies by commercialising publicly-owned services, and exposing service providers to market competition (PC 2005b). The principal areas of reform in urban transport have been in the areas of governance, supplier market competition and the setting of tariffs.

Governance reform

The relationships between urban transport GTEs and their owner-governments have been reformed to increase their commercial focus. The implementation of these reforms have varied across jurisdictions. However, there has been a general trend to separate urban transport policy, planning and regulatory functions from operational functions.

The only significant change in the governance structure of STA since the passing of the *Transport Administration Act 1988* was the separation — under legislation passed by the NSW Parliament in 2003 — of Sydney Ferries (now operating as the Sydney Ferries Corporation) from STA on 1 July 2004.

In South Australia, the former State Transport Authority was restructured in 1994-95. As a part of the restructure:

- TransAdelaide was corporatised and assumed the operating functions of the former State Transport Authority of South Australia; and
- the planning and regulatory functions, including the responsibility for setting urban transport prices, were transferred to a new organisation — the Passenger Transport Board (PTB), a statutory authority within the Department for Transport, Urban Planning and the Arts.

The *Passenger Transport (Dissolution of Passenger Transport Board) Amendment Act 2003* dissolved the PTB effective from 1 January 2004. In conjunction with this Act, the SA Government established an Office of Public Transport within the

Department of Transport and Urban Planning to assist the Minister in performing the functions previously carried out by the PTB.

In 1997-98, the Metropolitan Transport Trust of Tasmania became a government-owned company (Metro Tasmania) subject to Corporations Law.

On 1 January 2002, the status of ACTION changed from a division of the Department of Urban Services to a statutory authority.

Market reforms

Some aspects of the National Competition Policy reforms have had an impact on administrative and operational arrangements in the urban transport sector. These include the application of competitive neutrality principles and the contracting out of some services.

Competitive tendering arrangements have been introduced to provide incentives for improved commercial performance. Urban transport GTEs have been required to compete with private sector providers for the right to operate certain urban passenger services in New South Wales, South Australia and Victoria.

For example, since 1995-96 TransAdelaide has been required to compete with the private sector on the basis of a set of costing rules designed to ensure competitive neutrality. On 22 April 2000, TransAdelaide ceased providing bus services after it was unsuccessful in tendering for service contracts with the PTB. It continues however, to participate in a joint venture with Australian Transit Enterprises to operate bus services in the Adelaide Hills.

Competitive tendering is also planned for the ACT. In January 2002, ACTION entered into an exclusive contract with the ACT Government for the provision of urban transport services. It is intended that on the expiration of this contract on 31 December 2006, ACTION will be required to compete with the private sector to secure new service contracts.

STA expanded its bus services in Western Sydney after winning a tender to deliver high frequency services along the Liverpool–Parramatta Transitway. STA was awarded the contract in January 2002 ahead of competition from local and multinational companies. Services subsequently commenced under the new contract in February 2003.

Tariff reforms

Over the reporting period, the pricing of urban transport services was determined by independent pricing regulatory bodies in New South Wales and the ACT. In Tasmania, they are set by the Minister after considering reports by the Government Prices Oversight Commission (GPOC). In South Australia, prices were determined by the PTB until its abolition at the end of December 2003. Public transport prices in South Australia are now determined by the Government.

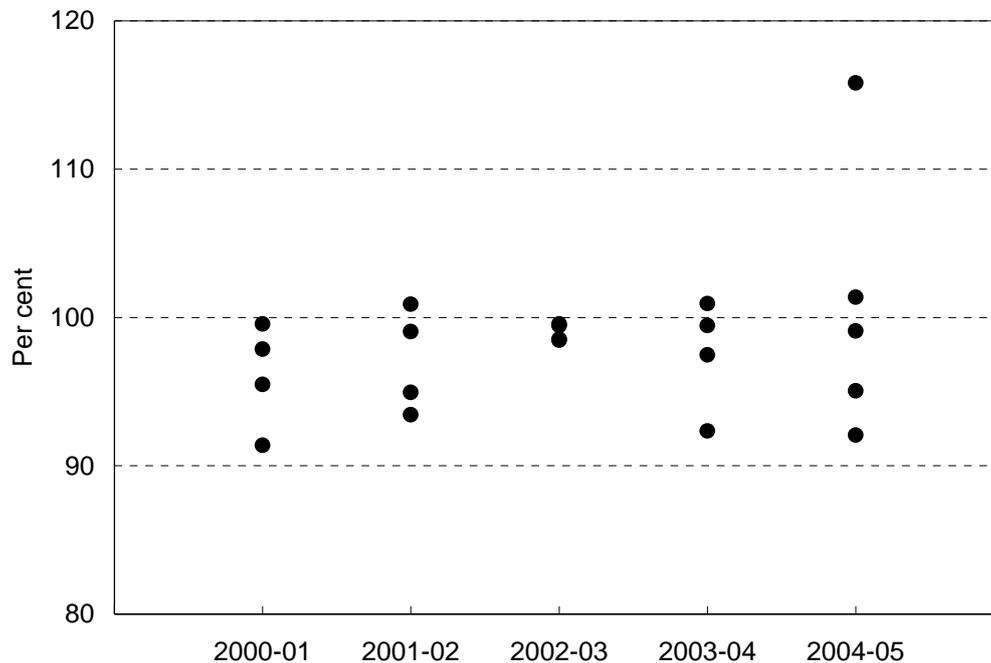
With the exception of ACTION, all urban transport GTEs increased prices in 2004-05. The ACT's Independent Pricing and Regulatory Commission determined that ACTION's prices would not increase for the period ending in June 2006.

8.3 Profitability

In 2004-05, STA and TransAdelaide significantly improved their profitability, while Metro Tasmania maintained a relatively small operating profit. ACTION's performance declined with operating losses being made over the reporting period. In 2004-05, SFC recorded an operating loss. Prior to 2004-05, urban transport GTEs (overall) have recorded negative operating results.

The average level of cost recovery for urban transport GTEs remained close to 100 per cent over the reporting period (figure 8.3). In 2004-05, cost recovery for Metro Tasmania and ACTION worsened slightly, while STA and TransAdelaide improved.

Figure 8.3 Cost recovery — urban transport GTEs



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 from total revenue, investment income and receipts from governments to cover operational deficits. Expenses from operations are calculated by subtracting gross interest expense from total expenses. A number of GTEs had virtually identical cost recovery ratios in 2002-03.

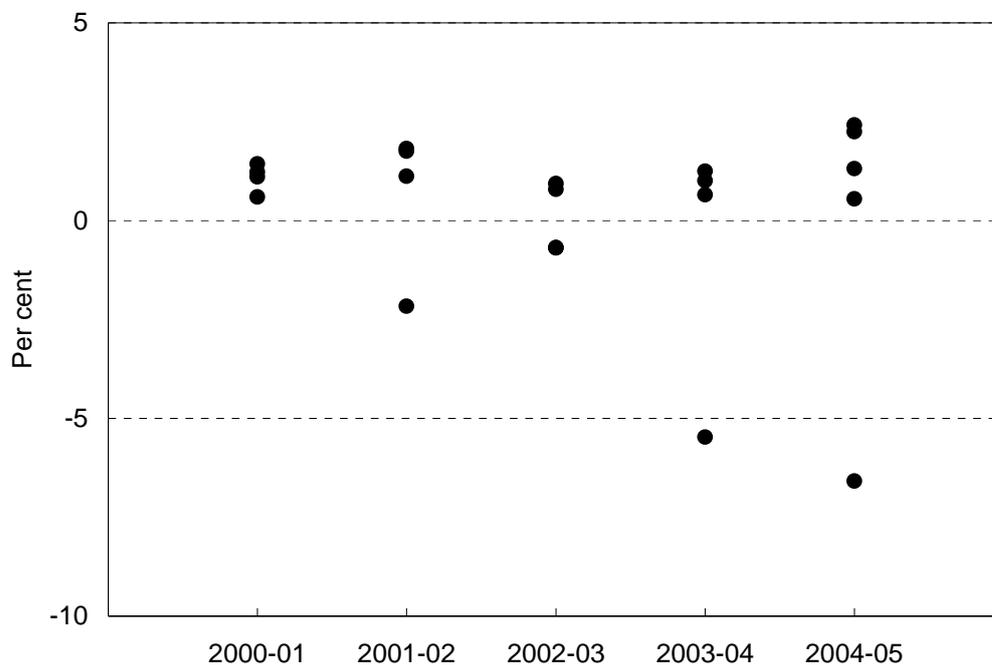
Source: Productivity Commission estimates.

Over the reporting period, the return on assets varied across urban transport GTEs (figure 7.4) with significant convergence in recent years. The major factors affecting this ratio are changes in total revenue and total expenses. However, return on assets is also influenced by changes in asset values — through asset transfers, sale and lease-buy-back arrangements, asset revaluations, asset disposals and depreciation.

Overall, returns are well below those required by private operators, indicating that urban transport GTEs are not operating on a commercially viable basis.¹

¹ Governments may not require a commercial rate of return from urban transport GTEs because urban transport provides external benefits that are not captured on the balance sheet — such as reductions in road user cost, environmental benefits and access for the young, elderly and poor. Alternatively, governments may believe that there is scope for further efficiency gains within the GTEs and set prices to reflect the efficient cost of service provision. In this case, low returns would be indicative of inefficient operations.

Figure 8.4 Return on assets — urban transport GTEs



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 and adding back the gross interest expense.

Source: Productivity Commission estimates.

Like return on assets, the return on equity achieved by urban transport GTEs varied significantly over the reporting period. STA, TransAdelaide and Metro Tasmania each reported a (small) positive return on equity in 2004-05, while ACTION and SFC reported a negative return on equity.

8.4 Financial management

Financial management indicators provide information about the capital structure of GTEs and their ability to meet the cost of servicing debt and other liabilities as they fall due.

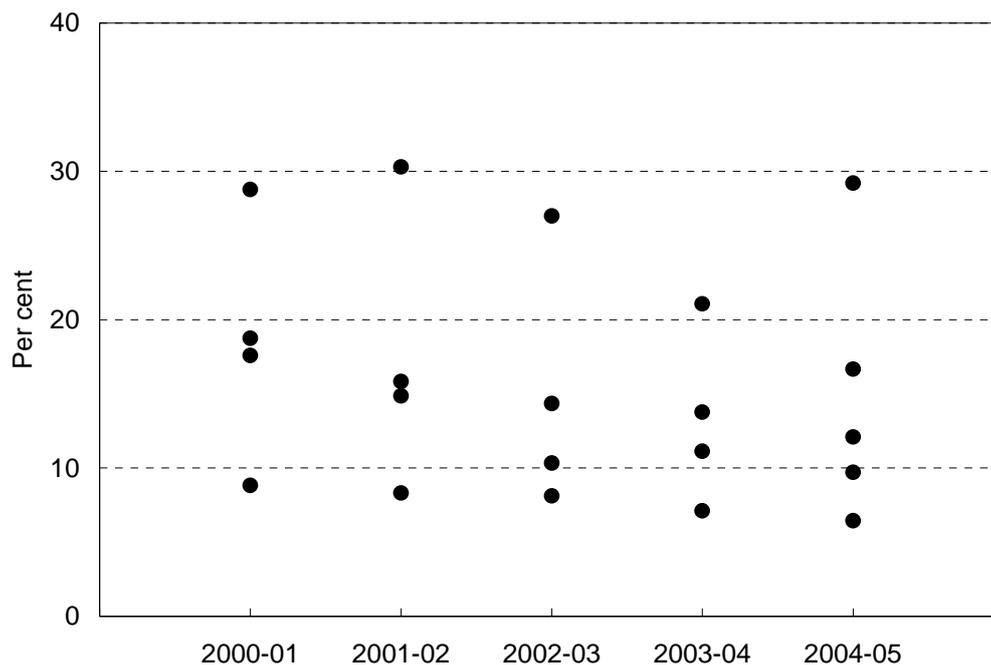
Most urban transport GTEs have restructured their capital over the reporting period and reduced debt levels. This restructuring includes debt for equity swaps, debt transfers to government and debt repayments.

Changes in the capital structure of the GTEs make it difficult to assess financial management performance over time. Asset revaluations also have an impact on inter-temporal performance comparisons.

Over the reporting period, the debt to total assets ratios generally declined across the monitored GTEs (figure 8.5). This could suggest that total assets increased from means other than additional borrowing. An improvement in this ratio can also result from asset revaluations, debt restructuring, and the transfer of liabilities to government departments. For example, despite an absolute increase in its amount of debt, the upward revaluation of assets by STA in 2002-03 resulted in a decrease in the debt to total assets ratio from 30 per cent (2001-02) to 27 per cent (2002-03).

Over the reporting period, STA, TransAdelaide, Metro Tasmania and ACTION decreased their level of debt by 31 per cent, 28 per cent, 9 per cent and 37 per cent, respectively.

Figure 8.5 Debt to total assets — urban transport GTEs



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.

Source: Productivity Commission estimates.

Sound financial management requires that profits are sufficient to ensure interest payments can be met. A high level of interest cover — the ratio of earnings before

interest and tax expenses to gross interest expenses — indicates that the entity can sustain a fall in profit or an increase in interest expenses and still meet the cost of servicing debt.

In 2004-05, the interest cover levels reported by the urban transport GTEs ranged from –5.4 times to 2.6 times. This was a larger range than the previous year, when interest cover levels were between –4.2 times and 1.3 times.

ACTION's interest cover was negative in 2004-05, indicating that it may have to fund interest expenses from sources other than current operating profits. The other urban transport GTEs are likely to be able to meet their interest commitments from operating profit. However, due to the small margins involved, cover may be significantly affected by increases in interest rates or negative shocks to revenue.

8.5 Transactions with government

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

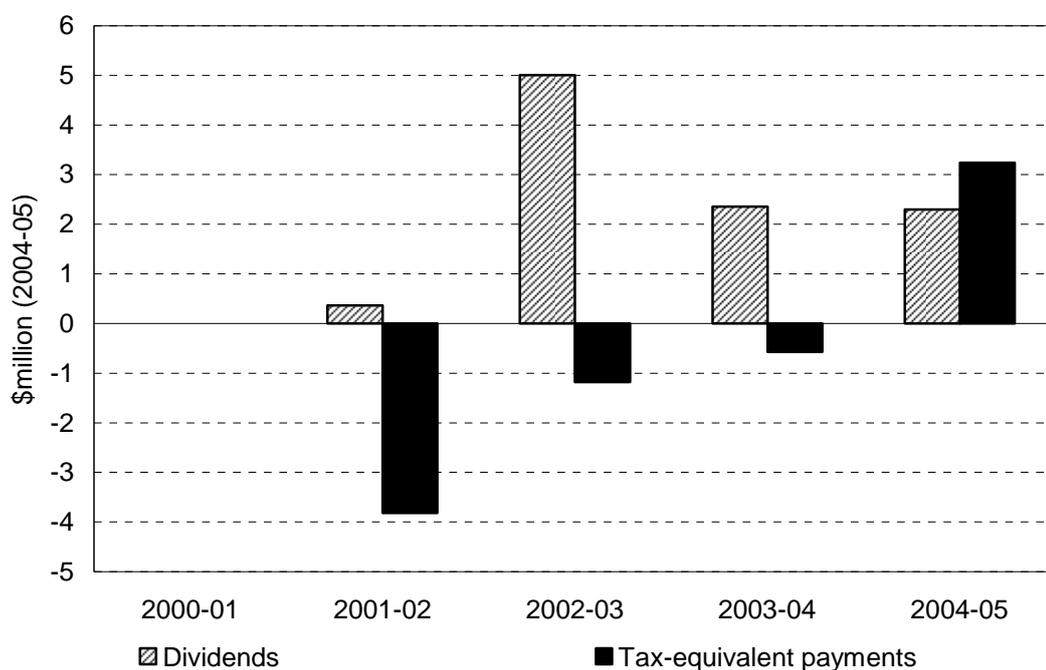
The monitored urban transport GTEs are required to make tax-equivalent and dividend payments, along with debt guarantee fee payments, to achieve competitive neutrality with private sector businesses.

Income tax and dividend payments by the urban transport GTEs have been low in comparison to payments made by GTEs in other industry sectors, and have varied considerably since 2001-02 (figure 8.6). This reflects the small and volatile returns of urban transport GTEs over the reporting period.

TransAdelaide was the only urban transport GTE to make a tax-equivalent payment over the reporting period. Tax-equivalent payments were not required of the other urban transport GTEs because of negative operating results and accumulated tax losses.

Since 2000-01, TransAdelaide has made one dividend payment, as well as three special dividend payments from retained earnings. Metro Tasmania has made one dividend payment, and STA, SFC and ACTION have not paid dividends.

Figure 8.6 Dividend and tax-equivalent payments — urban transport GTEs



Note The value of dividends and tax-equivalent payments were converted to 2004-05 dollars using the implicit price deflator — Gross Fixed Capital Formation for Public Corporations (chapter 3). No dividend or tax-equivalent payments were made in 2000-01. The negative values for tax-equivalent payments in 2001-02, 2002-03 and 2003-04 represent income tax benefits for those years.

Source: Productivity Commission estimates.

Traditionally, the social benefits associated with the provision of low-cost urban transport services were recognised implicitly by governments and paid for by funding operating deficits in addition to the provision of CSO payments.

Governments have entered into CSO contracts with their respective urban transport GTEs. CSO contracts across urban transport GTEs include:

- *Pricing* — to reimburse GTEs for offering fares at below a commercial level. The government pays the difference between the full fare applicable for the journey and the fare paid by the traveller.
- *Service* — to reimburse GTEs for providing non-commercial services, such as late night services when patronage is low.
- *Concessions* — to reimburse GTEs for administering government determined concessions. This includes the provision of free and concession travel for school students, tertiary students, pensioners and senior citizens, people with disabilities and welfare recipients.

STA, SFC, Metro Tasmania and ACTION receive CSO payments, although Metro Tasmania does not reveal the value of this funding in its financial statements. TransAdelaide also receives government payments, though funding is generally in the form of capital contributions.

For most urban transport GTEs, CSOs account for a relatively large share of total revenue. In 2004-05, CSO funding accounted for 77 per cent of ACTION's total revenue, 48 per cent for STA and 45 per cent for SFC.

URBAN TRANSPORT

Table 8.2 Whole sector performance indicators, 2000-01 to 2004-05

	Units	2000-01	2001-02	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	1 228	1 244	1 350	1 333	1 459
Total revenue	\$m	680	691	723	736	808
<i>Profitability</i>						
Operating profit before tax	\$'000	- 7 297	- 19 504	- 16 878	- 7 961	7 548
Operating sales margin	%	1.8	- 0.3	- 0.3	1.1	2.7
Cost recovery	%	96.8	94.7	98.7	99.6	101.3
Return on assets	%	1.3	0.0	0.2	0.8	1.9
Return on equity	%	- 1.1	- 2.2	- 2.1	- 0.9	0.5
<i>Financial management</i>						
Debt to equity	%	35.8	37.2	30.8	27.9	23.5
Debt to total assets	%	21.5	20.9	19.1	16.6	16.7
Total liabilities to equity	%	72.0	79.6	67.8	66.5	54.4
Interest cover	times	0.7	0.0	0.1	0.6	1.4
Current ratio	%	59.5	46.7	38.6	42.0	58.0
Leverage ratio	%	172.0	179.6	167.8	166.5	154.4
<i>Payments to and from government</i>						
Dividends	\$'000	0	353	4 878	2 296	2 296
Dividend to equity ratio	%	0.0	0.1	0.7	0.3	0.3
Dividend payout ratio	%	0.0	- 2.2	- 31.0	- 29.1	55.7
Income tax expense	\$'000	0	- 3 711	- 1 152	- 558	3 239
CSO funding	\$'000	236 406	255 398	290 789	293 648	334 521

8.6 GTE performance reports

State Transit Authority (NSW)

Sydney Ferries (NSW)

TransAdelaide (SA)

Metro Tasmania (Tasmania)

ACTION Authority (ACT)

State Transit Authority (STA) is incorporated under the *Transport Administration Act 1988* and operates within the regulatory framework of the *Passenger Transport Act 1990*. In 2004-05, it operated three metropolitan passenger transport businesses — Sydney Buses, Western Sydney Buses, and Newcastle Bus and Ferry Services.

Prices for STA's services are set by the Independent Pricing and Regulatory Tribunal of New South Wales. In accordance with the *Public Transport Fares Determination*, Sydney Buses', Newcastle Buses and Ferry Services' fares were increased in 2004-05.

STA's total assets and liabilities decreased in 2004-05 by around \$122 million (21 per cent) and \$50 million (15 per cent), respectively. This was largely because of the transfer of certain assets (\$146 million) and liabilities (\$63 million) to Sydney Ferries, as decided by the Minister for Transport Services.

Capital expenditure was around \$55 million in 2004-05, an increase from \$29 million in 2003-04. The current capital works program comprised \$51 million on the bus replacement program and \$4 million on the renewal or replacement of assets required for bus servicing, ferry maintenance, depot facilities and computing resources.

In 2004-05, STA recorded an operating profit (before tax) of \$5.8 million (an increase in the operating result of \$10 million from 2003-04) and the return on assets improved to 2.3 per cent. Prior to 2004-05, over the reporting period STA had not recorded a positive operating result.

STA is subject to dividend and tax-equivalent payments. In 2004-05, no dividend or tax was paid reflecting STA's operating results over the reporting period.

Costs are recovered by a combination of fares, charters and tourists' services, as well as government reimbursements for CSOs. Of the \$232 million in CSO funding for 2004-05, \$128 million was fare payments by government for pensioners, school children and other eligible groups. The remaining \$104 million was for two general reimbursements — a pricing CSO to cover the gap between State Transit's fares and those generally prevailing in the private bus sector, and a service CSO to cover the operation of a number of non-commercial services.

STATE TRANSIT AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02	2002-03 ^a	2003-04	2004-05 ^b
<i>Size</i>						
Total assets	\$m	439	467	599	585	463
Total revenue	\$m	479	490	519	527	487
<i>Profitability</i>						
Operating profit before tax	\$'000	- 4 313	- 19 580	- 13 968	- 4 556	5 776
Operating sales margin	%	0.9	- 2.0	- 0.8	1.0	2.4
Cost recovery	%	97.9	93.4	98.5	100.9	101.4
Return on assets	%	1.2 ^c	- 2.2	- 0.7	1.0 ^a	2.3
Return on equity	%	- 3.0	- 15.0	7.7	- 1.9	2.8
<i>Financial management</i>						
Debt to equity	%	89.9	112.4	59.2	51.6	51.6
Debt to total assets	%	28.8	30.3	27.0	21.1	16.7
Total liabilities to equity	%	214.5	282.3	146.5	142.6	173.8
Interest cover	times	0.6	- 1.0	- 0.4	0.6	2.0
Current ratio	%	44.9	30.5	20.9	24.4	32.1
Leverage ratio	%	314.5	382.3	246.5	242.6	273.8
<i>Payments to and from government</i>						
Dividends	\$'000	0	0	0	0	0
Dividend to equity ratio	%	0.0	0.0	0.0	0.0	0.0
Dividend payout ratio	%	0.0	0.0	0.0	0.0	0.0
Income tax expense	\$'000	0	0	0	0	0
CSO funding	\$'000	193 675	208 860	239 430	241 395	231 975

^a The increase in the value of assets is largely attributable to a \$137 million asset revaluation increment. ^b On 30 June 2004, the Minister for Transport Services authorised the transfer of certain assets and liabilities to Sydney Ferries, which had a net value of \$83 million. ^c Return on assets was positive, despite STA recording a negative operating result. Return on assets is the ratio of Earnings Before Interest and Tax (EBIT) to total assets. The discrepancy between pre-tax operating profit and return on assets reflects an increase in borrowing costs (which are excluded from EBIT) as a percentage of total costs.

Sydney Ferries Corporation (SFC) was established under the *State Owned Corporations Act 1989*, by an amendment to the *Transport Administration Act 1988*. Prior to 2004-05, State Transit Authority operated Sydney Ferries. SFC provides approximately 110 000 ferry services per year, carrying more than 14 million people on Sydney Harbour and the Parramatta River.

Prices for SFC's services are set by the Independent Pricing and Regulatory Tribunal (IPART) of New South Wales. In its determination issued in December 2004, IPART allowed for an average overall increase in fares of 4.2 per cent. The determination was implemented in full.

SFC recorded total assets of \$144 million and total liabilities of \$26 million in 2004-05. The current ratio was 145 per cent and the leverage ratio was 122 per cent in this period.

In 2004-05, SFC made an operating loss of \$1.9 million, with total revenue of \$96 million and total expenses of \$98 million. Return on assets was 1.3 per cent in 2004-05. Patronage reportedly grew by 0.6 per cent over the financial year.

For 2004-05, SFC was exempt from the Tax Equivalent Regime under the NSW *State Owned Corporations Act 1989*.

Costs are recovered by a combination of fares, charters and tourists' services, as well as government reimbursements for CSOs. Of the \$43 million in CSO funding for 2004-05, around \$10 million was fare payments by government for pensioners, school children and other eligible groups. The remaining \$33 million was for two general reimbursements — a pricing CSO to cover the gap between SFC's fares and the equivalent commercial benchmark, and a service CSO to cover the operation of a number of non-commercial services.

SYDNEY FERRIES CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05^a</i>
<i>Size</i>						
Total assets	\$m					144
Total revenue	\$m					96
<i>Profitability</i>						
Operating profit before tax	\$'000					- 1 898
Operating sales margin	%					1.1
Cost recovery	%					95.0
Return on assets	%					1.3
Return on equity	%					- 1.6
<i>Financial management</i>						
Debt to equity	%					35.5
Debt to total assets	%					29.2
Total liabilities to equity	%					21.7
Interest cover	times					0.5
Current ratio	%					144.6
Leverage ratio	%					121.7
<i>Payments to and from government</i>						
Dividends	\$'000					0
Dividend to equity ratio	%					0.0
Dividend payout ratio	%					0.0
Income tax expense	\$'000					0
CSO funding	\$'000					33 812

^a 2004-05 was the first period that Sydney Ferries Corporation was included in this report, commencing operations on 1 July 2004.

TransAdelaide was established as a Public Authority under the *TransAdelaide (Corporate Structure) Act 1998* and is subject to the provisions of the *Public Corporations Act 1993*. TransAdelaide has a 50 per cent share in TransitPlus Pty Ltd, a joint-venture entity established for the provision of bus services in the Adelaide Hills.

TransAdelaide provides passenger transport services to the Adelaide metropolitan area under a service contract with the Public Transport Division for the period April 2005 to April 2010, and is responsible for the management of train and tram infrastructure.

Total assets increased by \$107 million (17 per cent) in 2004-05 mainly because of an asset revaluation increment of \$73 million for land and buildings. From 2000-01 to 2003-04, total assets and liabilities declined by \$65 million (10 per cent) and \$30 million (18 per cent), respectively.

In 2004-05, TransAdelaide increased operating profit (before tax) to \$10 million from \$1.4 million in 2003-04. Further, the return on assets increased to 2.4 per cent in 2004-05 from 1.2 per cent in 2003-04. However, TransAdelaide's improved performance was largely attributable to an increase in government funding, which included a \$9.9 million capital contribution for an upgrade of the Glenelg tram line. Work on the upgrade of the track commenced at the end of the 2004-05 reporting period.

TransAdelaide is subject to dividend and tax-equivalent payments. There was no declared dividend paid during 2004-05, however, a special dividend of \$2.3 million was paid from retained earnings for depreciation funding.

TransAdelaide was not subject to CSOs over the reporting period.

TRANSADELAIDE (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01 ^a	2001-02 ^b	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	685	670	642	620	726
Total revenue	\$m	107	104	104	106	114
<i>Profitability</i>						
Operating profit before tax	\$'000	- 1 755	6	- 1 225	1 377	10 092
Operating sales margin	%	7.2	6.2	2.7	6.7	13.6
Cost recovery	%	91.4	99.0	99.6	97.5	115.8
Return on assets	%	1.4	1.1	0.9	1.2	2.4
Return on equity	%	- 0.4	0.7	0.0	0.4	1.3
<i>Financial management</i>						
Debt to equity	%	22.0	21.1	19.0	18.0	14.0
Debt to total assets	%	17.6	15.8	14.3	13.8	12.1
Total liabilities to equity	%	32.6	31.9	29.5	28.8	24.7
Interest cover	times	0.8	1.0	0.8	1.2	2.6
Current ratio	%	89.5	76.1	61.0	76.4	92.5
Leverage ratio	%	132.6	131.9	129.5	128.8	124.7
<i>Payments to and from government</i>						
Dividends ^c	\$'000	0	353	4 592	2 296	2 296
Dividend to equity ratio	%	0.0	0.1	0.9	0.5	0.4
Dividend payout ratio	%	0.0	9.5	- 193.2	118.7	33.5
Income tax expense	\$'000	0	- 3 711	- 1 152	- 558	3 239
CSO funding	\$'000	0	0	0	0	0

^a An independent revaluation increased the value of TransAdelaide's assets by almost \$90 million. The reduced total revenue reflects the first full year of operations after losing the Office of Public Transport bus service contract. ^b Operating profit (before tax) for 2001-02 is based on Government Finance Statistics data and did not take into account the loss on sale of assets, which resulted in a \$12 million loss in 2001-02 according to the General Purpose Financial Report framework. This loss on sale of assets in 2001-02 was primarily due to the transfer of TransAdelaide's interest in the Belair rail line to the Australian Railways Track Corporation for nil consideration, pursuant to an agreement reached in 1999 between State and Federal Ministers. ^c A special dividend was paid as directed by the Treasurer from retained earnings for depreciation funding from 2001-02 to 2004-05.

Metro Tasmania Pty Ltd (Metro) was incorporated on 2 February 1998 under the *Metro Tasmania Act 1997*. Upon incorporation, the assets and liabilities of the Metropolitan Transport Trust were transferred to Metro. Metro provides bus services within Hobart, Launceston and Burnie, as well as between Wynyard, Burnie and Ulverstone. On 30 June 2005, Metro acquired the current business of its subsidiary Metro Coaches (Tas) Pty Ltd.

The maximum prices that Metro can charge are determined by the Tasmanian Government after considering reports by the Government Prices Oversight Commission. Metro's fares for adult passengers were increased by roughly between 5 per cent to 9 per cent in January 2005, though fares for children and other student passengers remained the same.

Metro's current ratio improved to 142 per cent in 2004-05 from 93 per cent in 2003-04. Current assets increased 32 per cent and current liabilities decreased 14 per cent in the current financial year.

In 2004-05, total revenue increased by \$1.8 million (5.6 per cent), contributing to a 16 per cent increase in revenue over the reporting period. However, since 2001-02 Metro's operating profit (before tax) has declined by around 89 per cent, which is reflected in a gradual decline in the return on assets.

The *Metro Tasmania Act 1997* and the *Government Business Enterprises Act 1995* require Metro to make income tax-equivalent payments to the Government. Metro has not made tax-equivalent payments during the reporting period because of accumulated tax losses. No dividend was announced for 2004-05.

Metro has a Community Service Activity (CSA) Agreement with the Tasmanian Government, which enables Metro to deliver specified (quantity and quality) services whilst achieving a break-even operating result. CSO funding is not separately identified in Metro's financial statements.

METRO TASMANIA (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	36	37	37	43	44
Total revenue	\$m	29	30	30	32	34
<i>Profitability</i>						
Operating profit before tax	\$'000	- 53	413	80	63	47
Operating sales margin	%	- 0.4	0.9	- 0.6	- 0.6	- 0.9
Cost recovery	%	99.6	100.9	99.5	99.4	99.1
Return on assets	%	0.6	1.8	0.8	0.7	0.5
Return on equity	%	- 0.3	2.4	0.5	0.3	0.2
<i>Financial management</i>						
Debt to equity	%	18.2	17.7	17.9	13.3	13.2
Debt to total assets	%	8.8	8.3	8.1	7.1	6.4
Total liabilities to equity	%	108.5	118.0	119.6	100.9	107.1
Interest cover	times	0.8	2.8	1.4	1.3	1.2
Current ratio	%	109.5	118.0	159.7	93.2	142.4
Leverage ratio	%	208.5	218.0	219.6	200.9	207.1
<i>Payments to and from government</i>						
Dividends ^b	\$'000	0	0	286	0	0
Dividend to equity ratio	%	0.0	0	1.7	0.0	0.0
Dividend payout ratio	%	0.0	0	357.5	0.0	0.0
Income tax expense	\$'000	0	0	0	0	0
CSO funding ^c	\$'000	0	0	0	0	0

^a Includes a one-off receipt of \$336 000 from the Tasmanian Government for prior year increases in superannuation provisions. ^b A change in accounting policy adopted by Metro Tasmania Pty Ltd (Metro) from 1 July 2002 means that dividends from this year on are recognised in the financial statements for the year in which they are announced. As explained in chapter 3, this change affects certain year-to-year comparisons.

^c Metro receives CSO payments under its Community Service Activity Agreement with the Tasmanian Government. The level of CSO funding is not reported separately in Metro's accounts.

The Australian Capital Territory Internal Omnibus Network Authority (ACTION) provides urban and school bus services to the Canberra metropolitan area.¹ On 1 January 2002, the *ACTION Authority Act 2001* came into effect, changing the status of ACTION from a division of the ACT Government's Department of Urban Services to a statutory authority. ACTION operates pursuant to the *Road Transport (Public Passenger Services) Act 2001*.

Prices for ACTION's services are set by the ACT's Independent Pricing and Regulatory Commission, which determined that there should be no fare increases for the period ending in June 2006. Such regulatory decisions have implications for patronage and the level of financial support provided to ACTION by the ACT Government.

Total assets remained steady in 2004-05 at \$85 million, with current assets declining by 35 per cent resulting in the current ratio decreasing from 121 per cent (2003-04) to 80 per cent (2004-05). Interest cover over the five year reporting period (2000-01 to 2004-05) fell from 0.4 times to -5.4 times.

In 2004-05, ACTION's profitability declined by 25 per cent with revenue and expenses increasing by 10 per cent and 11 per cent, respectively. Further, the return on assets declined to -6.6 per cent. Over the reporting period, ACTION's operating losses have increased from \$1.2 million in 2000-01 to \$6.7 million in 2004-05.

ACTION's operating result is budgeted to be in deficit. In general, recurrent expenditure is met from annual revenue, with the exception of depreciation. ACTION receives capital grants to fund its capital expenditure on plant and equipment.

ACTION receives CSO payments for offering fares below a commercial level as well as providing general route off-peak services, concession travel for students, school services and special needs transport. In 2004-05, CSO funding comprised 77 per cent of ACTION's total revenue.

¹ The ACTION Authority has a five year contract with the Department of Urban Services for the exclusive provision of public transport in the ACT. The contract expires on 31 December 2006.

ACTION AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	68	70	73	85	85
Total revenue	\$m	65	67	69	70	77
<i>Profitability</i>						
Operating profit before tax	\$'000	- 1 176	- 343	- 1 765	- 5 345	- 6 655
Operating sales margin	%	1.1	1.6	- 1.3	- 6.9	- 7.6
Cost recovery	%	95.5	94.9	98.5	92.4	92.1
Return on assets	%	1.1	1.8	- 0.7	- 5.5	- 6.6
Return on equity	%	- 2.9	- 0.8	- 3.7	- 10.1	- 11.7
<i>Financial management</i>						
Debt to equity	%	32.4	22.6	15.0	15.4	14.5
Debt to total assets	%	18.7	14.9	10.3	11.1	9.7
Total liabilities to equity	%	68.5	53.4	48.0	49.5	49.4
Interest cover	times	0.4	0.8	- 0.4	- 4.2	- 5.4
Current ratio	%	60.3	123.9	134.1	120.5	80.2
Leverage ratio	%	168.5	153.4	148.0	149.5	149.4
<i>Payments to and from government</i>						
Dividends	\$'000	0	0	0	0	0
Dividend to equity ratio	%	0.0	0.0	0.0	0.0	0.0
Dividend payout ratio	%	0.0	0.0	0.0	0.0	0.0
Income tax expense	\$'000	0	0	0	0	0
CSO funding	\$'000	42 731	46 538	51 271	52 253	59 179

9 Railways

The financial performances of six rail government trading enterprises (GTEs) are reported in this chapter. In 2004-05, they controlled \$27.1 billion in assets and generated around \$6.7 billion in revenue.

Financial performance summaries, including performance indicators for the rail sector and each rail GTE are presented. The performance indicators are consistent across individual GTEs. However, consideration should be given to differences in the nature and scale of the businesses, their market environments and issues relating to the valuation of their assets, when making comparisons.

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

9.1 Monitored GTEs

The activities of the six monitored rail GTEs are shown in table 9.1. Queensland Rail (QR) is vertically integrated, providing all the activities involved in managing a rail network and operating rail freight and passenger services. The other five have fewer activities.

Rail Corporation New South Wales (RailCorp) and the Public Transport Authority (PTA) of Western Australia operate urban and regional rail passenger transport services and are responsible for managing rail infrastructure.

During 2004-05, the responsibilities of the Rail Infrastructure Corporation (RIC) of New South Wales, which had managed the Hunter Valley and country rail networks, changed. The Australian Rail Track Corporation (ARTC) took responsibility for these networks under leases and other contractual arrangements. The RIC continues to own these rail networks. The ARTC is also responsible for all operations relating to the greater part of the interstate rail networks, including track management services and the administration of rail access regimes.

V/line Passenger Corporation (VPC) provides transportation services both to and within Victorian regional areas.

Table 9.1 **Activities — rail GTEs, 2004-05**

Rail GTE	Jurisdiction	Activities			
		Track ^a	Freight transport	Urban passenger transport	Regional passenger transport
Rail Infrastructure Corporation	New South Wales	✓	x	x	x
Rail Corporation	New South Wales	✓	x	✓	✓
V/Line Passenger Corporation	Victoria	x	x	x	✓
Queensland Rail	Queensland	✓	✓	✓	✓
Public Transport Authority ^b	Western Australia	✓	x	✓	✓
Australian Rail Track Corporation	Australian Government	✓	x	x	x

^a Refers to the ownership of mainline tracks and does not include ownership of sidings, terminals and other 'below track' infrastructure. ^b The PTA also operates metropolitan, regional and school bus services, as well as ferry services.

TransAdelaide — South Australia's rail GTE — is included in chapter 9 because it provides urban passenger services only.

The set of monitored GTEs included in the rail sector has changed over the reporting period. QR has been reported over the entire reporting period. The RIC and the ARTC have been reported since 2001-02. The PTA and RailCorp were added in 2003-04.¹ VPC has been included for the first time in 2004-05.²

There have also been changes within the set of monitored GTEs. For example, the metropolitan functions of the RIC were transferred to RailCorp following a structural change to the NSW rail system in 2003-04.

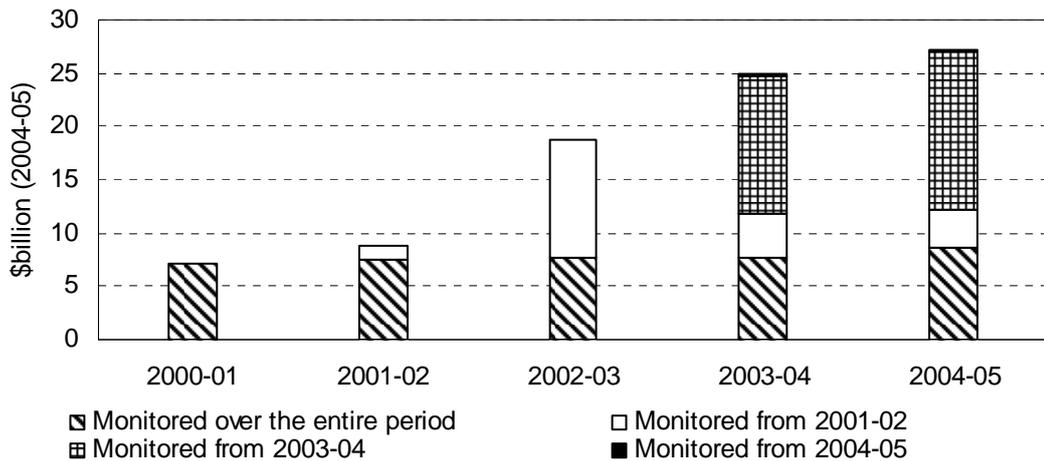
The performance of StateRail Authority of New South Wales (StateRail) is not included in this year's report because its role and responsibilities have been transferred to RailCorp.

1 The PTA and RailCorp replaced the Western Australian Government Railway Commission (WAGRC) and State Rail Authority of New South Wales (StateRail) respectively, which were both previously monitored.

2 VPC commenced operation as a GTE in July 2003. Its financial performance has been included for both the 2003-04 and 2004-05 financial years.

The value of assets controlled by the GTEs monitored in 2004-05 are shown in figure 9.1. However, the asset base of GTEs is highly dependent on the accounting methodology used for their valuation.

Figure 9.1 **Sector assets — rail GTEs**



Note QR has been monitored over the entire reporting period, RIC and ARTC have been reported since 2001-02, the PTA and RailCorp have been reported since 2003-04, and VPC has been included for the first time in 2004-05. VPC data have been included for both 2003-04 and 2004-05, however, its addition to sector assets (of \$0.2 billion) is not clearly discernable in this figure. A change in accounting policy led to a \$10 billion revaluation increment to RIC's assets in 2002-03. The value of sector assets prior to 2004-05 were converted to 2004-05 dollars using the implicit price deflator — Gross Fixed Capital Formation of Public Corporations (chapter 3).

Source: Productivity Commission estimates.

A change in RIC's methodology for calculating the fair value of its physical non-current assets led to a revaluation of its community service infrastructure assets in 2002-03.³ This increased its asset value by over \$10 billion — or over 900 per cent — and was the major contributing factor to an increase in total rail GTE assets to over \$19 billion in 2002-03.

In 2003-04, the inclusion of the PTA (\$2 billion of assets) and the transfer of StateRail's assets to RailCorp resulted in the total assets of the monitored rail GTEs increasing to \$25 billion.

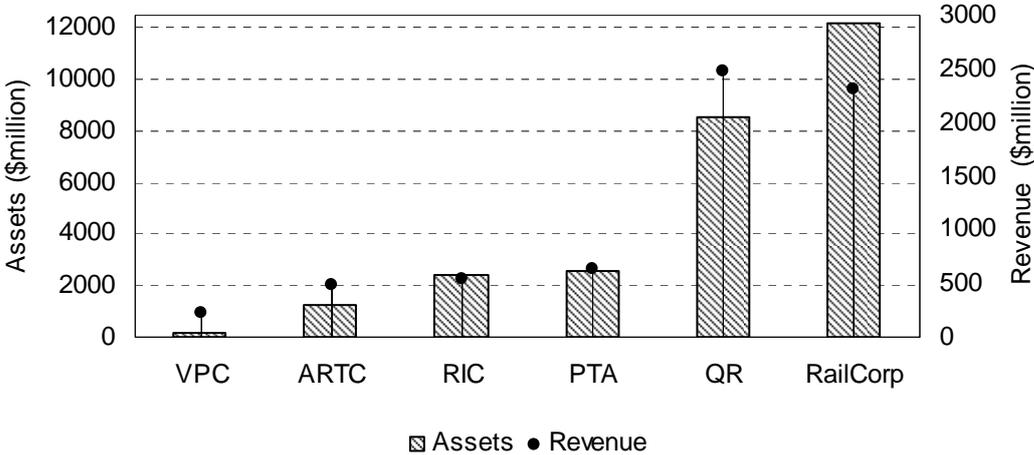
³ Prior to 2002-03, RIC's assets were valued at zero to represent the net present value of their future cash flows. From 2002-03, assets were valued at their depreciated optimised replacement cost.

In 2003-04, RIC transferred approximately \$3.1 billion in assets to RailCorp and wrote-down a further \$3.0 billion in assets that it leased to the ARTC.⁴ While RailCorp has increased its assets to reflect this transfer, the ARTC has not reported a transaction to reflect the corresponding increase in its assets base.

Total assets increased by \$1.5 billion in 2004-05, mainly from infrastructure investment by RailCorp and QR. The inclusion of VPC had little impact on total rail GTE assets in 2003-04 and 2004-05.

The relative size of each GTE monitored for 2004-05 in terms of their asset values and revenue is shown in figure 9.2.

Figure 9.2 Assets and revenue — rail GTEs, 2004-05



Source: Productivity Commission estimates.

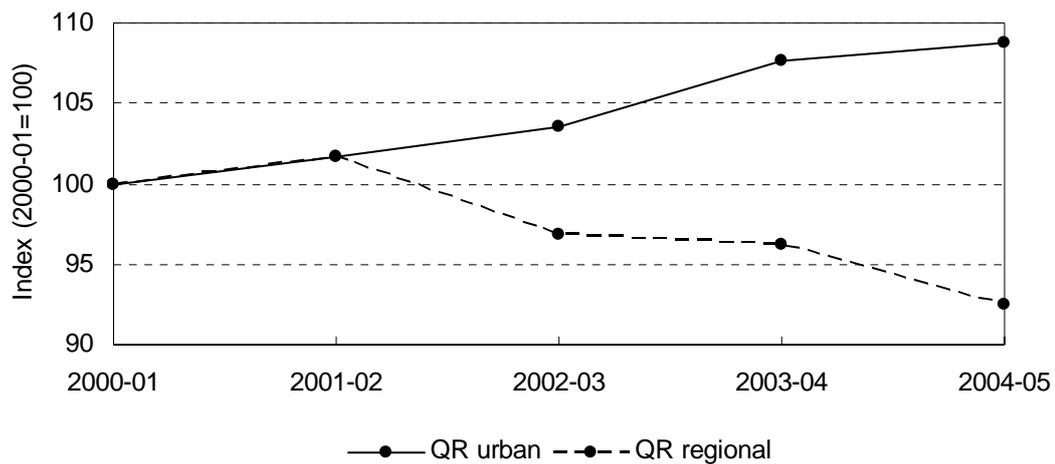
9.2 Market environment

Rail transport has been partly displaced in many of its traditional markets by road transport, causing rail’s share of the transport market to decline over the last 30 years (ARA 2005). However, rail has maintained a dominant role in the transport of bulk commodities, such as coal, grain and iron ore, for which it is well suited. For example, QR has increased revenue in each year over the reporting period as the volume of coal transported increased.

⁴ The RIC has leased assets to the ARTC for 60 years, for \$1. Due to the length of the lease, RIC has treated the transaction as a sale of the assets and was therefore required to write down the value of those assets.

Rail GTEs providing urban and regional passenger transport services have experienced higher demand for urban passenger services. For QR, demand for urban and regional services has steadily diverged since 2001-02 (figure 9.3).

Figure 9.3 Passenger trends — Queensland Rail



Note QR urban refers to passenger trips on Queensland Rail's Citytrain services. QR regional refers to passenger trips on Traveltrain services. For 2004-05, QR urban trips have been conservatively estimated due to the introduction of a new ticketing system.

Source: QR (2005).

Rail access charges are typically set by negotiation between the track owners and rail operators or under the relevant access regime. Disputes may be settled by arbitration.⁵

Passenger services are regulated. Charges for RailCorp's CityRail services are determined by the Independent Pricing and Regulatory Tribunal (IPART) of New South Wales. Charges for CountryLink services are determined by the Minister for Transport after a recommendation from RailCorp's Board. Charges for QR's urban transport services are determined by Translink, a business unit within Queensland Transport. QR's rural passenger charges are determined by QR, but are subject to ministerial oversight.

In Victoria, the Minister for Transport determines charges for VPC's transport services based on recommendations from the relevant government department and subject to contractual obligations with the service provider. The PTA's passenger

⁵ In New South Wales, Independent Pricing and Regulatory Tribunal (IPART) may arbitrate access disputes. Access to the ARTC's network may be arbitrated by a nominated party or by the Australian Competition and Consumer Commission. In Queensland, a nominated party may act as arbitrator or, if no agreement can be reached between the track owners and rail operators, the Queensland Competition Authority is the default arbitrator.

service charges are determined by the board, but are subject to the approval of the relevant Minister.

Structural reforms

Reforms within the rail sector have been aimed at improving performance by subjecting operators to stronger financial disciplines and competitive pressures. Changes included the vertical and horizontal separation of rail GTEs.

Access regimes have been established to encourage competition in the market for rail infrastructure by stipulating the methods by which a third party may gain access to rail track. They are covered by Part IIIA of the *Trade Practices Act 1974*, which provides three ways of gaining access — by using an existing, state-based access regime; by seeking access under the terms and conditions specified in an undertaking given by the service provider; or by having a service declared under the provisions of the National Access Regime.⁶

An applications for a declaration is made to the National Competition Council (NCC). This initiates a process of negotiation and, if required, compulsory arbitration in order to settle disputes between operators and track managers. However, if the state-based access regime has been certified by the NCC, or if a private undertaking has been accepted by the Australian Competition and Consumer Commission (ACCC), access seekers are unable to use the declaration process.

The ARTC manages parts of the interstate rail network, mainly in New South Wales, Victoria, South Australia and Western Australia. The ARTC has a registered undertaking with the ACCC with respect to the terms and conditions by which it provides access to the network.

During 2004-05, RIC commenced leases and contractual arrangements with the ARTC, to have the ARTC manage its rail infrastructure and access arrangements.⁷ The ARTC will continue to abide by RIC's existing access undertaking, until its access undertaking is registered by the ACCC.

⁶ On 10 February 2006, CoAG agreed to amend the economic regulation of significant infrastructure, including rail, to make access arrangements simpler and nationally consistent (CoAG, 2006).

⁷ On 5 September 2004, the ARTC commenced its lease of the New South Wales interstate and Hunter Valley networks for 60 years, and commenced management of the remaining non-interstate, non-Hunter country branch rail network, under the Country Regional Network Management Agreement.

In Queensland, the Network Access Unit — a division of QR — has been responsible for negotiating access with third-party operators and the development of network access provisions. 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. Queensland's draft access undertaking was approved by the Queensland Competition Authority (QCA) in December 2001. This undertaking will remain in place until the QCA and QR reach agreement on the 2005 undertaking.⁸

In Western Australia, since 2001, the Economic Regulation Authority (ERA) has had responsibility for administering the rail access regime under the *Railways (Access) Act 1998*. The regime covers track controlled by the PTA and WestNet Rail, a subsidiary of the Australian Railroad Group.⁹ Like the New South Wales and Queensland access regimes, the Western Australian regime is not certified.¹⁰

A feature of structural reform in some jurisdictions has been the separation and sale to the private sector of rail freight operations. In New South Wales, the freight operations of StateRail were transferred to the Freight Rail Corporation in 1996-97. The Freight Rail Corporation was sold to the private sector, together with the government-owned National Rail Corporation in January 2002.¹¹

Structural reforms that change the scope of a GTE's activities complicate the assessment of performance over time. Changes to the asset base, liability structure and revenue stream, together with any redundancy payments that accompany such reforms, affect the financial ratios presented in the individual GTE performance reports. Over the reporting period, financial reforms included capital restructuring, the revaluation of assets, the identification and direct funding of community service obligations (CSOs), and the development of dividend policies.

For example, since 2000-01, the role and responsibilities of RIC have changed substantially, as has its methodology for calculating the fair value of non-current assets. These changes have made key financial performance indicators, such as the RIC's current ratio, vary greatly over the reporting period.

⁸ In April 2004, QR submitted a draft access undertaking in response to an initial notice issued by the QCA in November 2003. The new undertaking was to take effect on 30 June 2005, however, it has not yet been approved by the QCA.

⁹ The sale of the WAGRC's freight business on 18 December 2000 incorporated a 49-year lease of track infrastructure to the privately-owned Australian Railroad Group.

¹⁰ The only regime certified under the *Trade Practices Act 1974*, as of May 2005, is the AustralAsia Railway (Third Party Access) Code, which applies to the Tarcoola to Darwin Railway.

¹¹ The Australian Government, NSW and Victorian Governments were co-owners of NRC.

9.3 Profitability

Profitability indicators provide information on how GTEs are using the assets vested in them by shareholder governments to generate earnings.

In 2004-05, the rail sector recorded an operating profit before tax of \$420 million. This was a turnaround from the \$2.4 billion operating loss posted in 2003-04, which was primarily the result of RIC writing down assets leased to the ARTC by \$3.0 billion. In 2004-05, the RIC and VPC reported operating losses.

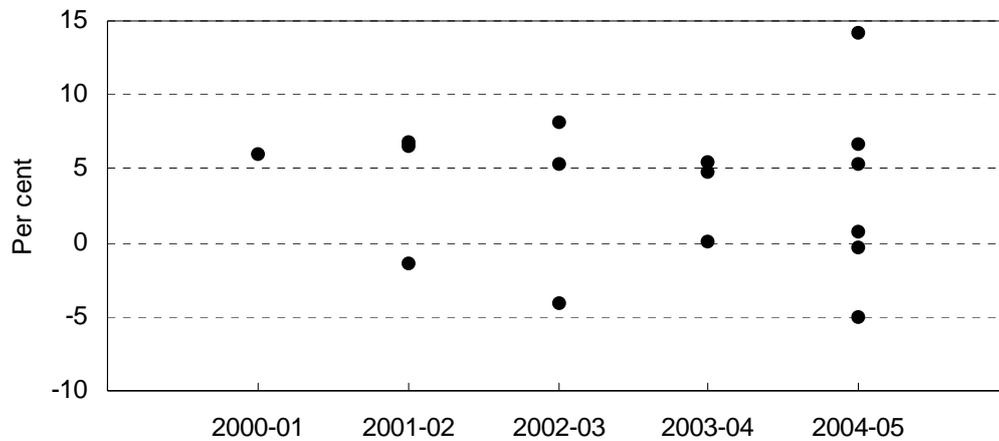
Profitability, in terms of the rail sector's return on assets in 2004-05 (2.9 per cent) was well below the risk free rate of 5.4 per cent for 10-year Australian Government bonds. However, return on assets varied across railway GTEs (figure 9.4).¹²

The returns of some GTEs have been affected by industry and financial restructuring. For example, the RIC provided its worst return (-44 per cent) in 2003-04, following an uncompensated transfer of assets to the ARTC. VPC earned a return on assets of 71 per cent in 2003-04, following gains on a transfer of assets. The ARTC recorded a return of 83 per cent in 2003-04 because of a special government grant and an equity injection.

Trends in the return on equity for each rail GTE have generally reflected trends in the return on assets (figure 9.4). For the rail sector, the return on equity was 2.0 per cent in 2004-05.

¹² Asset revaluations can have a significant influence on the return on assets ratio because of their impact on asset values and operating profit (through depreciation expense). In addition to RIC's major revaluation, QR has also revalued assets throughout the reporting period.

Figure 9.4 Return on assets — rail GTEs



Note QR has been monitored over the entire reporting period, RIC and ARTC have been reported since 2001-02, the PTA and RailCorp have been reported since 2003-04, and VPC has been included for the first time in 2004-05. 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 and adding back gross interest expense. Average total assets is the average of the value of assets at the beginning and end of each financial year. Where an average could not be calculated, the value of total assets at the end of the financial year was used.

The return on assets of RIC (-44.2 per cent), ARTC (82.7 per cent) and VPC (71.1 per cent) in 2003-04 are not shown in the figure.

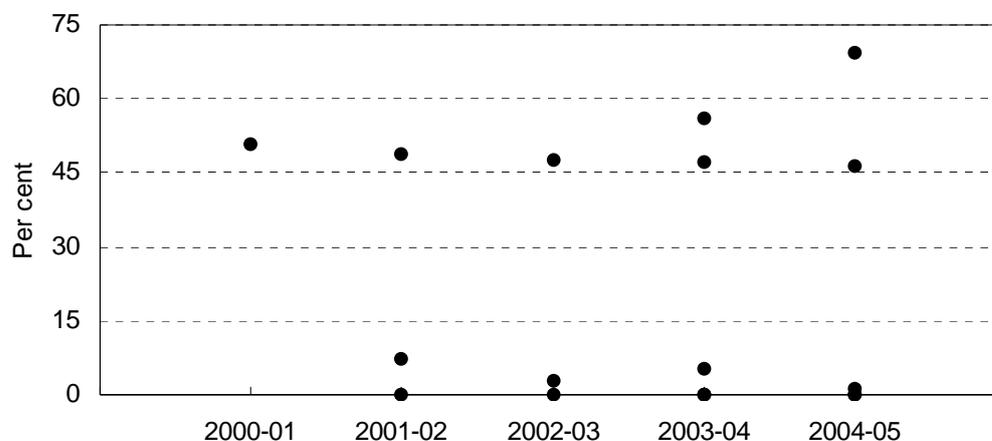
Source: Productivity Commission estimates.

9.4 Financial management

Financial management indicators provide information about the capital structure of a GTE and whether the costs of servicing debt and other liabilities can be met in a timely manner.

In 2004-05, QR and the PTA were carrying debt levels equivalent to 47 per cent and 36 per cent respectively of their total assets (figure 9.5). RIC had a debt to total assets ratio of 1.2 per cent. Three rail GTEs, RailCorp, VPC and the ARTC, operated debt free.

Figure 9.5 Debt to total assets — rail GTEs



Note QR has been monitored over the entire reporting period, RIC and ARTC have been reported since 2001-02, the PTA and RailCorp have been reported since 2003-04, and VPC has been included for the first time in 2004-05. Debt is defined to include all repayable borrowings (interest bearing and non-interest bearing), interest bearing non-repayable borrowings and finance leases. Average total assets is the average of the value of assets at the beginning and end of each financial year. Where an average was not available, the value of total assets at the end of the financial year was used.

Source: Productivity Commission estimates.

Over the reporting period, debt to total assets ratios for rail GTEs have not only been influenced by the acquisition and retirement of debt, but also through changes in the total value of assets. For example, RIC's debt level increased by almost 120 per cent during 2002-03, but its debt to assets ratio fell because the increase in debt was not proportionally as large as the increase in asset values. Despite a similar increase in debt levels (113 per cent) in 2003-04, RIC's debt to assets ratio increased.

Under sound financial management, profits should be sufficient to ensure interest payments can be met. A high interest cover ratio indicates that the entity can sustain a fall in profit or increased interest expense and still meet the cost of servicing debt.

In 2004-05, two of the three rail GTEs with debt reported positive interest cover ratios. However, there does not appear to be a significant margin to insulate these GTEs from increases in interest rates or falling revenue.

A current ratio of less than 100 per cent indicates that the short-term obligations of the GTE may need to be met using sources of funds other than current assets. The current ratio for the sector overall was 92 per cent in 2004-05, down from 125 per cent in 2003-04.

Only VPC experienced growth in its current ratio, and only the ARTC recorded a current ratio of more than 100 per cent in 2004-05.

9.5 Transactions with government

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 financial disciplines and regulations similar to those faced by privately-owned businesses.

Dividend payments from GTEs are a return on shareholder funds that impose capital disciplines and are consistent with competitive neutrality. In 2004-05, QR and ARTC were the only rail GTEs that made dividend payments (\$190 million and \$5.0 million respectively).

QR was also the only rail GTE required to make tax-equivalent payments. ARTC did not pay income tax in 2004-05 due to the way in which profit is calculated for taxation purposes. RailCorp was not required to make tax-equivalent payments because its operating profit excluding capital grants was negative, while RIC and VPC also reported operating losses. As an 'on budget agency', the PTA is not required to make tax-equivalent payments.

Dividend and income tax-equivalent payments over the reporting period are shown in figure 9.6.

Tax-equivalent payments made by QR have been constant over the period, except for 2002-03. Variation between years reflects changes in company income tax rates and over provisioning by QR. For example, the significant decrease in 2002-03 reflects an adjustment to offset an over provision by QR in 2001-02 following the reduction in the company tax rate from 34 per cent to 30 per cent in 2001-02.

Governments have moved towards identifying, costing and explicitly funding CSOs provided by rail GTEs. All of the monitored rail GTEs, except ARTC, had agreements to provide CSOs over the reporting period.

CSOs form a significant part of revenue for some rail GTEs. For example, CSO funding received by RailCorp for concessional fares and the provision of certain train services at the request of the NSW Government, accounted for 45 per cent of revenue in 2004-05.

In 2004-05, CSO funding increased by \$750 million (39 per cent), largely because RailCorp received a full year's worth of CSO payments.

Figure 9.6 Dividend and income tax-equivalent payments — rail GTEs



Note QR has been monitored over the entire reporting period, RIC and ARTC have been reported since 2001-02, the PTA and RailCorp were included in 2003-04, and VPC was included for the first time in 2004-05. The value of dividends and tax-equivalent payments prior to 2004-05 was converted to 2004-05 dollars using the implicit price deflator — Gross Fixed Capital Formation of Public Corporations (chapter 3).

Source: Productivity Commission estimates.

RAIL

Whole of sector performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	7 354	8 985	19 167	25 614	27 101
Total revenue	\$m	2 092	3 430	3 459	2 916	6 665
<i>Profitability</i>						
Operating profit before tax	\$'000	185 531	249 134	- 65 054	- 2 372 580	418 488
Operating sales margin	%	21.8	14.0	5.1	- 72.2	10.8
Cost recovery	%	124.5	108.9	102.0	41.9	98.9
Return on assets	%	3.5	3.4	0.9	- 7.1	2.9
Return on equity	%	1.7	2.4	- 0.7	- 11.5	2.0
<i>Financial management</i>						
Debt to equity	%	174.8	108.5	28.9	29.5	29.7
Debt to total assets	%	29.7	26.3	19.6	17.9	20.6
Total liabilities to equity	%	234.5	161.0	44.2	45.0	48.2
Interest cover	times	1.7	2.0	0.7	-6.8	2.2
Current ratio	%	117.3	94.4	88.4	125.3	91.8
Leverage ratio	%	334.5	261.0	144.2	145.0	148.2
<i>Payments to and from government</i>						
Dividends	\$'000	69 736	175 466	141 639	116 603	198 090
Dividend to equity ratio	%	1.1	2.4	1.1	0.5	1.1
Dividend payout ratio	%	63.5	100.0	- 161.5	- 4.8	55.3
Income tax expense	\$'000	75 722	73 698	22 622	70 725	60 238
CSO funding	\$'000	637 269	852 020	941 677	1 907 522	2 659 027

Note QR has been monitored over the entire reporting period, RIC and ARTC have been reported since 2001-02, the PTA and RailCorp were included in 2003-04, and VPC was included for the first time in 2004-05. VPC data has been included for 2003-04, its first year of operation.

9.6 GTE performance reports

Rail Infrastructure Corporation (NSW)

Rail Corporation NSW

V/line Passenger Corporation (Victoria)

Queensland Rail (Queensland)

Public Transport Authority (WA)

Australian Rail Track Corporation (Australian Government)

Rail Infrastructure Corporation (RIC) operates under the *Transport Administration Act 1988* and the *State Owned Corporations Act 1989*. It was formed by merging the assets, rights and liabilities of two NSW Government-owned corporations — the Rail Access Corporation, which was responsible for rail network management and access, and Rail Services Australia, which operated principally as a maintenance service provider.

The past two years have seen substantial change in the role and responsibilities of the RIC. On 1 January 2004, the metropolitan functions of RIC were transferred to Rail Corporation NSW (RailCorp). On 5 September 2004, RIC leased the NSW interstate and Hunter Valley rail corridors and dedicated metropolitan freight lines to the Sydney ports to the Australian Rail Track Corporation (ARTC), for 60 years. In addition, the ARTC also commenced management of the remaining country branch rail network, under a management agreement with the RIC.

As owner of the NSW country rail network, RIC now has responsibility for managing the lease and contractual arrangements undertaken with the ARTC. RIC is also responsible for managing the divestment of non-core and surplus infrastructure assets, and has been providing RailCorp with a number of business services.¹

These changes to RIC's responsibilities have altered both the level and mix of revenues received during the financial year. In 2004-05, major sources of revenue were recoveries from RailCorp for business services (\$230 million), CSO funding from the NSW Government (\$130 million),² and redundancy funding from the Ministry of Transport (\$70 million). However, the \$2.3 billion increase in total revenue in 2004-05 reflects the significant negative impact (\$3.0 billion) that the write down of assets leased to the ARTC had on total revenue in 2003-04.

Assets decreased by \$950 million in 2004-05, primarily because of a \$380 million transfer of infrastructure assets to RailCorp, depreciation and a downward revaluation of infrastructure assets (\$250 million) and a \$180 million reduction in receivables.

RIC is subject to dividend and tax-equivalent payments. In 2004-05, no such payments were made.

¹ From 1 July 2005, RailCorp took responsibility for providing business services to the two organisations.

² The RIC receives CSO funding for the cost of maintaining non-commercial railway lines.

RAIL INFRASTRUCTURE CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03 ^b	2003-04 ^c	2004-05 ^d
<i>Size</i>						
Total assets	\$m		1 085	11 086	3 327	2 379
Total revenue	\$m		1 184	1 141	- 1 721	536
<i>Profitability</i>						
Operating profit before tax	\$'000		- 20 414	- 255 637	-3 190 667	- 145 790
Operating sales margin	%		- 1.8	- 22.7	185.2	- 26.9
Cost recovery	%		84.8	77.4	- 119.4	77.6
Return on assets	%		- 1.4	- 4.1	- 44.2	- 5.0
Return on equity	%		- 3.1	- 4.6	- 49.6	- 6.4
<i>Financial management</i>						
Debt to equity	%		12.3	1.7	15.2	1.6
Debt to total assets	%		7.4	2.9	5.2	1.2
Total liabilities to equity	%		66.3	6.5	35.0	13.0
Interest cover ^e	times		- 3.1	- 57.6	- 1 493.5	- 57.4
Current ratio	%		98.4	69.6	113.2	42.1
Leverage ratio	%		166.3	106.5	135.0	113.0
<i>Payments to and from government</i>						
Dividends	\$'000		0	0	0	0
Dividend to equity ratio	%		0.0	0.0	0.0	0.0
Dividend payout ratio	%		0.0	0.0	0.0	0.0
Income tax expense	\$'000		0	0	0	0
CSO funding	\$'000		246 625	285 813	356 343	133 000

^a 2001-02 was the first year that Rail Infrastructure Corporation (RIC) was included in this report. It was established on 1 January 2001 from a merger of the Rail Access Corporation and Rail Services Australia by the *Transport Administration Amendment (Rail Management) Act 2000*. ^b From 2002-03, the NSW Treasury Accounting Policy on Valuation of Physical Non-Current Assets at Fair Value required RIC to value assets at depreciated optimised replacement cost. This necessitated the revaluation of community service infrastructure assets — previously valued at zero to represent the net present value of their future cash flows — and increased the balance sheet value of property, plant and equipment by almost \$10 billion. Total depreciation rose from \$46.7 million in 2001-02 to \$479 million in 2002-03. ^c Includes a \$4.7 billion transfer to Rail Corporation of New South Wales and Transport Infrastructure Development Corporation, and a \$3.0 billion write down of assets leased to Australian Rail Track Corporation. ^d On 5 September 2004, RIC leased the NSW interstate and Hunter Valley rail corridors and dedicated metropolitan freight lines to the Sydney ports to the Australian Rail Track Corporation, for 60 years. This diminishes the comparability of 2004-05 data with 2003-04 data. ^e With the capitalisation of certain borrowings and borrowing costs, interest cover is not a reliable measure of RIC's ability to make interest payments.

Rail Corporation NSW (RailCorp) was formed on 19 December 2003 under the *Transport Administration Act 1988* to give effect to the restructuring of the NSW rail industry. RailCorp commenced operations by merging the State Rail Authority New South Wales (StateRail) and transferring the metropolitan responsibilities of Rail Infrastructure Corporation.

RailCorp is responsible for the control and operation of CityRail and CountryLink in providing passenger rail transport. Additionally, RailCorp controls the metropolitan rail network and provides access to freight operators. Charges for RailCorp's CityRail services are regulated by the NSW Independent Pricing and Regulatory Tribunal. Charges for CountryLink services are determined by the Minister for Transport after a recommendation from RailCorp's board.

In 2004-05, RailCorp's first full financial year of operation, it managed over \$12 billion of assets, of which property, plant and equipment accounted for 95 per cent.

RailCorp received \$2.3 billion in revenue in 2004-05, with \$1.0 billion from CSO payments, \$520 million from passenger services, and \$600 million from capital and other government contributions. As total expenses grew by 125 per cent (to \$2.2 billion) over the same period, operating profit before tax grew to \$93 million.

RailCorp is not subject to dividend payments.¹ While RailCorp is subject to tax-equivalent payments, it did not make any such payment in 2004-05, as operating profits excluding capital grants were negative.

RailCorp receives CSO payments relating to the provision of concession fares to specified classes of passengers and for revenue shortfalls resulting from providing certain train services at the request of the NSW Government.

¹ Section 20S (Dividends) of the *State Owned Corporations Act 1989* does not apply to RailCorp under Section 17B of the *Transport Administration Act 1988*.

RAIL CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04^a</i>	<i>2004-05^b</i>
<i>Size</i>						
Total assets	\$m				11 280	12 188
Total revenue	\$m				991	2 316
<i>Profitability</i>						
Operating profit before tax	\$'000				4 952	92 581
Operating sales margin	%				- 0.5	3.7
Cost recovery	%				73.8	76.9
Return on assets	%				0.0	0.8
Return on equity	%				0.0	0.8
<i>Financial management</i>						
Debt to equity	%				0.0	0.0
Debt to total assets	%				0.0	0.0
Total liabilities to equity	%				2.5	6.4
Interest cover	times				708.4	n.r.
Current ratio	%				94.2	85.2
Leverage ratio	%				102.5	106.4
<i>Payments to and from government</i>						
Dividends	\$'000				0	0.0
Dividend to equity ratio	%				0.0	0.0
Dividend payout ratio	%				0.0	0.0
Income tax expense	\$'000				0	0.0
CSO funding	\$'000				401 383	1 041 505

^a 2003-04 was the first year that Rail Corporation was included in this report, commencing operations on 1 January 2004. Performance indicators are only provided for the six months ended 30 June 2004. ^b As RailCorp only operated for six months in 2003-04, 2004-05 transactions, cash flows, year end assets, liabilities and equity items are not directly comparable with those of the previous year. **n.r.** Not relevant.

V/line Passenger Corporation (VPC) was established on 15 July 2003 as a statutory rail corporation under the *Rail Corporations Act 1996* to acquire National Express Group Australia (V/Line Passenger) Pty Ltd from the National Rail Group. This acquisition took place on 1 October 2003, and V/Line Passenger Pty Ltd (V/Line) commenced operation.¹

V/line provides public transport services in regional centres, coach and rail passenger services to regional areas, and is responsible for maintaining regional train stations.

In 2004-05, VPC posted an operating loss (before tax) of \$650 000, this compares to an operating profit of \$126 million in 2003-04.

Revenues from operating activities grew by 65 per cent to \$206 million in 2004-05, however, total revenues declined. In 2003-04, VPC reported a once-off gain of \$137 million resulting from the purchase of V/Line Passenger Pty Ltd as revenue (in accordance with AAS 21). The transaction involved the acquisition of net assets of \$137 million for a consideration of \$1.

Total expenses increased by \$78 million to around \$220 million in 2004-05, as a result of growth in operating and administrative expenses, reflecting a full year of operations for the consolidated entity compared to 2003-04.

VPC receives CSO payments from the Victorian Government. The State Government subsidises VPC's provision of public transport services to rural and regional Victoria. In 2004-05, this subsidy accounted for over 72 per cent of total revenue.

VPC is subject to dividend and tax-equivalent payments. VPC has not made either form of payment since commencing operation.

¹ VPC is the parent, and the operating result reported in this chapter is for the consolidated entity.

V/LINE PASSENGER (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04^a</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m				178	183
Total revenue	\$m				264	215
<i>Profitability</i>						
Operating profit before tax	\$'000				126 137	- 650
Operating sales margin	%				47.8	-0.4
Cost recovery	%				130.0	27.4
Return on assets	%				71.1	-0.4
Return on equity	%				100.0	-0.5
<i>Financial management</i>						
Debt to equity	%				0.0	0.0
Debt to total assets	%				0.0	0.0
Total liabilities to equity	%				40.7	46.2
Interest cover	times				n.r.	n.r.
Current ratio	%				33.5	36.2
Leverage ratio	%				140.7	146.2
<i>Payments to and from government</i>						
Dividends	\$'000				0	0
Dividend to equity ratio	%				0.0	0.0
Dividend payout ratio	%				0.0	0.0
Income tax expense	\$'000				0	0
CSO funding	\$'000				84 411	155 538

^a 2004-05 was the first year that VPC was included in this report, however, as VPC commenced operation on 15 July 2003, its 2003-04 financial data has been included in this chapter. **n.r.** Not relevant.

Queensland Rail (QR) is subject to the *Transport Infrastructure Act 1994* and the *Government Owned Corporations Act 1993*. QR provides freight services throughout regional Queensland, and operates passenger rail services in the Brisbane metropolitan area and between key regional centres.¹ It also manages Queensland's rail infrastructure.

QR is subject to an Access Undertaking for third-party operators. Service charges are set by QR's Network Access Unit subject to floor and ceiling prices determined by the Queensland Competition Authority (QCA). The Unit operates separately from QR's other business units.

Total assets increased by over \$630 million (8.0 per cent) in 2004-05. Increased capital expenditure, up by 47 per cent, accounted for most of this growth. A program to revalue QR's assets, finalised in 2004-05, resulted in a further \$160 million upward adjustment in the value of non-current assets.²

In 2004-05, additional Government CSO payments in conjunction with revenue from record coal haulage have resulted in QR's total revenue increasing by 8.5 per cent. As revenue growth exceeded growth in expenses, QR's operating profit before tax increased by more than 50 per cent to \$290 million.

The Queensland Government makes CSO payments to QR. In 2004-05, these amounted to \$770 million under Transport Services Contracts for the provision of urban and intercity passenger services, low volume freight services, infrastructure, and concession fares to senior citizens, pensioners and students. QR also received a new 'shareholder agreement revenue' payment of \$81 million in 2004-05, for non-transport services provided to the Government.³ CSO payments accounted for 34 per cent of total revenue received in the financial year.

QR is subject to dividend and tax-equivalent payments. In 2004-05, QR made provision for a dividend payment of \$190 million, a 68 per cent increase from 2003-04.

¹ QR is the sole government-owned rail freight operator in Australia.

² In July 2000, QR commenced the progressive revaluation of its non-current assets from the deprival value to either the cost or fair value (depending on the asset class).

³ The shareholder agreement provides for QR to receive funding for those costs incurred that result from the Government's (shareholder) request to carry out certain activities or adopt certain policies that QR would not elect to do on a commercial basis.

QUEENSLAND RAIL (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02 ^b	2002-03 ^c	2003-04 ^d	2004-05 ^e
<i>Size</i>						
Total assets	\$m	7 353	7 649	7 818	7 936	8 570
Total revenue	\$m	2 091	2 151	2 218	2 283	2 476
<i>Profitability</i>						
Operating profit before tax	\$'000	185 531	252 373	169 612	191 198	287 358
Operating sales margin	%	21.8	22.5	18.7	18.5	22.1
Cost recovery	%	124.5	125.8	120.1	119.7	126.3
Return on assets	%	6.0	6.5	5.4	5.4	6.7
Return on equity	%	4.8	7.5	5.6	4.5	8.1
<i>Financial management</i>						
Debt to equity	%	174.8	142.1	138.7	137.1	131.1
Debt to total assets	%	50.7	48.7	47.5	47.1	46.2
Total liabilities to equity	%	234.5	197.3	195.5	193.3	194.3
Interest cover	times	1.7	2.1	1.7	1.8	2.1
Current ratio	%	117.3	86.9	90.3	65.8	64.1
Leverage ratio	%	334.5	297.3	295.5	293.3	294.3
<i>Payments to and from government</i>						
Dividends	\$'000	69 736	169 741	139 639	114 603	193 100
Dividend to equity ratio	%	3.1	7.1	5.4	4.3	6.9
Dividend payout ratio	%	63.5	95.0	95.0	95.1	85.0
Income tax expense	\$'000	75 722	73 698	22 622	70 725	60 238
CSO funding	\$'000	637 269	605 395	655 864	665 671	853 614

^a In 2000-01, further lease transactions from previous years were written down by \$376 million, contributing to a \$540 million asset devaluation. ^b A revaluation in 2001-02 led to a \$253 million increment to infrastructure assets. ^c Revaluation of assets during 2002-03 led to a net increase of \$53 million in asset values. ^d Revaluation of assets during 2003-04 led to an increase in asset value by \$68 million. ^e Revaluation of assets during 2004-05 led to a \$158 million increase in asset values.

The Public Transport Authority (PTA) was established as a state-owned corporation on 1 July 2003 and operates under the *Public Transport Authority Act 2003*. The PTA is an ‘on budget agency’ in the Planning and Infrastructure Portfolio.

The PTA replaces the WA Government Railway Commission and is responsible for providing rail, bus and ferry services in the metropolitan area (Transperth), public transport services in regional centres, coach and rail passenger services to regional areas (Transwa), and school buses. The PTA is also responsible for designing, building, managing and maintaining public transport infrastructure throughout the state.

In 2004-05, the PTA increased assets under management by \$550 million to \$2.6 billion. This reflects the PTA’s investment in infrastructure and rolling stock. This investment resulted in a corresponding 40 per cent increase in interest bearing liabilities to \$1.6 billion, and has resulted in the PTA’s current ratio falling from 46 per cent in 2003-04 to 11 per cent in 2004-05.

The PTA recorded an operating profit of \$37 million in 2004-05. Overall, total revenue increased by \$91 million to \$630 million. Of this revenue, \$480 million was provided by the State Government and \$85 million was generated from fees and user charges. Total expenses increased by \$80 million to \$600 million over the same period.

The PTA is not subject to dividend payments and was not required to make tax-equivalent payments in 2004-05.

Funding from the Government constitutes 75 per cent of the PTA’s total revenue.¹

¹ As the PTA is classified as an ‘on budget agency’, funding from the Government does not strictly constitute a CSO payment.

PUBLIC TRANSPORT AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04^a</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m				2 019	2 566
Total revenue	\$m				542	632
<i>Profitability</i>						
Operating profit before tax	\$'000				26 190	37 139
Operating sales margin	%				17.5	19.2
Cost recovery	%				116.5	121.4
Return on assets	%				4.7	2.7
Return on equity	%				5.1	3.4
<i>Financial management</i>						
Debt to equity	%				221.6	267.1
Debt to total assets	%				56.0	34.6
Total liabilities to equity	%				295.8	332.0
Interest cover	times				1.4	1.4
Current ratio	%				45.7	11.2
Leverage ratio	%				395.8	432.0
<i>Payments to and from government</i>						
Dividends	\$'000				0	0
Dividend to equity ratio	%				0.0	0.0
Dividend payout ratio	%				0.0	0.0
Income tax expense	\$'000				0	0
CSO funding ^b	\$'000				399 714	475 370

^a 2003-04 was the first year that the Public Transport Authority (PTA) was included in this report, commencing operations on 1 July 2003. The PTA replaced the WA Government Railway Commission. ^b As the PTA is an 'on budget' agency, the WA Government consider this funding as an appropriation to fund services. However, it is classified under the GFS code used to identify CSO payments.

Australian Rail Track Corporation (ARTC) Ltd was established on 28 February 1998 as part of the corporatisation of the former Australian Government-owned Australian National Railways Commission (ANRC). It operates as an access provider and infrastructure manager. ARTC owns interstate track, principally in SA and WA, and manages interstate track in NSW and Victoria under long-term lease arrangements.¹ It is bound by the *Corporations Act 2001*.

Rail access prices are set by the ARTC Board. Price guidelines are contained in the Rail Access Undertaking, a binding agreement between the Australian Competition and Consumer Commission (ACCC) and ARTC.² These guidelines specify floor and ceiling access prices based on ARTC's costs and risk profile.

ARTC's assets increased from \$870 million in 2003-04 to \$1.2 billion in 2004-05. This result reflects an increase in cash assets of \$200 million due to a \$100 million special government grant, a \$140 million increase in access revenue and an upward revaluation of plant and equipment of \$99 million.

In 2004-05, revenue for ARTC's ordinary activities grew by 260 per cent to \$390 million, with increased access fee revenue (\$140 million) and the receipt of \$88 million in Country Regional Network revenue for the first time. However, total revenue fell by \$68 million in 2004-05 with a decrease in Special Government Grants from the Australian Government. In 2003-04, Special Government Grants provided \$450 million to total revenue, which was reduced to \$100 million in 2004-05.

The decline in total revenue in conjunction with a 290 per cent increase in total expenses (associated with operations in New South Wales), has resulted in a 69 per cent decline in operating profits in 2004-05.

Division 58 of the *Income Tax Assessment Act 1997* entitles ARTC to value its assets for tax purposes at the book value recorded in the accounts of its precursor, the ANRC. This is a higher value than that used by ARTC for accounting purposes and generates higher depreciation for taxation purposes, leading to significant tax losses. As a result, ARTC has not made income tax payments over the reporting period. ARTC does not receive CSO funding.

¹ The NSW Government agreed in December 2003 to lease the interstate and Hunter Valley networks to ARTC for 60 years. This lease commenced on 5 September 2004.

² ARTC's voluntary access undertaking was approved by the ACCC in May 2002. The undertaking binds ARTC for five years.

AUSTRALIAN RAIL TRACK CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02^a</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m		251	262	874	1 216
Total revenue	\$m		94	99	558	490
<i>Profitability</i>						
Operating profit before tax	\$'000		17 175	20 971	469 610	147 850
Operating sales margin	%		16.9	19.4	84.1	24.3
Cost recovery	%		120.3	124.1	117.8	96.8
Return on assets	%		6.9	8.2	82.7	14.2
Return on equity	%		7.9	9.2	86.5	15.3
<i>Financial management</i>						
Debt to equity	%		0.0	0.0	0.0	0.0
Debt to total assets	%		0.0	0.0	0.0	0.0
Total liabilities to equity	%		14.8	10.5	3.1	11.5
Interest cover	times		n.r.	n.r.	n.r.	n.r.
Current ratio	%		187.2	301.8	2 773.7	734.2
Leverage ratio	%			114.8	110.5	111.5
<i>Payments to and from government</i>						
Dividends	\$'000		5 725	2 000	2 000	4 990
Dividend to equity ratio	%		2.6	0.9	0.4	0.5
Dividend payout ratio	%		33.3	9.5	0.4	3.4
Income tax expense	\$'000		0	0	0	0
CSO funding	\$'000		0	0	0	0

^a 2001-02 was the first year that Australian Rail Track Corporation was included in this report. It was established on 28 February 1998. **n.r.** Not relevant.

10 Ports

The financial performances of 22 port government trading enterprises (GTEs) are reported in this chapter. In 2004-05, these GTEs were responsible for assets valued at over \$6.7 billion and earned around \$1.1 billion in revenue.

These GTEs vary in size and the range of services they provide. The principal activities undertaken include the provision and maintenance of port infrastructure and, in some cases, port services such as mooring, stevedoring and pilotage.

The overall performance of the sector is presented in table 10.2 at the end of this overview. This is followed by performance summaries for each GTE. For a discussion of the data and the performance indicators used, and some of the factors that should be considered when assessing performance, see chapter 3.

10.1 Monitored GTEs

The port GTEs monitored in this report do not all undertake the same activities, although the management of port land and channels is common to almost all (table 10.1). The nature of involvement (if at all) in other port activities — such as pilotage, stevedoring, towage and cold storage facilities — varies across GTEs.

A number of port GTEs also have interests in other areas of business, such as airports. For example, the Port of Brisbane Corporation (PBC) and the Hobart Ports Corporation (HPC) each have a substantial interests in their local airport.¹ Some regional port GTEs — including the Cairns Port Authority, Mackay Port Authority and the Port of Devonport Corporation — also own and operate airports.

¹ In 2004-05, the PBC owned 38 per cent of the Brisbane Airport Corporation Limited. These airport investments are not consolidated in PBC's financial accounts as it does not own a controlling interest in the airport.

Table 10.1 **Activities — port GTEs, 2004-05**

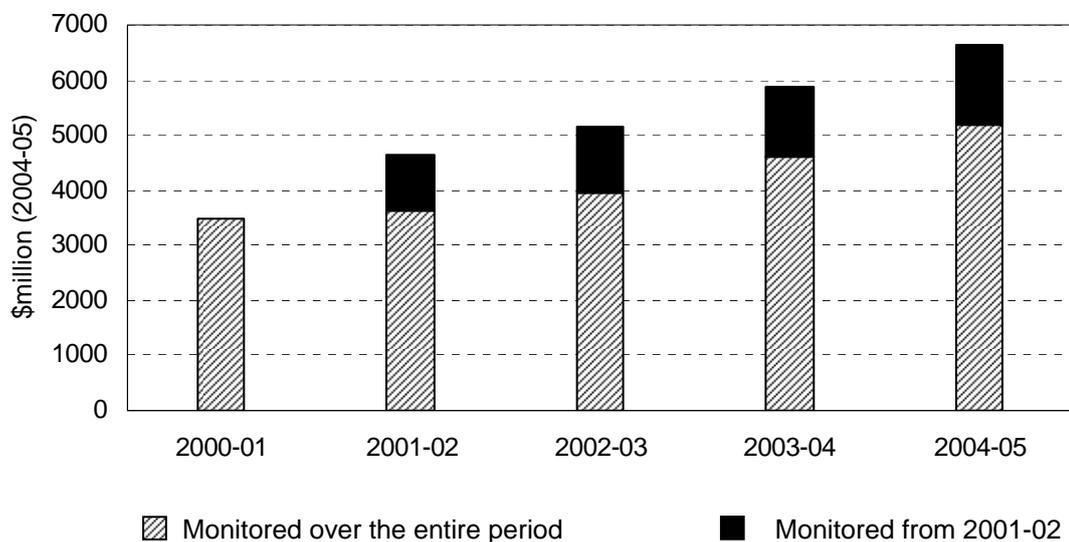
Port GTE	Jurisdiction						Activities
		Port facilities management	Pilotage	Stevedoring	Cold storage	Airport operations	
Newcastle Port Corporation	NSW	✓	✓	X	X	X	
Port Kembla Port Corporation	NSW	✓	✓	X	X	X	
Sydney Ports Corporation	NSW	✓	✓	X	X	X	
Port of Melbourne Corporation	Victoria	✓	X	X	X	X	
Victorian Regional Channels Authority ^a	Victoria	X	X	X	X	X	
Central Queensland Ports Authority ^b	Queensland	✓	✓	✓	X	X	
Port of Brisbane Corporation	Queensland	✓	X	X	X	X ^c	
Cairns Port Authority	Queensland	✓	X	X	X	✓	
Townsville Port Authority	Queensland	✓	✓	X	X	X	
Ports Corporation of Queensland	Queensland	✓	✓	X	X	X	
Mackay Port Authority	Queensland	✓	X	X	X	✓	
Fremantle Port Authority	WA	✓	X	X	X	X	
Bunbury Port Authority	WA	✓	✓	X	X	X	
Port Hedland Port Authority	WA	✓	✓	X	X	X	
Dampier Port Authority	WA	✓	X	X	X	X	
Geraldton Port Authority	WA	✓	✓	X	X	X	
Albany Port Authority	WA	✓	✓	X	X	X	
Burnie Port Corporation	Tasmania	✓	✓	X	✓	X	
Hobart Ports Corporation	Tasmania	✓	✓	✓ ^d	✓	✓	
Port of Devonport Corporation	Tasmania	✓	✓	X	✓	✓	
Port of Launceston Pty Ltd	Tasmania	✓	✓	X	X	X	
Darwin Port Corporation	NT	✓	✓	X	X	X	

^a The Victorian Regional Channels Authority (VRCA) began operations on 1 April 2004. ^b The Central Queensland Ports Authority (CQPA) was formed on 1 July 2004, from the merger of the Port Authorities responsible for the Port of Gladstone and Port Alma (Rockhampton). ^c Investment only — Not direct operation. ^d Subsidiaries of the Hobart Ports Corporation provide stevedoring services in several SA ports and in Tasmania.

Changes to the range of services should be taken into account when assessing and comparing financial performances over time. The financial performances of some port GTEs have been affected by the franchising of some activities, for example, the issuing of exclusive or non-exclusive licences to operate or provide services within the port, such as stevedoring, pilotage and towage.

The value of assets controlled by the GTEs monitored in 2004-05 are shown in figure 10.1.

Figure 10.1 **Sector assets — port GTEs**



Note An additional eight regional port GTEs (four in Queensland and four in Western Australia) were monitored for the first time in 2001-02. The values of sector assets prior to 2004-05 were converted to 2004-05 dollars using the implicit price deflator — Gross Fixed Capital Formation for Public Corporations (see chapter 3).

Source: Productivity Commission estimates.

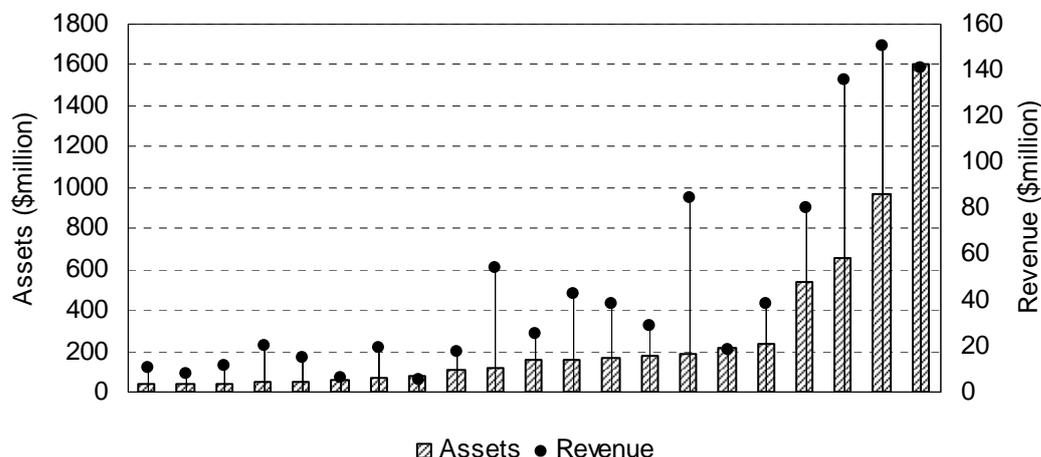
The number of monitored port GTEs has changed over the reporting period. Four additional port GTEs were added for the first time in 2001-02. In 2004-05, the set of monitored port GTEs included one less port than the previous year, due to the former Victorian Channels Authority (VCA) being merged into other GTEs.²

The size of the monitored port GTEs — in terms of the value of the assets controlled and revenue — varies substantially (see figure 10.2). In 2004-05, the

² Part of the VCA was transferred to the Port of Melbourne Corporation in November 2003. The remaining operations of the VCA became the Victorian Regional Channels Authority (VRCA), which commenced operations in April 2004.

smallest in terms of asset value was the Burnie Port Authority (\$35 million) and the largest was the Port of Brisbane Corporation (\$1.6 billion).

Figure 10.2 Assets and revenue — port GTEs, 2004-05



Source: Productivity Commission estimates.

There are also differences across jurisdictions in the operating principles established for port GTEs. These differences include the emphasis on commercial and other objectives such as trade facilitation and regional development. In most jurisdictions, port GTEs operate under a jurisdiction-specific, GTE-wide corporatisation framework.

10.2 Market environment

The financial performances of port GTEs are affected by changes in the level and composition of trade throughput. Port reforms over the last decade have also affected performance by changing the scope and nature of activities carried out by some port GTEs and by increasing their commercial focus.

Trade throughput

Trade throughput is susceptible to changes in both domestic and international markets, particularly shifts in demand for key trade commodities. With differences in the composition and size of the markets served, changing market environments do not impact on all GTEs uniformly.

Port GTEs with a diversified range of cargoes are less affected by market trends in key commodities, but usually retain an exposure to changes in the overall level of economic activity. For port GTEs, where a single commodity accounts for a dominant share of total port throughput — such as Newcastle Port, where coal accounted for around 93 per cent of throughput in 2004-05 — changes in market conditions for that commodity can substantially affect the GTE's financial performance.

Over the reporting period, some monitored port GTEs have experienced extraordinary changes in the market environment specific to a particular port or activity, such as that experienced by the Newcastle Port Corporation with the 1999-00 closure of BHP steel making facilities in Newcastle. Events of this nature usually have a significant effect on financial performance and extra care is required when making comparisons with previous years.

Corporate reforms

Government reforms in the ports sector over the last decade or so were aimed at improving the efficiency and financial performance of GTEs by making them more commercially focused. In general, the reforms were consistent with those recommended in the 1993 Industry Commission report *Port Authority Services and Activities* (IC 1993). Some of the major recommendations of the Industry Commission's report were:

- ports should be constituted as statutory bodies, which are separate from the departmental structure of government;
- ports should be exposed to a tax-equivalent regime, be reimbursed for any community service obligations (CSOs) and pay dividends from after tax profits;
- the adoption, where cost efficient, of a landlord model of operation;³ and
- where the landlord model is adopted, governments should identify and divest non-core activities and contract out, where cost effective, core activities.

The primary aim of these reforms was the establishment of clear objectives that eliminate any conflicts arising out of the commercial and non-commercial activities of the GTE, as well as replicating market disciplines. With reform, competition in the provision of port services has increased, mainly through the competitive tendering and franchising to private operators of activities such as stevedoring, pilotage, mooring, general maintenance and ship cleaning.

³ The landlord model is characterised by the port authority concentrating on the supply of core activities only, with the more contestable waterfront services, such as stevedoring and pilotage, supplied privately.

Most restructuring and rationalisation occurred prior to the reporting period. For example, three independent port corporations replaced the former Maritime Services Board of New South Wales in 1995-96.⁴ In the same year, the Port of Melbourne Authority was divided into three separate entities.

In Victoria, the *Port Services Act 1995* was amended in 2003 as part of the Victorian Government's port reform process. As a result, the Melbourne Port Corporation (MPC) was abolished on 1 July 2003 and replaced by the Port of Melbourne Corporation (PoMC).

On 3 November 2003, the PoMC also assumed responsibility for the management of the Melbourne channels, which were formerly managed by the Victorian Channels Authority (VCA). All assets of the VCA, with the exception of those assets required for the ongoing management of the ports of Geelong, Hastings and Portland, were transferred to the PoMC on this date. Responsibility for the Geelong channels and the approaches to the ports of Portland and Hastings remained with the VCA, which was renamed the Victorian Regional Channels Authority (VRCA) and commenced operations on 1 April 2004.

In Queensland, the Gladstone Port Authority was amalgamated with the smaller Port of Alma (Rockhampton) in July 2004, forming the Central Queensland Ports Authority.

In Western Australia, separate legislation covering several individual port authorities was repealed and replaced by the *Port Authorities Act 1999*. This provided for the commercialisation of port authorities and included provisions relating to the establishment of boards of directors, financial arrangements and dividend payments.

In the Northern Territory, the *Darwin Port Authority Act 1983* was replaced by the *Darwin Port Corporation Act 1999*. Included in the new Act were provisions relating to the establishment of a commercial charter, a board of directors and ministerial directions.

Port charges

A number of reforms have led to improved pricing and allocative mechanisms over the reporting period. Volume-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 (PC 2002b).

⁴ Newcastle Port Corporation, Port Kembla Port Corporation and Sydney Port Corporation were established.

In Victoria, port charges were regulated for the majority of the reporting period by the Essential Services Commission (ESC).⁵ The ESC introduced a price monitoring regulatory framework that applies from 1 July 2005. The framework involves port operators determining their own reference tariffs which are then subject to monitoring by the ESC. Port operators and users may, however, negotiate prices that differ from the tariff. In all other jurisdictions, port charges are determined by the board of each GTE, but are generally subject to the approval of the relevant minister.

Generally, the charges imposed by port GTEs in capital cities have declined in real terms since 1990. For example, real charges for container vessels fell by more than 50 per cent in Sydney and Melbourne between 1990-91 and 2000-01 (PC 2002b).⁶ Port charges have also fallen across a number of regional ports.

10.3 Profitability

In 2004-05, the overall profitability of the port GTEs declined 15 per cent (\$47 million) over the previous year, to a total of \$268 million. The result remains 91 per cent ahead of profits at the beginning of the reporting period as measured in 2004-05 dollar terms, when total profits were \$141 million (a real increase of \$127 million).

In 2004-05, most ports were able to sustain the considerable increase in throughput as the boom in world commodity sales continued. Despite the resulting strong profitability in 2004-05, profit results were lower relative to the previous year, when profits were boosted by one-off upward asset revaluations across much of the sector. The profitability of most GTEs increased in 2004-05 over the previous year if the effect of the revaluations are excluded.

In 2004-05, the cost recovery ratio for the sector as a whole decreased from 156 per cent to 143 per cent. The declines in cost ratios at some ports were due to cost increases during the year, while others reflected lower revenue compared to the previous year, where, as mentioned, large asset revaluations had inflated revenues.

⁵ Formerly the Office of the Regulator-General (ORG).

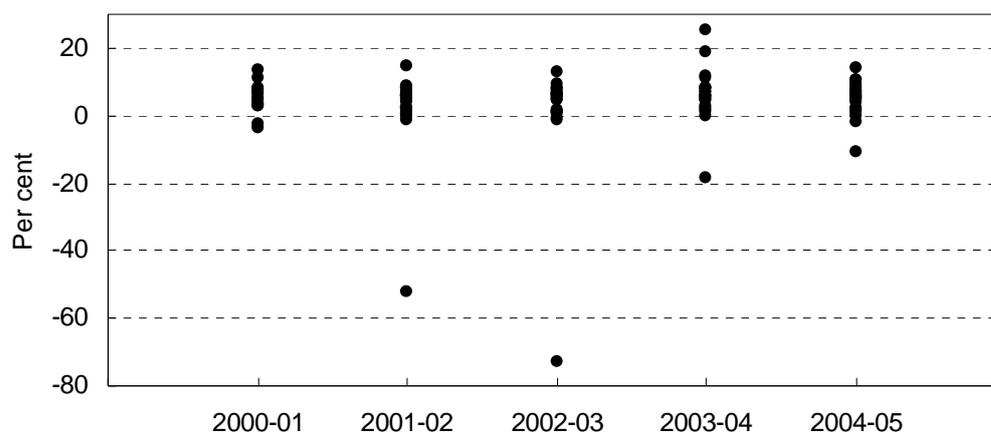
⁶ Beyond this period, the Victorian ORG determined that land-based prescribed services charges should be reduced by an average of 5.2 per cent per annum in real terms and that channel-based prescribed services charges should be reduced by 2.1 per cent per annum in real terms over the period 2000-01 to 2004-05. Under the PoMC's Reference Tariff Schedule, submitted as part of the ESC price monitoring framework applying from 1 July 2005, wharfage prices have increased 3.5 per cent across the majority of services.

The median cost recovery rate was 131 per cent, with the highest at 216 per cent and lowest at 70 per cent.

The decline in profits relative to 2003-04 was mirrored by a similar decline in the return on assets, falling from 7.2 per cent in 2003-04 to 6.6 per cent in 2004-05. Prior to this, the return on assets had remained under 5 per cent from 2001-02 to 2003-04. The majority of monitored port GTEs reported returns on assets in the range of zero to 12 per cent over the reporting period (figure 10.3), although returns by some of the GTEs have on occasion been substantially lower than zero. For those GTEs monitored over the entire reporting period, total profits improved more than 80 per cent (\$85 million) from \$102 million in 2000-01 to \$188 million in 2004-05.

In 2004-05, the median rate of return on assets for the monitored port GTEs was 6 per cent, which is above the 2004-05 risk free rate on 10-year Commonwealth Government bonds at 5.42 per cent.

Figure 10.3 Return on assets — port GTEs



ote The figure includes eight GTEs (four from Queensland and four from Western Australia) that were included for the first time in 2001-02. 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 and adding back gross interest expense. Average total assets is the average of the value of assets at the beginning and end of each financial year. Where an average was not available, the value of total assets at the end of the financial year was used.

Source: Productivity Commission estimates.

The return on equity — the GTE's earnings for the year expressed as a proportion of equity remaining in the business — closely followed the trend in return on assets. In 2004-05, the sector returns to equity decreased from 5.9 to 4.9 per cent. However, for GTEs monitored over the entire reporting period, returns on equity improved from 4.7 per cent in 2000-01 to 6.5 per cent in 2004-05.

10.4 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.

Over the reporting period there was considerable diversity in port GTEs' capital structure (figure 10.4). In 2004-05, four port GTEs operated debt free.

In addition to being influenced by the acquisition and retirement of debt, the debt to total assets ratios for port GTEs have been influenced by changes in the total value of port assets. Asset revaluations in particular have a large impact on this ratio. For example, the Sydney Ports Corporation debt to total assets ratio decreased from 26 per cent in 2000-01 to 19 per cent in 2004-05, despite borrowings increasing by 12 per cent in nominal terms. The fall in the debt to total assets ratio can be attributed to an upward asset revaluation of \$186 million made in 2003-04.

Figure 10.4 Debt to total assets — port GTEs



Note The figure includes eight GTEs (four in Queensland and four in Western Australia) that were included for the first time in 2001-02. One port GTE did not have any debt in 2000-01, five port GTEs did not have any debt in 2001-02 or 2002-03 and four port GTEs did not have debt in 2003-04 or 2004-05. Debt is defined to include all repayable borrowings (interest bearing and non-interest bearing), interest bearing non-repayable borrowings and finance leases. Average total assets is the average of the value of assets at the beginning and end of each financial year. Where an average was not available, the value of total assets at the end of the financial year was used.

Source: Productivity Commission estimates.

A decline in the debt position of some GTEs was achieved through the retirement of debt. For example, the Burnie Port Corporation reduced nominal debt levels by almost 60 per cent over the reporting period, contributing to the fall in the debt to total assets ratio from 39 per cent in 2000-01 to 17 per cent in 2004-05.

In 2004-05, interest cover — a measure of the capacity to meet periodic interest payments out of current earnings — was 4.3 times for the sector. This is less than the previous year (5.5 times), and higher than the sector-wide interest cover at the beginning of the reporting period (3.5 times).

Changes in interest cover from year-to-year for some GTEs were related to asset revaluations. For example, the Gladstone Port Authority's interest cover increased from 3.7 times in 2002-03 to 9.7 times in 2003-04 with a \$61 million increase in revenue, mainly attributable to a large asset revaluation.

The ability of port GTEs to meet short-term liabilities from short-term assets has improved over the reporting period, with the current ratio for the sector overall increasing from 128 per cent in 2000-01 to 178 per cent in 2004-05. However, three GTEs recorded a current ratio of less than 100 per cent in 2004-05 — this indicates that the short-term obligations of these GTEs may need to be met from sources of funds other than current assets.⁷

10.5 Transactions with government

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

Owner-governments generally require their GTEs to make tax-equivalent and dividend payments, as well as pay debt guarantee fees. The introduction of these requirements resulted in an increase in payments to governments.

The dividend required to be paid by each GTE depends on the dividend policy of its state or territory government. In 2004-05, eight of the port GTEs had dividend payout ratios above 50 per cent. Four port GTEs did not pay or propose a dividend for 2004-05.⁸

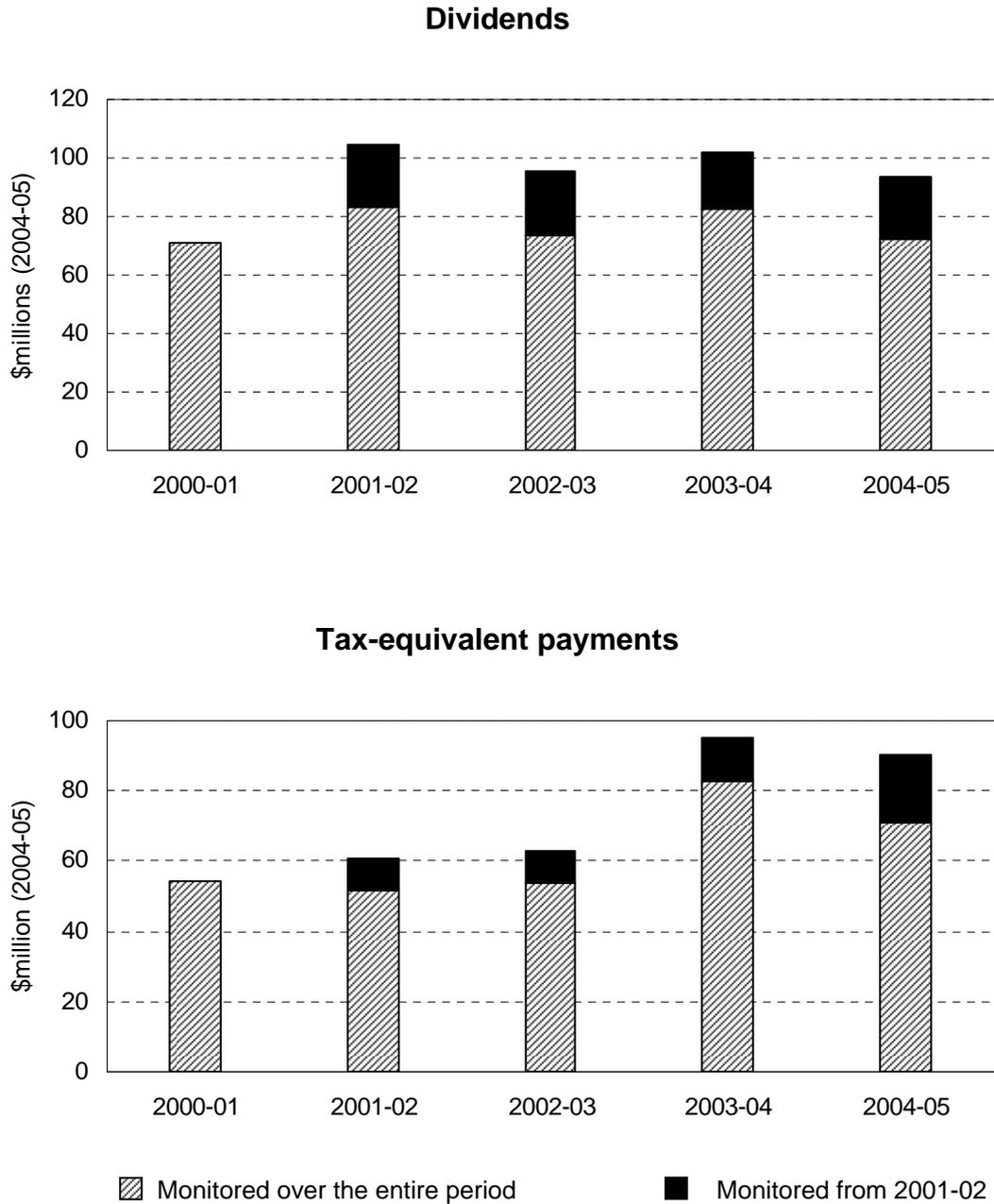
The level of tax-equivalent and dividend payments varies from year-to-year (figure 10.5). In 2004-05, port GTEs made around \$185 million in tax-equivalent and dividend payments to owner-governments. The Queensland and NSW

⁷ Current assets comprise 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.

⁸ This figure includes the PoMC, the board of which had not yet decided on a dividend recommendation by the reporting date.

Governments were the major beneficiaries, receiving 51 per cent and 32 per cent of the total payments respectively.

Figure 10.5 Dividend and tax-equivalent payments — port GTEs



Note The figure includes eight GTEs (four in Queensland and four in Western Australia) that were included for the first time in 2001-02. The value of dividends and tax-equivalent payments prior to 2004-05 were converted to 2004-05 dollars using the implicit price deflator — Gross Fixed Capital Formation for Public Corporations (chapter 3).

Source: Productivity Commission estimates.

Under agreed reforms, port GTEs required to undertake non-commercial activities should receive government community service obligation (CSO) payments equivalent to the net cost incurred through these non-commercial activities.

Three port GTEs received CSO payments during the reporting period. The Port Kembla Port Corporation received CSO funding until 2003-04 (no CSO payment was reported for 2004-05). The payments were provided as compensation for the shortfall in income generated by the NSW Rental Relief Scheme for the Port Kembla Coal Terminal.

The Darwin Port Corporation received \$2.9 million in 2004-05. The payments were to cover the costs associated with marine industry support services, development and management of the Darwin Wharf Precinct for tourism and recreation, and for the provision of port and reception facilities for cruise and naval vessel visits.

The Bunbury Port Authority reported receiving CSO funding for the first time in 2004-05. The payments amounted to \$85 000 and were for the port's provision of leased areas to community-based organisations.

PORTS

Table 10.2 Whole of sector performance indicators, 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	3 356	4 521	4 997	5 722	6 655
Total revenue	\$m	606	821	890	1 024	1 072
<i>Profitability</i>						
Operating profit before tax	\$'000	140 715	130 548	163 659	315 874	268 448
Operating sales margin	%	31.2	23.6	23.9	35.9	30.1
Cost recovery	%	146.7	130.8	131.3	156.0	143.0
Return on assets	%	6.1	4.7	4.8	7.2	6.6
Return on equity	%	3.9	2.3	3.1	5.9	4.9
<i>Financial management</i>						
Debt to equity	%	32.3	30.1	32.8	30.2	28.7
Debt to total assets	%	23.3	21.5	23.8	22.5	26.0
Total liabilities to equity	%	43.0	42.7	44.9	42.3	39.4
Interest cover	times	3.5	2.7	3.6	5.5	4.3
Current ratio	%	128.2	136.8	130.4	157.1	177.6
Leverage ratio	%	143.0	142.7	144.9	142.3	139.4
<i>Payments to and from government</i>						
Dividends	\$'000	68 533	100 838	91 136	99 165	93 231
Dividend to equity ratio	%	3.0	3.2	2.8	2.6	2.6
Dividend payout ratio	%	77.1	141.3	88.8	44.4	52.8
Income tax expense	\$'000	51 869	59 163	61 075	92 629	91 772
CSO funding	\$'000	12 184	13 994	15 354	7 778	3 078

10.6 GTE performance reports

Newcastle Port Corporation (NSW)
Port Kembla Port Corporation (NSW)
Sydney Ports Corporation (NSW)
Port of Melbourne Corporation (Victoria)
Victorian Regional Channels Authority (Victoria)
Central Queensland Ports Authority (Queensland)
Port of Brisbane Corporation (Queensland)
Cairns Port Authority (Queensland)
Ports Corporation of Queensland (Queensland)
Mackay Port Authority (Queensland)
Townsville Port Authority (Queensland)
Fremantle Port Authority (WA)
Bunbury Port Authority (WA)
Port Hedland Port Authority (WA)
Albany Port Authority (WA)
Dampier Port Authority (WA)
Geraldton Port Authority (WA)
Burnie Port Corporation (Tasmania)
Hobart Ports Corporation (Tasmania)
Port of Devonport Corporation (Tasmania)
Port of Launceston Pty Ltd (Tasmania)
Darwin Port Corporation (NT)

Newcastle Port Corporation (NPC) operates under the *State Owned Corporations Act 1989* and the *Ports Corporatisation and Waterways Management Act 1995*. The NPC has responsibility for the management of port facilities and provides pilotage services.

Newcastle is one of Australia's largest ports by tonnage, with a total throughput of 84 million tonnes in 2004-05. Coal accounted for around 93 per cent of this throughput.

The NPC's current ratio increased substantially again in 2004-05, following large increases throughout the reporting period. In 2004-05, this was mainly caused by a 13 per cent (\$3.7 million) increase in cash assets and a significant decline in tax liabilities.

Pre-tax operating profit decreased by 18 per cent (\$2.4 million) in 2004-05, with a 19 per cent (\$5.0 million) increase in expenses. The result is largely attributable to an increase in repairs and services costs which caused operating expenses to outpace growth in revenue.

The NPC is required to make both dividend and tax-equivalent payments. In 2004-05 the NPC provided for a \$3.0 million dividend payment and recorded a income tax-equivalent expense of \$3.0 million.

NEWCASTLE PORT CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	141	138	135	157	161
Total revenue	\$m	38	39	40	40	43
<i>Profitability</i>						
Operating profit before tax	\$'000	6 737	9 251	8 650	13 524	11 037
Operating sales margin	%	23.1	29.0	26.1	37.8	31.0
Cost recovery	%	130.1	140.8	135.3	160.8	144.9
Return on assets	%	6.6	8.3	8.0	10.9	9.0
Return on equity	%	8.9	6.7	6.4	9.7	7.2
<i>Financial management</i>						
Debt to equity	%	34.9	36.5	35.2	28.5	27.3
Debt to total assets	%	21.5	22.0	22.5	21.1	19.4
Total liabilities to equity	%	60.5	64.5	54.8	44.8	42.3
Interest cover	times	3.6	4.9	4.7	6.9	4.4
Current ratio	%	94.8	117.6	240.8	323.9	405.1
Leverage ratio	%	160.5	164.5	154.8	144.8	142.3
<i>Payments to and from government</i>						
Dividends	\$'000	9 000	9 000	3 012	2 429	3 057
Dividend to equity ratio	%	10.4	10.5	3.5	2.5	2.8
Dividend payout ratio	%	116.0	156.3	55.0	25.5	38.3
Income tax expense	\$'000	- 1 023	3 494	3 176	4 007	3 051
CSO funding	\$'000	0	0	0	0	0

^a Includes a \$3.6 million expense relating to an adjustment to superannuation payments. An asset revaluation resulted in a \$2.5 million increase in the value of plant and breakwater assets. Income tax expense is negative due to a write-back of the tax effect on the superannuation adjustment expense.

Port Kembla Port Corporation (PKPC) operates under the *State Owned Corporations Act 1989* and the *Ports Corporatisation and Waterways Management Act 1995*. As well as managing the port, the PKPC provides pilotage services, and berths and equipment for private sector lease or common use.

The major cargoes that move through Port Kembla are coal, iron ore and steel products. The port managed a total throughput of 24.3 million tonnes in 2004-05.

PKPC's pre-tax operating profit was \$18 million in 2004-05, a decline of \$10 million over the previous year. This was largely because of a 17 per cent (\$8 million) decrease in revenue. However, if revenue attributable to an asset revaluation is excluded from the 2003-04 figure, operating revenue in 2004-05 instead represents a 56 per cent (\$14 million) increase. Excluding the effect of the asset revaluation, pre-tax operating profit in 2004-05 increased by almost \$12 million.

PKPC is required to make both dividend and tax-equivalent payments. In 2004-05 PKPC recorded a dividend of \$6.2 million and a tax-equivalent expense of \$5.8 million.

PORT KEMBLA PORT CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02^a</i>	<i>2002-03^b</i>	<i>2003-04^c</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	139	127	114	146	163
Total revenue	\$m	33	30	21	47	39
<i>Profitability</i>						
Operating profit before tax	\$'000	10 588	7 226	- 2 731	28 575	18 244
Operating sales margin	%	45.4	39.0	1.4	68.6	53.9
Cost recovery	%	183.2	164.0	101.4	318.8	216.9
Return on assets	%	11.3	8.8	1.2	25.1	14.0
Return on equity	%	11.3	7.0	- 6.4	31.7	15.0
<i>Financial management</i>						
Debt to equity	%	90.1	91.1	87.7	61.3	57.0
Debt to total assets	%	43.4	40.7	40.5	37.8	31.9
Total liabilities to equity	%	110.4	114.5	104.4	82.0	89.0
Interest cover	times	3.2	2.6	0.3	8.1	6.4
Current ratio	%	137.4	193.1	182.1	282.4	150.7
Leverage ratio	%	210.4	214.5	204.4	182.0	189.0
<i>Payments to and from government</i>						
Dividends	\$'000	8 200	3 928	0	2 333	6 233
Dividend to equity ratio	%	13.1	6.3	0.0	3.4	7.5
Dividend payout ratio	%	116.0	90.0	0.0	10.8	50.0
Income tax expense	\$'000	3 516	2 862	956	7 065	5 779
CSO funding	\$'000	8 784	9 251	8 510	3 186	0

^a Includes \$500 000 in revenue related to a redundancy provision write-back and a \$900 000 adjustment to superannuation payments. A recoverable amounts test resulted in an expense and downward asset revaluation of \$2.8 million. ^b Includes a net revaluation decrement of property, plant and equipment equal to \$9.5 million. Port Kembla Corporation incurred a tax expense in 2002-03 from permanent differences in accounting and tax profit. ^c Includes a net revaluation increment of property, plant and equipment of \$19 million.

Sydney Ports Corporation (SPC) operates under the *State Owned Corporations Act 1989* and the *Ports Corporatisation and Waterways Management Act 1995*. The SPC manages the commercial ports of Sydney Harbour and Botany Bay, and leases land to private stevedores. SPC also owns Sydney Pilot Service Pty Ltd (SPS), which operates as the pilot service provider for Sydney Harbour and Port Botany.¹

During 2004-05 the SPC handled container throughput of approximately 1.3 million twenty-foot equivalent units, an 8.4 per cent increase on the previous year. In addition, cargo throughput totalling 26 mass tonnes, (a 3.1 per cent increase over the previous year), were handled during the year. The major cargoes moving through Sydney Harbour and Botany Bay included chemicals, manufactures and machinery. Sydney Harbour is also regularly visited by cruise ships.

During October 2005, the NSW Government approved SPC's plans for the development and expansion of its Port Botany facilities. Onsite works for the 51 hectare, four berth expansion commenced in December 2005.

The SPC's revenue and profitability increased in 2004-05. Revenue increased 9 per cent (\$15 million) to \$151 million, resulting in an 18 per cent (\$9.6 million) increase in pre-tax operating profit to \$61.4 million. Increased trade volumes contributed significantly to the growth in revenue. The SPC also reviewed rents for its Port Botany container terminal land during the year and updated them to reflect current market conditions.

Total assets increased 18 per cent (\$147 million) in 2004-05, which is largely attributable to upward revaluations to property, plant and equipment totalling \$123 million. This had a positive effect on the SPC's financial management indicators, with debt to equity, debt to total assets and total liabilities to equity ratios all decreasing.

The SPC is required to make both dividend and tax-equivalent payments to the NSW Government. In 2004-05, SPC provided for a \$19 million dividend payment and recorded an income tax-equivalent expense of \$19 million.

¹ SPS commenced operations in 2002-03. Before this, pilotage services were carried out by private operators.

SYDNEY PORTS CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03^a</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	576	606	792	816	965
Total revenue	\$m	109	106	123	138	151
<i>Profitability</i>						
Operating profit before tax	\$'000	33 044	28 825	41 230	51 789	61 415
Operating sales margin	%	41.0	38.2	44.1	46.4	47.9
Cost recovery	%	169.4	161.9	178.8	186.4	191.8
Return on assets	%	7.9	7.0	7.9	8.1	8.3
Return on equity	%	6.5	4.3	5.5	6.1	6.4
<i>Financial management</i>						
Debt to equity	%	39.7	42.9	29.8	29.0	23.3
Debt to total assets	%	26.4	28.5	24.2	21.2	19.2
Total liabilities to equity	%	49.8	54.0	39.3	39.2	31.1
Interest cover	%	3.6	3.3	4.0	5.0	5.9
Current ratio	%	95.8	51.0	65.4	149.1	206.7
Leverage ratio	%	149.8	154.0	139.3	139.2	131.1
<i>Payments to and from government</i>						
Dividends	\$'000	10 994	8 540	13 157	17 625	18 910
Dividend to equity ratio	%	2.9	2.2	2.7	3.1	2.9
Dividend payout ratio	%	44.8	50.9	50.0	50.1	44.4
Income tax expense	\$'000	8 478	12 049	14 915	16 610	18 864
CSO funding	\$'000	0	0	0	0	0

^a Total assets increased by \$186 million in 2002-03, caused mainly by an upward revaluation of non-current assets. Land accounted for \$139.5 million of this revaluation increment.

The Port of Melbourne Corporation (PoMC) operates under the *Ports Services Act 1995* and commenced operations in 2003-04.¹ Under the Act, the PoMC is responsible for managing and developing the Port of Melbourne, ensuring the availability of essential port services and the management of channels.²

The Port of Melbourne is Australia's largest by trade volume, with the PoMC responsible for handling around 38 per cent of Australia's total container trade in 2004-05. Total trade through the port increased by 8.4 per cent to 64 million revenue tonnes in 2004-05.

The PoMC's pre-tax operating profit was \$33 million in 2004-05, a more than doubling of profitability over the previous year. The Corporation reports that the growth in revenue reflects increased trade, higher prices and the inclusion of Station Pier revenue.³ The increased profits led to a significant improvement in the PoMC's return on assets and return on equity. Borrowing costs were lower than the prior year because of a reduction in the level of debt, which improved the Corporation's debt ratios significantly.

The PoMC's total assets were \$960 million in 2004-05, an 11 per cent (\$96 million) increase over the previous financial year. The corporation undertook capital expenditure totalling \$50 million during the year, investing \$25 million in the progression of the channel deepening project.⁴

The PoMC did not pay or declare a dividend in respect of the 2004-05 year. The Corporation reported no provision was made because the obligation to pay a dividend had not been determined in consultation with the Treasurer of Victoria by the reporting date. The PoMC recorded an income tax-equivalent expense of \$11 million.

¹ The Melbourne Port Corporation (MPC), which began operation on 1 March 1996, ceased operations on 30 June 2003 and was replaced by the PoMC.

² On 3 November 2003, PoMC assumed responsibility for the channels and port waters of the Port of Melbourne from the former Victorian Channels Authority.

³ On 1 February 2005 the corporation assumed responsibility for the operation of Station Pier from the Department of Infrastructure.

⁴ The Victorian State Government contributed an additional \$7.5 million to this project during 2004-05.

PORT OF MELBOURNE CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01	2001-02	2002-03	2003-04 ^a	2004-05 ^b
<i>Size</i>						
Total assets	\$m				862	958
Total revenue	\$m				101	124
<i>Profitability</i>						
Operating profit before tax	\$'000				14 801	32 747
Operating sales margin	%				16.8	28.0
Cost recovery	%				120.2	139.0
Return on assets	%				2.3	3.8
Return on equity	%				1.1	2.6
<i>Financial management</i>						
Debt to equity	%				9.0	7.4
Debt to total assets	%				7.8	6.5
Total liabilities to equity	%				15.4	13.9
Interest cover	times				4.2	9.1
Current ratio	%				84.7	86.2
Leverage ratio	%				115.4	113.9
<i>Payments to and from government</i>						
Dividends	\$'000				5 880	0
Dividend to equity ratio	%				0.8	0.0
Dividend payout ratio	%				73.0	0.0
Income tax expense	\$'000				6 743	11 169
CSO funding	\$'000				0	0

^a The Port of Melbourne Corporation (PoMC) commenced operations on 1 July 2003. ^b A dividend with respect to 2004-05 profits had not been declared or paid by the reporting date.

The Victorian Regional Channels Authority (VRCA) was established under the *Port Services Act 1995* to manage channels in the port waters of Geelong and overseeing channel operations in the ports of Hastings and Portland. It commenced operations on 1 April 2004.¹

The VRCA is directly responsible for shipping control in the port waters of Geelong and contracts out the shipping control and navigation services for the ports of Portland and Hastings.

The VRCA has total assets valued at \$59 million. The debt to equity and debt to total assets ratios were zero in 2004-05, as the VRCA had no interest bearing liabilities.

The VRCA recorded an improved pre-tax operating profit of \$779 000 in 2004-05, following a profit of \$68 000 in 2003-04. The result is due to \$4 million increase in revenue from \$2 million to \$6 million and reflects the first full year of the authority's operation.

The VRCA is required to make tax-equivalent payments under the *State Owned Enterprises Act 1992*. In addition, the VRCA is required to pay dividends to the Victorian Government. A tax benefit of \$82 000 was recorded and no dividend was provided for or paid during 2004-05.

¹ The Victorian Channels Authority (VCA) commenced operations on 1 March 1996. Responsibility for the Geelong channels and the approaches to the ports of Portland and Hastings has been assigned to the new entity, the VRCA. The VRCA began operations on 1 April 2004. The PoMC took over the land and waterside functions of the Port of Melbourne, including the Melbourne operations of the VCA, on 3 November 2003.

VICTORIAN REGIONAL CHANNELS AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04^a</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m				59	59
Total revenue	\$m				2	6
<i>Profitability</i>						
Operating profit before tax	\$'000				68	779
Operating sales margin	%				- 0.5	7.4
Cost recovery	%				99.5	108.0
Return on assets	%				0.1	1.3
Return on equity	%				0.2	1.5
<i>Financial management</i>						
Debt to equity	%				0.0	0.0
Debt to total assets	%				0.0	0.0
Total liabilities to equity	%				2.2	1.2
Interest cover	times				n.r.	n.r.
Current ratio	%				840.7	4 213.9
Leverage ratio	%				102.2	101.2
<i>Payments to and from government</i>						
Dividends	\$'000				0	0
Dividend to equity ratio	%				0.0	0.0
Dividend payout ratio	%				0.0	0.0
Income tax expense	\$'000				- 56	- 82
CSO funding	\$'000				0	0

^a The VRCA commenced operations on 1 April 2004. The 2003-04 figures represent only one quarter. **n.r.** Not relevant.

On 1 July 2004, the assets and liabilities of Rockhampton Port Authority were transferred to Gladstone Port Authority, which was then renamed the Central Queensland Ports Authority (CQPA). The CQPA operates under the *Government Owned Corporations Act 1993* and the *Transport Infrastructure Act 1994*. The CQPA is responsible for the provision of infrastructure for bulk operations as well as pilotage and stevedoring services.

In 2004-05 the CQPA recorded total combined throughput of over 63 million tonnes, which comprised 63 million tonnes at the Gladstone facilities (up from under 60 million in 2003-04) and 144 000 tonnes at Rockhampton.

Total revenue declined in 2004-05, following steady increases over the earlier part of the reporting period. However, operating revenue in 2004-05 represents a 7 per cent (\$9 million) increase over 2003-04, if the revenue growth attributable to an asset revaluation is excluded from the 2003-04 figure. Despite a higher revenue base as a merged entity, higher operating costs and depreciation led to a smaller pre-tax operating profit of \$16 million.

Since 2000-01, the CQPA's total assets have grown steadily, a result of asset revaluations and ongoing capital works programs. Recorded assets increased substantially (24 per cent) in 2004-05, mainly attributable to the net contribution from capital works in progress. The Corporation's debt to equity, debt to total assets and total liabilities to equity ratios also improved. The decline in revenue (when the previous year's asset revaluation is included) contributed to a decline in interest cover to 2.7 times.

The CQPA is required to make both dividend and tax-equivalent payments to the Queensland Government. In 2004-05, CQPA provided for a \$5.6 million dividend payment and recorded an income tax-equivalent expense of \$4.4 million.

CENTRAL QUEENSLAND PORTS AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	389	410	452	533 ^c	659
Total revenue	\$m	98	108	127	188	135
<i>Profitability</i>						
Operating profit before tax	\$'000	16 071	20 801	18 774	83 956	15 901
Operating sales margin	%	15.7	22.1	19.7	49.5	16.5
Cost recovery	%	118.6	128.4	124.6	197.9	119.8
Return on assets	%	4.4	6.2	5.9	19.0	4.3
Return on equity	%	2.9	4.8	5.1	21.0	3.1
<i>Financial management</i>						
Debt to equity	%	4.3	43.3	60.5	45.1	32.3
Debt to total assets	%	3.8	27.1	35.1	29.0	23.5
Total liabilities to equity	%	15.7	64.0	80.9	68.4	51.9
Interest cover	times	25.0	6.2	3.7	9.7	2.7
Current ratio	%	124.5	85.0	89.1	79.1	330.4
Leverage ratio	%	115.7	164.0	180.9	168.4	151.9
<i>Payments to and from government</i>						
Dividends	\$'000	13 085 ^a	16 874 ^b	12 200	12 860	5 619
Dividend to equity ratio	%	4.0	5.8	4.9	4.5	1.5
Dividend payout ratio	%	135.8	119.0	95.0	21.7	48.9
Income tax expense	\$'000	6 434	6 625	5 932	24 627	4 408
CSO funding	\$'000	0	0	0	0	0

^a An asset revaluation in January 2001 resulted in an increase of \$16 million in the value of assets, mainly relating to channels, plant and equipment. Dividends include \$3.5 million that was attributed to 1999-00 but not provided for. ^b Dividend includes \$3.4 million that was attributed to 2000-01 but not provided for. ^c The substantial increase in assets recorded in 2003-04 was caused mainly by large asset revaluation increments.

PORT OF BRISBANE CORPORATION

QueenslandThe

Port of Brisbane Corporation (PBC) operates under the *Government Owned Corporations Act 1993* and the *Transport Infrastructure Act 1994*. The PBC manages the Port of Brisbane, Brisbane Multimodal Terminal, and the boat harbours of Manly, Scarborough, Cabbage Tree Creek and Gardens Point. It is also a major shareholder in Brisbane Airport Corporation Ltd (BACL).

In 2004-05 the PBC's major bulk cargoes included oil and coal. Container throughput increased 14 per cent to 726 000 twenty-foot equivalent units.

Pre-tax operating profit increased by 25 per cent (\$10 million) in 2004-05, with a 20 per cent (\$23 million) increase in revenue. The Corporation reported that contributing factors included trade growth, improved rental revenue from new leases and higher land values, along with improved services revenue from dredging contracts and security cost recoveries.

The PBC's total assets have increased in the reporting period by over 80 per cent in nominal terms. Major contributors to this growth were investment in BACL¹ and a number of upward revaluations over the reporting period totalling \$498 million.² The 20 per cent increase in the PBC's assets during 2004-05 is largely attributable to \$167 million in upward asset revaluations, which were mainly applied to recorded land and land improvements values.

Despite a 25 per cent (\$96 million) increase in debt during 2004-05, the PBC's debt to total assets ratio improved slightly, declining as a result of the substantial upward asset revaluations. The debt to equity ratio increased by a small amount to 46 per cent.

The PBC is required to make both dividend and tax-equivalent payments. In 2004-05, PBC provided for a \$28 million dividend payment and recorded an income tax-equivalent expense of \$17 million.

¹ The PBC invested in BACL in 1996-97. The initial investment was entirely funded through borrowings from the Queensland Treasury Corporation. In 1999-00, the PBC increased its shareholding in BACL to 38 per cent.

² Over the reporting period, increases in the value of assets attributable to revaluations have been as follows: \$63 million (2000-01); \$17 million (2001-02); \$33 million (2002-03); \$218 million (2003-04); and \$167 million (2004-05).

PORT OF BRISBANE CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01	2001-02 ^b	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	868 ^a	912	988	1 332 ^c	1 604
Total revenue	\$m	88	96	109	117	141
<i>Profitability</i>						
Operating profit before tax	\$'000	19 535	31 806	33 636	41 783	52 135
Operating sales margin	%	44.3	49.7	46.2	48.1	50.0
Cost recovery	%	186.4	198.6	185.9	192.7	200.2
Return on assets	%	5.0	5.4	5.5	5.3	5.3
Return on equity	%	2.1	4.4	4.6	4.2	3.6
<i>Financial management</i>						
Debt to equity	%	60.2	60.8	64.1	44.3	45.8
Debt to total assets	%	38.6	36.3	38.2	33.3	32.7
Total liabilities to equity	%	68.8	71.7	74.6	52.4	53.0
Interest cover	times	2.0	2.9	2.8	3.1	3.1
Current ratio	%	73.9	79.1	186.0	92.2	130.9
Leverage ratio	%	168.8	171.7	174.6	152.4	153.0
<i>Payments to and from government</i>						
Dividends	\$'000	13 184	21 980	23 396	28 678	27 977
Dividend to equity ratio	%	2.7	4.2	4.3	4.0	2.9
Dividend payout ratio	%	130.5	95.0	91.8	95.0	80.0
Income tax expense	\$'000	9 429	8 669	8 158	11 590	17 164
CSO funding	\$'000	0	0	0	0	0

^a An asset revaluation resulted in an increase in the value of assets by \$63 million, mainly relating to the Port of Brisbane Corporation's (PBC) investment in Brisbane Airport Corporation Ltd. Includes \$1.8 million expense relating to redundancy payments. ^b An asset revaluation resulted in an increase in the value of assets by \$17 million, mainly relating to land improvements. Revenue includes a profit on the sale of assets of \$3.3 million. ^c The 35 per cent increase in the PBC's assets in 2003-04 is largely attributable to \$218 million in upward asset revaluations, which were mainly recorded to land and land improvement values.

The Cairns Port Authority (CPA) operates under the *Government Owned Corporations Act 1993* and the *Transport Infrastructure Act 1994*. It has responsibility for the management and operation of the port of Cairns, Cairns International Airport, and associated land and property. Most port activities such as towage and stevedoring are conducted by private operators.

In 2004-05 total cargo was approximately 1.1 million tonnes, which was slightly lower than the previous year. The major cargoes moving through the port were petroleum products and sugar.

Pre-tax operating profit decreased by \$9 million in 2004-05, which was mainly the result of a large upward revaluation of non-current assets in 2003-04. Excluding the effect of asset revaluations in 2003-04, the CPA's profit increased by \$12 million. Operating revenue in 2004-05 represents a 7 per cent (\$9 million) increase without the effect of asset revaluations in 2003-04. Operating expenditure increased by 8 per cent (\$4.5 million).

The CPA's assets increased by \$95 million (21 per cent) in 2004-05, along with an increase in borrowings of \$18 million. This resulted in increases in the debt to equity and debt to total assets ratios, along with a significant fall in the return on equity.

The CPA is required to make dividend and tax-equivalent payments to the Queensland Government. In 2004-05, the CPA provided for a \$8 million dividend payment and recorded an income tax-equivalent expense of \$11 million.

CAIRNS PORT AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m		325	378	439 ^b	534
Total revenue	\$m		57	71	85	80
<i>Profitability</i>						
Operating profit before tax	\$'000		12 014	25 218	29 784	20 618
Operating sales margin	%		22.4	37.6	39.9	30.6
Cost recovery	%		128.9	160.1	166.3	144.0
Return on assets	%		4.1	7.6	8.3	5.1
Return on equity	%		3.1	7.7	8.4	2.7
<i>Financial management</i>						
Debt to equity	%		12.7	20.0	17.1	19.4
Debt to total assets	%		10.1	16.4	14.6	16.1
Total liabilities to equity	%		26.0	31.4	25.7	32.0
Interest cover	times		9.7	17.6	8.4	6.2
Current ratio	%		84.9	71.3	227.5	40.2
Leverage ratio	%		126.0	131.4	125.7	132.0
<i>Payments to and from government</i>						
Dividends	\$'000		13 986	6 096	5 190	8 030
Dividend to equity ratio	%		5.4	1.1	1.6	2.1
Dividend payout ratio	%		176.5	29.0	19.3	80.0
Income tax expense	\$'000		4 089	4 214	2 922	10 580
CSO funding	\$'000		0	0	0	0

^a 2001-02 was the first year that the Cairns Port Authority was included in this report. It was established in July 1995 under the *Government Owned Corporations Act 1993*. Dividend includes \$6.6 million for a dividend under-provision in 2000-01. ^b An upward adjustment of \$61 million in land values occurred in 2003-04. The current ratio, increased substantially in 2003-04 with the inclusion of \$27 million of land held for sale in current assets.

The Ports Corporation of Queensland (PCQ) operates under the *Government Owned Corporations Act 1993* and the *Transport Infrastructure Act 1994*. The PCQ manages the commercial ports of Hay Point, Abbot Point, Lucinda, Mourilyan, Cape Flattery, Weipa, Karumba and Skardon River and also manages five other non-trading ports. Pilotage services at the ports are now provided by Maritime Safety Queensland, a government agency of the Queensland Department of Transport. Stevedoring and towage are generally franchised to the private sector.

Most of the PCQ's ports specialise in handling bulk cargo such as coal, sugar or bauxite. The PCQ reports total through put increased by 10 per cent over the previous year, handling almost 120 million tons during 2004-05.

The PCQ's assets increased by 5 per cent (\$11 million) in 2004-05, mainly caused by an asset revaluation of property, plant and equipment. The PCQ did not have any outstanding borrowings at the end of 2004-05 and therefore has debt to equity and debt to total asset ratios of zero.

Pre-tax operating profit was \$14 million in 2004-05, compared to \$17 million in 2003-04. An 8 per cent gain in revenue — associated with the operation and maintenance of the Abbot Point Coal Terminal since 1 March 2005 — was offset by a corresponding increase in repairs and maintenance expenses relating to that agreement.

The PCQ is required to make both dividend and tax-equivalent payments. The PCQ accrued a tax-equivalent benefit of \$30 000 in 2004-05, which resulted from a reconciliation of the PCQ's deferred tax liability balance. The PCQ provided for a dividend payment of \$10.3 million.

PORTS CORPORATION OF QUEENSLAND (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m		237	234	224	235
Total revenue	\$m		57	37	35	38
<i>Profitability</i>						
Operating profit before tax	\$'000		- 13 544	16 019	16 501	14 182
Operating sales margin	%		0.4	37.5	41.6	33.4
Cost recovery	%		100.4	159.9	171.3	150.2
Return on assets	%		2.4	6.8	7.2	6.2
Return on equity	%		- 8.2	7.2	6.5	7.5
<i>Financial management</i>						
Debt to equity	%		0.0	0.0	0.0	0.0
Debt to total assets	%		0.0	0.0	0.0	0.0
Total liabilities to equity	%		16.7	19.2	22.9	19.6
Interest cover ^b	times		0.3	n.r.	n.r.	n.r.
Current ratio	%		309.5	245.7	198.9	169.4
Leverage ratio	%		116.7	119.2	122.9	119.6
<i>Payments to and from government</i>						
Dividends	\$'000		5 780	13 000	11 456	10 259
Dividend to equity ratio	%		2.8	3.3	6.0	5.4
Dividend payout ratio	%		- 34.5	90.6	92.8	72.2
Income tax expense	\$'000		3 231	1 675	4 157	- 30
CSO funding	\$'000		0	0	0	0

^a 2001-02 was the first year that the Ports Corporation of Queensland (PCQ) was monitored. It was established in July 1994 under the *Government Owned Corporations Act 1993*. The dividend of \$5.8 million relates to a dividend under-provision in 2000-01. ^b The PCQ incurred borrowing costs during 2001-02, but had no outstanding debt at the end of that financial year. **n.r.** Not relevant.

The Mackay Port Authority (MPA) operates under the *Government Owned Corporations Act 1993* and the *Transport Infrastructure Act 1994*. The MPA has responsibility for the management of the port of Mackay and Mackay Airport. The MPA franchises pilotage, towage and stevedoring activities.

In 2004-05 the major cargoes moving through the port were sugar and grain. The MPA achieved record growth of more than 30 per cent in passenger numbers through the Mackay Airport, totalling 580 000 passengers in 2004-05. The Mackay port recorded more than 2 million tonnes of throughput, representing an increase of 18 per cent over the previous year.

The MPA's revenue increased by approximately 20 per cent through increased trade volumes, higher port prices and an increase in airport passenger numbers. Seaport expenses (excluding depreciation and asset write-downs) increased by 24 per cent, which were the result of significant non-recurring expenses associated with pier demolition and a preventative maintenance program.

The substantial increase in aircraft passenger numbers led to improved airport operations revenue. Expenses from airport operations (excluding depreciation and write-downs) also increased, because of increased outlays for safety and security, general facilities and equipment maintenance costs. Overall, the MPA's pre-tax operating profit more than doubled from \$1.3 million to \$2.6 million in 2004-05.

The MPA's assets had until 2004-05 remained stable at approximately \$160 million since monitoring of the MPA began in 2001-02. In 2004-05, the MPA undertook a significant asset revaluation of land and infrastructure assets of the Mackay Airport, which added \$54 million in value. The majority of the revaluation applied to land asset, reflecting current market conditions. The MPA has not carried any debt over the reporting period.

The MPA is required to make tax-equivalent and dividend payments to the Queensland Government. In 2004-05, \$952 000 in dividend payments and \$1.2 million in tax-equivalent payments were made.

MACKAY PORT AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m		158	159	160	218
Total revenue	\$m		12	14	15	18
<i>Profitability</i>						
Operating profit before tax	\$'000		- 513	960	1 300	2 648
Operating sales margin	%		- 16.6	- 0.3	0.5	6.8
Cost recovery	%		85.8	99.7	100.5	107.3
Return on assets	%		- 0.3	0.6	0.8	1.4
Return on equity	%		- 0.4	0.3	0.1	0.8
<i>Financial management</i>						
Debt to equity	%		0.0	0.0	0.0	0.0
Debt to total assets	%		0.0	0.0	0.0	0.0
Total liabilities to equity	%		4.6	5.8	6.2	5.5
Interest cover	times		n.r.	n.r.	n.r.	n.r.
Current ratio	%		784.5	702.1	701.9	526.4
Leverage ratio	%		104.6	105.8	106.2	105.5
<i>Payments to and from government</i>						
Dividends	\$'000		0	459	146	952
Dividend to equity ratio	%		0.0	0.2	0.1	0.5
Dividend payout ratio	%		0.0	94.3	94.8	67.1
Income tax expense	\$'000		84	473	1 146	1 229
CSO funding	\$'000		0	0	0	0

^a 2001-02 was the first year that the Mackay Port Authority was monitored. It was established in July 1995 under the *Government Owned Corporations Act 1993*. n.r. Not relevant.

Townsville Port Authority (TPA) operates under the *Government Owned Corporations Act 1993* and the *Transport Infrastructure Act 1994*. The TPA is responsible for the management of Townsville Port.

In 2004-05, the major cargoes passing through the port included nickel ore, minerals and sugar. Almost 10 million tonnes of cargo passed through the TPA in 2004-05, representing a slight decline on the previous year.

Total assets increased by \$45 million (more than 33 per cent) in 2004-05, largely attributable to a \$46 million revaluation to non-current assets conducted during the year. The TPA reduced total debt by 12 per cent (\$2 million), which improved the Corporation's debt to equity and debt to total assets ratios. An increase in the current ratio occurred mainly as a result of smaller dividends provisioned.

In 2004-05, the TPA recorded a pre-tax operating profit of almost \$2.1 million, representing a decline from the previous year's profit of \$2.6 million. This result is attributable to a 7 per cent increase (\$2 million) in revenue that was offset by an 8 per cent (\$2.1 million) increase in expenses over the financial year.

The TPA is required to make tax-equivalent and dividend payments to the Queensland Government. It made a dividend payment of \$577 000 and a tax-equivalent payment of \$1.4 million in 2004-05.

TOWNSVILLE PORT AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m		131	127	133	178
Total revenue	\$m		25	26	27	29
<i>Profitability</i>						
Operating profit before tax	\$'000		1 156	- 236	2 651	2 172
Operating sales margin	%		8.4	3.1	13.2	10.2
Cost recovery	%		109.2	103.2	115.2	111.3
Return on assets	%		1.7	0.8	2.9	2.1
Return on equity	%		0.1	- 0.8	1.2	0.5
<i>Financial management</i>						
Debt to equity	%		20.7	19.3	16.4	10.1
Debt to total assets	%		16.4	15.2	13.6	10.1
Total liabilities to equity	%		26.7	25.0	23.2	14.6
Interest cover	times		2.0	0.8	3.3	2.9
Current ratio	%		147.5	104.3	143.6	182.3
Leverage ratio	%		126.7	125.0	123.2	114.6
<i>Payments to and from government</i>						
Dividends	\$'000		0	0	1 170	577
Dividend to equity ratio	%		0.0	0.0	1.1	0.4
Dividend payout ratio	%		0.0	0.0	95.0	80.0
Income tax expense	\$'000		1 065	585	1 419	1 451
CSO funding	\$'000		0	0	0	0

^a 2001-02 was the first year that the Townsville Port Authority was monitored. It was established in July 1995 under the *Government Owned Corporations Act 1993*.

The Fremantle Port Authority (FPA) operates under the *Port Authorities Act 1999*. It provides and maintains port infrastructure and port services, including ship scheduling, port communications and mooring. The FPA contracts pilotage, towage and stevedoring to the private sector.

Major cargoes moving through the port were petroleum products, grain and alumina. In 2004-05, container throughput grew by 1 per cent to 474 000 twenty-foot equivalent units.

Total assets increased in value by 18 per cent (\$30 million) in 2004-05, with a large increase in non-current assets. However, an 80 per cent (\$20 million) increase in total debt led to significant increases in the FPA's debt to equity and debt to total assets ratios.

The Authority reported that increased revenue during the year resulted from strong trade growth in non-transshipment containers and motor vehicle trade. However, the FPA's pre-tax operating profit declined by 6 per cent (\$1 million) because of a 14 per cent (\$8 million) increase in expenses.

The FPA is required to make both income tax-equivalent and dividend payments to the WA Government. In 2004-05 the FPA provided for a \$5 million dividend payment and recorded an income tax-equivalent expense of \$4 million. This amount includes a \$460 000 'Government efficiency dividend,' unrelated to profit.

FREMANTLE PORT AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	132	150	156	166	187
Total revenue	\$m	54	63	76	77	84
<i>Profitability</i>						
Operating profit before tax	\$'000	15 637	19 462	17 779	17 634	16 458
Operating sales margin	%	29.7	32.1	25.1	22.6	20.0
Cost recovery	%	142.2	147.2	133.6	129.1	125.0
Return on assets	%	13.5	14.9	13.0	11.9	10.5
Return on equity	%	12.1	16.3	13.1	11.3	11.5
<i>Financial management</i>						
Debt to equity	%	26.8	32.6	25.9	24.5	42.5
Debt to total assets	%	17.1	21.1	16.7	16.0	26.1
Total liabilities to equity	%	63.5	64.3	58.4	58.1	72.3
Interest cover	times	12.5	14.4	9.1	12.8	9.1
Current ratio	%	150.0	160.4	107.9	118.9	135.5
Leverage ratio	%	163.5	164.3	158.4	158.1	172.3
<i>Payments to and from government</i>						
Dividends	\$'000	1 907	6 798 ^a	5 155 ^b	5 760 ^c	4 929
Dividend to equity ratio	%	2.4	7.9	5.4	5.7	4.6
Dividend payout ratio	%	20.0	48.7	41.5	50.0	40.1
Income tax expense	\$'000	6 102	5 496	5 358	6 115	4 160
CSO funding	\$'000	0	0	0	0	0

^a The dividend includes \$413 000 for a 'Government efficiency dividend' that is not related to profit. ^b The dividend includes \$438 000 for a 'Government efficiency dividend' that is not related to profit. ^c The dividend includes \$449 000 for a 'Government efficiency dividend' that was unrelated to profitability.

The Bunbury Port Authority (BPA) operates under the *Port Authorities Act 1999*. It owns and manages port facilities and provides pilotage services. Stevedoring and towage services are franchised to the private sector.

The BPA handled 12 million tonnes of cargo in 2004-05, which represented a 4.6 per cent increase over the previous financial year. In 2004-05, alumina accounted for 69 per cent of total port throughput by tonnage. Other major cargoes included caustic soda, woodchips and mineral sands.

The value of the BPA's assets have remained stable throughout the reporting period. Its debt to equity and debt to total assets ratios have declined, with a steady decrease in the level of debt since 2000-01.

Pre-tax operating profit increased 9 per cent (\$441 000) to \$5.2 million in 2004-05, the result of a 12 per cent (\$2 million) increase in revenue and a 13 per cent (\$1.4 million) increase in expenses. The Authority reported that improved revenue was attributable to higher trade volumes.

The BPA is required to make dividend and income tax-equivalent payments to the WA Government. In 2004-05, the BPA provided for a \$1.7 million dividend payment and recorded income tax-equivalent expense of \$2.1 million.

BUNBURY PORT AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	99	99	100	100	103
Total revenue	\$m	15	14	16	16	18
<i>Profitability</i>						
Operating profit before tax	\$'000	6 076	4 768	5 623	4 824	5 265
Operating sales margin	%	45.5	35.7	37.5	31.4	30.6
Cost recovery	%	186.7	164.2	168.9	145.8	144.0
Return on assets	%	7.4	5.7	6.6	5.7	6.0
Return on equity	%	5.8	4.2	4.8	4.2	3.9
<i>Financial management</i>						
Debt to equity	%	21.8	20.2	18.2	17.9	16.3
Debt to total assets	%	16.6	15.4	14.7	14.1	13.4
Total liabilities to equity	%	34.7	31.3	24.6	26.9	22.9
Interest cover	times	6.5	6.6	7.0	6.5	7.1
Current ratio	%	391.4	354.4	428.2	547.5	423.3
Leverage ratio	%	134.7	131.3	124.6	126.9	122.9
<i>Payments to and from government</i>						
Dividends	\$'000	1 276	1 582	1 882	1 525	1 756
Dividend to equity ratio	%	1.7	2.1	2.4	1.9	2.2
Dividend payout ratio	%	30.0	50.0	50.0	46.1	55.4
Income tax expense	\$'000	1 823	1 604	1 859	1 517	2 098
CSO funding	\$'000	0	0	0	0	85

The Port Hedland Port Authority (PHPA) operates under the *Port Authorities Act 1999*. It manages port facilities including wharves and storage areas, and provides pilotage services. Stevedoring, towage and lineboat services are franchised.

PHPA's total throughput for 2004-05 was more than 108 million tonnes. Iron ore accounted for around 95 per cent of port throughput by tonnage. The other main cargoes were salt and bulk minerals.

In 2004-05 ship-based charges accounted for around 58 per cent of revenue, with most of the remainder derived from cargo-based charges (30 per cent) and lease rentals (8 per cent). The major expenses for the PHPA in 2004-05 were pilotage transit and hydro survey services (30 per cent) and maintenance (20 per cent).

Pre-tax operating profit improved 6 per cent (\$151 000) in 2004-05, mainly because of a 30 per cent (\$5 million) increase in revenue. The increased revenue was attributable to higher throughput, which the Authority noted was the result of higher world demand for iron ore. The profit result remains, however, lower than earlier years. The rate of return on assets remains low after peaking at 6.6 per cent in 2002-03.

The PHPA operates debt free. The PHPA's liquidity, as measured by the current ratio, decreased in 2004-05. This was the result of a decrease in current assets in the form of cash deposits.

The PHPA is required to make tax-equivalent and dividend payments to the WA Government. In 2004-05, the PHPA provided for a \$810 000 dividend payment and recorded an income tax-equivalent expense of \$783 000.

PORT HEDLAND PORT AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	1999-00	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m		44	46	50	49
Total revenue	\$m		13	15	15	20
<i>Profitability</i>						
Operating profit before tax	\$'000		2 617	2 952	2 231	2 382
Operating sales margin	%		17.5	16.1	11.3	11.3
Cost recovery	%		121.1	119.2	112.7	112.7
Return on assets	%		6.0	6.6	4.7	4.8
Return on equity	%		4.8	5.3	2.7	3.5
<i>Financial management</i>						
Debt to equity	%		0.0	0.0	0.0	0.0
Debt to total assets	%		0.0	0.0	0.0	0.0
Total liabilities to equity	%		9.9	14.6	10.2	7.6
Interest cover	times		n.r.	n.r.	n.r.	n.r.
Current ratio	%		378.5	285.7	256.9	100.3
Leverage ratio	%		109.9	114.6	110.2	107.6
<i>Payments to and from government</i>						
Dividends	\$'000		949	1 043	1 119	810
Dividend to equity ratio	%		2.4	1.3	2.6	1.8
Dividend payout ratio	%		50.0	50.0	96.4	50.7
Income tax expense	\$'000		718	865	1 070	783
CSO funding	\$'000		0	0	0	0

^a 2001-02 was the first year that the Port Hedland Port Authority was monitored. It was established under the *Port Authorities Act 1999*. n.r. Not relevant.

The Albany Port Authority (APA) operates under the *Port Authorities Act 1999*. The APA manages port facilities and provides pilotage services. Stevedoring, mooring and cold storage services are contracted to the private sector.

In 2004-05, the APA's total throughput was 5 per cent greater than the previous year at almost 3 million tonnes. The main cargoes moving through the port were grain, silica sand and woodchips.

The APA recorded a pre-tax operating profit of \$2.8 million in 2004-05, increasing from \$2.3 million in 2003-04. A 14 per cent (\$1.0 million) increase in revenue and a 7 per cent (\$300 000) decrease in expenses brought about the improvement in profit. The higher revenue was attributed to higher volumes of throughput and increased charges. The result is the second year of profitability for the APA since its results were first reported in 2001-02.

The APA's debt to equity and debt to total assets ratios declined in 2004-05, with a 16 per cent (\$2 million) decrease in debt.

The APA is required to make tax-equivalent and dividend payments to the WA Government. In 2004-05, the APA recorded an income tax-equivalent expense of \$611 000 and made provision for \$826 000 in dividends.

ALBANY PORT AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	1999-00	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m		42	38 ^b	39	37
Total revenue	\$m		4	5	7	8
<i>Profitability</i>						
Operating profit before tax	\$'000		- 36	- 1 463	2 306	2 876
Operating sales margin	%		1.4	- 17.7	42.9	44.7
Cost recovery	%		101.4	84.9	175.1	180.9
Return on assets	%		0.7	- 1.4	8.0	9.3
Return on equity	%		0.3	- 9.8	7.5	9.6
<i>Financial management</i>						
Debt to equity	%		59.2	72.6	54.0	42.7
Debt to total assets	%		31.8	37.3	32.5	26.6
Total liabilities to equity	%		86.0	86.7	68.1	55.1
Interest cover	times		0.9	- 0.6	3.8	5.3
Current ratio	%		43.6	32.1	48.5	43.4
Leverage ratio	%		186.0	186.7	168.1	155.1
<i>Payments to and from government</i>						
Dividends	\$'000		0	0	0	826
Dividend to equity ratio	%		0.0	0.0	0.0	3.5
Dividend payout ratio	%		0.0	0.0	0.0	36.5
Income tax expense	\$'000		- 99	643	653	611
CSO funding	\$'000		0	0	0	0

^a 2001-02 was the first year that the Albany Port Authority was monitored. It was established under the *Port Authorities Act 1999*. ^b Includes an extraordinary write-down of assets totalling \$1.8 million.

The Dampier Port Authority (DPA) operates under the *Port Authorities Act 1999*. The DPA manages port facilities including wharves and storage areas. Stevedoring, pilotage and towage services are franchised.

In 2004-05, the DPA's total throughput reached 96 million tonnes, increasing 9 per cent compared to the previous year's 89 million tonnes. The main cargoes included iron ore, liquefied natural gas, gas condensates and salt.

The DPA's operating loss of \$1.0 million represents a decline from an operating profit of \$513 000 in the previous year. The result is attributable to higher expenses, which increased by almost \$2 million. The increase reflected higher administration costs and provisions, as well as increased consulting fees. The increase in consulting fees related to additional outsourcing of staff, required due to limited staff availability and higher demand.

Total assets increased by more than 74 per cent (\$22 million) in 2004-05, mainly reflecting additions to the production of infrastructure underway. The expenditure was partially funded from a \$33 million increased drawing on a \$75 million loan facility with the WA Treasury Corporation.¹ This was associated with a substantial increase in DPA's debt to equity and debt to total assets ratios, along with a substantial increase in the leverage ratio.

The DPA is required to make tax-equivalent and dividend payments to the WA Government. In 2004-05, the DPA recorded an income tax-equivalent benefit of \$322 000 and did not provide for a dividend payment. The DPA paid a \$24 000 'efficiency dividend' in 2004-05 that was unrelated to profitability.

¹ The total loan facility of \$75 million is expected to be fully drawn by 30 June 2006.

DAMPIER PORT AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m		22	23	43	75
Total revenue	\$m		3	5	5	5
<i>Profitability</i>						
Operating profit before tax	\$'000		- 269	360	513	- 1 045
Operating sales margin	%		- 13.4	3.4	7.5	- 20.4
Cost recovery	%		88.2	103.5	108.2	83.0
Return on assets	%		- 1.2	1.6	1.5	- 1.8
Return on equity	%		- 0.9	1.2	2.2	- 3.4
<i>Financial management</i>						
Debt to equity	%		0.0	0.0	71.5	235.9
Debt to total assets	%		0.0	0.0	47.3	83.6
Total liabilities to equity	%		3.5	8.1	96.0	258.4
Interest cover	times		n.r.	n.r.	n.r.	n.r.
Current ratio	%		692.2	368.5	29.0	41.6
Leverage ratio	%		103.5	108.1	196.0	358.4
<i>Payments to and from government</i>						
Dividends	\$'000		96	150 ^b	230 ^b	24 ^c
Dividend to equity ratio	%		0.4	0.7	1.1	0.1
Dividend payout ratio	%		- 48.5	59.8	47.3	- 3.3
Income tax expense	\$'000		- 71	109	27	- 322
CSO funding	\$'000		0	0	0	0

^a 2001-02 was the first year that the Dampier Port Authority was monitored. It was established under the *Port Authorities Act 1999*. ^b In 2002-03, the operating dividend was found to have been overestimated by \$37 000 after a capital gains liability was realised on the sale of three Authority houses. This overstatement was adjusted against the 2003-04 operating dividend. ^c The DPA paid a \$24 000 'efficiency dividend' in 2004-05 that was unrelated to profitability. n.r. Not relevant.

The Geraldton Port Authority (GPA) operates under the *Port Authorities Act 1999*. It manages port facilities, including wharves and storage areas, and provides pilotage and mooring services. Stevedoring and towage services are franchised to the private sector.¹

Total port throughput was 5.5 million tonnes in 2004-05, which was 26 per cent higher than the previous year. The main cargoes moved through the port were grains and minerals.

In 2004-05, total assets declined by \$1 million as additions to non-current assets were largely offset by a higher depreciation charge. The GPA's level of debt remained largely unchanged and both debt to equity and debt to total assets ratios declined. However, the GPA's debt to equity ratio remains the highest of all ports monitored because of increased borrowings from the previous year, made for the completion of the PEP.

Despite a 37 per cent (\$7 million) increase in revenue, the GPA's pre-tax operating profit declined by \$1 million in 2004-05, with a 53 per cent (\$8 million) increase in expenses. The improved revenue was achieved mainly from higher earnings on increased ship charges and throughput as a direct result of the completed Port Enhancement Project (PEP). Expenses increased as a result of higher operating expenses and borrowing costs, along with a higher depreciation charge.

The GPA is required to make tax-equivalent and dividend payments to the WA Government. In 2004-05, GPA recorded an income tax-equivalent expense of \$5.2 million but did not provide for any dividends. The GPA paid a \$126 000 'efficiency dividend' during the year.

¹ The GPA issues non-exclusive licences to stevedores operating in the port. Under the licences, the GPA monitors tariffs, manning levels, operational procedures, continuity of service, customer satisfaction and improvement in working practices.

GERALDTON PORT AUTHORITY (continued)

Performance indicators 2000-01 to 2004-05

	Units	1999-00	2001-02 ^a	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m		36	130	153	152
Total revenue	\$m		10	10	19	26
<i>Profitability</i>						
Operating profit before tax	\$'000		25	103	3 967	2 835
Operating sales margin	%		5.4	6.3	44.9	40.0
Cost recovery	%		105.7	106.7	181.3	166.6
Return on assets	%		2.1	0.9	6.0	6.8
Return on equity	%		0.0	0.5	16.3	- 10.0
<i>Financial management</i>						
Debt to equity	%		46.2	441.2	504.1	483.8
Debt to total assets	%		28.2	114.1	83.2	80.4
Total liabilities to equity	%		63.6	505.6	556.7	499.9
Interest cover	times		1.0	1.2	1.9	1.4
Current ratio	%		131.2	76.0	128.7	219.5
Leverage ratio	%		163.6	605.7	656.7	599.9
<i>Payments to and from government</i>						
Dividends	\$'000		0	126	129	0 ^b
Dividend to equity ratio	%		0.0	0.3	0.6	0.0
Dividend payout ratio	%		0.0	117.8	3.5	0.0
Income tax expense	\$'000		19	- 4	318	5 277
CSO funding	\$'000		0	0	0	0

^a The Geraldton Port Authority was established under the *Port Authorities Act 1999*. 2001-02 was the first year that it was monitored. Actual return on equity was 0.03 per cent. ^b The GPA paid a \$126 000 'efficiency dividend' during 2004-05, which was unrelated to profitability.

Burnie Port Corporation (BPC) was established on 30 July 1997 under the *Port Companies Act 1997* and is subject to the *Corporations Act 2001* (Cwlth). The BPC owns and manages port and cold storage facilities, and provides pilotage services.¹

Total cargo throughput at Burnie declined slightly for the year at 4.1 million tonnes, while the number of containers handled increased 8 per cent from 167 000 to 188 000 twenty foot equivalent units. In 2004-05, the main cargoes passing through the port were woodchips, logs, minerals and paper.

Total assets decreased by 10 per cent (\$4 million) in 2004-05 and is largely attributable to a fall in current assets.

Pre-tax operating profit increased by 18 per cent (\$320 000) to \$2.1 million in 2004-05, despite an 11 per cent fall in revenue. The Corporation reports that revenue fell because of one-off revenue received in 2003-04, with other revenue sources improving slightly in 2004-05.

Debt levels again declined in 2004-05, having fallen each year since 2000-01. The decline in debt has contributed to a fall in the debt to equity and debt to total assets ratios and an increase in interest cover.

BPC is required to make both tax-equivalent and dividend payments to the Tasmanian Government. BPC recommended (but did not provide for) a dividend of \$726 000 with respect to 2004-05 profits. There has been no income tax expense or provision for income tax over the reporting period because of carried forward tax losses.

¹ The Tasmanian Government announced in June 2005 the amalgamation of four Tasmanian ports (Burnie, Hobart, Devonport and Launceston) into a single corporate entity, Tasmanian Ports Corporation (trading as TasPorts), which would have its head offices located in Devonport. TasPorts reports that the merger took effect in January 2006.

BURNIE PORT CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01^a</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	38	41	38	39	35
Total revenue	\$m	12	11	11	12	11
<i>Profitability</i>						
Operating profit before tax	\$'000	- 2 536	1 377	1 126	1 764	2 084
Operating sales margin	%	- 12.0	16.8	11.8	14.8	20.5
Cost recovery	%	107.2	120.1	113.4	117.4	125.9
Return on assets	%	- 2.3	5.8	4.7	5.9	7.2
Return on equity	%	- 14.4	8.2	6.4	9.4	10.3
<i>Financial management</i>						
Debt to equity	%	95.1	75.3	53.8	36.3	29.9
Debt to total assets	%	39.0	32.5	24.5	18.2	16.9
Total liabilities to equity	%	135.0	140.2	109.8	102.6	66.2
Interest cover	times	- 0.6	2.5	2.5	4.3	4.6
Current ratio	%	206.6	353.7	352.5	242.6	525.2
Leverage ratio	%	235.0	240.2	209.8	202.6	166.2
<i>Payments to and from government</i>						
Dividends ^b	\$'000	0	270	383	617	726
Dividend to equity ratio	%	0.0	1.6	2.2	3.3	3.6
Dividend payout ratio	%	0.0	19.6	34.0	35.0	34.8
Income tax expense	\$'000	0	0	0	0	0
CSO funding	\$'000	0	0	0	0	0

^a Includes an abnormal expense of \$2.6 million due to an asset devaluation. ^b Dividends prior to 2004-05 have been adjusted to take account of changes in practices or policies during the reporting period.

Hobart Ports Corporation (HPC) was established on 30 July 1997 under the *Port Companies Act 1997* and is subject to the *Corporations Act 2001* (Cwlth). The HPC owns and operates port facilities in Hobart, Triabunna, Port Huon, Strahan, Stanley and King Island.¹ It also provides stevedoring and plant hire services in several other Tasmanian and South Australian ports. The Hobart International Airport Pty Ltd (HIA) and King Island Ports Corporation are both wholly owned subsidiaries of HPA.

In 2004-05, total port trade was over 3 million mass tonnes. The main bulk cargoes were zinc and petroleum products. HIA also recorded significant growth in passenger numbers during the year.

In 2004-05, HPC's pre-tax operating profit rose 48 per cent (\$3 million) to \$9.1 million. The result was mainly attributable to a 42 per cent increase in revenue, which the Corporation reported was the result of an expansion in stevedoring operations. Profit also increased with the consolidation of HIA's business operations into HPC's accounts for 2004-05.²

The HPC's assets increased by 7 per cent (\$7 million) to \$118 million in 2004-05, while total debt declined slightly to \$40.1 million. The corporation's debt to equity and debt to total liabilities ratios improved, while an increase in borrowing costs resulting from the consolidation of HIA caused interest cover to decline from 11.7 to 4.5 times.

HPC is required to make tax-equivalent and dividend payments. In 2004-05, HPC recorded an income tax-equivalent expense of \$2.8 million and declared a \$1.4 million dividend.

¹ The Tasmanian Government announced in June 2005 the amalgamation of four Tasmanian ports (Burnie, Hobart, Devonport and Launceston) into a single corporate entity, Tasmanian Ports Corporation (trading as TasPorts), which would have its head offices located in Devonport. TasPorts reports that the merger took effect in January 2006.

² Despite previously owning a 98 per cent share in the HIA, the airport's operations were not consolidated in the HPC's 2003-04 financial accounts because a joint venture agreement limited HPC's control over HIA. On 30 June 2004, HPC acquired the remaining HIA shares, making HIA a fully-owned subsidiary for the purposes of the 2004-05 accounts.

HOBART PORTS CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	70	73	76	111	118
Total revenue	\$m	22	31	36	38	54
<i>Profitability</i>						
Operating profit before tax	\$'000	1 220	5 285	6 122	6 178	9 174
Operating sales margin	%	7.9	18.5	18.3	17.4	20.9
Cost recovery	%	108.6	122.8	122.4	121.0	126.5
Return on assets	%	2.8	8.4	9.1	7.2	10.3
Return on equity	%	1.5	7.5	8.8	8.6	10.2
<i>Financial management</i>						
Debt to equity	%	29.8	24.9	22.2	68.5	62.2
Debt to total assets	%	21.4	17.7	16.4	43.3	35.0
Total liabilities to equity	%	45.6	43.9	37.8	87.8	82.6
Interest cover	times	2.8	8.8	10.3	11.7	4.5
Current ratio	%	100.7	128.4	186.1	218.0	181.6
Leverage ratio	%	145.6	143.9	137.8	187.8	182.6
<i>Payments to and from government</i>						
Dividends ^a	\$'000	540	975	875	1000	1 420
Dividend to equity ratio	%	1.1	2.0	1.7	1.7	2.3
Dividend payout ratio	%	76.9	26.4	18.7	20.4	22.6
Income tax expense	\$'000	518	1 590	1 452	1 271	2 898
CSO funding	\$'000	0	0	0	0	0

^a Dividends prior to 2004-05 have been adjusted to take account of changes in practices or policies during the reporting period.

The Port of Devonport Corporation (PDC), formerly the Port of Devonport Authority, was established on 30 July 1997 under the *Port Companies Act 1997* and is subject to the *Corporations Act 2001* (Cwlth). PDC's activities cover the management of port facilities, cold storage operations and the ownership and management of an airport.¹

In 2004-05, the port handled 3.2 million mass tonnes of cargo and 172 000 twenty foot equivalent units. The port is the second largest provider of cold storage in Tasmania, with a capacity of 83 000 cubic metres.

The value of assets and the level of debt remained largely constant in 2004-05. PDC's debt ratios also remained unchanged, while the level of liquidity, as measured by the current ratio increased. PDC's return on equity declined slightly to 6 per cent and an increase in borrowing costs led to a decline in interest cover.

Pre-tax operating profit declined 8 per cent (\$293 000) in 2004-05, despite a 16 per cent (\$2 million) increase in revenue. The increase in revenue was partially offset by higher operations expenditure on port operations and cold stores. A significant proportion of this increase was an amount of \$1.4 million for maintenance dredging. The contribution to profits from Devonport Airport decreased as a result of slightly lower passenger numbers in 2004-05.

PDC is required to make tax-equivalent and dividend payments to the Tasmanian Government. PDC recorded an income tax equivalent expense of \$1 million and a dividend of over \$1.1 million was recommended for 2004-05.

¹ The Tasmanian Government announced in June 2005 the amalgamation of four Tasmanian ports (Burnie, Hobart, Devonport and Launceston) into a single corporate entity, Tasmanian Ports Corporation (trading as TasPorts), which would have its head offices located in Devonport. TasPorts reports that the merger took effect in January 2006.

PORT OF DEVONPORT CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	2000-01 ^a	2001-02	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	45	45	47	55	54
Total revenue	\$m	11	10	11	12	14
<i>Profitability</i>						
Operating profit before tax	\$'000	1 068	499	2 530	3 553	3 260
Operating sales margin	%	9.0	5.2	23.7	31.9	26.6
Cost recovery	%	109.9	105.4	131.0	146.8	136.2
Return on assets	%	3.5	2.3	6.6	8.1	7.7
Return on equity	%	0.6	0.5	4.7	6.7	6.0
<i>Financial management</i>						
Debt to equity	%	22.0	21.7	20.9	32.2	31.6
Debt to total assets	%	16.6	16.6	16.3	23.6	22.2
Total liabilities to equity	%	32.0	30.4	31.4	47.0	40.3
Interest cover	times	3.0	2.0	6.0	7.1	4.6
Current ratio	%	336.0	675.4	436.4	278.4	350.6
Leverage ratio	%	132.0	130.4	131.4	147.0	140.3
<i>Payments to and from government</i>						
Dividends ^b	\$'000	108	77	875	1 000	1 126
Dividend to equity ratio	%	0.3	0.2	2.5	2.7	3.0
Dividend payout ratio	%	50.0	48.7	52.7	41.0	50.0
Income tax expense	\$'000	852	343	869	1 116	1 008
CSO funding	\$'000	0	0	0	0	0

^a Includes a net loss of \$1.6 million on the sale of assets. ^b Dividends prior to 2004-05 have been adjusted to take account of changes in practices or policies during the reporting period.

Port of Launceston Pty Ltd was established on 30 July 1997 under the *Port Companies Act 1997* and is subject to the *Corporations Act 2001* (Cwlth). The Port of Launceston provides pilotage services and port facilities, including wharves and equipment.¹

The Port of Launceston is the largest cargo handler in Tasmania. In 2004-05, more than 6 million tonnes of cargo passed through the port, representing a 17 per cent increase over throughput in the previous year. The major cargoes traded through the port are woodchips, metals, minerals and containerised cargoes.

The value of the Port of Launceston's total assets have remained stable since 2000-01, while its level of debt has fallen by 25 per cent (\$3.5 million). This resulted in a decline in the Port of Launceston's debt to total asset ratio over the reporting period.

Pre-tax operating profit increased by 37 per cent (\$415 000) in 2004-05, with a 12 per cent (\$1.2 million) increase in revenue that was partly offset by a 9 per cent (\$806 000) increase in expenses.

The Port of Launceston is required to make tax-equivalent and dividend payments to the Tasmanian Government. In 2004-05, the Port of Launceston recorded income tax-equivalent expense of \$454 000. A dividend of \$577 000 was declared in relation to 2004-05.²

¹ The Tasmanian Government announced in June 2005 the amalgamation of four Tasmanian ports (Burnie, Hobart, Devonport and Launceston) into a single corporate entity, Tasmanian Ports Corporation (trading as TasPorts), which would have its head offices located in Devonport. TasPorts reports that the merger took effect in January 2006.

² A dividend with respect to 2003-04 profits was paid during 2004-05.

PORT OF LAUNCESTON PTY LTD (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	43	44	44	44	43
Total revenue	\$m	9	9	10	10	11
<i>Profitability</i>						
Operating profit before tax	\$'000	462	942	1 097	1 133	1 548
Operating sales margin	%	14.8	19.7	19.2	18.9	20.5
Cost recovery	%	117.4	124.5	123.8	123.3	125.8
Return on assets	%	3.5	4.3	4.5	4.5	5.6
Return on equity	%	0.8	1.9	2.7	3.0	4.1
<i>Financial management</i>						
Debt to equity	%	29.3	43.3	39.4	39.0	33.4
Debt to total assets	%	27.7	26.1	23.9	23.8	20.8
Total liabilities to equity	%	4.1	67.6	64.2	63.5	58.9
Interest cover	times	1.4	2.0	2.3	2.4	2.7
Current ratio	%	161.9	170.7	147.6	150.0	159.2
Leverage ratio	%	104.1	167.6	164.2	163.5	158.9
<i>Payments to and from government</i>						
Dividends ^a	\$'000	335	662	475	752	577
Dividend to equity ratio	%	1.0	1.9	1.8	2.8	2.2
Dividend payout ratio	%	119.0	102.8	65.3	93.6	52.7
Income tax expense	\$'000	180	298	370	330	454
CSO funding	\$'000	0	0	0	0	0

^a Dividends prior to 2004-05 have been adjusted to take account of changes in practices or policies during the reporting period.

Darwin Port Corporation (DPC) was established under the *Darwin Port Corporation Act 1999*.¹ DPC is responsible for the management of a portfolio of marine facilities for pilotage services and reception of cruise and naval vessels.

In 2004-05, total throughput increased 73 per cent to 1.8 million tonnes. The port attributed this growth to an additional 600 000 tonnes of cargo throughput, consisting of rock used as anchor protection in the construction of the Darwin LNG plant. Major cargoes passing through the port include petroleum products, metal products and livestock.

The NT Department of Infrastructure, Planning and Environment is funding the construction of new facilities at East Arm wharf. Work on progress on the East Arm Wharf is transferred to the DPC annually and treated as an equity injection. From 2001-02 to 2004-05 the values of assets transferred to DPC were written down to zero as no extra income is expected to be accrued from these assets.

DPC has affected a number of downward revaluations of its assets during the reporting period, which adversely affect profitability. The adjustments were \$61 million, \$7 million, \$35 million, \$44 million, \$18 million, and in 2004-05, \$13 million. The Corporation reported a \$4.2 million pre-tax operating profit before the asset write down in 2004-05.

DPC's total revenue has remained stable over most of the reporting period, remaining at \$19 million over the previous three years.

DPC is required to make tax-equivalent and dividend payments. Dividend payments are set at 50 per cent of operating profit after tax. No dividend has been provided for or paid in the reporting period.

In 2004-05, the DPC received a total of \$3 million in CSO funding to cover costs associated with small craft services, tourism and real estate, cruise and defence facilities, the Fort Hill Wharf, the NT Express, dredging of the City Wharves and the East Arm Port development.²

¹ Prior to September 1999, DPC's operations were carried out by the Darwin Port Authority.

² This CSO addressed debt servicing and costs incurred in the duplication of services at DPC's current operations and at the new wharf.

DARWIN PORT CORPORATION (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01 ^a	2001-02 ^b	2002-03 ^c	2003-04 ^d	2004-05
<i>Size</i>						
Total assets	\$m	62	55	57	62	70
Total revenue	\$m	15	17	19	19	19
<i>Profitability</i>						
Operating profit before tax	\$'000	- 5 202	- 33 072	- 43 458	- 12 961	- 8 955
Operating sales margin	%	- 20.5	- 188.7	- 221.6	- 64.7	- 42.8
Cost recovery	%	83.0	34.6	31.1	60.7	70.0
Return on assets	%	- 3.8	- 52.0	- 73.2	- 18.5	- 10.8
Return on equity	%	- 21.1	- 198.6	- 272.5	- 63.3	- 30.9
<i>Financial management</i>						
Debt to equity	%	173.1	227.5	187.7	142.7	91.7
Debt to total assets	%	51.9	57.1	59.5	55.2	48.3
Total liabilities to equity	%	218.0	275.8	220.7	169.4	101.0
Interest cover	times	- 0.9	- 11.6	- 17.8	- 5.9	- 3.9
Current ratio	%	180.9	201.6	429.4	418.2	400.1
Leverage ratio	%	318.0	375.8	320.7	269.4	201.0
<i>Payments to and from government</i>						
Dividends	\$'000	0	0	0	0	0
Dividend to equity ratio	%	0.0	0.0	0.0	0.0	0.0
Dividend payout ratio	%	0.0	0.0	0.0	0.0	0.0
Income tax expense	\$'000	- 362	879	- 865	- 18	- 24
CSO funding	\$'000	3 400	4 743	6 844	4 592	2 993

^a Includes a \$15 million revaluation decrement resulting from a revaluation of harbour improvements using deprival methodology. ^b Includes a revaluation decrement of \$4.8 million relating to assets that are used to fulfil CSOs rather than to generate profits. Includes a decrement of \$30 million relating to assets that were written down to zero to reflect that they will result in no extra income to the Darwin Port Corporation, after being transferred from the NT Department of Infrastructure, Planning and Environment. ^c Includes a decrement of \$43 million relating to assets that were written down to zero to reflect that they will result in no extra income to the Darwin Port Corporation, after being transferred from the NT Department of Infrastructure, Planning and Environment. ^e Includes a decrement of \$18 million relating to assets that were written down to zero to reflect that they will not generate additional income for the Darwin Port Corporation.

11 Forestry

The financial performances of six forestry government trading enterprises (GTEs) are reported in this chapter. The forestry sector was first included in this series of reports in 2001-02.

Forestry GTEs from six states are monitored — Forests of New South Wales (FNSW), VicForests, DPI Forestry Queensland (DPI Forestry), the Forest Products Commission of Western Australia (FPCWA), ForestrySA and Forestry Tasmania.

VicForests financial performance is reported for the first time. Formally, it commenced operating as a GTE in August 2004. Prior to this, it operated as a business unit within the Victorian Government's Department of Sustainability and Environment.

ACT Forests operates within the Department of Urban Services and is not reported because of substantial restructuring following the catastrophic bushfire in 2002-03. The Northern Territory does not have a government-owned forestry GTE.

Financial data for the reported GTEs are presented from 2001-02 to 2004-05. Given the volatile nature of changes in the valuation of standing timber assets, profits are reported both before and after movements in forest valuations.

In 2004-05, the six monitored forestry GTEs had a combined asset value of \$6.2 billion and generated \$710 million in revenue.

Financial performance summaries, including performance indicators for the forestry sector and each forestry GTE, are presented after this introduction. The performance indicators are consistent across individual GTEs. For a discussion of the data and the financial indicators used, along with some of the factors that should be considered when assessing performance, see chapter 3. Specifically, care should be taken because of differences in market environments and issues relating to the valuation of forestry assets.

11.1 Monitored GTEs

The monitored forestry GTEs provided a broad range of services (table 11.1) including:

- plantation and native forest management;
- supply of forest products to the timber industry;
- research and development of new forestry techniques and processes;
- contributions to the marketing of forest products; and
- management of activities not related to timber production, which occur in state-managed native forests and plantations, including beekeeping, recreation facilities, grazing and quarrying.

Table 11.1 **Activities — forestry GTEs, 2004-05**

Forestry GTE	Activities			
	Plantation management	Native forest management	Research and marketing	Tourism and recreation activities
SFNSW	✓	✓	✓	a
VicForests	✓	x	✓	x
DPI Forestry	✓	✓	✓	a
FPCWA	✓	✓	✓	x
ForestrySA	✓	✓ b	✓	a
Forestry Tasmania	✓	✓	✓	✓

a Most of the monitored forestry GTEs provided services and infrastructure for tourism activities, such as scenic drives, picnic areas and hiking trails. Except for Forestry Tasmania, these activities generated negligible revenue for the GTEs over the reporting period. **b** ForestrySA receives community service obligation (CSO) funding for specific native forest management activities.

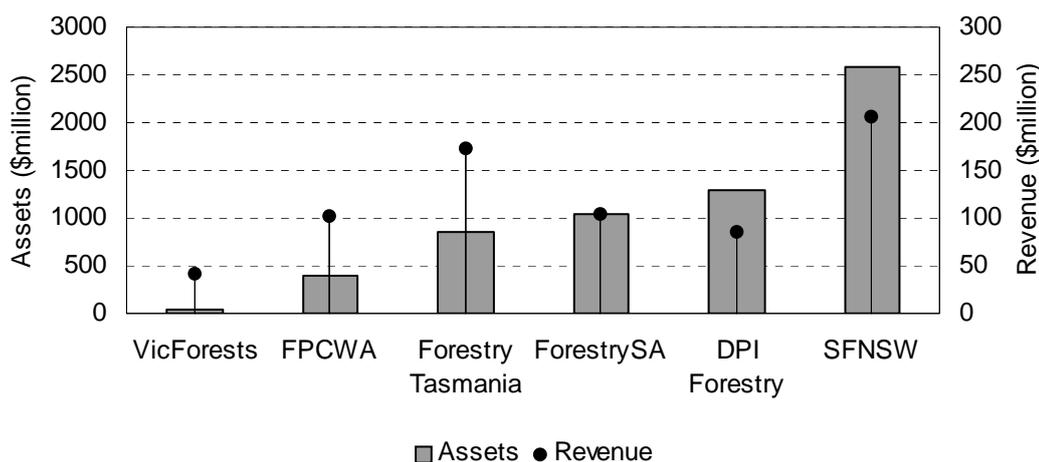
In addition, forestry GTEs generally have responsibility for fire-fighting and other ancillary forest management activities.

The sizes of monitored forestry GTEs vary substantially, in terms of the value of their assets and revenue (figure 11.1). In 2004-05, the largest was SFNSW (\$2.6 billion in assets and \$206 million in revenue) and the smallest GTE was VicForests (\$37 million in assets and \$41 million in revenue).

Governance arrangements also vary. With the exception of DPI Forestry, which is a commercialised business unit within the Queensland Department of Primary Industries and Fisheries, all other monitored forestry GTEs are coporatised.

Governance objectives for forestry GTEs also differ across jurisdictions. Differences include the degree of emphasis on commercial objectives by boards and governments compared with other objectives, such as environmental management and community education.

Figure 11.1 **Assets and revenue — forestry GTEs, 2004-05**



Source: Productivity Commission estimates.

11.2 Market environment

The financial performances of forestry GTEs are affected by the volatility of demand for timber products, industry reforms and changes to accounting standards.

Demand for forest products

The major traded output of forestry GTEs is logs. These are either harvested by the GTEs themselves or by private loggers operating as sub-contractors. Logs can be harvested as either:

- sawlogs — for conversion into sawn-timber, plywood, or veneer products that are mainly used in the construction and furniture industries; or
- pulp logs — for conversion into woodchips and fibreboard, particleboard or pulp (for subsequent conversion into paper and paperboard products).

Sawlogs are generally not exported and the demand for them is influenced by local economic conditions and government policies. For example, the introduction of the goods and services tax (in July 2000) pulled forward building activity and, hence,

the demand for forest products in 2000-01. However, with a return to more buoyant building activity, demand for sawn timber and ultimately sawlogs increased strongly over the reporting period (ABS 2006).

According to the Australian Bureau of Agricultural and Resource Economics, 40 per cent of pulpwood harvested in Australia each year is sold domestically for making pulp and paper products, while the balance is exported — mainly as woodchips. Almost 99 per cent of Australia's woodchip exports go to Japan (ABARE, 2000).

Industry reforms

During the 1990s, forestry GTEs were reformed. The reforms arose out of the National Forest Policy Statement (NFPS), Regional Forest Agreements (RFAs), the Plantations 2020 Strategy and the application of National Competition Policy (NCP).

National Forest Policy Statement

The Australian and all state and territory governments signed the NFPS in 1992. The NFPS was a comprehensive agreement that sought to provide a 'blueprint' for the future management of Australia's forests, particularly its native forests. Aspects of the statement that were of particular significance to forestry GTEs were:

- the establishment of market-based pricing principles for forest resources;
- the use of RFAs as a means of providing integrated management of forest resources; and
- the expansion of Australia's commercial plantations of softwoods and hardwoods.

Regional Forest Agreements

RFAs are intended to provide greater certainty and security in relation to forest conservation and timber resource supply. More specifically, RFAs are intended to:

- reduce uncertainty for industry and duplication in government processes for land-use decision making;
- produce long-term solutions that meet the requirements of governments, the community and industry, while also being consistent with the principles of ecologically sustainable development;

-
- equitably balance competing objectives and coordinate the policies and activities of governments;
 - maintain regional, environmental, heritage and social values; and
 - provide secure access to resources for the forestry industry.

Since 2000, hardwood woodchips from native forests can only be exported from forest regions in which RFAs have been successfully negotiated. South Australia, the Northern Territory and the Australian Capital Territory do not have commercial native forest operations.

Plantations 2020

The Plantations 2020 Strategy included a proposal to treble the area of Australia's plantation forests by 2020, in line with previous proposals in the NFPS. In July 1996, this initiative was endorsed by the Ministerial Council on Forestry, Fisheries and Aquaculture. In addition to providing timber assets, plantations can provide salinity controls, biomass energy and carbon sequestration.

ABARE has forecast that by 2010 forest plantations could be providing 75 per cent of domestic wood supplies, compared with earlier expectations of only 62 per cent (ABARE 2002).

National Competition Policy

Under NCP, governments have agreed, among other things, to minimise resource allocation distortions relating to any competitive advantage derived by forestry GTEs as a result of their public sector ownership. To the extent that the benefits outweigh the costs, under clause 3 of the Competition Principles Agreement, governments are obliged to:

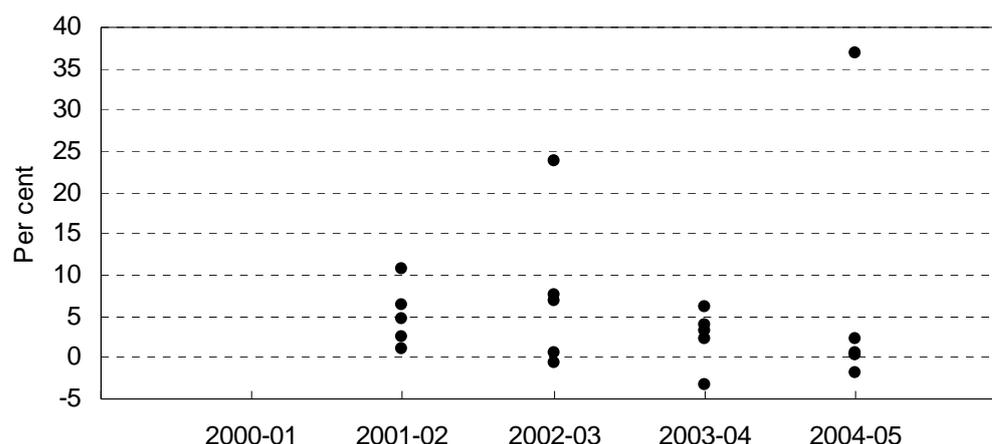
- adopt a corporatisation model where appropriate; and
- impose taxes or tax-equivalent payments, debt guarantee fees and regulations equivalent to those of private sector competitors.

11.3 Profitability

Profitability indicators provide information on how GTEs are using the assets vested in them by shareholder governments to generate earnings.

All GTEs, except the FPCWA, reported a positive return on assets in 2004-05 (figure 11.2). However, only DPI Forestry improved its return on assets in 2004-05. Overall, return on assets for the forestry sector decreased to 0.7 per cent in 2004-05, down from 1.8 per cent in 2003-04.

Figure 11.2 Return on assets — forestry GTEs



Note 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 and adding back the gross interest expense. Average total assets is the average of the value of assets at the beginning and end of each financial year. Where an average was not available, the value of total assets at the end of the financial year was used. The Productivity Commission commenced monitoring the forestry sector in 2001-02.

Source: Productivity Commission estimates.

Forestry sector operating profits before self-generating and regenerating asset (SGARA) revaluations increased from \$27 million to \$38 million over the reporting period, whereas operating profits after SGARA revaluations have decreased from \$231 million to \$26 million over that same period. However, some of this variation is a consequence of accounting policy and expected market conditions.

Following the introduction of accounting standards AAS 35 and AASB 1037 in June 2000, SGARAs, which are held primarily for profit, have been valued at their net market value at each reporting date. Increments and decrements to SGARAs are recognised directly in the statement of financial performance.¹

The value of SGARAs are influenced primarily by changes in the following:

¹ AAS 35 and AASB 1037 are equivalent standards. However, AAS standards were developed specifically for the government sector. Both these standards will be superseded by AASB 141 for reporting periods commencing after 1 January 2005.

- *The volume of timber* — the volume of timber is affected by changes in the area of commercial forests (natural or plantation) controlled by a GTE, or by changes in the commercial timber available within the existing commercial forest areas.
- *Age and quality of timber* — trees of different ages attract a different value per cubic metre. Older, larger trees generally have higher value uses — such as building materials and furniture — than do younger, smaller trees. Different species of trees also have different use values and attract different prices in the market.
- *Market prices* — the prevailing market prices for the sawlogs and pulp logs harvested from SGARA assets.

Other things being equal, forestry GTEs can model with some precision the expected physical changes in their SGARA asset base resulting from the first two items. However, changes in the demand for SGARAs can be highly variable and are outside the control of forestry GTEs.

Importantly, changes in demand conditions are generally the predominant factor influencing market prices because supply is relatively constant. Therefore, fluctuations in demand largely determine movement in the overall value of SGARAs from year to year. Over the reporting period, each monitored forestry GTE adjusted the value of their SGARAs, which in some cases had a significant impact on reported revenue (table 11.2). For example, DPI Forestry's SGARA revaluation in 2002-03 resulted in a \$255 million increment in the valuation of plantation timber, accounting for around 71 per cent of its total revenue in that year.

Table 11.2 Size of SGARA revaluations — forestry GTEs

<i>GTE</i>	<i>SGARA revaluation (\$million)</i>			
	2001-02	2002-03	2003-04	2004-05
FNSW	34.3	57.1	9.0	39.3
VicForests	n.r.	n.r.	n.r.	- 2.2
DPI Forestry	84.5	255.2	- 81.5	- 21.9
FPCWA	- 1.2	13.7	22.4	0.5
ForestrySA	3.8	21.0	14.8	24.5
Forestry Tasmania	9.6	- 25.3	9.3	- 12.6
Total	131.0	321.7	- 26.0	27.6

n.r. not relevant

Source: GTE Annual Reports.

Typically, forest assets are valued at the 'net market value', which reflects the amount that could be expected to be received from the disposal of the volume of standing timber, less the direct costs of such a disposal. Under AAS 35 and

AASB 1037, forest assets may be valued at either the *in situ* market price of the timber asset, or at the net present value (NPV). However, there is a great deal of uncertainty attached to the *in situ* market prices since there are few transactions on which to value forest-lots of *in situ* timber.

There is a link between asset values and rates of return when assets are valued using the NPV approach. This arises because there is an implicit assumption of a required rate of return in determining the NPV, linking the asset value to the rate of return. Since rates of return themselves depend on asset values, this creates a circularity between asset values and rates of return.

This ‘circularity’, coupled with the sensitivity of rate of return measures to factors unrelated to the performance of the forestry agency (for example, changes in market conditions), suggests that, for performance monitoring purposes, annual rates of return need to be assessed in the context of longer-term trends and other relevant information (CCNCO 2001).

Over the reporting period, VicForests, DPI Forestry, the FPCWA and Forestry Tasmania used different approaches to estimating the NPV of timber assets. ForestrySA used current market prices, though ‘pre-commercial’ stands of timber (those aged less than 15 years) were valued at historical cost. SFNSW used market price to assess softwood plantation and native forest timber, but valued hardwood plantations on the basis of historical cost, because of difficulties in determining market prices for this asset.

Profitability measures can also be affected by the changes in the treatment of SGARA assets. For example, in 2004-05 Forestry Tasmania stopped treating its native forest assets as SGARAs.² In 2004-05, this change in policy resulted in equity being reduced by \$32 million, whereas in 2003-04, the revaluation of native forest assets resulted in a \$23 million increase in profits.

Further, profitability will be affected by corrections of modelling results. For example, Forestry Tasmania reported that the net market value of standing timber in 2000-01 was overstated by \$12.5 million, because of a modelling error.

The cost recovery ratio indicates whether there was adequate revenue to cover expenses. Over the reporting period, the forestry sector’s cost recovery ratio has exceeded 100 per cent, although it has declined over this period.

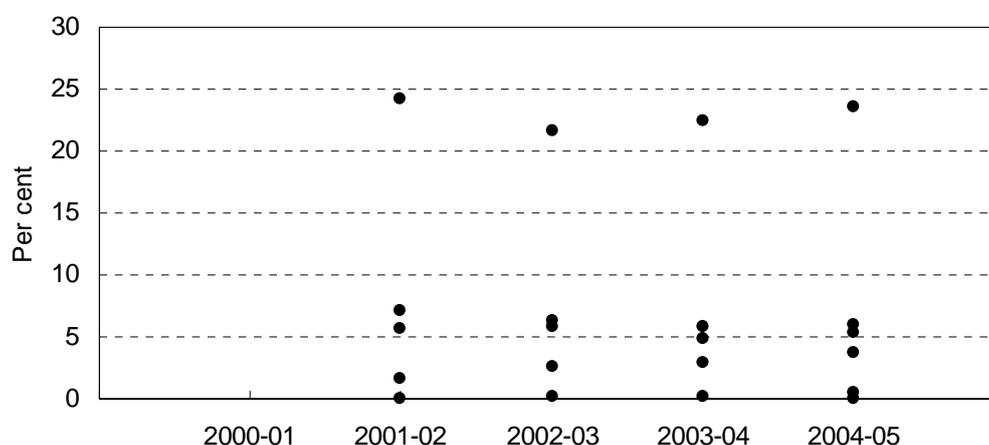
² Forestry Tasmania considers that the timeframe over which the asset is utilised and the drivers of changes in value (discount rate, stumpage prices and forest management costs) made it more appropriate to treat the assets in a similar way to property, plant and equipment.

11.4 Financial management

Financial management indicators provide information about the capital structure of GTEs and their ability to meet the cost of servicing debt and other liabilities as they fall due.

The total level of debt for the monitored forestry sector overall in 2004-05 was around \$340 million, with only VicForests operating debt-free. Over the reporting period, the sector's debt to total assets ratio varied little from the 2004-05 level of 5.6 per cent (figure 11.3).

Figure 11.3 Debt to total assets — forestry GTEs



Note Debt is defined to include all repayable borrowings (interest bearing and non-interest bearing), interest bearing non-repayable borrowings and finance leases. Average total assets is the average of the value of assets at the beginning and end of each financial year. Where an average was not available, the value of total assets at the end of the financial year was used. During 2002-03 and 2003-04, no forestry GTE operated debt free, while in 2001-02, only one forestry GTE — ForestrySA — operated debt-free. The Productivity Commission commenced monitoring the forestry sector in 2001-02.

Source: Productivity Commission estimates.

As a whole, the monitored forestry GTEs in 2004-05 had a far lower debt to assets ratio (5.6 per cent) than did other industry sectors. GTEs in the other monitored sectors reported significantly higher ratios — electricity (39 per cent), ports (22 per cent), water (21 per cent), rail (21 per cent) and urban transport (14 per cent).

Sound financial management requires that profits are sufficient to ensure that interest payments can be met. A high interest cover ratio indicates that the entity can sustain a fall in profit or an increased interest expense and still meet the cost of servicing debt.

In 2004-05, the forestry sector's ability to cover interest costs fell by 75 per cent, even though four of the six forestry GTEs reported positive interest cover ratios. The interest cover ratios of SAForestry, Forestry Tasmania and the FPCWA all fell in 2004-05, with the FPCWA's ratio becoming negative. It is not possible to calculate an interest cover ratio for SFNSW because its reported interest expenses are capitalised.

A current ratio of less than 100 per cent indicates that the short-term obligations of the GTE may need to be met using sources of funds other than current assets. Four of the six GTEs recorded a current ratio of over 100 per cent in 2004-05, with SFNSW and the FPCWA being the exceptions.

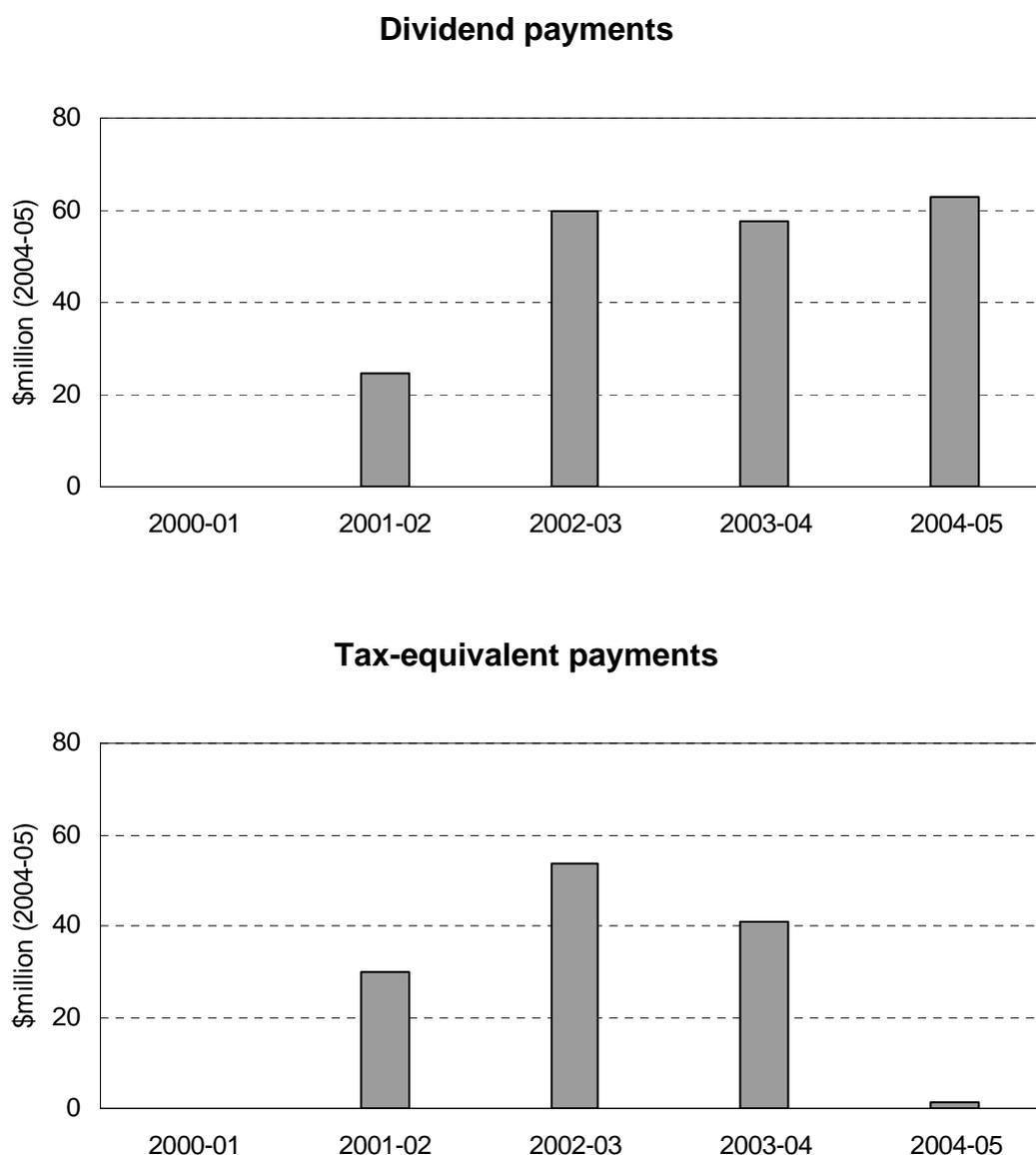
11.5 Transactions with government

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 capital market disciplines and regulations similar to those faced by private sector businesses.

Governments act as the shareholder of forestry GTEs on behalf of the community. Dividend payments from GTEs are generally justified as a return on shareholder funds. In 2004-05, four of the six forestry GTEs reported dividend payments (figure 11.4).

Overall, dividends from the forestry GTEs increased in 2004-05, despite the fall in operating profits before tax (figure 11.4). SFNSW and Forestry Tasmania increased dividend payments in 2004-05, while ForestrySA and DPI Forestry decreased dividend payments. The FPCWA and VicForests did not pay dividends during the year. ForestrySA was the only GTE to pay a special dividend.

Figure 11.4 Dividend and income tax-equivalent payments — forestry GTEs



Note The Productivity Commission commenced monitoring the forestry sector in 2001-02. The value of dividends and tax-equivalent payments prior to 2004-05 were converted to 2004-05 dollars using the implicit price deflator — Gross Fixed Capital Formation of Public Corporations (chapter 3).

Source: Productivity Commission estimates.

Since 2002-03, the forestry sector's dividend payments have remained relatively constant. However, as operating profit (after tax) has decreased by almost \$350 million in that time, the dividend payout ratio has grown from 18 per cent in 2002-03 to 867 per cent in 2004-05.

All forestry GTEs fall within the National Tax Equivalent Regime and are required to make income tax-equivalent payments. In 2004-05, tax-equivalent payments

from the sector fell by 53 per cent, essentially reflecting the decline in operating profits over the financial year.

In 2004-05, both the FPCWA and Forestry Tasmania received tax credits. DPI Forestry has not been required to make tax-equivalent payments over the reporting period, due to differences between accounting and taxable incomes.

Three of the monitored forestry GTEs — SFNSW, ForestrySA and the FPCWA — had agreements to meet CSOs in 2004-05. CSO payments constituted 5 per cent of SFNSW's total revenue, 3 per cent of ForestrySA's total revenue, and 1 per cent of FPCWA's total revenue. Overall, CSO payments accounted for 2 per cent of total revenue in the forestry sector.

FORESTRY

Whole of sector performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^a	2002-03	2003-04	2004-05 ^b
<i>Size</i>						
Total assets	\$m		5 470	5 802	6 082	6 212
Total revenue	\$m		811	986	730	711
<i>Profitability</i>						
Operating profit before tax	\$'000		230 790	371 014	96 978	25 941
Operating sales margin	%		29.7	38.6	14.4	5.6
Cost recovery	%		140.3	160.7	115.3	105.2
Return on assets	%		4.4	6.7	1.8	0.7
Return on equity	%		4.2	6.4	1.1	0.1
<i>Financial management</i>						
Debt to equity	%		6.5	6.2	5.9	6.5
Debt to total assets	%		5.5	5.4	5.1	5.6
Total liabilities to equity	%		15.5	16.2	16.2	17.9
Interest cover	times		20.5	32.2	9.3	2.3
Current ratio	%		151.5	128.4	144.4	139.2
Leverage ratio	%		115.5	116.2	116.2	117.9
<i>Payments to and from government</i>						
Dividends	\$'000		23 873	58 415	56 268	62 770
Dividend to equity ratio	%		0.5	1.2	1.1	1.2
Dividend payout ratio	%		11.8	18.3	98.8	867.0
Income tax expense	\$'000		29 065	52 051	40 002	18 701
CSO funding	\$'000		13 604	14 639	14 355	14 277

^a 2001-02 was the first year that the forestry sector was included in this report. ^b 2004-05 is the first year to include VicForest data.

Whole of sector performance indicators before SGARA revaluation 2000-01 to 2004-05

	Units	2000-01	2001-02	2002-03	2003-04	2004-05
<i>Profitability</i>						
Operating profit before tax	\$'000		28 682	- 29 585	40 064	38 244
Return on assets	%		0.7	- 0.3	0.9	0.9
Return on equity	%		0.0	- 1.7	0.0	0.4

11.6 GTE performance reports

Forests New South Wales

VicForests (Victoria)

DPI Forestry (Queensland)

Forest Products Commission (WA)

ForestrySA (SA)

Forestry Tasmania

The Forestry Commission of New South Wales — trading under the name Forests NSW (FNSW)¹ — operates under the *Forestry Act 1916*. FNSW is responsible for managing almost three million hectares of plantation and native forests throughout New South Wales. During 2004-05, 1200 hectares of new hardwood plantations were established, as well as an additional 6900 hectares of softwood plantations.

More than 60 per cent (over \$1.6 billion) of FNSW's assets are self-generating and regenerating assets (SGARAs). Their value can fluctuate significantly each year, affecting measures of profitability and financial management.²

In 2004-05, FNSW's operating profit before tax fell by \$38 million due to a \$39 million decrement in the market value of its standing timber assets. This decrement reflects a revaluation of FNSW's softwood plantation assets. While total revenue fell by 15 per cent in 2004-05, revenue before SGARA revaluation increased by \$10 million (1.6 per cent).

The downturn in the housing market reduced FNSW's timber sales in the latter part of the financial year. However, additional revenue was generated from the sale of non-current assets and FNSW's inaugural sale of New South Wales Greenhouse Abatement Certificates in the New South Wales Greenhouse Gas Abatement Scheme (\$1.5 million).

FNSW is subject to dividend and tax-equivalent payments. In 2004-05, FNSW made provision for a dividend of \$27 million. This represents a 108 per cent increase on the 2003-04 dividend provision, which, in conjunction with the reduction in operating profits, has resulted in a substantial increase in the dividend payout ratio.

FNSW is funded for the provision of CSOs. These payments account for 5 per cent of FNSW total revenue.

¹ Prior to 1 July 2004, the Forestry Commission of New South Wales had traded under the name State Forests of New South Wales.

² Under AAS 35, SGARAs are reported at their net market value. FNSW uses three separate net market value models to determine the value of their softwood plantation, hardwood plantation and native forest timber. Increments and decrements to SGARAs resulting from market value movements are recognised directly in the statement of financial performance.

FORESTS NSW (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02^b</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m		2 365	2 362	2 588	2 592
Total revenue	\$m		232	220	245	207
<i>Profitability</i>						
Operating profit before tax	\$'000		57 903	12 154	55 252	7 656
Operating sales margin	%		24.7	5.4	22.5	3.5
Cost recovery	%		117.3	99.7	124.4	102.0
Return on assets	%		2.4	0.5	2.2	0.3
Return on equity	%		2.2	- 0.9	1.8	0.1
<i>Financial management</i>						
Debt to equity	%		6.8	7.1	5.7	6.6
Debt to total assets	%		5.6	5.7	4.9	5.3
Total liabilities to equity	%		20.9	24.0	21.7	23.2
Interest cover ^a	times		n.r.	n.r.	n.r.	n.r.
Current ratio	%		80.1	62.8	71.1	78.9
Leverage ratio	%		120.9	124.0	121.7	123.2
<i>Payments to and from government</i>						
Dividends	\$'000		4 717	4 162	13 096	27 254
Dividend to equity ratio	%		0.2	0.2	0.6	1.3
Dividend payout ratio	%		11.0	- 24.6	35.4	938.8
Income tax expense	\$'000		15 014	29 071	18 246	4753
CSO funding	\$'000		9 557	9 557	9 455	9 577

^a All interest expenses related to borrowings from acquisitions of land, and the establishment and development of new plantations have been capitalised, as these assets take a considerable period to become commercially productive. Consequently, interest cover cannot be calculated. n.r. Not relevant. ^b 2001-02 was the first year that Forests of New South Wales was included in this report.

Performance indicators before SGARA revaluation 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Profitability</i>						
Operating profit before tax	\$'000		23 646	- 44 904	46 259	46 995
Return on assets	%		1.0	- 1.9	1.9	1.8
Return on equity	%		0.4	- 3.8	1.4	2.0

VicForests was declared a state corporation in accordance with the *State Owned Enterprises Act 1992* in October 2003, and commenced operation on 1 August 2004. VicForests is responsible for managing the harvest and sale of timber resources from Victoria's State forests.¹ In 2004-05, VicForests oversaw the harvesting and thinning of 6400 hectares of forest.

Just over 30 per cent (\$11 million) of VicForests assets are self-generating and regenerating assets (SGARAs). Their value can fluctuate significantly each year, affecting measures of profitability and financial management.²

In 2004-05, VicForests' \$13 million operating profit before tax included a \$2.2 million increment in the market value of its standing timber assets. VicForests' operating position also benefited from the seasonal nature of the forestry business. This allowed VicForests to receive almost a full 12 months worth of revenue but only incur costs for the eleven months it was in operation.

Profitability indicators reflected VicForests' strong operating result. VicForests provided a return on assets of 36 per cent and a return on equity of 37 per cent in 2004-05.

VicForests is subject to dividend and tax-equivalent payments. Dividends are determined by the Treasurer of Victoria following consultation with the VicForests Board. As an amount for a final dividend was not finalised by the reporting date, VicForests has not made provision for a dividend in its 2004-05 financial statements.

VicForests is not subject to CSOs.

¹ The Department of Sustainability and Environment retains responsibility for the stewardship (policy and regulation) of Victorian State forests.

² Under AASB 1037, SGARAs are reported at their net market value. VicForests determines net market value by calculating the net present value of future cash flows it expects to realise from the timber. Increments and decrements to SGARAs resulting from market value movements are recognised directly in the statement of financial performance.

VICFORESTS (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05^a</i>
<i>Size</i>						
Total assets	\$m					37
Total revenue	\$m					41
<i>Profitability</i>						
Operating profit before tax	\$'000					13 135
Operating sales margin	%					32.0
Cost recovery	%					147.0
Return on assets	%					36.8
Return on equity	%					36.4
<i>Financial management</i>						
Debt to equity	%					0.0
Debt to total assets	%					0.0
Total liabilities to equity	%					62.9
Interest cover	times					34.9
Current ratio	%					237.0
Leverage ratio	%					0.0
<i>Payments to and from government</i>						
Dividends	\$'000					0
Dividend to equity ratio	%					0.0
Dividend payout ratio	%					0.0
Income tax expense	\$'000					4 937
CSO funding	\$'000					0

^a 2004-05 is the first year that VicForests has been included in this report. Note that VicForests was only in operation for 11 of the 12 months.

Performance indicators before SGARA revaluation 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Profitability</i>						
Operating profit before tax	\$'000					10 985
Return on assets	%					62.0
Return on equity	%					53.7

DPI Forestry of Queensland was established on 1 July 1995, as a commercial business unit within the Queensland Department of Primary Industries and Fisheries. It is responsible for more than 80 per cent of Queensland's domestic timber production. DPI Forestry manages plantation estates that cover 170 000 hectares.

Around 88 per cent (\$1.1 billion) of DPI Forestry's assets are self-generating and regenerating assets (SGARAs). Their value can fluctuate significantly each year, affecting measures of profitability and financial management.¹

In 2004-05, DPI Forestry posted an operating loss of \$4 million, a result which includes a net decrement of \$22 million in the standing value of timber plantations. This is a \$45 million improvement over the previous year's result. However, the operating result before SGARA revaluations decreased by 45 per cent since the previous year because total revenue before SGARA fell marginally. In addition, total expenses increased by \$14 million, due to plantation establishment and fire protection work.

DPI Forestry improved its return on assets and return on equity in 2004-05. Return on assets was positive with positive earnings before interest and tax. However, return on equity remained negative because of the operating loss.

DPI Forestry is subject to dividend and tax-equivalent payments. The dividend payable is declared at a negotiated percentage (currently 50 per cent) of profit from ordinary activities after tax and adjustments for plantation timber valuation increments. As DPI Forestry reported an operating loss in 2004-05, it was not required to make a tax-equivalent payments.²

DPI Forestry was not subject to CSOs over the reporting period.

¹ Under AAS 35, SGARAs are reported at their net market value. DPI Forestry determines net market value by calculating the net present value of future cash flows it expects to realise from the timber. Increments and decrements to SGARAs resulting from market value movements are recognised directly in the statement of financial performance.

² The payment has been deferred because of timing differences. The provision for deferred income tax has not been brought to account in the annual reports since it is considered unlikely that any taxation will occur in the foreseeable future.

DPI FORESTRY (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02^a</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m		1 087	1 352	1 294	1 289
Total revenue	\$m		187	361	26	85
<i>Profitability</i>						
Operating profit before tax	\$'000		110 630	285 348	- 48 832	- 4 039
Operating sales margin	%		61.6	80.3	- 195.9	6.0
Cost recovery	%		260.5	508.3	33.3	106.2
Return on assets	%		10.6	23.8	- 3.3	0.6
Return on equity	%		11.2	25.4	- 4.0	- 0.3
<i>Financial management</i>						
Debt to equity	%		7.7	6.1	6.4	6.4
Debt to total assets	%		7.0	6.3	5.8	5.9
Total liabilities to equity	%		9.7	7.9	8.5	8.1
Interest cover	times		24.6	61.8	- 9.4	0.6
Current ratio	%		276.9	251.9	290.3	344.5
Leverage ratio	%		109.7	107.9	108.5	108.1
<i>Payments to and from government</i>						
Dividends	\$'000		10 979	24 795 ^b	16 065	8 618
Dividend to equity ratio	%		1.1	2.2	1.3	0.7
Dividend payout ratio	%		9.9	8.7	- 32.9	- 213.4
Income tax expense	\$'000		0	0	0	0
CSO funding	\$'000		0	0	0	0

^a DPI Forestry, established in 1995, was monitored for the first time in 2001-02. In 2001-02, the application of AASB 1041 led to the revaluation of several non-current assets. ^b Includes dividend payable of \$14.8 million as well as a special dividend of \$10 million. Before the special dividend, the dividend to equity and dividend payout ratios would have been 1.3 per cent and 5.2 per cent respectively.

Performance indicators before SGARA revaluation 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Profitability</i>						
Operating profit before tax	\$'000		26 139	30 160	32 700	17 853
Return on assets	%		2.8	2.9	2.8	2.3
Return on equity	%		2.6	2.7	2.7	1.5

Note: This table has been revised since last year's report to reflect amendments to revenue before the unrealised component of SGARA revaluations.

The Forest Products Commission of Western Australia (FPCWA) was established in November 2000 under the *Forest Products Act 2000*. The FPCWA is responsible for the commercial production, allocation and sale of forest products from Western Australia's native forests and state-owned and state-managed plantations. FPCWA manages tree farms in Western Australia, with the land controlled by the public and the private sector.

About 82 per cent (\$327 million) of the FPCWA's assets are self-generating and regenerating assets (SGARAs). Their value can fluctuate significantly each year, affecting measures of profitability and financial management.¹

Under the accounting standards for SGARAs, FPCWA's operating profit before tax fell by \$22 million (102 per cent). In 2004-05, FPCWA's operating position worsened because of a \$497 000 decrement in the standing value of its timber assets, this followed a \$22 million increment in 2003-04.

In contrast, FPCWA's operating profit (pre-tax) before the SGARA revaluation increased by \$890 000 (0.07 per cent), reflecting revenue growth from cost recovery activities and increased grants from the Australian Government.

The FPCWA's return on assets and return on equity has declined over the reporting period, largely because of a reduction in operating profit before tax of \$29 million (190 per cent) and an increase in assets of \$59 million (17 per cent).²

FPCWA is subject to dividend and tax-equivalent payments. No dividend was declared in 2004-05 due to insufficient cash from operations.

FPCWA receives CSO payments for its forest enhancement program. In 2004-05, FPCWA also received funding from the Australian Government in the form of grants for the Nation Action Plan for Salinity and Water Quality.

¹ Under AASB 1037, SGARAs are reported at their net market value. FPCWA determines net market value by calculating the net present value of future cash flows it expects to realise from the timber. Increments and decrements to SGARAs resulting from market value movements are recognised directly in the statement of financial performance.

² Values based on nominal changes in operating profits and assets between 2001-02 and 2004-05.

FOREST PRODUCTS COMMISSION (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02^a</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m		340	360	379	399
Total revenue	\$m		123	122	121	102
<i>Profitability</i>						
Operating profit before tax	\$'000		15 468	20 122	8 630	- 13 319
Operating sales margin	%		17.7	21.6	11.8	- 7.3
Cost recovery	%		121.3	127.6	113.4	91.3
Return on assets	%		6.4	7.6	3.9	- 1.9
Return on equity	%		5.6	5.9	2.3	- 3.5
<i>Financial management</i>						
Debt to equity	%		34.4	29.7	31.8	35.9
Debt to total assets	%		24.2	21.6	22.3	23.5
Total liabilities to equity	%		41.8	41.8	45.9	56.3
Interest cover	times		3.4	4.2	2.5	- 1.2
Current ratio	%		175.4	122.5	112.3	85.4
Leverage ratio	%		141.8	141.8	145.9	156.3
<i>Payments to and from government</i>						
Dividends	\$'000		0	1 557	1 470	0
Dividend to equity ratio	%		0.0	0.6	0.6	0.0
Dividend payout ratio	%		0.0	10.7	24.3	0.0
Income tax expense	\$'000		2 158	5 622	2 592	- 4 399
CSO funding	\$'000		500	1 570	1 300	1 100

^a The Forest Products Commission, established in November 2000, was included in this report for the first time in 2001-02.

Performance indicators before SGARA revaluation 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Profitability</i>						
Operating profit before tax	\$'000		16 693	6 443	- 13 720	- 12 822
Return on assets	%		6.8	3.6	- 2.2	-1.8
Return on equity	%		6.1	0.3	- 6.3	-3.3

The South Australia Forestry Corporation, trading under the name ForestrySA, was incorporated under the *South Australia Forestry Corporation Act 2000*, on 1 January 2001.¹ It is also subject to the provisions of the *Public Corporations Act 1993* and the *Forestry Act 1950*. ForestrySA is responsible for managing over 82 000 hectares of plantation forests. During 2004-05, over 2600 hectares of plantation lands were replanted.

Around 59 per cent (\$609 million) of ForestrySA's assets are self-generating and regenerating assets (SGARAs). Their value can fluctuate significantly each year, affecting measures of profitability and financial management.²

ForestrySA earns almost all its revenue from trading softwood timber products — most of which are utilised by the Australian building industry. In 2004-05, 1.9 million cubic metres of log and pulp products were sold, 61 percent of which were log products. This included over 1.8 million cubic metres harvested from ForestrySA plantations, with the balance from logs harvested by ForestrySA for private forest owners.

Operating profit before tax fell by \$34 million in 2004-05, due to a \$25 million decrement in the market value of ForestrySA's standing timber assets. However, revenue before SGARA revaluation increased by \$4.6 million (3.7 per cent). ForestrySA attributes this revenue growth to stronger than expected timber sales to the housing construction and renovation market.

ForestrySA is subject to dividend and tax-equivalent payments. In 2004-05, the Treasurer determined that a dividend of \$22 million was payable. Of this, \$1.35 million has been provided as a special dividend due to higher than expected earnings in 2003-04.

ForestrySA is funded for the provision of CSOs, including forest industry development, policy and legislative support, community use of forests, native forest management, and community protection (including fire protection).

¹ Prior to the creation of the South Australia Forestry Corporation, its functions were carried out by the ForestrySA business unit within the Department for Administrative and Information Services.

² Under AASB 1037, ForestrySA's SGARAs are reported at their net market value, using current market prices, though pre-commercial stands (younger than 15 years) are valued at historical cost. Increments and decrements to SGARAs resulting from market value movements are recognised directly in the statement of financial performance.

FORESTRY SA (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02^a</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05^b</i>
<i>Size</i>						
Total assets	\$m		842	890	946	1 032
Total revenue	\$m		115	140	139	104
<i>Profitability</i>						
Operating profit before tax	\$'000		38 847	58 858	56 125	22 343
Operating sales margin	%		33.4	41.5	40.1	20.6
Cost recovery	%		149.1	170.1	166.4	125.9
Return on assets	%		4.6	6.8	6.1	2.3
Return on equity	%		3.4	5.6	4.9	0.9
<i>Financial management</i>						
Debt to equity	%		0.0	0.2	0.2	0.5
Debt to total assets	%		0.0	0.2	0.2	0.5
Total liabilities to equity	%		1.8	2.0	2.2	3.5
Interest cover	times		n.r.	1 436.6	476.6	139.8
Current ratio	%		285.3	259.0	255.3	190.4
Leverage ratio	%		101.8	102.0	102.2	103.5
<i>Payments to and from government</i>						
Dividends ^c	\$'000			3 216	27 901	21 666
Dividend to equity ratio	%			0.4	3.3	2.3
Dividend payout ratio	%			11.4	59.0	263.0
Income tax expense	\$'000			10 653	11 593	14 105
CSO funding	\$'000			3 547	3 512	3 600

^a ForestrySA, established on 1 January 2001, was monitored for the first time in 2001-02. ^b Annual report data has been used for 2004-05. ^c Includes special dividend payments of \$7.8 million (2002-03), \$920 000 (2003-04) and \$1.35 million in (2004-05). n.r. Not relevant.

Performance indicators before SGARA revaluation 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Profitability</i>						
Operating profit before tax	\$'000		35 047	37 838	41 369	46 862
Return on assets	%		4.2	4.4	4.5	4.8
Return on equity	%		2.9	3.1	3.2	3.4

Forestry Tasmania was established by the *Forestry Act 1920* and is subject to the *Government Business Enterprises Act 1995*. Forestry Tasmania is responsible for managing around 1.5 million hectares of state forests and plantations. During 2004-05, 5100 hectares of hardwood and softwood plantations were established.

About 32 per cent (\$276.5 million) of Forestry Tasmania's assets are self-generating and regenerating assets (SGARAs). Their value can fluctuate significantly each year, affecting measures of profitability and financial management.¹ In 2004-05 Forestry Tasmania ceased revaluing its native forest assets as SGARAs, as it considered it more appropriate to value them in a similar manner as property, plant and equipment.

In 2004-05, operating profit was influenced by a \$13 million decrement in the market value of Forestry Tasmania's standing timber assets. This follows an increment of \$9 million in 2003-04. Total revenue fell by \$28 million (14 per cent) in 2004-05, with revenue before SGARA decreasing by \$5.7 million (0.03 per cent). Forestry Tasmania attributes the decline in its financial performance to the decline in sales of wood products (particularly pulpwood exports to Japan), increasing domestic costs, and costs associated with its CSOs.

Forestry Tasmania did not receive CSO payments over the reporting period. However, it estimates the cost of meeting these obligations at \$5.6 million for the 2004-05 financial year.²

Forestry Tasmania is subject to dividend and tax-equivalent payments. In 2004-05, Forestry Tasmania paid a dividend of \$5.2 million, a 36 per cent increase on the previous year. The increase in dividends coupled with the decline in operating profit has resulted in the dividend payout ratio increasing from 20 per cent in 2003-04 to 340 per cent in 2004-05.

¹ Under AASB 1037, SGARAs are required to be reported at their net market value. Forestry Tasmania determines net market value by calculating the net present value of cash flows it expects to realise from the timber. Increments and decrements to SGARAs resulting from market value movements are recognised directly in the statement of financial performance.

² Forestry Tasmania does not specify how this figure has been calculated.

FORESTRY TASMANIA (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02 ^b	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m		837	838	874	863
Total revenue	\$m		154	142	201	173
<i>Profitability</i>						
Operating profit before tax	\$'000		7 942	- 5 468	25 803	861
Operating sales margin	%		5.3	- 3.7	13.2	1.0
Cost recovery	%		115.4	96.5	115.2	101.0
Return on assets	%		1.0	- 0.6	3.2	0.3
Return on equity	%		0.9	- 1.6	2.6	0.2
<i>Financial management</i>						
Debt to equity	%		2.0	3.0	3.4	4.6
Debt to total assets	%		1.7	2.5	2.9	3.7
Total liabilities to equity	%		16.2	18.2	20.3	23.9
Interest cover	times		11.5	- 5.6	22.9	1.5
Current ratio	%		138.9	155.5	153.5 ^c	160.9
Leverage ratio	%		116.2	118.2	120.3	123.9
<i>Payments to and from government</i>						
Dividends ^a	\$'000		4 961	0	3 844	5232
Dividend to equity ratio	%		0.7	0.0	0.5	0.7
Dividend payout ratio	%		74.0	0.0	20.3	336.2
Income tax expense	\$'000		1 240	5 765	6 913	- 695
CSO funding	\$'000		0	0	0	0

^a A change in accounting policy to meet the requirements of AASB 1044 meant that no dividend was recognised in 2002-03 (see chapter 3). Forestry Tasmania has proposed a \$4.8 million dividend for 2004-05. The proposed dividend is subject to approval by the Treasurer and the relevant Minister and had not been recognised as a provision as at 30 June 2004-05. ^b Forestry Tasmania, established in 1995, was monitored for the first time in 2001-02. ^c In 2004-05, Forestry Tasmania reclassified some non-current, forest estate assets as current assets for 2003-04. The 2003-04 current ratio has been adjusted to reflect this change.

Performance indicators before SGARA revaluation 2000-01 to 2004-05

	Units	2000-01	2001-02	2002-03	2003-04	2004-05
<i>Profitability</i>						
Operating profit before tax	\$'000		- 1 635	19 909	16 500	13 506
Return on assets	%		- 0.1	2.5	2.1	1.7
Return on equity	%		- 0.4	2.0	1.3	2.0

12 Australian Government GTEs

Three Australian Government trading enterprises (GTEs) are covered in this chapter — Airservices Australia, Australia Post and Telstra. These GTEs vary significantly in size and in the range of services that they provide.

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

Airservices Australia (ASA) was established in July 1995 under the *Air Services Act 1995*, and is responsible for providing and managing Australia's air navigation and air traffic services infrastructure. In April 2004 the commercial activities and regulatory functions of ASA were separated.¹ It is proposed that the regulatory functions will ultimately be transferred to an airspace directorate within the Department of Transport and Regional Services (DOTARS).

On 1 January 2005, ASA commenced pricing en route and terminal air traffic control services under its five-year pricing agreement. These charges vary with maximum take-off weight of the aircraft, the time services are used and where the aerodrome is located.

In 2004-05, ASA's total assets increased by almost \$56 million (10 per cent). This was largely the result of a \$65 million (140 per cent) increase in the assets under construction. Total liabilities increased by \$28 million (8.0 per cent). As growth in assets was less than the growth in total equity, the leverage ratio fell to 275 per cent in 2004-05 from 285 per cent in 2003-04.

Operating profit before tax increased by around \$14 million in 2004-05. ASA's operating profit (pre-tax) continues to be driven by growth in airways revenue, which increased by \$77 million (14 per cent) in 2004-05. However, operating expenses also increased by \$62 million (11 per cent) in 2004-05, primarily due to growth in expenses for staffing.

ASA is subject to dividend and income tax payments. ASA made dividend payments totalling \$30 million in 2004-05. These consisted of an interim dividend of \$13 million for 2004-05 and a final dividend of \$17 million for 2003-04. The marginal decrease from the 2003-04 dividend payment reflected the impact of ASA recognising its 2002-03 interim dividend in July 2003.

Since 2000-01, ASA has received CSO payments of \$7 million per year to cap prices at regional and general aviation airports.² This CSO payment arrangement expired on 30 June 2005. These payments will cease as the policy of capping prices has been discontinued.

¹ On 1 July 2004, a separate unit was established within ASA to provide its regulatory services, such as strategic airspace planning for Australian administered airspace.

² ASA also internally funds a number of other non-commercial community service activities, including an environmental information (maps, reports and statistics) gathering service, as well as aircraft noise and flight path monitoring.

AIRSERVICES AUSTRALIA (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01	2001-02	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	592	585	602	545	601
Total revenue	\$m	583	511	617	615	691
<i>Profitability</i>						
Operating profit before tax	\$'000	86 695	36 118	65 871	68 932	82 548
Operating sales margin	%	15.4	7.3	10.8	11.8	12.6
Cost recovery	%	118.2	107.9	112.1	113.4	114.4
Return on assets	%	15.5	7.2	12.3	13.3	15.5
Return on equity	%	23.2	9.9	13.5	22.3	28.4
<i>Financial management</i>						
Debt to equity	%	40.7	38.8	44.2	52.4	45.7
Debt to total assets	%	16.5	17.0	16.9	17.5	17.5
Total liabilities to equity	%	140.9	126.2	166.1	185.2	174.5
Interest cover	times	13.0	6.7	10.6	10.8	14.1
Current ratio	%	76.5	194.3	135.4	105.9	97.6
Leverage ratio	%	240.9	226.2	266.1	285.2	274.5
<i>Payments to and from government</i>						
Dividends	\$'000	22 100	11 400	14 900	30 600 ^a	30 300
Dividend to equity ratio	%	9.2	4.5	6.1	14.7	14.8
Dividend payout ratio	%	39.5	45.9	45.6	65.7	52.0
Income tax expense	\$'000	30 744	11 269	33 187	22 368	24 313
CSO funding	\$'000	7 000	7 000	7 000	7 000	7 000 ^b

^a An interim dividend (\$11 million) for 2002-03 was not recognised until 2003-04. ^b The CSO payment arrangements expired on 30 June 2005.

Australia Post was established in 1975 and corporatised in 1989 under the *Australian Postal Corporation Act 1989*. Its principal activities are letter delivery, parcel delivery and logistics, third party agency services (receiving payments for company and government services and charges), as well as the sale of postal products and merchandise. Australia Post holds a statutory monopoly for the processing and distribution of letters weighing 250 grams or less, or priced at less than two dollars.

In 2004-05, Australia Post's assets and liabilities increased by \$107 million (3.2 per cent) and \$35 million (1.9 per cent) respectively. The increase in assets was comprised of growth in current assets, particularly cash, and the acquisition of companies to improve its capacity in the parcels and logistics market. Debt to equity declined in 2004-05 from 34 per cent to 29 per cent, with debt levels unchanged and equity increasing by around 18 per cent. The current ratio increased from 112 per cent to 128 per cent.

Revenue growth (3.9 per cent) assisted Australia Post in achieving a record operating profit before tax of \$525 million in 2004-05. Operating profit increased each year throughout the reporting period. In 2004-05, revenue growth was experienced across all Australia Post's core business areas.

Australia Post is subject to all taxes and pays dividends to the Australian Government. In 2004-05, dividend payments increased by \$23 million to \$242 million.

Australia Post is required to internally fund CSOs, which require it to provide letter services that meet (or exceed) specified standards, to all parts of Australia at a uniform price. This obligation has been estimated by Australia Post on an avoidable cost basis to be \$79 million in 2004-05.

Achievement of the prescribed standards — mainly relating to service frequency, on-time delivery and geographical access to postal facilities — is independently audited by Australian National Audit Office. All of the prescribed standards were met or exceeded in 2004-05.

AUSTRALIA POST (continued)

Performance indicators 2000-01 to 2004-05

	<i>Units</i>	<i>2000-01^a</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<i>Size</i>						
Total assets	\$m	3 199	3 229	3 365	3 472	3 762
Total revenue	\$m	3 733	3 758	3 972	4 161	4 324
<i>Profitability</i>						
Operating profit before tax	\$'000	402 100	407 200	462 000	521 100	524 500
Operating sales margin	%	11.2	11.1	11.7	12.7	12.3
Cost recovery	%	112.7	112.4	113.2	114.6	114.0
Return on assets	%	14.0	13.6	14.9	16.2	15.4
Return on equity	%	24.7	26.3	26.9	25.8	22.2
<i>Financial management</i>						
Debt to equity	%	47.5	46.5	40.2	34.0	29.3
Debt to total assets	%	17.0	16.5	16.1	15.5	14.7
Total liabilities to equity	%	186.6	183.3	155.2	122.6	107.4
Interest cover	times	13.1	15.3	16.7	17.2	17.2
Current ratio	%	100.2	108.8	106.7	111.6	127.9
Leverage ratio	%	286.6	283.3	255.2	222.6	207.4
<i>Payments to and from government</i>						
Dividends	\$'000	274 500	291 800	314 000	218 500	241 700
Dividend to equity ratio	%	24.7	25.9	25.5	15.2	14.3
Dividend payout ratio	%	100.0	98.2	94.9	58.9	64.5
Income tax expense	\$'000	127 600	110 200	131 200	150 000	149 600
CSO funding	\$'000	0	0	0	0	0

^a Net abnormal expenses of \$34 million incurred for year 2000 compliance and GST implementation costs.

Telstra Corporation Limited was established in April 1993 and operates under the *Telecommunications Act 1997*. Telstra was first partially privatised in November 1997, when 33 per cent of the Corporation's shares were offered for sale. The second sale of 16 per cent occurred in October 1999. Under the *Telstra Corporation Act 1991*, the Australian Government must own at least 50.1 per cent of Telstra. At 30 June 2005, the Australian Government held 51.8 per cent of Telstra's shares.

Telstra offers a full range of telecommunication services. Most of these services are provided at both a retail level and at a wholesale level to other carriers, carriage service providers and internet service providers.

In 2004-05, Telstra's assets increased by \$1.3 billion (3.8 per cent). Telstra's current ratio increased from 70 per cent to 97 per cent because of growth in current assets of 16 per cent and a decline in current liabilities of 16 per cent.

Operating profit before tax increased by \$421 million (7.2 per cent) in 2004-05. This result was driven by steady growth in revenue, particularly in Telstra's emerging products, such as broadband internet services.

Telstra is subject to all taxes and pays dividends to its shareholders. In 2004-05, Telstra's dividend payments to all shareholders increased by \$945 million (30 per cent) to \$4.1 billion.

Telstra's universal service obligation (USO) requires that standard telephone services, public payphones and prescribed carriage services are reasonably accessible to all people in Australia, including services for the disabled, on an equitable basis, wherever they reside or carry on business. Telstra is also subject to the digital data service obligation (DDSO) whereby it must provide reasonable and equitable access to a digital data service with a data speed broadly equivalent to 64 kbps.¹

Telstra does not receive government funding for the USO or DDSO, though it receives contributions from other carriers for recognised USO costs it incurs on their behalf.²

¹ Telstra fulfils the DDSO through the supply of Integrated Services Digital Network services, to which at least 96 per cent of the Australian population has access, and through the Bigpond satellite one way services for the remainder of the population.

² The Communications Minister determines the net cost of universal service provision, which is then shared among carriers based on the proportion of eligible telecommunications revenue. In

TELSTRA (continued)

Performance indicators 2000-01 to 2004-05

	Units	2000-01 ^a	2001-02	2002-03	2003-04	2004-05
<i>Size</i>						
Total assets	\$m	37 473	38 219	35 599	34 993	36 310
Total revenue	\$m	23 086	20 928	21 700	21 335	22 760
<i>Profitability</i>						
Operating profit before tax	\$'000	6 297 000	5 446 000	4 928 000	5 848 000	6 269 000
Operating sales margin	%	30.2	29.9	26.5	30.8	30.6
Cost recovery	%	143.4	142.6	136.0	144.6	144.1
Return on assets	%	20.8	16.8	15.7	18.7	19.7
Return on equity	%	32.1	26.2	23.0	26.7	29.4
<i>Financial management</i>						
Debt to equity	%	102.0	101.9	81.4	79.8	89.6
Debt to total assets	%	41.3	38.0	34.0	34.7	37.4
Total liabilities to equity	%	173.1	170.9	130.8	127.8	144.0
Interest cover	times	9.2	7.1	6.6	8.6	9.2
Current ratio	%	67.4	77.5	98.7	70.3	96.8
Leverage ratio	%	273.1	270.9	230.8	227.8	244.0
<i>Payments to and from government</i>						
Dividends ^b	\$'000	2 445 000	2 830 000	1 930 000 ^c	3 186 000	4 131 000 ^d
Dividend to equity ratio	%	19.3	20.8	13.1	20.7	27.3
Dividend payout ratio	%	60.2	77.5	56.9	77.4	92.9
Income tax expense	\$'000	2 236 000	1 796 000	1 534 000	1 731 000	1 822 000
CSO funding	\$'000	0	0	0	0	0

^a Includes net unusual revenue of \$600 million, mainly relating to the sale of a global wholesale business, acquisition costs and superannuation adjustments. ^b Only part of Telstra's dividend payments are made to the Government. ^c A special dividend of \$386 million was paid in 2002-03. A change in accounting policy in 2002-03 to meet the requirements of AASB 1044 meant provisions for dividends can no longer be raised at balance date when the dividend is declared after that date (chapter 3). ^d A special dividend of \$747 million was paid in 2004-05.

2004-05, USO costs were set at \$211 million, although Telstra considers that the Australian Government's determination is less than Telstra's actual costs of providing these services.

A Monitored GTEs

Table A.1 **Monitored GTEs — by jurisdiction, 2003-04**

<i>GTE</i>	<i>Sector</i>
New South Wales	
Delta Electricity	Electricity
Macquarie Generation	Electricity
Eraring Energy	Electricity
TransGrid	Electricity
Country Energy	Electricity
Australian Inland	Electricity
EnergyAustralia	Electricity
Integral Energy	Electricity
Hunter Water Corporation	Water
Sydney Water Corporation	Water
Sydney Catchment Authority	Water
State Transit Authority	Urban Transport
Sydney Ferries	Urban Transport
Rail Corporation New South Wales	Railways
Rail Infrastructure Corporation	Railways
Newcastle Port Corporation	Ports
Port Kembla Port Corporation	Ports
Sydney Ports Corporation	Ports
Forests New South Wales	Forestry
Victoria	
Barwon Regional Water Authority	Water
City West Water	Water
Gippsland and Southern Rural Water Authority	Water
Melbourne Water Corporation	Water
South East Water	Water
Yarra Valley Water	Water
Coliban Water	Water
Goulburn Valley Water	Water
Central Gippsland Water	Water
Central Highlands Water	Water

(Continued next page)

Table A.1 (continued)

<i>GTE</i>	<i>Sector</i>
Wimmera Mallee Water	Water
Goulburn–Murray Water	Water
Sunraysia Rural Water	Water
Southern Rural Water	Water
Lower Murray Water	Water
V/line Passenger Corporation	Railways
Port of Melbourne Corporation	Ports
Victorian Regional Channels Authority	Ports
VicForests	Forestry
Queensland	
CS Energy	Electricity
Stanwell Corporation	Electricity
Tarong Energy	Electricity
Enertrade	Electricity
Powerlink	Electricity
Ergon Energy	Electricity
Energex	Electricity
Sunwater	Water
Queensland Rail	Railways
Central Queensland Ports Authority	Ports
Port of Brisbane Corporation	Ports
Cairns Port Authority	Ports
Townsville Port Authority	Ports
Ports Corporation of Queensland	Ports
Mackay Port Authority	Ports
DPI Forestry	Forestry
Western Australia	
Western Power	Electricity
Water Corporation	Water
Public Transport Authority	Railways
Bunbury Port Authority	Ports
Fremantle Port Authority	Ports
Port Hedland Port Authority	Ports
Dampier Port Authority	Ports
Geraldton Port Authority	Ports
Albany Port Authority	Ports
Forest Products Commission	Forestry
South Australia	
SA Water Corporation	Water
TransAdelaide	Urban Transport
ForestrySA	Forestry

(Continued next page)

Table A.1 (continued)

<i>GTE</i>	<i>Sector</i>
Tasmania	
Hydro-Electric Corporation	Electricity
Aurora Energy	Electricity
Transend Networks	Electricity
Hobart Regional Water Authority	Water
Cradle Coast Water	Water
Esk Water Authority	Water
Metro Tasmania Pty Ltd	Urban Transport
Burnie Port Corporation	Ports
Hobart Ports Corporation	Ports
Port of Devonport Corporation	Ports
Port of Launceston Pty Ltd	Ports
Forestry Tasmania	Forestry
Australian Capital Territory	
ACTEW Corporation	Water/Electricity
ACTION Authority	Urban Transport
Northern Territory	
Power and Water Corporation	Electricity/Water
Darwin Port Corporation	Ports
Australian Government	
Snowy Hydro	Electricity
Australian Rail Track Corporation	Railways
Airservices Australia	Other Australian Government
Australia Post	Other Australian Government
Telstra Corporation	Other Australian Government

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