



PUBLIC ACCOUNTS COMMITTEE

**COMMUNITY SERVICE
OBLIGATIONS IN THE
WESTERN AUSTRALIAN
PUBLIC SECTOR**

Report No. 48

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WESTERN AUSTRALIAN
PUBLIC SECTOR**

Report No. 48

Presented by:
Mr Max Trenorden, MLA
Laid on the Table of the Legislative Assembly
on 16 November 2000

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COMMITTEE'S FUNCTIONS AND POWERS

The Committee obtains its powers and functions from the Standing Orders of the Legislative Assembly.¹ Standing Order 299 states that the functions of the Committee are:

. . . to inquire into and report to the Assembly on any proposal, matter or thing it considers necessary, connected with the receipt and expenditure of public moneys, including moneys allocated under the annual Appropriation bills and Loan Fund.

Moreover the Committee is empowered by Standing Order 300 to:

- (1) Examine the financial affairs and accounts of government agencies of the State which includes any statutory board, commission, authority, committee, or trust established or appointed pursuant to any rule, regulation, by-law, order, order in Council, proclamation, ministerial direction or any other like means.
- (2) Inquire into and report to the Assembly on any question which:
 - (a) it deems necessary to investigate;
 - (b) is referred to it by resolution of the Assembly;
 - (c) is referred to it by a Minister; or
 - (d) is referred to it by the Auditor General.
- (3) Consider any papers on public expenditure presented to the Assembly and such of the expenditure as it sees fit to examine.
- (4) Consider whether the objectives of public expenditure are being achieved, or may be achieved more economically.

The Committee is also empowered by Standing Order 264 which states that:

A committee has power to send for persons, papers and records.

¹ On September 7 1999, the Legislative Assembly agreed to Trial Standing Orders that replaced the former Public Accounts and Expenditure Review Committee with the Public Accounts Committee and redefined the Committee's powers and functions. On 21 December 1999, the Trial Standing Orders were adopted as amended and became effective on 1 January 2000.

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CHAIRMAN'S PREFACE

Mr Speaker,

I have for tabling the Public Accounts Committee's Report on *Community Service Obligations in the Western Australian Public Sector*, Report No. 48.

The tabling of this Report is the culmination of a lengthy and complex inquiry. The Committee has taken the best part of two years to examine in detail the Community Service Obligations (CSOs) currently funded by the Government and the associated issues related to the funding and administration of CSOs in the Western Australian public sector.

The Committee decided to undertake this inquiry as a result of concerns with respect to the size of CSO funding in Western Australia and the impact of National Competition Policy on the delivery of services and basic infrastructure. As a consequence, the Committee examined the application of CSOs across the public sector, in particular those of the Water Corporation, Western Power, Westrail and LandCorp, together with the avenues available for the public to approach Government with a view to influencing or encouraging the provision of new or additional CSOs.

The size and growing importance of CSOs in Western Australia has resulted not from any specific government policy: rather it has evolved over time. As a consequence, the need for an agency-wide system to ensure adequate and consistent management has become apparent.

In this report, the Committee has made a number of recommendations that are aimed at ensuring greater consistency and transparency in the provision of CSO funding. In particular, the Committee has recommended a broadening of the definition of a CSO to include provision of all goods and services as a public service, whether provided by a public or private entity.

The Committee received submissions from a number of regional groups, including local government, who strongly argued for, and expressed the need, to define, manage and participate in the provision of CSOs, as they are considered to be critical for maintaining the viability of regional communities.

The Committee has also recommended that an independent body be established to arbitrate disputes relating to CSOs and to oversee the provision, funding and monitoring of CSOs across all agencies. As CSOs are a substantial social and regional issue in Western Australia the Committee has recommended that regional groups be included in the policy-making process relating to the provision of CSOs in regional areas.

The reporting of CSOs in the Budget Papers was another area that the Committee considered could be improved upon by the provision of a consolidated CSO figure and a breakdown by agency of each of their CSOs.

A detailed examination of the CSOs received by the Water Corporation, Western Power, Westrail and LandCorp (Chapters 4, 5, 6 and 7 respectively) highlighted the existence of inconsistencies between the agencies in the receipt of CSOs for the provision of essentially similar services and in the way in which CSOs are reported. The recommendations made by the Committee in these chapters are aimed at providing consistency in the way in which CSOs are treated by these agencies.

In conclusion, the Committee believes that as CSOs represent a relatively substantial proportion of Government expenditure and an extremely important source of funds for the provision of essential services to many regional areas, an increase in transparency and consistency across all providers of CSOs will only serve to improve the provision of these services.

I would like to extend my appreciation to the Members of the Committee for their contribution throughout this long inquiry. Finally, I would also like to thank the Committee's staff for their contribution to this report, in particular Senior Research Officer, Dr Janet Preuss and Research Officer, Ms Amanda Millsom-May, and former Senior Research Officer, Mr Andrew Young and former Research Officer, Ms Kirsten Robinson. I would also like to acknowledge Mr Brendan Carvalho, who was seconded from the Office of the Auditor General in 1998, for his substantial research contribution in the early phases of this inquiry.

MAX TRENORDEN, MLA
CHAIRMAN

ABBREVIATIONS AND ACRONYMS

ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
ARG	Australian Railroad Group
CF	Consolidated Fund
CN	Competitive Neutrality
CoAG	Council of Australian Governments
CPA	Competition Principles Agreement
CSO	Community Service Obligation
DCT	Department of Commerce and Trade
GBD	Government Business Division
GBE	Government Business Enterprise
GSRL	Great Southern Railways Ltd
GST	Goods and Services Tax
GTE	Government Trading Enterprise
GWh	GigaWatt hour
kWh	kiloWatt hour
NCC	National Competition Council
NCP	National Competition Policy
NSW	New South Wales
NT	Northern Territory
NWIS	North West Interconnected System
OWR	Office of Water Regulation
PAC	Public Accounts Committee
QLD	Queensland

RDC	Regional Development Council
SA	South Australia
SCI	Statement of Corporate Intent
SCNPMGTE	Steering Committee on National Performance Monitoring of Government Trading Enterprises.
SDP	Strategic Development Plan
SECWA	State Electricity Commission of Western Australia
SWIS	South West Interconnected System
TAS	Tasmania
TER	Tax Equivalent Regime
TPA	Trade Practices Act
WA	Western Australia
WAMA	Western Australian Municipal Association
WAWA	Water Authority of Western Australia
WWTP	Wastewater Treatment Plant
VIC	Victoria

SUMMARY OF FINDINGS

Finding 1

The current Treasury CSO definition does not include subsidies that are provided to the private sector for goods or services that would be called a CSO if provided by a public sector entity.

Finding 2

There is little consistency among different Government agencies in the approach to the provision of, funding for, or monitoring of CSOs.

Finding 3

Regional groups consider that they are largely excluded from the policy-making process relating to the provision of CSOs in regional areas.

Finding 4

There is currently no means to monitor CSOs or to arbitrate disputes relating to CSOs.

Finding 5

There is currently no provision in the annual Budget Papers for a dedicated and consolidated CSO figure.

Finding 6

There is currently no means by which the public can identify the need for a CSO.

Finding 7

The Office of Water Regulation receives insufficient data from the Water Corporation to make the required level of decision making.

Finding 8

Through provisions in the *Water Services Coordination Act 1995*, the Water Corporation has an advantage over other water service providers.

Finding 9

While the treatment of Western Power's supply charge rebates as CSOs is consistent with those of the Water Corporation, there is an inconsistency in the way the two Corporations are treated in relation to administration costs.

Finding 10

It appears from the definition of CSOs that the concession provided by Western Power to eligible voluntary and charitable organisations should be treated as a CSO. Moreover, the Water Corporation receives a CSO for a similar arrangement.

Finding 11

Western Power's regional losses are not regarded as a CSO despite the fact that Western Power is required under its legislation to operate in a commercial manner, yet at the same time, it is required to carry out the Government's Uniform Tariff Policy.

Finding 12

Westrail does not disaggregate the fares received from country passenger services to ascertain that received by pensioners or other groups from country passenger services.

Finding 13

Westrail currently has no means with which to verify the amount claimed by Great Southern Railways Ltd for pensioners travelling on the Indian Pacific service.

Finding 14

CSO payments figures to Westrail disclosed in the Budget Papers also include the value of land sales revenue credited to the Consolidated Fund.

Finding 15

The amount of LandCorp's CSOs is not easily determined from the annual Budget Papers without referring to other agencies (if known).

SUMMARY OF RECOMMENDATIONS

Recommendation 1

That the Treasury definition of a CSO be broadened to include the provision of all goods and services as a public service, whether provided by a public or private entity.

Recommendation 2

- (a) That the new definition for a CSO (refer to Recommendation 1) be applied uniformly across all Government agencies.**
- (b) As there is currently no independent body that can arbitrate disputes relating to CSOs, a Committee comprising the Under Treasurer and other independent representatives (not the Auditor General) should be established to oversee CSOs provided by all agencies to ensure consistency in the provision, funding and monitoring of all CSOs. It is envisaged that this Committee should initially establish consistency across all agencies and then meet on an annual basis to monitor the application of formulas for the identification of CSOs by agencies.**

Recommendation 3

That regional groups, particularly local government, be included in the policy-making process relating to the provision of CSOs in regional areas.

Recommendation 4

That the proposed portfolio-based Committees, to be established in the Legislative Assembly in 2001, have the role of monitoring the CSOs provided to government agencies under their respective portfolios on a regular basis, including following up on complaints from the public and from the agencies themselves, with the ability to refer matters to the CSO Committee, as necessary for arbitration.

Recommendation 5

That a separate CSO section be included in the Budget Papers, which will provide:

- (a) a consolidated CSO figure; and**
- (b) a breakdown by agency of their previous actual figures and forward estimates for every CSO involved.**

Recommendation 6

That members of the public who have identified the need for a CSO be provided with the opportunity to present their case to the CSO Committee (as proposed under Recommendation 2) and/or portfolio-based Legislative Assembly Standing Committees (Recommendation 4).

Recommendation 7

That the Water Corporation:

- (a) develop and put in place systems to generate and evaluate data relating to CSOs; and**
- (b) provide reliable data to the Office of Water Regulation in a timely and efficient manner.**

Recommendation 8

That, in order to ensure consistency across the water industry, amendments be made to the *Water Services Coordination Act 1995* that require the Water Corporation to provide the same information as all other water service providers.

Recommendation 9

That consistency across all government agencies be established with respect to the way that CSOs are treated.

Recommendation 10

That Western Power receive a CSO for its community service concessions.

Recommendation 11

That the supply of power by Western Power to its isolated supply systems be classed as a CSO.

Recommendation 12

That Westrail separately identify and disclose the pensioner concessions on country passenger services as they do with the Indian Pacific and in the same manner as currently adopted by the Water Corporation and Western Power.

Recommendation 13

That a process be developed that enables the verification of the amount claimed by Great Southern Railways Ltd with regard to the Indian Pacific service.

Recommendation 14

That for reasons of transparency, the Budget revenue from land sales be separately disclosed so as to more accurately reflect Westrail's CSO payment figures.

Recommendation 15

That LandCorp's CSOs be both consolidated and clearly identifiable (i.e. source of agency) in the Budget Papers, in line with the Committee's Recommendation 5.

MINISTERIAL RESPONSE

Standing Order 277 (1) of the Standing Orders of the Legislative Assembly states that:

A report may include a direction that a Minister in the Assembly is required within not more than three months, or at the earliest opportunity after that time if the Assembly is adjourned or in recess, to report to the Assembly as to the action, if any, proposed to be taken by the Government with respect to the recommendations of the Committee.

Accordingly, the Public Accounts Committee (PAC) directs that the Premier and Treasurer, the Minister for Water Resources, the Minister for Energy, the Minister representing the Minister for Transport and the Minister for Lands respond to the Committee's recommendations.

CHAPTER ONE

INTRODUCTION

BACKGROUND TO THE INQUIRY

The PAC (“the Committee”) decided to undertake this inquiry for a number of reasons. Of principle concern was the size of Community Service Obligation (CSO) funding in Western Australia (WA), the impact of National Competition Policy (NCP) on the delivery of services and basic infrastructure and concerns about how CSOs are applied. The Committee was also interested in examining the opportunities that are available for consumers to approach government in order to influence or encourage the provision of new or additional CSO services or concessions.

In light of recent moves toward the privatisation of public sector service providers and the implementation of NCP, concerns over the future of CSOs have understandably arisen. The Committee considers that nowhere are these issues more critical than in regional WA. CSOs have a major impact on regional users of infrastructure services and also play an important role in ensuring essential services are provided to regional and remote communities.

TERMS OF REFERENCE

The terms of reference for this inquiry were adopted by the Committee on 8 April 1998 and stated that the Public Accounts and Expenditure Review Committee (now the PAC) would examine and report on the funding and administration of CSOs in the Western Australian public sector.

INQUIRY OBJECTIVES

The objectives associated with this inquiry include:

- To determine how CSOs are identified and by whom.
- To determine how CSOs are administered.
- To determine the adequacy of current costing and funding models.
- To determine the level of monitoring and compliance of CSOs.
- To improve the ability of Parliament to scrutinise and review CSOs.
- To determine whether the current structures are consistent with competition policy and the future impact of competition policy.

SCOPE

The Committee's inquiry has had a public sector-wide focus, and included, but was not limited to, examining three agencies that receive CSO funding in Western Australia:

- Water Corporation;
- Westrail; and
- Western Power.

During the course of the inquiry, it was discovered that the Western Australian Land Authority (LandCorp) also received significant levels of CSO funding and it was therefore decided to include this agency in the inquiry. A detailed examination of each of these agencies is undertaken in later chapters of this report.

PUBLIC HEARINGS

The Committee held a day of hearings early in the inquiry in which a total of 16 witnesses from six organisations gave evidence. A further series of hearings was held towards the end of the inquiry to ascertain whether significant changes had occurred in the interim. At these hearings, 16 witnesses from six organisations gave evidence. A list of all the witnesses is provided in Appendix 1.

SUBMISSIONS

The Committee advertised widely and received written submissions from a range of organisations (Appendix 2).

CHAPTER TWO

COMMUNITY SERVICE OBLIGATIONS

BACKGROUND

Following the implementation of NCP and recommendations made by the Council of Australian Governments (CoAG), government agencies were required to put into place mechanisms by which to operate to ensure compliance with these policies.

The size and growing importance of CSOs in Western Australia has resulted not from any specific Government policy: rather it has evolved over time. As a result, CSOs funded by government have now reached the stage whereby an agency-wide system needs to be implemented to provide adequate and consistent management of them.

DEFINITION OF CSOs

The Steering Committee on National Performance Monitoring of Government Trading Enterprises (SNPMGTE) was established in 1994 to develop and publish measures of the financial and non-financial performance of major Government Business Enterprises (GBEs) in a range of core industries. Comprised of representatives of all Australian Governments, the SCNPMGTE was chaired by the Chairman of the Industry Commission.

The accuracy and comparability of the financial and non-financial performance measures depends on the consistency in the governments' definition, costing and funding of CSOs. To this end, the SCNPMGTE developed a preferred definition for CSOs:

A CSO arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis, and which the government does not require other businesses in the public or private sectors to generally undertake, or which it would only do commercially at higher prices.²

Importantly, a CSO arises only as a result of a directive or request by government, in the absence of which, the activity would not otherwise be performed. Thus, under this definition, commercial discounts to stimulate demand are not CSOs, nor are regulatory requirements impacting on both public and private sectors (such as environmental controls and occupational health and safety standards).³ A flow chart illustrating the methodology used to determine whether an activity is a CSO or not is presented in Appendix 3.

Some of the activities that meet the definition of CSOs include:

- Government-imposed welfare objectives through the provision of price concessions or services provided to a particular group of users, e.g. concessions provided to disadvantaged groups that have no commercial basis.

² SCNPMGTE (Steering Committee on National Performance Monitoring of Government Trading Enterprises) 1994, *Community Service Obligations: Some Definitional, Costing and Funding Issues*, Industry Commission, Belconnen.

³ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 3.

- Government requirements for the provision of some form of industry assistance, e.g. providing subsidised services to private companies which are not otherwise commercially justifiable.
- The losses incurred by a government trading enterprise (GTE) as a result of a Government directive for the provision of a service at a uniform price, regardless of factors such as geographical location, that make the cost of providing this service greater than the price which can be charged.⁴

In Western Australia, application of CSO policy across Government continues to evolve. Whilst the Water Corporation receives a CSO for country losses, the Western Power Corporation does not.⁵ However, this is expected to change in regional areas as the most efficient method of delivering electricity services is identified.

The definition currently in use refers to activities carried out by public enterprises. In effect, at this stage, only corporatised or commercialised utilities have identified CSOs.

The Committee believes that the definition currently used in relation to CSOs lacks consistency, clarity and scope. For example, the issue of subsidies provided to both the public and private sectors for the supply of non-commercial goods and services is one area that falls outside the widely accepted definition of a CSO developed by the SCNPMGTE.

SUBSIDIES

The difference between a CSO and a subsidy has contributed to some confusion relating to the provision of goods and services by public and private enterprises.

In supplementary information provided to the Committee, Treasury defined a subsidy as follows:

A subsidy is a broad generic term, which is capable of encompassing CSOs and payments to the private sector. Therefore, a subsidy can be defined as a payment from Government to a private or public sector entity for the provision of a good or service, for which revenue collected through pricing does not meet the full cost of providing the good or service.⁶

Furthermore, in evidence to the Committee, Treasury stated that:

Depending on the nature of the business, [external funding] may be provided in another way. It may be provided in the form of a subsidy . . . The CSO is meant to be a payment to a trading enterprise; that is, a government entity which has among its remit a commercial focus for its operations. To say that a CSO is to be given to a private entity confuses the concept. A private entity is asked to provide a service, and that service would be funded by contractual arrangement [i.e. a subsidy]. The contractual agreement would obviously be for a period of time, and it would be a direct payment from the Government to the entity. It is comparable because the trading enterprise could be asked to do it, but it is not a community service obligation in the way we are seeking to define it as relating simply to the trading enterprise. That is in the nature of a contractual payment to a private operator. We draw that distinction. The distinction is in the ownership.⁷

⁴ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 3.

⁵ Refer to Appendices 8 and 9 for a comparison of Government agencies.

⁶ Supplementary Information provided in correspondence from the Under Treasurer, Mr John Langoulant, Treasury Department, to the Chairman of the PAC, Mr Max Trenorden, MLA, 24 July 2000.

⁷ Transcript of Evidence, 4 July 2000, p. 4.

An example of an activity that is not within the scope of the CSO definition in Western Australia is the urban passenger railway services provided by Westrail under a formal arrangement with the Department of Transport. Funding is provided to the Department as part of its budgetary allocation for urban public transport. Of concern here, is that there is not the same level of specific reporting to Parliament on the urban passenger railway service as there is for CSOs performed by public enterprise agencies: rather, it is captured as part of the broader Budget process. The payments to Westrail for urban transport paid via the Department of Transport program budgets are therefore not included in the definition of a CSO and are thus less open to Parliamentary scrutiny.

The current definition refers to a CSO being an activity that the Government specifically requires a public enterprise to undertake. The Committee believes that some form of written Ministerial direction to provide the CSO satisfies the definition. In addition, the Committee has noted that no specific direction has been given for the responsibilities that the enterprise inherits and continues to provide. More attention tends to be paid to new or additional CSOs.

The Committee is therefore of the view that the definition for CSOs should be amended to include a broader perspective of CSOs and include contracts that a budget agency makes for public service, whether they be provided by Government or the private sector.

Finding 1

The current Treasury CSO definition does not include subsidies that are provided to the private sector for goods or services that would be called a CSO if provided by a public sector entity.

Recommendation 1

That the Treasury definition of a CSO be broadened to include the provision of all goods and services as a public service, whether provided by a public or private entity.

APPLICATION OF THE DEFINITION

The decision to provide CSO funding to an agency or GTE should be based on the social or economic circumstances under which the goods or services are provided.

The question that must be resolved is whether there are issues of effectiveness and efficiency related to the application of the definition. The implications for the State's finances that warrant examination of the consistency of application of CSO policy include:

- government is typically the sole or major shareholder of the enterprise;

- where government is promoting competition in the industry, only the profitable segments of the market will be targeted by the competitors (“cherry picking”);
- the loss of profitable areas by the enterprise whilst maintaining service to loss-making areas will diminish the profitability of the enterprise and therefore diminish its viability and dividend return to the people; and
- the enterprise may opt out of providing a service to loss-making areas.

To this end, the Committee believes that a CSO Committee should be established to provide consistency across all government agencies in the establishment and regulation of CSOs.

Finding 2

There is little consistency among different Government agencies in the approach to the provision of, funding for, or monitoring of CSOs.

Recommendation 2

- (a) That the new definition for a CSO (refer to Recommendation 1) be applied uniformly across all Government agencies.**
- (b) As there is currently no independent body that can arbitrate disputes relating to CSOs, a Committee comprising the Under Treasurer and other independent representatives (not the Auditor General) should be established to oversee CSOs provided by all agencies to ensure consistency in the provision, funding and monitoring of all CSOs. It is envisaged that this Committee should initially establish consistency across all agencies and then meet on an annual basis to monitor the application of formulas for the identification of CSOs by agencies.**

NATIONAL COMPETITION POLICY

On face value, one may consider that CSOs, or the idea of the Government financially supporting non-profitable activities of GTEs, is inconsistent with NCP. It should be noted, however, that:

The national competition policy reforms are not intended to reduce the commitment of governments to effective delivery of CSOs. On the contrary, they will facilitate a more careful and systematic consideration of the identification and implementation of these requirements.⁸

⁸ Industry Commission. *Community Service Obligations: Policies and Practices of Australian Governments*. Information Paper, February 1997, p. 1.

Primarily, NCP has sought to address the declining performance of the Australian economy, attributed largely to the protective nature of the marketplace. In 1992, the Council of Australian Governments (CoAG) established an independent committee of inquiry into a NCP with the aim of addressing problems that may arise from a fragmented State-by-State approach to reform.⁹

The Western Australian Government, along with each of the other Australian States, is a signatory to NCP, which comprises three intergovernmental agreements:

1. Conduct Code Agreement.
2. Competition Principles Agreement.
3. Agreement to Implement the National Competition Policy and Related Reforms.

In addition, the *Competition Policy Reform Act 1995* established two institutions – the Australian Competition and Consumer Commission (ACCC) and the National Competition Council (NCC). The ACCC is principally involved with enforcement of the *Trade Practices Act 1974* (TPA), whereas the NCC has the key role of monitoring and advising the Commonwealth on the progress of NCP reforms.

The aim of NCP is to encourage greater competition, particularly in markets where little competition has existed and to create incentives for improved economic performance through higher productivity, lower prices and improved quality. The Competition Principles Agreement (CPA) sets out, among other things:

- principles for prices oversight of government businesses;
- reform of public monopolies and competitive neutrality; while also
- detailing matters of ‘public interest’ that require consideration when measuring the costs and benefits of a potential course of action.¹⁰

An integral component of the CPA is the principle of Competitive Neutrality (CN), which states that:

The objective of competitive neutrality policy is the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership.¹¹

Under NCP, the notion of CN is designed to neutralise any net competitive advantage a government business enterprise (GBE) may have over private sector enterprises, simply by virtue of government ownership or activity.¹² Each State is free to determine its own arrangements for carrying out CN principles and in this respect Western Australia uses methods such as commercialisation and corporatisation, along with the compulsory Tax Equivalent Regime (TER).¹³

⁹ Hilmer, F., Rayner, M. and Taperell, G. (1993). *The Independent Committee of Inquiry into a National Competition Policy*, National Competition Policy, AGPS, Canberra.

¹⁰ Productivity Commission Inquiry Report No. 8, *Impact of Competition Policy Reforms on Rural and Regional Australia*, September 1999, p. 71.

¹¹ Government of Western Australia, *Policy Statement of Competitive Neutrality*, June 1996.

¹² Productivity Commission Inquiry, Report No. 8, op. cit., p. 85.

¹³ Refer to Chapter 3 of this report.

It should also be noted that whilst the Western Australian Government is a signatory to NCP agreements to reform electricity and water markets, rail reforms fall outside the framework of NCP.¹⁴

The purpose of NCP could thus be summarised as a means to facilitate effective competition in the interests of efficiency and economic growth while dealing with social objectives and concerns about potential market failure. It is not about pursuing competition for its own sake, but rather for the community benefits it can generate.

SOCIAL AND REGIONAL CONCERNS

In Western Australia, CSOs are a substantial social and regional issue. That is, apart from pensioner concessions on power and water, the bulk of CSOs are designed to alleviate the higher cost of goods and services in regional or remote areas. The Committee received a number of submissions from regional groups concerned that the current trends toward corporatisation and privatisation may affect the future funding of these initiatives.

The Regional Development Council (RDC)¹⁵ is one such organisation with concerns over the future of CSOs. In a submission to the Committee, the RDC made the point that:

Access to essential services such as power, water and transport plays a pivotal role in regional development [and] the presence or lack of [such] infrastructure affects community cohesion and the retaining and attracting of business and households into regional areas.¹⁶

Traditionally, governments have been the supplier of services. The Committee, however, found that there was a difference between how government agencies interpret their legislative requirements to act in a commercial manner, as against the provision of services that may not be commercially prudent. Consequently, the evaluation of CSOs has often been misinterpreted, resulting in unrealistic expectations of government agencies to achieve maximum commercial outcomes.

Increased competition in the provision of services to regional areas is of concern to both the users and the government agencies that currently supply to these areas. Of principal concern for the government agencies is that competing companies may “cherry pick” the profitable areas, leaving the non-profitable areas for the government agencies. This would ultimately reduce the capacity of the government agencies to remain profitable and to continue to provide services to the non-profitable regions. The regional users in turn, are fearful that they may see a reduction in the quality and quantity of services provided to them.

As part of its inquiry into the impact of competition policy reforms on rural and regional Australia, the Productivity Commission recognised the stabilising effect of services provided to regional communities and the important role these services have in maintaining the viability of such communities.¹⁷

¹⁴ Submission from the Goldfields Esperance Development Commission (GEDC) to the PAC, 17 March 2000.

¹⁵ The State Government’s peak advisory body on regional development issues.

¹⁶ Regional Development Council, *Submission to Public Accounts Committee Inquiry into CSOs in the WA Public Sector*, May 2000, p. 4.

¹⁷ Productivity Commission Inquiry, Report No. 8, op. cit., p. 355.

Regional Development Policy

The development of a regional development policy for Western Australia has acknowledged the need for the ongoing development of regional Western Australia and the development of productive partnerships between communities, industry and government.

The policy, endorsed by the State Government in May 2000, was formulated through the RDC and the Department of Commerce and Trade (DCT) and was overseen by a Policy Steering Committee comprising various Government agencies. The value of regional development was particularly recognised, which can be best illustrated by the following extract:

Regional residents should expect that the Government will make provision for service delivery in accordance with their particular needs. Regional Development efforts require that . . . residents living in regional Western Australia have access to the range of services and facilities needed to maintain and enhance their quality of life . . . The State's ability to develop its potential in economic and social terms is dependent on regional development.¹⁸

Moreover, the issue of CSOs was raised in the context of the development of regional development goals, objectives and strategies. Under the goal of *Developing Wealth and Employment*, one of the objectives listed was to minimise the regional cost of living through a range of strategies, including the implementation of transparent CSOs and support for essential services. This particular strategy recognised that:

A number of government agencies provide essential services to domestic customers and small business that are supported by community service obligations or internal subsidies. Consideration will be given to providing the equivalent of community service obligations support to non-government providers. Where essential services are supported by a community service obligation, this will be individually reported upon in a transparent manner.¹⁹

The Committee understands from informal discussions with the DCT that underpinning the issue of the provision of CSO support to non-government providers, was the belief by some, that in light of NCP, consideration should be given to supporting non-government providers, particularly in the water industry, in servicing the market at competitive prices by way of the equivalent to a CSO, i.e. a subsidy.

On the issue of transparency, some regional groups had expressed concerns during the policy development consultation phase over their inability, due to confidentiality restrictions, to access information from utilities regarding CSOs. In their opinion, information should be readily available that would enable them to make comparisons on a region-by-region and locality-by-locality basis.

The issue concerning the role of local government and regional development commissions was also considered in the development of regional development goals, objectives and strategies as part of the policy. Under the goal of *Responsive Government*, one of the objectives listed was to improve whole-of-government arrangements through the following two strategies:

1. Recognise the significant role of Local Government in community and regional development and undertake joint action to enhance that role.
2. Enhance the role of Regional Development Commissions to facilitate whole-of-government planning and decision making.

¹⁸ Western Australia, Department of Commerce and Trade. *A Regional Development Policy for Western Australia*, March 2000, p. 4.

¹⁹ *ibid.*, p. 22.

It was envisaged that ‘opportunities to enhance roles for Local Government in regional development will be jointly identified with State Government agencies. This includes partnering with Regional Development Commissions and other agencies to formulate and implement region-wide and local strategies and action plans’.²⁰

Submissions - Summary of Issues

One common thread running through the submissions received by the Committee from regional groups was that policy decisions relating to regional areas rarely involve the key stakeholders in regional issues. The major issues raised by various agencies included:

- If CSOs are viewed in isolation to other approaches,²¹ the longevity of reforms (e.g. public monopoly reforms and privatisation) may not be achieved.²²
- CSOs, particularly relating to those services provided by the Water Corporation, Western Power and Westrail, are fundamental to the economic and social development of regional communities in the Wheatbelt region.²³
- ‘CSOs do not acknowledge the inherent natural, economic and social differences between regions.’²⁴
- ‘. . . Regional Development Commissions are extremely well placed to be consulted and to provide detailed input into CSOs that will benefit regional communities.’²⁵
- On the issue of water, the Goldfields Esperance Development Commission’s main concern is more over supply than actual price. Until alternative sources of supply are developed, the importance of retaining CSOs such as that for the Water Corporation cannot be emphasised strongly enough.²⁶
- There should be a stronger role for the regional development commissions on behalf of government in determining how CSOs are identified and by whom.²⁷
- ‘The contestable market for electricity and gas supply is gradually increasing . . . [therefore,] the need to provide CSO funding in a deregulated market will be necessary in some cases, and the mechanism for this to happen should be addressed as soon as possible.’²⁸
- A comprehensive CSO policy framework is needed to outline broad guidelines that will apply where Government seeks to have a commercial business (public or private sector) deliver “non-commercial” products and services to the community.²⁹

²⁰ Western Australia, Department of Commerce and Trade. *A Regional Development Policy for Western Australia*, March 2000, p. 34.

²¹ Such as: legislation; the interests of consumers; equity of concerns (including CSOs); regional economic development and employment impacts; and competitiveness of regional businesses.

²² Wheatbelt Region Development Commission. Submission to the PAC, 31 March 2000.

²³ *ibid.*

²⁴ *ibid.*

²⁵ Peel Development Commission. Submission to the PAC, 20 March 2000.

²⁶ Goldfields Esperance Development Commission. Submission to the PAC, 17 March 2000.

²⁷ South West Development Commission. Submission to the PAC, 27 March, 2000.

²⁸ *ibid.*

²⁹ National Party of Australia – WA Incorporated. Submission to the PAC, 12 May 2000.

- ‘The approach to CSOs must expressly incorporate a recognition of community expectations and the achievement of social goals on an equal footing to relevant financial and administrative considerations’.³⁰

Quality of life is obviously of great concern to those in regional areas, in particular the ability to maintain a standard of living that people in urban areas may take for granted. The Senate Select Committee on the Socio-Economic Consequences of NCP recently concluded that communities on the whole are demanding that governments pay greater attention to the intangible costs of policy changes.³¹

Clearly, there remains anxiety over the future of CSOs in relation to the potential for corporatisation and privatisation and in particular how this will affect the social cohesion of regional communities that are especially susceptible to policy changes in the area of CSOs.

The Committee expects that the implementation of the Regional Development Policy strategies related to CSOs will to some extent alleviate some of the concerns raised by regional groups by providing clearer guidance and greater transparency of information. However, there should also be an imperative that regional groups be involved in the specific policy-making process relating to the provision of CSOs in regional areas.

Despite a number of regional groups stating that little or no consultation occurred with respect to CSOs, the Water Corporation and Westrail, when questioned by the Committee, asserted that extensive public consultation did occur. The Water Corporation stated that:

There is considerable public consultation associated with the provision of many CSO projects. This consultation helps to determine the type and level of service that is to be provided, the preferred service delivery options and the timing and priority of projects. This usually includes all local or regional groups with an interest in a project.

. . . Regional groups have the opportunity to approach the Minister for Water Resources, their local member or the Water Corporation to initiate consideration of the provision of any new or improved Water Corporation service.³²

Similarly, Westrail stated that:

We consult extensively with regional groups, particularly shire councils and ticketing agents, on any request for variations, deletions or additions to services prior to the finalisation of passenger timetables.³³

Conversely, Western Power does not undertake consultation with the public for reasons arising from Treasury’s definition of a CSO:

A key element of the definition is that a CSO arises only as a result of a directive or request by Government; it cannot derive from any other source.

³⁰ National Party of Australia – WA Incorporated. Submission to the PAC, 12 May 2000.

³¹ Senate Select Committee on the Socio-Economic Consequences of the National Competition Policy, *Riding the Waves of Change*, February 2000, p. xx.

³² Correspondence from Dr James Gill, Managing Director, Water Corporation, to the Chairman of the PAC, Mr Max Trenorden, MLA, 11 October 2000.

³³ Correspondence from Mr Wayne James, Acting Commissioner of Railways, Westrail, to the Chairman of the PAC, Mr Max Trenorden, MLA, 10 October 2000.

Western Power identifies CSOs through an internal review process based on its knowledge of Government policy and the cost of supply for products and services to customer groups. It then seeks to agree the CSOs [*sic*]with the Minister. Accordingly, Western Power does not undertake a formal consultation process in connection with CSOs with regional groups or any other customer segments.³⁴

As LandCorp is the State's property development agency, it generally relies on administrative Government agencies to be the proponent for CSO projects. With respect to CSOs, the proponent normally consults at the project initiation stage. According to LandCorp, however:

Where LandCorp is appointed by the proponent to project manage the project definition and feasibility phase, broad community and stakeholder consultation is a standard procedure.

In the case of significant regional projects, particularly where community infrastructure is involved, the project is often guided by a steering committee of key stakeholders.

Regional Development Commissions play a major role in bringing forward community input to urban projects in non-metropolitan areas.³⁵

Clearly, there are differences in opinion between government agencies and regional groups on the level of consultation that takes place with regard to CSOs. Much of these differences arise from the diverse nature of CSOs undertaken by different government agencies (e.g. LandCorp) and the definition of a CSO as defined by Treasury. As a result, the need for a broader definition of a CSO becomes clearer (refer to Chapter Two, Finding and Recommendation 1), as does the need for a standardised means by which regional groups and the public in general can input into the CSO process.

Finding 3

Regional groups consider that they are largely excluded from the policy-making process relating to the provision of CSOs in regional areas.

Recommendation 3

That regional groups, particularly local government, be included in the policy-making process relating to the provision of CSOs in regional areas.

³⁴ Correspondence from Mr Nenad Ninkov, General Manager, Corporate Strategy, Western Power, to the Chairman of the PAC, Mr Max Trenorden, MLA, 12 October 2000.

³⁵ Correspondence from Mr John Ellis, Acting Chief Executive Officer, LandCorp, to the Chairman of the PAC, Mr Max Trenorden, MLA, 9 October 2000.

INTERSTATE EXPERIENCE

Most of the State and Territory Governments within Australia have adopted explicit policies on CSOs (see Appendix 4). Whilst there are some minor variations, all have adopted the commonly agreed definition of CSOs developed by the SCNPMGTE and use similar criteria in the identification of them. There are, however, some differences in the costing and funding methodologies adopted by the different governments (Appendix 5). A review of the definitions adopted, the legislation governing CSOs and the funding methods adopted for each of the States are summarised in Appendix 6.

In Western Australia, the Government has adopted the SCNPMGTE definition of CSOs and has initiated programs to review CSOs and provide guidelines for their identification, costing and funding (refer to Chapter Three).³⁶

FUNDER/PURCHASER/PROVIDER MODEL

The Funder/Purchaser/Provider model has been adopted by South Australia to bring some structure to the process of measuring the true cost of CSOs. The important aspect of this model is that there is a different Minister responsible for each role.

The basis of the Funder/Purchaser/Provider model is that it separates the purchasing, providing and funding roles of a CSO and allocates its function to separate entities. In this manner, the role of the government business enterprise is significantly modified and the potential conflicts of interest that arise from its requirement to operate in a commercial environment are negated.³⁷

In South Australia, the specific roles are as follows:

Funder Role: this role lies with the Government of the day and has the following responsibilities:

- disbursement of funds to purchasers;
- setting of strategic directions and priorities;
- answerable to Parliament and the public;
- accountability for money spent;
- monitoring of prices charged by the Provider; and
- monitoring and accountability for future decisions on continued funding.

Purchaser Role: this role lies with the relevant Minister for the area to where the service is delivered and has the following responsibilities:

- deciding which goods and services will be bought by the government to fulfil community needs;
- establishment of contract specifications, general service standards, performance indicators and criteria;
- determination of conditions of services such as price, quantity and quality;
- negotiation of contracts or agreements with providers;

³⁶ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 3.

³⁷ Denis Mutton, *The Importance of the Purchaser/Provider/Funder Model when Measuring Costing Issues with Community Service Obligations*. Presentation given to the conference on Community Service Obligations, conducted by the Institute for International Research, Sydney, 9-10 December 1998.

- monitoring of service delivery; and
- encouragement of competition between Providers.

Provider Role: this role lies with the government business enterprise that is responsible for delivering the CSO and has the following responsibilities:

- delivering the service to the community;
- entering into a contract or agreement with the purchaser; and
- managing the resources necessary to produce the required outputs.

Whilst the Committee recognises the existence of the Funder/Purchaser/Provider Model, it is not in favour of it because it considers that given the separation of roles, it would be difficult to ensure consistency and accountability for the provision of CSOs.

MONITORING AND REGULATION OF CSOs

In order to facilitate assessment of a GTE's performance, there must be clear reporting of the nature, scope and cost of a CSO. In order to allow full public scrutiny of a GTE's objectives, strategies and policies in regard to the provision of CSOs, it is appropriate that the GTE provide relevant information within its annual report, including:

- statistical information on, and assessment of the performance of, the GTE in carrying out its CSOs;
- a clear distinction in the presentation of its financial statements between CSOs and commercial activities; and
- a detailed estimate of the cost of carrying out the GTEs and CSOs.³⁸

In addition, it is expected that the relevant portfolio Minister's office, department or other appropriate regulatory body would undertake an annual review of the CSO provisions of a GTE. The review should encompass issues relating to:

- the nature of the CSO;
- the beneficiaries of the CSO;
- the public benefit gained from the provision of the CSO and how effectively the CSO meets the government's social objectives;
- the annual cost of the CSO over the period of time in which it operates;
- the appropriateness of the costing methods adopted; and
- whether or not the provision of the CSO is the most cost-effective means of meeting the government's social objectives (rather than, for example, outsourcing or direct payments to recipients).

In addition, with the establishment of the proposed portfolio-based Standing Committees in the Legislative Assembly,³⁹ the Committee believes that once consistency in the application of CSOs has been established by the CSO Committee (refer to Finding and Recommendation 2), the ongoing role of monitoring CSOs should then be undertaken by the relevant portfolio-based Standing Committee, with disputes arbitrated by the CSO Committee. This process should not be

³⁸ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 14.

³⁹ Legislative Assembly, Procedure and Privileges Committee. *Operation of the Standing Committee System*, 22 June 2000.

confined to disagreements between agencies or GTEs and their respective Minister, but should be open to anyone with a grievance concerning a CSO.

Finding 4

There is currently no means to monitor CSOs or to arbitrate disputes relating to CSOs.

Recommendation 4

That the proposed portfolio-based Committees, to be established in the Legislative Assembly in 2001, have the role of monitoring the CSOs provided to government agencies under their respective portfolios on a regular basis, including following up on complaints from the public and from the agencies themselves, with the ability to refer matters to the CSO Committee, as necessary for arbitration.

ACCOUNTABILITY/TRANSPARENCY

Accountability is considered by the Committee to be one of the fundamental principles of the Parliamentary process.

In evidence to the Committee, the Under Treasurer, Mr John Langoulant stated that:

[CSOs] not only enhance the transparency of financial arrangements between government and the commercial agencies, but they were also an important component of the policy direction which government has been undertaking in the operation of commercial entities; that is, requiring them to meet commercial outcomes and giving them commercial objectives, while ensuring that they deliver services to an appropriate level.⁴⁰

Monitoring and reviewing of CSOs is conducted mostly on an annual basis through the Statements of Corporate Intent (SCIs) and Strategic Development Plans (SDPs), which Treasury requires the agencies to update and reach agreement with the relevant Minister and Treasurer each year.⁴¹

Whilst Treasury oversees the costing methods used, it is constrained in its ability to determine the accuracy of the loss claimed by the GTEs because of the complexity and enormous information

⁴⁰ Transcript of Evidence, 15 June 1998, pp. 1-2.

⁴¹ *ibid.*, p. 9.

requirements of the task. The Regulatory Bodies⁴² established to oversee the industry are also hampered by some limitations of their legislation and lack of resources.

REPORTING IN BUDGET PAPERS

As CSOs assume a larger proportion of the State's Budget, the Committee believes that there will be a greater user demand for information on CSOs. Any individual should be able to follow the CSO process through the Budget Papers to see how much government assistance has been given to a GTE. In other words, the people at the other end of the process will have an interest in what CSOs have been identified, how they have been valued, how much money is involved, how they have been depreciated, what was the earning rate and so on, for their own or comparative purposes. In the Committee's view, the current system of having only a single-line item in the Budget Papers relating to Western Power, the Water Corporation, Westrail and the Western Australian Land Authority (LandCorp) is simply inadequate.

There is a growing expectation that bodies such as local governments should be able to follow these processes themselves. In order to enable public questioning, people need the information to do so. More importantly, because CSOs involve GTEs, which operate commercially but receive public expenditure for non-commercial expenditure, millions of taxpayers dollars are expended.

A number of different CSO figures are reported at different times of the year, for example, in the Budget in April/May, in annual reports and in SCIs. The Committee does not consider that the solution is to publish more information on CSOs in annual reports in addition to that already required to be provided in SCIs: rather, the Committee believes that the SCI and reporting in the annual Budget Papers should be the primary providers of information about CSOs.

To this end, the Committee believes that a process needs to be developed that is transparent and that can easily be understood and followed, regardless of whether another agency has control of a CSO project. The Committee believes that this can be achieved by having a dedicated CSO page in the Budget Papers, which would highlight all the CSOs the State Government was involved in. In addition, as it has been noted that various payments were disaggregated by definition (e.g. CSO or subsidy), reporting of all CSOs (and subsidies) would obviate the need to define or differentiate them.

In particular, this section should include a consolidated CSO figure, along with a breakdown by agency, of their previous actual, budget and forward estimates for every CSO involved.

Finding 5

There is currently no provision in the annual Budget Papers for a dedicated and consolidated CSO figure.

⁴² Both the Water Corporation and Western Power have regulatory bodies in the form of the Office of Water Regulation and the Office of Energy respectively. These bodies were established, among other things, to promote competition within their respective industries.

Recommendation 5

That a separate CSO section be included in the Budget Papers, which will provide:

- (a) a consolidated CSO figure; and**
- (b) a breakdown by agency of their previous actual figures and forward estimates for every CSO involved.**

CHAPTER THREE

WESTERN AUSTRALIAN CSO POLICY

INSTITUTIONAL STRUCTURE

In Western Australia, Treasury is responsible for compensating GTEs for the performance of CSOs. In addition, Treasury views its role as one of setting policy guidelines for the funding of CSOs,⁴³ ensuring that the CSO is as transparent as possible and that the service is being delivered.⁴⁴ Treasury also provides advice to government on whether a claim by a government agency is a CSO and assists agencies in the measurement of the CSO.⁴⁵

As previously discussed, whilst Treasury also oversees the costing methods used, it is constrained in its ability to determine the accuracy of the loss claimed by the GTEs because of the complexity and enormous information requirements of the task. The Regulatory Bodies established to oversee the industry are also hampered by some limitations of their legislation and lack of resources.

The question posed is: what powers should the Treasury and Regulatory Bodies have in relation to the performance of CSOs and what level of resources should be dedicated to the task?

IDENTIFICATION OF NEW OR ADDITIONAL CSOs

Over time, it can be anticipated that new CSOs may arise from:

- the Government requiring a GTE to provide new or additional goods or services that may not be within their commercial interests; or
- the recognition of existing goods or services, currently provided on a non-commercial basis, as a CSO.⁴⁶

Treasury, in their new policy guidelines for CSOs, recommend that where a GTE believes that a new CSO has arisen or the existing provision of a good or service should be recognised as a CSO, a submission should be prepared with Treasury's assistance, as appropriate, for consideration by the relevant Minister.⁴⁷

The Committee feels that it is important that the make-up of a CSO Committee as suggested in Chapter Two of this report, should be undertaken as a whole-of-government approach and include, in addition to Treasury, peak industry representatives and interested members of the public. Ideally, within a forum of this nature, existing CSOs would be re-assessed for their relevance and effectiveness. Additionally, any future CSOs could be identified and implemented in such a manner as to incorporate a community's expectations and social goals.

⁴³ Transcript of Evidence, 15 June 1998, p. 2.

⁴⁴ Transcript of Evidence, 4 July 2000, p. 5.

⁴⁵ Transcript of Evidence, 15 June 1998, p. 2.

⁴⁶ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 11.

⁴⁷ *ibid.*

Finding 6

There is currently no means by which the public can identify the need for a CSO.

Recommendation 6

That members of the public who have identified the need for a CSO be provided with the opportunity to present their case to the CSO Committee (as proposed under Recommendation 2) and/or portfolio-based Legislative Assembly Standing Committees (Recommendation 4).

REVIEW OF CSOs

Treasury recommends that all new and existing CSOs of a recurring nature should be reviewed every five years or a period agreed to between the portfolio Minister and Treasury. The aim of this review would be to ensure that the Government's original policy objectives continue to be met through the provision of the CSO.⁴⁸

MONITORING AND REPORTING OF CSOs

In order to ensure transparency and accountability, GTEs receiving CSOs are required to provide information relating to their CSOs in their annual reports. The information that Treasury suggests should be provided includes the identification of each CSO, statistical information relating to the GTE's performance of the CSOs and a detailed estimate of the cost of carrying out the CSOs. Similar information relating to the expected CSOs to be performed, their costing and funding and the compensation for performing them should also be provided by corporatised and commercialised entities such as the Water Corporation and Western Power in their annual SCI.⁴⁹

MEASURING, COSTING AND FUNDING OF CSOs

The accurate costing of CSOs is an important issue and is necessary for a number of reasons:

- to ensure that the Government is able to make an informed decision when balancing the cost of providing a service to a loss-making area or group and not providing the service;
- to promote the efficient use of very valuable and scarce resources such as water and energy;
- to enable the Parliament to conduct an informed debate about CSO costs and to make interstate and international comparisons meaningful; and

⁴⁸ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 12.

⁴⁹ *ibid.*, p. 14.

- to accurately determine the net return from an enterprise to the Government when tax equivalent payments, dividends and CSO payments are all balanced.

The amount of CSOs received by some GTEs is significant in relation to their annual revenue. For example, the Water Corporation alone receives around \$200 million per year in CSOs – in excess of 20% of annual revenue.

From the viewpoint of a GTE, once CSOs have been identified within a GTE, the costs incurred by the GTE must be determined in order to:

- assess the commercial performance of the GTE - this is particularly relevant when comparative analyses are made between the GTE and private sector companies;
- assess whether or not the benefits gained from the CSO exceed the costs of providing it;
- determine whether or not the CSO is being delivered in the most efficient manner; and
- provide an indication to the Government of the amount required to compensate GTEs for undertaking the CSOs and thus enable them to compete with the private sector.⁵⁰

The net cost of a CSO should be measured as the difference between the change in the GTE's overall costs and the change in the overall revenue that occurs as a result of implementing the CSO. To avoid the possibility of the costs of the CSO including a component related to inefficiencies of the GTE, the CSOs should be costed on a 'best practice' basis. As there are inherent difficulties in determining the costs related to the CSO, mainly due to the extensive information requirements involved in making these measurements, the costing of CSOs is likely to involve trade-offs between precision and the time and resources required for the task.

The key measurement concept for CSOs is therefore one of causality – that the revenue received and costs incurred would no longer occur should the CSO cease. There are a number of ways in which the cost of CSOs can be calculated and these are described in detail in Appendix 7. Treasury regards the long-run avoidable cost approach for costing CSOs as the preferred approach as it makes provision for the cost of capital employed and the cost of consuming the assets in the provision of the CSO.⁵¹

The Committee does not intend to give recommendations on how CSOs should be costed and funded, but does feel there is a need for the processes to be transparent.

COSTING ISSUES

There are essentially two forms of CSO in operation in WA. The first and most easily calculated is the loss incurred by enterprises as a result of price concession to groups such as pensioners and charitable organisations. The other and more complex CSO is the result of 'country losses' where customers in non-metropolitan areas receive a service at the same or similar rate to metropolitan customers, despite the identified cost of service delivery being greater than revenue.

There are a number of dynamic factors that impact on the country loss model used in WA to determine the opportunity cost to the enterprise of providing the CSO. The country loss calculation can be summarised as:

$$\text{CSO} = \text{Revenue} - (\text{Operating Cost} + \text{Depreciation} + \text{Rate of Return})$$

⁵⁰ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 5.

⁵¹ *ibid.*, p. 7.

Whilst it is very difficult to determine whether an entity has accurately costed its CSO, it is possible to examine the basic methodology and the definitions and standards used by the entity to calculate its CSO. Some of the important issues to consider include:

Revenue. What is being included as revenue? Revenue often includes many components other than payments from customers.

Apportioning Overheads. How does the entity apportion overheads throughout its cost centres? There is a risk that costs could be disproportionately attributed to loss-making areas where the enterprise will receive a CSO payment from Government.

Asset Valuation and Calculation of Depreciation. How does the entity value its assets and calculate depreciation? Given the impact of depreciation on the CSO calculation, the importance of scrutinising asset valuation is clear.

Rates of Return. Is there a difference in the rate of return in the CSO formula between new capital and old capital? Are agreed rates of return comparable with market standards and set at a rate that will encourage competition if that is the policy of the Government?

In general, agencies value their assets using either the historical cost value or a deprival value. Historical cost refers to the cost of an asset when originally purchased, whereas deprival value refers to the cost to the entity if it were deprived of the future economic benefits embodied in the asset. In the long-run, the method of valuation of the assets should not affect the costing of the CSO as the rates of return used should reflect a nominal (higher) rate of return for assets valued using (lower) historical cost or a (lower) real rate of return when the assets are valued using the deprival method.⁵²

The different methods of asset valuations are reflected in the agencies' calculation of CSOs:

Organisation and CSOs	Asset Valuation in Calculating CSOs	Asset Valuation used in Financial Statements
<i>Water Corporation</i> Country Operations	Deprival Value	Deprival Value
<i>Western Power</i> Isolated Supply Systems SWIS	Historical Cost Deprival Value	Historical Cost Historical Cost
<i>Westrail</i> Country Passenger Services	Deprival Value	Historical Cost
<i>LandCorp</i> Trading Stock Assets Non-trading Stock Assets	Historical Cost*	Historical Cost* Market Value

* LandCorp generally uses Historical Cost or the Net Realisable Value (the estimated proceeds of sale, less any costs) when valuing trading stock assets.

⁵² Correspondence from the Under Treasurer, Mr John Langoulant, to the Chairman of the PAC, Mr Max Trenorden, MLA, 24 July 2000.

The advantage in using the deprival method for the valuation of assets lies in the fact that it allows recognition of current service potential of assets, whereas the historical cost method of valuation is unlikely to adequately deal with the effects of inflation.⁵³

FUNDING METHODS

Treasury's preferred approach to funding of CSOs is by direct funding, although it is also recognised that practical considerations relating to individual CSOs may see the adoption of alternative funding methods.⁵⁴ The different ways in which CSOs may be funded are described in more detail in Appendix 7.

FINANCIAL ACCOUNTABILITY

CORPORATISATION/COMMERCIALISATION

With the move to commercialised utilities in areas such as water, power and rail, there is now an emphasis on identifying and costing CSOs. This is part of the desire to see CSOs provided efficiently without unduly burdening other consumers - as occurs through cross-subsidisation.

Australian Governments agreed to promote competition in markets typically dominated by public monopolies by considering:

- the separation of regulatory and commercial functions of public monopolies;
- the separation of natural monopoly and potentially competitive activities; and
- the separation of potentially competitive activities into a number of smaller, independent business units.

For example, in Western Australia, the former Water Authority was split into three discrete entities:

- the commercially oriented water service provider, the Water Corporation;
- the water resource manager, the Water and Rivers Commission; and
- the industry regulator, the Office of Water Regulation.

Agencies such as the Water Authority had previously delivered services to areas that were loss-making by way of price concession and cross-subsidisation. Agencies did not typically report the cost of providing services to loss-making areas as they were not commercially motivated.

TAX EQUIVALENT REGIME

The *State Enterprises (Commonwealth Tax Equivalents) Act 1996* authorises the imposition on State Enterprises of liability to pay amounts equivalent to income and sales tax. This payment is made to the Consolidated Fund, allowing jurisdictions to maintain their revenue bases.⁵⁵ The TER is designed to expose GTEs to similar tax requirements as private sector bodies, thereby

⁵³ Correspondence from the Under Treasurer, Mr John Langoulant, to the Chairman of the PAC, Mr Max Trenorden, MLA, 24 July 2000.

⁵⁴ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 9.

⁵⁵ The Government of Western Australia, Budget Paper No. 3, *Economic and Fiscal Overview*, April 1997, pp. 177-178.

eliminating the advantage government-owned enterprises have previously had over their private sector counterparts. This is in keeping with the principles of CN.

DIVIDENDS

According to Treasurer's Instruction 28 and for the purposes of the TER, all GTEs are deemed to constitute Public Companies. GTEs that receive a dividend income are required to return the cash amount of the dividend (excluding franking credits) as assessable income and are entitled to a tax rebate equal to the tax otherwise payable on the cash amount of the franked dividend.⁵⁶

CSOs IN WESTERN AUSTRALIA

The principal GTEs that currently provide CSOs in Western Australia include the Water Corporation, Western Power, Westrail and LandCorp. An overview of the main CSOs currently identified by each of these agencies is provided in Appendix 8. Furthermore, a direct comparison of the salient features of CSOs from each of these agencies is provided in Appendix 9, with a more detailed description of each of the individual agencies provided in the following chapters.

⁵⁶ Western Australia, Treasury Department. *Western Australia's Taxation Equivalent Regime for Government Trading Enterprises, Treasurer's Directions and Commentary for Income Tax*, May 2000.

CHAPTER FOUR

WATER CORPORATION

BACKGROUND

Established under the *Water Corporation Act 1995*, the Water Corporation is a state-owned enterprise responsible for public water supplies, wastewater, main drainage and irrigation services. It is managed by a Board of Directors who report directly to the Minister for Water Resources.

The Water Corporation was established on 1 January 1996 after the former Water Authority of Western Australia (WAWA) was restructured into two bodies. The driving principle behind the restructure of the water industry was to separate responsibilities for service delivery, resource protection and industry regulation. Hence, the Water Corporation took on the responsibility for the supply of water to end-users, while the Water and Rivers Commission became responsible for maintaining the quality and measurement of water resources. A third body, the Office of Water Regulation, was formed to take responsibility for the issuing of licences to end-users and for the regulation of pricing.

The Water Corporation inherited WAWA's infrastructure and as a result, it owns almost all of Western Australia's major sources of water (such as the Mundaring Weir) and water supply infrastructure.

LEGISLATION

The restructure of the water industry described above involved enactment of the following legislation:

- *Water Corporation Act 1995*.
- *Water and Rivers Commission Act 1995*.
- *Water Services Coordination Act 1995*.
- *Water Agencies Restructure (Transitional and Consequential Provisions) Act 1995*.

The restructure allowed new entrants into the water services industry to compete with the Water Corporation. The new entrants are required, like the Water Corporation, to obtain appropriate licences from the Coordinator.

The *Water Corporation Act 1995* establishes the Water Corporation with the function of 'providing water services, and with functions necessary for and related to that purpose, and for connected purposes'.⁵⁷ The Water Corporation is not classified as a company under Corporations Law and is distinguishable from a corporation set up under the Corporations Law by the fact that its functions and powers are defined in the Act and it is not incorporated under the Corporations Law.

⁵⁷ *Water Corporation Act 1995*, p. 1.

Schedule 2 of the *Water Corporation Act 1995* contains several corporate governance provisions similar to those in the Corporations Law. Similarly, Schedule 3 of the Act contains accounting and reporting requirements that resemble, as far as practicable, equivalent provisions in the Corporations Law.⁵⁸

The Corporation is subject to the control of the Minister for Water Resources who also holds all shares in the corporation. Although Section 5 of the *Water Corporation Act 1995* states that the corporation is not an agent of the Crown, it has all the indications of an agency of government in that:

- the Corporation, through its Board, must report to the Commissioner for Public Sector Standards;⁵⁹ and
- the Minister must table an annual report in Parliament.⁶⁰

REGULATION

Following the restructure of the former WAWA, the Office of Water Regulation (OWR) was established with the responsibility of issuing licences to end-users (which apply to all providers of water supply, sewerage, drainage and irrigation services) and for the regulation of pricing.

The OWR reports to the Minister for Water Resources and provides advice on policy, CSOs, pricing and service quality. With respect to pricing however, Section 24(3) and parts of Schedule 1 of the *Water Services Coordination Act 1995* specifically exclude the ability of the OWR from having any pricing responsibilities with respect to the Water Corporation. The OWR can, however, provide advice to the Minister on pricing should the Minister request it.

The core roles of the OWR include:

- administration of a licensing system for providers of water, sewerage, irrigation and drainage services in Western Australia;
- promotion of competition;
- issuing of technical standards;
- promotion of customer service charters;
- water industry policy and planning; and
- farm water planning, including the management of the Farm Water Grants Scheme.

There are four classifications of Operating Licence that the OWR administers:

1. Water supply services.
2. Sewerage services.
3. Irrigation services.
4. Drainage services.⁶¹

⁵⁸ Correspondence from Dr James Gill, Managing Director, Water Corporation, to the Chairman of the PAC, Mr Max Trenorden, MLA, 21 July 2000.

⁵⁹ *Water Corporation Act 1995*, Sections 17 and 25: Reports to Commissioner for Public Sector Standards.

⁶⁰ *Water Corporation Act 1995*, Section 60: Annual Reports.

⁶¹ *Water Services Coordination Act 1995*, Section 15(1): Classification of operating licences.

As at October 1999, the number of Operating Licence Holders were described as follows:

- Water Supply, Sewerage, Irrigation and Drainage Services (1: Water Corporation).
- Water Supply, Sewerage and Drainage Services (1: Rottnest Island Authority).
- Water Supply Services (3: Aqwest, Bunbury Water Board; Busselton Water Board; and Fremantle Port Authority).
- Wastewater Services (19 Shires throughout Western Australia).
- Sewerage Services (2: Forrestdale Liquid Treatment Plant; and Shire of East Pilbara).
- Non-Potable Water Supply (1: Shire of Northampton).
- Irrigation Services (2: Preston Irrigation Co-operative; and South West Irrigation Management Co-operative).⁶²

An Operating Licence was initially granted to the Water Corporation by the Office of Water Regulation for a period of 5 years, with an expiry date of 1 July 2001. However, in December 1998, the Coordinator of Water Services agreed to an extension of the term of the licence for a period of 25 years. The Minister accepted this agreement.

The OWR stated that:

The changes were implemented as the Board of the Water Corporation made the argument that if the Corporation was going to make long term investments (as is the case in the Water Industry) the licence term should reflect this.⁶³

In response to concerns raised by the Committee that this move may be anti-competitive, the OWR replied that:

The change to a 25 year licence, viewed in isolation, could be seen as anti-competitive. However, within the context of the other changes that were negotiated at the same time, it was actually part of a move to an environment that is conducive to potentially greater competition.⁶⁴

The other changes that were negotiated with the Water Corporation and subsequently extended to all water service providers with the change to the new 25 year licences were:

- reduced operating areas;
- increased reporting requirements from the Water Corporation; and
- clarification of the issue of whether licences gave exclusive status to providers.

COMMERCIAL REQUIREMENTS

Under Section 30(1) of the *Water Corporation Act 1995*, the Water Corporation, in performing its functions must:

- (a) act in accordance with prudent commercial principles; and
- (b) endeavour to make a profit, consistently with maximizing its long term value.⁶⁵

⁶² Office of Water Regulation Website: <<http://www.wrc.wa.gov.au/owr/industry/servprov.htm>> (last updated 25 October 1999).

⁶³ Correspondence from Mr Brian Martin, Coordinator of Water Services, Office of Water Regulation, to the Chairman of the PAC, Mr Max Trenorden, MLA, 27 June 2000.

⁶⁴ *ibid.*

⁶⁵ *Water Corporation Act 1995*, Section 30: Corporation to act on commercial principles.

If, however, a direction is given by the Minister that is in conflict with this, the direction by the Minister prevails.⁶⁶ To date, only one Ministerial direction has been given:

The provision of irrigation services known as the South West Irrigation District currently conducted by the Water Corporation be transferred to the South West Irrigation Management Co-operative and the South West Irrigation Asset Co-operative as soon as the required documentation has been completed and signed by the parties.⁶⁷

The direction was issued on 27 August 1996⁶⁸ and resulted in the hand-over of the assets later that same month.

COMMUNITY SERVICE OBLIGATIONS

As mentioned above, the Water Corporation must act according to prudent commercial principles and endeavour to make a profit. However, many of the activities carried out by the Water Corporation would not be financially viable at current prices and therefore would not be carried out by any normal private business. Thus, these activities are normally only carried out if there is a direction or request from the Minister to do so. If there is a Ministerial direction or request, the activity will become a CSO. The Corporation's strategy for CSOs is as follows:

- Continue to provide the existing CSOs at the existing levels of service.
- Seek productivity improvements for CSOs in the same way as normal business operations. The Corporation has agreed to a fixed 2.5% reduction in CSO payments for country services each year. It is intended that after three years, each CSO should be renegotiated.
- For new CSOs, or changes to existing CSOs, the Corporation will seek Ministerial approval and any additional CSO payments required on a project-by-project basis.⁶⁹

DEFINITION

The Water Corporation's definition of CSOs is based on that provided by Treasury:

CSOs are the provision of services that are not commercially viable without additional compensation, and result from the Government's desire to satisfy the broader economic, environmental and social needs of the community.⁷⁰

DRAFT CSO AGREEMENT

In order to provide a formalised arrangement for the provision of CSOs, the Water Corporation and Treasury have prepared a draft CSO Agreement under which the Government will pay the Water Corporation to provide these services at a level that broadly reflects the shortfall between revenue and the cost of providing them.⁷¹ In addition, the Minister would have the ability to put a

⁶⁶ *Water Corporation Act 1995*, Section 30(2): Corporation to act on commercial principles.

⁶⁷ Water Corporation, Annual Report 1996-1997, p. 33.

⁶⁸ Transcript of Evidence, 28 June 2000, p. 11.

⁶⁹ Water Corporation, Statement of Corporate Intent 1997-98, p. 14.

⁷⁰ Water Corporation, Statement of Corporate Intent 1999-00, p. 20.

⁷¹ Water Corporation, Annual Report 1996-97.

CSO out to tender if they believed the Water Corporation was not acting efficiently as a service provider. The principles determined in the Agreement require payment for CSOs to be made to:

- facilitate meaningful measurement of the Corporation's performance;
- encourage performance improvement;
- facilitate external competition for the provision of CSOs, to ensure they are supplied by the organisation that can do so at least cost;
- ensure the Government does indeed want the CSO and that in its judgement the benefits of the CSO exceed the cost of its delivery when compared with other Government expenditure opportunities; and
- ensure consistency with the National Competition Policy as agreed by the CoAG.⁷²

Although written some 4 years ago, the Draft Agreement has not yet been signed. During this time, whilst minor changes have been made to the Agreement, the principle behind it has not changed. In the interim, the Water Corporation has been working on the basis of the Agreement and considers the main agreements between it and the Minister to be the SCI and the SDPs provided for under the Act.⁷³

IDENTIFICATION OF CSOS

The identification of CSOs is by agreement rather than by definition.⁷⁴ New CSOs are dealt with under the guidelines of the Draft Agreement.⁷⁵ The definition of a CSO becomes important where the service is required by the Government to be provided and is not in the commercial interests of the Water Corporation. The organisation would then argue for a CSO. Where legislation exists for all organisations to undertake an activity, it would not be classified as a CSO. However, where legislation requires the Water Corporation, but not other businesses, to do something, that then could be classified as a CSO.⁷⁶

CSOs RECEIVED

The key activities that the Water Corporation regards as CSOs include:

- Non-commercial country services.
 - Water.
 - Sewerage.
 - Drainage.
 - Irrigation.
- Infill sewerage program.
- Pensioner and senior discounts and concessions.
- Concessions to non-rated property owners.
- Unpaid town reserve bills.

⁷² Water Corporation, Statement of Corporate Intent 1997-98, p. 14.

⁷³ Transcript of Evidence, 28 June 2000, p. 12.

⁷⁴ Transcript of Evidence, 15 June 1998, p. 38.

⁷⁵ Transcript of Evidence, 28 June 2000, p. 12.

⁷⁶ Transcript of Evidence, 15 June 1998, p. 38.

The estimated value of CSO payments to the Water Corporation for the previous four years are indicated below:⁷⁷

Rebates	1996-97 (\$ M)	1997-98 (\$ M)	1998-99 (\$ M)	1999-00 (\$ M)
Existing Country loss-making services	135.8	135.7	135.0	136.4
Identified new or changed CSOs	4.6	-	2.4	6.3
Unidentified CSOs and abnormals	-	-	3.5	3.0
Infill Sewerage Program	5.2	8.0	12.4	21.7
Revenue Concessions	34.1	36.6	38.8	40.8
TOTAL CSOs	179.7	180.3	192.1	208.2

Minor Discrepancies in additions are due to rounding.

Figures obtained from the Water Corporation's annual reports and from correspondence from the Water Corporation⁷⁸ indicate that the actual and forecast CSOs paid by the Government are:

	Actual (\$ M)				Forecast (\$ M)
	1996-97	1997-98	1998-99	1999-00	2000-01
CSOs	182.3	180.3	192.1	205.6	219.0

Whilst the CSOs represent a cost to the Government, this is more than offset by the dividends and tax equivalent payments paid by the Water Corporation to the Government.⁷⁹

	Actual (\$ M)	Forecast (\$ M)	
	1998-99	1999-00	2000-01
CSO Payment	(192.1)	(206.9)	(219.0)
Dividend	163.9	134.5	318.0
Tax Equivalent Payments	129.8	105.1	125.0
Net Return to Government	101.6	32.7	224.0

⁷⁷ Water Corporation, Statements of Corporate Intent, 1996-97, 1997-98, 1998-99 and 1999-2000.

⁷⁸ Correspondence from Dr James Gill, Managing Director, Water Corporation, to the Chairman of the PAC, Mr Max Trenorden, MLA, 21 July 2000.

⁷⁹ *ibid.*

Whilst the level of return to the Government is projected to remain positive in future years, the actual amount paid is dependent on the level of new CSOs and other factors such as price increases, growth and productivity.⁸⁰

NON-COMMERCIAL COUNTRY SERVICES

The majority of Water Corporation's CSOs are derived from the supply of water to country regions. Due to economies of scale and the greater level of available water sources, the supply of water services to the Perth metropolitan region is considerably more cost-efficient than in country regions. However, as the Government's policy is to provide water services at similar cost to metropolitan and country regions, the revenue obtained from country operations does not cover the costs of supplying those services. CSOs are calculated for each scheme and only those that return a loss are included. An example of some of the costs involved in supply and the prices charged to residential and non-residential customers is provided in Appendix 10 for the Port Hedland region.

INFILL SEWERAGE PROGRAM

Begun in July 1994, the State Government Infill Sewerage Program is a 10 year, \$800 million program to provide deep sewerage services to existing properties in metropolitan and country regions. The two major reasons for undertaking this program include environmental and public health concerns over the use of septic tanks. In particular, there was concern over the unacceptably high levels of pollutants leaching into the groundwater system.

At the beginning of the program, 25% of metropolitan Perth properties and even higher proportions of some country towns were unsewered. For example, in the City of Geraldton, 75% of properties relied on septic tanks.⁸¹

PENSIONER AND SENIOR DISCOUNTS AND CONCESSIONS AND NON-RATED PROPERTY OWNERS

At the request of the Government, the Water Corporation provides concessions to pensioners, seniors and other types of non-rated customers. The actual cost of these concessions is reimbursed to the Water Corporation in the form of CSOs.

UNPAID TOWN RESERVE BILLS (ABORIGINAL RESERVES)

Many of the range of aboriginal corporate entities, communities and householders to which the Water Corporation supplies water services are either slow in paying their accounts or do not respond at all to payment requests. As there is little chance of recovery of these debts, the Water Corporation, as a commercial entity, would not continue to provide these services. However, as the Government requires that these services be maintained, a CSO is provided to the Water Corporation in order to continue the provision of these services.

⁸⁰ Correspondence from Dr James Gill, Managing Director, Water Corporation, to the Chairman of the PAC, Mr Max Trenorden, MLA, 21 July 2000.

⁸¹ Water Corporation Worldwide Web site: <<http://www.watercorporation.com.au/Infill/challenge/index.html>> (Accessed 2 November 2000).

PURCHASE OF WELLINGTON DAM LAND

In October 1998, Worsley Timber Ltd offered a parcel of land surrounding the reservoir of Wellington Dam for sale. Whilst the Water Corporation is responsible for the Wellington Dam reservoir basin and provides irrigation services from this facility, the Water and Rivers Commission is charged with the ownership and management of water catchment areas. The Water and Rivers Commission expressed an interest in purchasing the land, but did not have the funds to do so and a request for special funding from Treasury was denied.⁸² Consequently, the Water Corporation was requested by the Minister to submit a tender for purchase of the land and the transaction was bundled with a CSO, as allowed under the Corporation's legislation.⁸³ This CSO differs from existing CSOs however, in that it is not a non-commercial function of the Corporation's usual functions.

NEW CSOS

New CSOs are claimed for all new services provided, in addition to those outlined in the Draft Agreement. The Water Corporation categorises new CSOs into two groups:

1. New CSOs that require government funding in the current year.
2. New CSOs that involve capital investment in the current year, but with no emerging compensation requirement until the project is completed, perhaps in several years time.

The new CSOs identified in the 1999-00 SCI have been further categorised into eight programs:

WWTP Upgrades - refers to wastewater treatment plant (WWTP) upgrades that have been implemented in order to satisfy the higher standards required by the Department of Environmental Protection.

Rural Water Supply Improvement/Farm Water Program – this project involves extensions to existing regional water pipelines or the expansion of local water storage capacity in order to ensure that regional communities have more access to reliable water supplies.

New Services – refers to the provision of new services of water supply, sewerage, drainage or irrigation that have been introduced since 1996.

Service Improvements – provides customers, particularly those in the country, with a higher level of service than applied in 1996.

Water Supply Quality Upgrades – the improvement of water quality standards above those provided in 1996.

Miscellaneous Government Requirements – refers to projects that resulted from a government request or that were initiated to improve services in line with perceived current standards.

Dam Safety – involves the duty of care by the Water Corporation to maintain dams to current community standards.

⁸² Western Australia, Office of the Auditor General. Report No. 1, *Public Sector Performance Report 2000*, April 2000, pp. 14-15.

⁸³ *ibid.*, p. 16.

Abnormal Cost Growth – a provision for cases in which the methods of supply may substantially increase in cost, such as when a bore becomes exhausted and needs to be replaced with a supply pipe from an alternate source.

The estimated capital cost and CSO impact of these programs is shown in Appendix 11.

COSTING AND FUNDING OF CSOs

Funding of the Water Corporation's CSOs is directly from Treasury, via the Consolidated Fund. The Water Corporation received CSO funding for the first time in 1996-97 for a total of \$182.3 million, which comprised 21.5% of their total revenue (\$846.1 million). In 1999-00, this increased to \$205.6 million, but remained 20.5% total revenue (\$1 004.6 million).

The existing system of calculating CSOs uses a base year and then indexes this figure each year to calculate the new country loss figure. This method of indexation of a base year is used in lieu of calculating the figure 'from scratch' each year. Whilst the 1995-96 year was originally used as the base year, this was later changed to the 1996-97 year as the former included 6 months of WAWA data and 6 months of Water Corporation data.⁸⁴

The use of the base year is required for the Corporation's 2.5% per annum productivity incentive associated with providing country water services. Rather than simple reimbursement of the costs incurred, the Water Corporation considers that the use of the base year allows it to be financially rewarded for performance that is better than the target and penalised for performance less than the target.⁸⁵

ACCOUNTABILITY REQUIREMENTS

The accountability requirements of the Water Corporation as set out in the *Water Corporation Act 1995*, pertain to the preparation and submission of:

- a Draft Strategic Development Plan for the corporation and any subsidiary (Sections 41 to 49 of the Act);
- a Statement of Corporate Intent (Sections 50 to 58 of the Act);
- quarterly reports (Section 59 of the Act); and
- an annual report (Sections 60 to 62 of the Act).

In addition, Section 69(a) of the Act states that the Corporation must:

keep the Minister reasonably informed of the operations, financial performance and financial position of the corporation and its subsidiaries, including the assets and liabilities, profits and losses and prospects of the corporation and its subsidiaries.

Although the OWR has an important role in the issuing of licences for the supply of water services, it has difficulty in obtaining financial information, particularly that pertaining to CSOs, from the Water Corporation.⁸⁶ Whilst recent financial information provided to the OWR by the

⁸⁴ Correspondence from Dr James Gill, Managing Director, Water Corporation, to the Chairman of the PAC, Mr Max Trenorden, MLA, 21 July 2000.

⁸⁵ *ibid.*

⁸⁶ Correspondence from Mr Brian Martin, Coordinator of Water Services, Office of Water Regulation, to the Chairman of the PAC, Mr Max Trenorden, 27 June 2000.

Water Corporation in relation to prescribed areas were used to calculate CSOs, this data did not tally with previous CSO data. It was determined in discussions with the Water Corporation that the disaggregated CSO data is not reliable and that the Corporation does not have the systems in place to generate reliable data.

Finding 7

The Office of Water Regulation receives insufficient data from the Water Corporation to make the required level of decision making.

Recommendation 7

That the Water Corporation:

- (a) develop and put in place systems to generate and evaluate data relating to CSOs; and**
- (b) provide reliable data to the Office of Water Regulation in a timely and efficient manner.**

With respect to the provision of CSOs, Section 52(2) of the *Water Corporation Act 1995*, states that the Water Corporation is required to specify in its annual SCI:

- (j) the nature and extent of community service obligations that are to be performed;
- (k) the costings of, funding for, or other arrangements to make adjustments relating to, community service obligations; and
- (l) the ways in which, and the extent to which, compensation will be made for performing community service obligations.

Section 24 and Schedule 1 of the *Water Services Coordination Act 1995* deliberately exclude the Water Corporation from providing certain information in relation to an operating licence. Hence, the Water Corporation has a competitive advantage over other water service providers and the Act regulating the water industry is inconsistent in this regard.

Finding 8

Through provisions in the *Water Services Coordination Act 1995*, the Water Corporation has an advantage over other water service providers.

Recommendation 8

That, in order to ensure consistency across the water industry, amendments be made to the *Water Services Coordination Act 1995* that require the Water Corporation to provide the same information as all other water service providers.

CHAPTER FIVE

WESTERN POWER

BACKGROUND

Western Power was created on 1 January 1995, when the former State Energy Commission of Western Australia (SECWA) was divided into separate electricity and gas utilities: Western Power and AlintaGas.

Western Power is the principal generator, transmitter and distributor of electricity in Western Australia. Its main operations are:

- The South West Interconnected System (SWIS), which is the supply grid extending from Perth in the west to Kalgoorlie in the east and from Kalbarri in the north to Albany in the south.
- The North West Interconnected System (NWIS), which supplies the major towns in the Pilbara, including Port Hedland and Karratha. Additional power purchases to meet customer requirements are made from independent power producers.
- 29 Regional Systems around the State that are isolated from Western Power's interconnected grids.

LEGISLATION

Established under the *Electricity Corporation Act 1994*, Western Power is a corporatised GTE, governed by a commercially-oriented Board of Directors. The Board is responsible to the Minister for Energy for the operation and performance of the functions of the Corporation.

Consistent with the requirement for Western Power to operate commercially and to endeavour to make a profit, the Act does not impose any specific obligations on Western Power to supply electricity.

REGULATION

Another body established at the time of the restructure was the Office of Energy, which assumed some of the functions previously undertaken by SECWA, such as the energy policy and regulatory functions. The Office of Energy acts in an advisory capacity to the Minister in relation to Western Power's SDPs and SCIs and also monitors the performance of Western Power.

One of the Office of Energy's other primary functions is to encourage competition in the electricity industry. It is involved in formulating, implementing and administering third party access arrangements to the monopoly elements of Western Power. The Office of Energy believes that NCP will open up the opportunity for more suppliers in the marketplace.

COMMERCIAL REQUIREMENTS

Section 31(1) of the *Electricity Corporation Act 1994* requires that in performing its functions, Western Power must:

- (a) act in accordance with prudent commercial principles; and
- (b) endeavour to make a profit, consistently with maximizing its long-term value.

When Western Power was formed in January 1995, it was ‘. . . set up with commercial principles in mind; that is, to make a profit and maximise the long-term value of the organisation’.⁸⁷

However, while Western Power is required to act commercially, it is still required to provide uniform tariffs throughout the State, a policy it inherited from SECWA.

COMMUNITY SERVICE OBLIGATIONS

DEFINITION

Section 54(4) of the *Electricity Corporation Act 1994* states that “community service obligation” means obligations to perform functions that it is not in the commercial interests of the Corporation to perform. The intent of this section was that Western Power should not perform CSOs, but if it must, the Act clearly required that they be specified in the annual Statement of Corporate Intent (SCI) as to what they were, how much they cost and how they would be funded.

Each year, Western Power states in its SCI and SDP that it provides CSOs, outlining a description of what they were, how much they cost and how it thought they should be funded. However, only Western Power’s rebates were reimbursed as CSOs.

It is in the interpretation of the Act’s definition for a CSO that differences of opinion exist as to what constitutes a CSO.

MINISTERIAL DIRECTIONS

Under Section 66 of the *Electricity Corporation Act 1994*, the Minister for Energy may give a direction in writing to the Corporation with respect to the performance of its functions. Further, the Minister is required to cause the text of any direction given under the Act to be laid before Parliament. Under Section 31(2), if a direction is given by the Minister, which is in conflict with its requirement to operate in a commercial manner, the ministerial direction will prevail. To date, Western Power has not been given a written direction.

In evidence to the Committee in 1998, Western Power questioned what mechanisms were in place to resolve disputes about what constituted a CSO, as the Act did not specify what would

⁸⁷ Transcript of Evidence, 28 June 2000, p. 17.

happen if the Minister and Western Power disagreed about a CSO.⁸⁸ As was reiterated in supplementary information:

Of more immediate concern is the process by which an agency or Government Trading Enterprise and the responsible portfolio Minister are expected to negotiate a CSO, especially where fundamental agreement on the need for CSO payments cannot be reached. It is noteworthy that Treasury's CSO policy paper does not deal with these circumstances or propose a resolution process.⁸⁹

Further, Western Power stated that:

Each year, Western Power says that it performs CSOs and the Minister says it does not. That has not been sorted out, nor has there been any attempt to resolve that impasse.⁹⁰

The Committee feels that Western Power's concerns raise a pertinent issue relating to the requirement for some mechanism to be put in place to independently resolve disputes about CSOs, particularly between a Minister and an agency. In addition, this process should not be confined to disagreements between agencies or GTEs and their respective Minister, but should be open to anyone with a grievance concerning a CSO (refer to Chapter Two, Finding and Recommendation 4).

UNIFORM TARIFF POLICY

Western Power is required by the Government's uniform tariff policy to sell electricity at tariffs that are uniform across the state, irrespective of the actual costs of supply.⁹¹ This policy, which is intended to provide equity between city and country residents, was inherited by Western Power from SECWA.

As a result, Western Power incurs substantial losses in making power available to regional areas. One of the major areas to incur losses is in the SWIS area, where losses are estimated to be approximately \$100 m a year.⁹² The Pilbara region, comprising Port Hedland and Karratha, is separate to the rest of regional power and is currently making a profit.⁹³ Currently, Western Power does not receive a CSO payment for losses arising from the uniform tariff policy.

The losses by Western Power due to providing electricity in regional areas at uniform tariffs are covered internally by cross-subsidisation:

The customers who are wearing the cost of the uniform tariff policy are the small businesses and metropolitan domestic customers. They are being required to pay higher prices to cross-subsidise the rest of the State.⁹⁴

In establishing Western Power as a corporation, the Government took the view that these losses should be borne by Western Power as a condition of its effective distribution franchise, rather than being separately funded by Government as a CSO.⁹⁵

⁸⁸ Transcript of Evidence, 15 June 1998, p. 57.

⁸⁹ Supplementary Information provided in correspondence from Mr N. Ninkov, General Manager, Corporate Strategy, Western Power, to the Chairman of the PAC, Mr Max Trenorden, MLA, 25 July 2000.

⁹⁰ Transcript of Evidence, 28 June 2000, p. 18.

⁹¹ Correspondence from Mr N. Ninkov, General Manager, Corporate Strategy, Western Power, to the Chairman of the PAC, Mr Max Trenorden, MLA, 25 July 2000.

⁹² Transcript of Evidence, 28 June 2000, p. 22.

⁹³ *ibid.*, p. 20.

⁹⁴ *ibid.*, p. 23.

WESTERN POWER'S "FRANCHISE"

Western Power operates an electricity distribution business throughout the State. In evidence to the Committee in 1998, the Office of Energy alluded to the Minister for Energy's second reading speech to the *Electricity Corporation Act 1994*:

In the determination of the funding for community service obligations, regard will be given to the fact that the corporation has, in effect, been granted an exclusive franchise to operate in the electricity distribution business throughout the State. The existing uniform tariff policy . . . will be retained.⁹⁶

Given this, the Office of Energy explained that Western Power's franchise, which includes areas where it makes losses in the provision of service, is, overall, sufficiently commercially rewarding for the corporation that it sees the whole of the franchise opportunity as a commercial opportunity and, therefore, has not received a CSO payment for those areas in which it is making a loss. As Dr Farrant, Coordinator of Energy WA concluded:

Where Western Power is obliged to provide concessionary tariffs, it receives a CSO. Where the corporation provides a uniform tariff outcome across its system in return for its franchise position, it does not receive a CSO.⁹⁷

However, this situation does not take into account the deregulation of the electricity industry. Western Power is required to progressively provide open access to its transmission and distribution networks over the next few years (refer to Appendix 12 for an indication of the timetable for the Government's electricity deregulation). This will allow independent generators to supply consumers by utilising the Corporation's transmission and/or distribution systems. In addition, competition has been introduced in the supply of electricity to Western Power itself, so it is required to secure any substantial new supply of electricity through an open and competitive power procurement process (see Appendix 13 for Western Power's distribution access charges for different regions). In total, around 120 major customers are now contestable, which represents around 30 percent of Western Power's existing sales base.⁹⁸

Competition policy will change the nature of the franchise Western Power holds. That is, if large and attractive customers are taken away by competitors and Western Power's margins are eroded, its ability to cross-subsidise to the extent it has in the past will be eroded. For example, it was noted that the Minister had announced that Cabinet would shortly consider deregulating down to the 34 kilowatt level, which would mean that over half of Western Power's sales would become open to competition.⁹⁹ As a result of deregulation, Western Power no longer holds an exclusive franchise to operate in the electricity industry.

IMPLICATIONS FOR THIRD PARTIES

It has been noted that in some regional areas, the cost of supply appears to be inherently above the charges under the uniform tariff. If a private sector supplier sought to supply those customers, some form of subsidy would be essential to that private sector supplier so that the activity would be commercially viable. If such a subsidy were to be provided to private sector

⁹⁵ Office of Energy, Worldwide Web site: <http://www.energy.wa.gov.au/html/body_1-2-1.html> (Accessed 1 November 2000).

⁹⁶ Transcript of Evidence, 15 June 1998, pp. 44-45.

⁹⁷ *ibid.*, p. 45.

⁹⁸ Correspondence from Mr N. Ninkov, General Manager, Corporate Strategy, Western Power, to the Chairman of the PAC, Mr Max Trenorden, MLA, 25 July 2000.

⁹⁹ Transcript of Evidence, 28 June 2000, p. 23.

players, it is suggested it should be done on a competitive basis with private sector players bidding for the opportunity to win such a subsidy.

WESTERN POWER'S CSOs

Western Power delivers a number of output CSOs to the community on behalf of Government, including:

- providing rebates to eligible customers;
- supplying power at concession rates to voluntary and charitable organisations;
- supplying power in isolated areas at State-wide uniform tariffs which are below the cost of supply in those areas; and
- supplying power in the SWIS at State-wide uniform tariffs.

Western Power estimates that their total CSO will be about \$173 million per year, which equates to around 10 percent of their revenue.

CSOs RECEIVED

Currently, supply charge rebates are paid to around 242 000 customers, representing approximately 33% of Western Power's domestic customer base. Eligible customers include pensioners, veterans, seniors and health care card holders.¹⁰⁰

In the 1998-99 financial year, the total cost of rebates was \$29.3 million, for which Western Power was reimbursed. However, the Government has not reimbursed Western Power for the administration and financing costs incurred in administering the rebate scheme, which was \$0.4 million for 1998-99. This can be contrasted with the Water Corporation, which receives a CSO for the administration of their CSOs.

Finding 9

While the treatment of Western Power's supply charge rebates as CSOs is consistent with those of the Water Corporation, there is an inconsistency in the way the two Corporations are treated in relation to administration costs.

Recommendation 9

That consistency across all government agencies be established with respect to the way that CSOs are treated.

¹⁰⁰ Western Power, Statement of Corporate Intent 1998-99, p. 20.

CSOs NOT RECEIVED

Community Service Concessions

Western Power provides a Community Service tariff of up to \$276 per year to eligible voluntary and charitable organisations. The cost of this concession is estimated at \$0.27 million for the 1998-99 financial year. Western Power is not compensated for performing this CSO.

Finding 10

It appears from the definition of CSOs that the concession provided by Western Power to eligible voluntary and charitable organisations should be treated as a CSO. Moreover, the Water Corporation receives a CSO for a similar arrangement.

Recommendation 10

That Western Power receive a CSO for its community service concessions.

Isolated Supply Systems

Western Power's Regional Power Division is responsible for supplying power to customers in 29 towns isolated from the SouthWest and NorthWest Interconnected supply grids. According to Western Power, power is 'either purchased from third parties, such as mining companies, or generated at local diesel power stations'.¹⁰¹

Due to the Government's Uniform Tariff Policy, Western Power is required to sell electricity at uniform rates across the State. However, as a result of relatively high generation costs, Western Power incurs substantial losses in making supply available in isolated areas of the State.¹⁰² As Western Power confirmed, their '... significance is not in terms of the numbers of customers or the sales – the significance is in the size of the losses in those regional areas.'¹⁰³

Western Power faces further losses as a result of the State Government's decision to stop the funding of its Off-Road diesel rebate. In supplementary information to the Committee, Western Power explained that prior to 1 July 2000, fuel supplied to Western Power's regional power stations qualified for both the On-Road and Off-Road diesel rebates scheme. Under this scheme, eligible users of diesel qualified for the rebates totalling around 8.4 cents per litre (or around \$5 million per annum), funded by the State Government. However, with the implementation of the Commonwealth's tax reform package on 1 July, including the Goods and Services Tax (GST) and the associated changes in Commonwealth/State funding arrangements, the State Government

¹⁰¹ Western Power, Statement of Corporate Intent 1998-99, p. 36.

¹⁰² *ibid.*, p. 20.

¹⁰³ Transcript of Evidence, 28 June 2000, p. 19.

no longer provides the Off-Road component of the diesel rebate scheme. According to Western Power:

If the State Government were to continue to provide this rebate, then Western Power's Regional Power Division losses would be around 4.6 million dollars lower than they otherwise would be.¹⁰⁴

While attempts have been made to reduce costs in the nine largest loss-making isolated power systems, the 20 remaining small isolated systems preclude any similar arrangements. According to Western Power:

There is no economy of scale; they are all isolated towns and there is no interconnection. They all stand alone and every power station is unique because the size of the demand from the town is unique. Equipment is installed to meet unique demand.¹⁰⁵

Hence, in the Board's view:

. . . the losses incurred in supplying these regions at non-commercial uniform tariff rates should be recognised and funded as a CSO by Government.¹⁰⁶

In the 1998-99 financial year, Western Power made a loss of around \$36 million in regional areas in Western Australia.

Western Power has sought Government recognition of, and funding for, losses incurred in supplying power in regional areas as a CSO. In doing so, Western Power has recognised the need to maximise cost efficiencies in its regional systems, along the following principles:

- best practice operating arrangements be established;
- a tender-based power procurement process be undertaken for large regional systems to secure the lowest cost source of generation; and
- network access pricing reflecting optimised assets values.

Moreover, Mr Ninkov stated that:

Even though our cost structure has been growing, the losses have not been growing because we have been trying to make more use of renewable energy in the regional areas.¹⁰⁷

For example, Western Power has initiated the following:

- Low cost, privately owned hydro power supplies to the East Kimberley towns of Kununurra, Wyndham and Lake Argyle.
- A new gas-fired generation has been installed at Carnarvon.
- A hybrid wind/diesel system has been installed at Denham.
- A power procurement process is being undertaken in the West Kimberley, the Mid West and Esperance.
- An equitable open access regime that allows private sector generators to supply contestable customers has been established for regional systems.¹⁰⁸

¹⁰⁴ Supplementary Information provided by Mr N. Ninkov, General Manager, Corporate Strategy, Western Power to the PAC, 25 July 2000.

¹⁰⁵ Transcript of Evidence, 28 June 2000, p. 20.

¹⁰⁶ Western Power, Statement of Corporate Intent 1998-99, p. 21.

¹⁰⁷ Transcript of Evidence, 28 June 2000, p. 21.

Indeed, there has also been infrastructure cost-sharing arrangements with the Government, whereby the Government is providing capital up front, rather than as an ongoing CSO. For example, Western Power explained that:

. . . with the Onslow and mid-west projects, the Government has agreed to make a capital contribution up front rather than pay an ongoing CSO. At Onslow, the Government contributed to the cost of the infrastructure which involved a pipeline from the Tubridgi field down to Onslow. In the Mid West it has contributed to building part of the cost of the pipeline.¹⁰⁹

In Western Power's view, substantial progress has already been made in regard to the major regional systems and claims that a CSO payment should now be provided from Government. While the Government has acknowledged Western Power's efforts to reduce costs, it has decided to negotiate CSO payments for regional losses only when the power procurement process is substantially progressed:

Western Power's regional systems include 20 small systems mostly in regional communities that generate less than 7 GWh¹¹⁰ per annum. The State is to provide community service obligation payments through the Consolidated Fund to Western Power for losses associated with these systems provided substantial progress has been achieved with the nine major systems. For this to occur, however, the uniform tariff must be in place, costs must be at the lowest practical level and innovative supply options will have to be considered whenever they arise.¹¹¹

Western Power believed that it was highly unlikely, with current technology, that the whole of the regional system would become profitable while the Government's uniform tariff policy remained in force. It has been stated that the average price paid by a domestic customer does not even cover fuel and electricity purchases and revenue from a typical small/medium business customer is just sufficient to cover fuel and electricity purchases but makes no contribution to the remaining costs.¹¹² Hence, Western Power aims to reduce the size of the loss, rather than increase the amount of money made.

Similarly, Treasury admitted that while the ultimate aim would be to achieve financial viability by reducing costs to the lowest practical level, introducing competition and encouraging innovative supply options, in most circumstances:

. . . it is considered unlikely that such an outcome can be achieved with the current technology. Minimisation of costs is likely to be the focus of new initiatives.¹¹³

In the Committee's view, the primary reason why Western Power's regional losses are not regarded as a CSO is because Western Power was granted the exclusive franchise to operate in the electricity industry. As discussed previously however, deregulation has resulted in Western Power no longer holding an exclusive franchise to operate in the electricity industry and thus, the

¹⁰⁸ Supplementary Information provided by Mr N. Ninkov, General Manager, Corporate Strategy, Western Power to the PAC, 25 July 2000.

¹⁰⁹ Transcript of Evidence, 28 June 2000, p. 22.

¹¹⁰ GWh = gigawatt hour (= one million kilowatt hours). A kilowatt hour (kWh) is the standard unit of energy, equivalent to the consumption rate of one kilowatt for one hour.

¹¹¹ Office of Energy, Worldwide Web site: <http://www.energy.wa.gov.au/html/body_1-2-1.html> (Accessed 2 November 2000).

¹¹² Supplementary Information provided by Mr N. Ninkov, General Manager, Corporate Strategy, Western Power to the PAC, 25 July 2000.

¹¹³ Supplementary Information provided by Mr J.L. Langoulant, Under Treasurer to the PAC, 24 July 2000.

Committee believes that this is no longer a valid reason for withholding CSO funding from Western Power. Western Power is required under its legislation to operate in a commercial manner, yet at the same time, it is required to carry out the Government's Uniform Tariff Policy. As this situation accords with the current definition of a CSO, the Committee believes that the continuing losses incurred by Western Power in its isolated supply systems should be classified as a CSO.

While the Committee concurs with the aim of containing losses through efficiency and cost reduction measures, the Committee does not see it as necessary to withhold CSO funding from Western Power indefinitely. As the Water Corporation has not had its CSO funding denied in the same way, the Committee believes that Western Power should be accorded similar treatment. Indeed, the Water Corporation should also be required to show its attempts at cost reduction.

Finding 11

Western Power's regional losses are not regarded as a CSO despite the fact that Western Power is required under its legislation to operate in a commercial manner, yet at the same time, it is required to carry out the Government's Uniform Tariff Policy.

Recommendation 11

That the supply of power by Western Power to its isolated supply systems be classed as a CSO.

Western Power has suggested a staged approach to CSO funding as follows:

- Establish headworks committees to fund non-commercial SWIS non-metropolitan infrastructure.
- Implement a staged approach to CSO funding for uniform tariffs:
 - ▶ Regional businesses
 - Small town losses and any revenue shortfall from large towns after power procurement implemented.
 - ▶ SWIS
 - Any remaining shortfall after headworks funding for non-commercial, non-metropolitan infrastructure.
- 3-5 year transition period to full funding by Government.
- Net CSO cost to Government reduced through tax and ordinary dividends.
- Western Power to pay a special dividend so that there is a neutral State Budget impact during transition.¹¹⁴

¹¹⁴ Supplementary Material provided by Western Power to the PAC at formal evidence hearing, 28 June 2000.

In evidence, Western Power noted:

There should be scope for introducing some sort of headworks relief or headworks assistance for those people who want supply extended into those rural areas, and that should come from government . . . We believe that the towns that will never be commercial should be funded immediately. We also recognise that the Government has a problem in immediately taking on a \$200m commitment of its funds. We suggest a transitory process whereby Western Power basically agrees to compensate the Government for the CSO payment through higher dividends for a period until the Government can absorb the CSOs within its own budget.¹¹⁵

Rather than funding via cross-subsidisation, this would indicate the services Western Power provides and what it costs to provide those services.

SWIS

The second major area of losses is in the SouthWest Interconnected System (SWIS) area.

In evidence to the Committee, Western Power admitted that small businesses and metropolitan domestic customers were paying higher costs as a result of the uniform tariff policy:

Non-metropolitan customers are subsidised with uniform tariffs. Essentially these are being financed through cross subsidies. There is no doubt that people in the metropolitan area are paying higher prices for electricity than would be the case if we were reimbursed for the CSOs. There is no doubt that prices could drop 15 to 20 percent . . .¹¹⁶

COSTING AND FUNDING

Western Power undertakes the valuation of its CSOs, which are generally consistent with methodologies preferred by Treasury. It believes that CSO guidelines and methodologies should be drafted by a central body, such as Treasury, and circulated so that all agencies can work within a common framework. The agency claiming the CSO should have primary responsibility for preparing the associated costing and other supporting information. However, in Western Power's view, the CSO process would benefit from an independent review of the claiming agency's assumptions, methodologies and costings, for example by an appropriate auditor.¹¹⁷

Western Power viewed favourably the recommendation that all CSOs should be negotiated as a 3-year contract between Government and the CSO provider, which would promote an element of certainty. It was suggested that there may be a special case for extended CSO arrangements to be put in place in order to facilitate private sector investment in regional power supplies. This was because:

. . . it is likely that private sector generators, investing in remote regional locations, will seek to negotiate long term contract arrangements with Western Power which will provide them with reasonable assurance of paying off the associated debt and making a commercial return on their investment.¹¹⁸

¹¹⁵ Transcript of Evidence, 28 June 2000, p. 24.

¹¹⁶ *ibid.*, p. 23.

¹¹⁷ *ibid.*, p. 26.

¹¹⁸ Supplementary Information provided by Mr N. Ninkov, General Manager, Corporate Strategy, Western Power to the PAC, 25 July 2000.

CSO CALCULATION USED

As assets are consumed in providing CSOs, Western Power feels it is therefore appropriate that the costs of providing and maintaining the assets form part of CSO costs. Western Power determines CSO costs from the accounts of the corporation's ring fenced business units, which allows for the separate identification, recording and reporting of actual revenue and expenses. With regard to costing the regional power CSO, asset values are determined on a historical cost basis.

It was also noted that much of the existing plant in the regional systems was reaching the end of its economic life. Hence, it was expected that it would be progressively replaced, which would result in higher asset costs being incurred.¹¹⁹

In costing the SWIS CSO, asset values were determined on a depreciated optimised replacement basis for network assets, which was standard industry practice and a historical cost basis for all other assets.

As assets with different characteristics have different depreciation rates, for the purposes of CSO costing, depreciation costs were based on the asset valuation methodology used. For regional power, this was historic cost, while for the SWIS it was a combination of historic cost and depreciated optimised replacement cost.¹²⁰

ACCOUNTABILITY REQUIREMENTS

Currently, CSOs are reported in the SCI, annual report, SDP (confidential) and Budget Papers (a line item). These are reviewed by Treasury and the Office of Energy when they review the SCI and SDP.

¹¹⁹ *ibid.*

¹²⁰ *ibid.*

CHAPTER SIX

WESTRAIL

BACKGROUND

Westrail is the trading name of the Western Australian Government Railways Commission. As one of the major organisations in Australia's highly competitive transport industry, its main areas of activity relate to rail freight, passenger transport, infrastructure services and corporate support for these services.¹²¹

LEGISLATION

There is no legislation that specifically relates to Westrail in the same manner as, for example, the Water Corporation. Westrail is a statutory authority established under the *Government Railways Act 1904* to direct, manage, maintain and control the Government Railways in Western Australia.¹²² Other legislation relating specifically to rail transportation that impact on Westrail's functions include:

- *Railways (Access) Act 1998.*
- *Rail Freight System Act 2000.*
- *National Rail Corporation Agreement Act 1992.*
- *Railway Standardisation Agreement Act 1961 (No. 26).*
- *Trans-continental Railway Act 1911.*
- *Rail Safety Act 1998.*

COMMERCIAL REQUIREMENTS

Westrail was commercialised from 1 July 1996 and hence is required to solely pursue a commercial objective. Unlike Western Power, Water Corporation and LandCorp, this is not explicitly stated in its enabling legislation, the *Government Railways Act 1904*. As part of the commercialisation process, Westrail entered into a financial restructure arrangement with Treasury to:

. . . progress the implementation of competitive neutrality of Westrail in accordance with National Competition Policy and to increase the transparency of the cost and funding of its CSOs . . .¹²³

Specific elements of the restructuring package included:

- direct funding from Treasury for the net costs of CSOs;
- introduction of tax equivalent regime requirements;
- a land rationalisation program with proceeds used to reduce Westrail's debt; and

¹²¹ Westrail Worldwide Web site: <<http://www.westrail.wa.gov.au/about.htm>> (last updated 24 March 1999).

¹²² Westrail, Annual Report 1999.

¹²³ Westrail, Statement of Corporate Intent 1997-98, p. 17.

- annual dividend payments to Treasury.

According to Treasury:

We have applied the CSO policy into entities, such as Westrail. Over the past few years, as part of the reforms, we have gone down the same path of requiring Westrail to operate with more focus on its bottom line – that is, a commercial outcome – consistent with the structure that has been put in place for the three larger enterprises (Alinta Gas, Water Corporation and Western Power).¹²⁴

COMMUNITY SERVICE OBLIGATIONS

DEFINITION

Westrail's definition of a CSO is consistent with that provided by Treasury:

At the direction of Government, Westrail provides a number of services for which it does not fully recover the cost of providing those services.¹²⁵

MINISTERIAL DIRECTIONS

Section 8C of the *Government Railways Act 1904* provides for the Minister to give Directions:

The Minister may give directions in writing to the Commission with respect to the performance of its functions, either generally or in relation to a particular matter, and the Commission shall give effect to any such direction.

Westrail informed the Committee that to date no formal directive has been issued to provide existing country passenger CSOs¹²⁶: rather they are activities that Westrail has been performing for a considerable period of time at a continued loss. The Hotham Valley Railway CSO however, was a directive from the Minister and Midland Workshop was as the result of a Cabinet decision.¹²⁷

IDENTIFICATION OF CSOS

Westrail identifies CSOs on an annual basis and are approved by Government (i.e. by the Minister for Transport with the concurrence of the Treasurer via Westrail's SCI) and reviewed by Treasury (see also section on "Accountability Requirements").¹²⁸

There is no long-term agreement with Treasury for the continued receipt of funding for CSOs, although Westrail anticipates that they will continue to receive CSO funding in the foreseeable future.

¹²⁴ Transcript of Evidence, 15 June 1998, p. 3.

¹²⁵ *ibid.*, p. 73.

¹²⁶ Supplementary Information from the Acting Commissioner of Railways, Mr Wayne James, to the Chairman of the PAC, Mr Max Trenorden, MLA, 21 July 2000.

¹²⁷ *ibid.*

¹²⁸ Transcript of Evidence, 15 June 1998, p. 80.

In evidence, Westrail stated that:

Although Government has not specifically guaranteed that Westrail will continue to receive funding for the CSOs, in January 1996 State Treasury issued a paper entitled “Community service obligations performed by government trading enterprises” which proposed that the cost of community service obligations by GTEs would be directly funded from general government revenue to place the GTEs on a competitively neutral basis. Treasury has included the amount for CSO funding in 1998-99 budget papers, which cover three years out. There is not a specific guarantee. It was recommended by Treasury and approved by Government and it is included in the budget papers.¹²⁹

When asked in evidence what issues would affect future CSO funding, Westrail replied that:

When the freight business is sold¹³⁰, the question is of how precisely the residual Westrail activities would be classified; that is, direct budget appropriation or the continuation of CSO support for non-commercial activities is yet to be finally determined . . . The country passenger services are to remain in government hands. Whether we go onto a budget appropriation or whether there is a continuation of the CSO is yet to be determined in the structuring of funding post-residual Westrail after the sale, if the sale progresses.¹³¹

In the absence of any long-term agreement for the continued provision of CSO funding, there has been no documentation stating the process that should be followed if an activity is to be recognised as a new CSO. This has been somewhat rectified, however, by Treasury’s introduction of a new CSO policy that states how new CSOs should be treated.

To date Westrail has not been able to identify any other areas that should be identified as new CSOs.

CSOs RECEIVED

The major services for which Westrail receives a CSO payment are listed under the heading of “Country Passenger” and include the *Australind*, *Prospector* (which includes the *AvonLink*) and country road coach services. Another category of CSOs is termed ‘other’ by Westrail and includes activities that Westrail is required to undertake where it may be considered to be appropriate to include as a CSO.¹³²

Westrail has six areas for which it receives CSO payments, including 3 under the heading of ‘other’ and these are tabled below, together with the CSO revenue obtained for each:¹³³

¹²⁹ Transcript of Evidence, 15 June 1998, p. 79.

¹³⁰ The Government announced the sale of the freight business on 30 October 2000.

¹³¹ Transcript of Evidence, 4 July 2000, p. 25.

¹³² Transcript of Evidence, 15 June 1998, p. 73.

¹³³ Westrail, Annual Reports 2000, 1999, 1998 and 1997.

CSO	1996-97	1997-98	1998-99	1999-00
<i>Country Passenger</i>				
Australind	\$ 6 410 000	\$ 5 438 000	\$ 6 621 000	\$ 6 665 000
Prospector/Avonlink	\$ 9 403 000	\$ 8 288 000	\$ 6 907 000	\$ 7 950 000
Road Services	\$ 2 890 000	\$ 4 765 000	\$ 4 788 000	\$ 4 954 000
<i>Subtotal</i>	\$ 18 703 000	\$ 18 491 000	\$ 18 316 000	\$ 19 569 000
<i>Other</i>				
Indian Pacific	\$ 660 000	\$ 665 000	\$ 694 000	\$ 678 000
Midland Workshops Maintenance/ Security*	\$ 457 000	\$ 454 000	\$ 441 000	\$ 737 000
Hotham Valley Tourist Railway	\$ 50 000	\$ 101 000	\$ 96 000	\$ 132 000
<i>Subtotal</i>	\$ 1 167 000	\$ 1 220 000	\$ 1 231 000	\$ 1 547 000
TOTAL	\$ 19 870 000	\$ 19 711 000	\$ 19 547 000	\$ 21 116 000

* At the end of June 2000, the Midland Workshops site was transferred to the Midland Redevelopment Authority. As a result, Westrail will no longer receive a CSO in relation to this item.¹³⁴

In evidence, Westrail informed the Committee that the estimated net CSO payment for 2000-01 would be \$20.6 million, representing 5% of Westrail's total revenue budget.¹³⁵

COUNTRY PASSENGER SERVICES

The country passenger services represent the bulk of the CSOs claimed. Westrail does not separately identify a CSO for pensioners allowed to travel at concessional rates on country passenger services. The reason for this is that the CSO received is based on the difference between the fare box and the cost of providing the service. Therefore, when revenue is reduced by the amount of the concession, this difference is made up by the CSO claimed. Westrail sees no benefit in highlighting the free or half fares received by pensioners or any other group, although the information was available if required.¹³⁶

Finding 12

Westrail does not disaggregate the fares received from country passenger services to ascertain that received by pensioners or other groups from country passenger services.

¹³⁴ Transcript of Evidence, 4 July 2000, p. 24.

¹³⁵ *ibid.*, p. 30.

¹³⁶ *ibid.*, pp. 31-32.

Recommendation 12

That Westrail separately identify and disclose the pensioner concessions on country passenger services as they do with the Indian Pacific (see below) and in the same manner as currently adopted by the Water Corporation and Western Power.

OTHER***Indian Pacific***

Pensioners travelling on the Indian Pacific service (between Perth and Kalgoorlie) are entitled to a concessional fare as approved by Government. The service is operated by Great Southern Railways Ltd (GSRL). The difference between the concession fare and the regular fare is paid by Westrail to GSRL and the amount is then claimed directly from the Government by Westrail. Westrail's role is only administrative in the sense that they receive the invoice, pay the amount stated on the invoice and then claim the funds back directly from Treasury. The CSO is considered as foregone revenue and represents a standard rebate.

The amount of the payments paid by Westrail for this CSO is determined simply on advice from the auditor in other States. On querying the reliability of this system, Westrail was informed by the auditors that the GSRL system was appropriate and rigorous, so that the payment made was true and valid. However, Westrail (and indeed Treasury) have no means of verifying the amount and requests for the GSRL to provide names and details of people who have travelled have been met by refusal on the basis that it would be too much work for the GSRL.¹³⁷

In evidence, Westrail stated that they were still not satisfied with this arrangement and that in order to maintain some control over the process, Westrail had placed a cap on the amount that it will pay per month.¹³⁸ Westrail further stated that:

. . . dealing with this could be placed in a more appropriate agency than with Westrail because we are an intermediary . . . The Office of Seniors would be appropriate.¹³⁹

Conversely, Treasury considered that this existing process was preferable to Treasury reimbursing GSRL directly as it provided a more accountable process and better transparency with respect to the cost of country rail and bus subsidies.¹⁴⁰

¹³⁷ Transcript of Evidence, 4 July 2000, p. 32.

¹³⁸ *ibid.*, p. 33.

¹³⁹ *ibid.*,

¹⁴⁰ Supplementary Information from Mr John Langoulant, Under Treasurer, to the Chairman of the PAC, Mr Max Trenorden, MLA, 24 July 2000.

Finding 13

Westrail currently has no means with which to verify the amount claimed by Great Southern Railways Ltd for pensioners travelling on the Indian Pacific service.

Recommendation 13

That a process be developed that enables the verification of the amount claimed by Great Southern Railways Ltd with regard to the Indian Pacific service.

Maintenance and Security at the Midland Workshops

Westrail has in the past performed site maintenance and security at the Midland Railway Workshops. This activity was initiated as a result of a Cabinet decision that these costs were to be treated as CSOs. The Midland Workshops were sold to the Midland Redevelopment Authority at the end of June 2000 and therefore are no longer on Westrail's books.¹⁴¹

Hotham Valley Tourist Railway

Westrail's track access agreement with the Hotham Valley Tourist Railway originally included a provision which was inserted as a directive from government, that the track access fee be set at a nominal \$1 per annum per tour until November 1997. The Committee understands that this was further extended for 5 years from 31 October 1998.¹⁴² The difference between the nominal figure and the long-run avoidable costs of providing track access represented the CSO claimed by Westrail.

URBAN PASSENGER SERVICES

The Department of Transport reimburses Westrail for all the costs incurred in providing the urban passenger railway services under a formal arrangement entitled "Alliance Agreement for Provision of Urban Passenger Rail Services". Responsibilities under this agreement are as follows:

- The Director General of Transport must:
 - fund the Operator in accordance with the approved operating budget;
 - fund the Operator in accordance with the approved capital works program;
 - approve train operating service standards;

¹⁴¹ Transcript of Evidence, 4 July 2000, p. 24.

¹⁴² Memorandum from the Office of the Minister for Transport to Mr Wayne James, Acting Commissioner for Railways, 24 August 1998.

- approve customer service standards including security and passenger service staffing levels;
 - provide a “Systems Quality Manual” for the services;
 - provide a system-wide signage and information system;
 - provide a public information service;
 - market and promote the services;
 - supply patronage and revenue statistics to the Operator; and
 - undertake passenger satisfaction surveys at least once in a financial year and table such information as Alliance Board business.
- The Operator must:
 - operate the services in accordance with the approved timetable at Schedule 4 of the agreement;
 - maintain assets and infrastructure in accordance with the approved asset and maintenance standards at Schedule 6 of the Agreement;
 - undertake capital works in accordance with the approved program;
 - provide security and passenger services, both on and off the trains, in accordance with the approved levels at Schedule 5 of the Agreement;
 - supply, install and maintain signage;
 - conduct fare evasion operations;
 - provide public relations services; and
 - respond to media inquiries.¹⁴³

Westrail collects and retains the fare from passengers travelling on the urban network. The difference between the costs to operate the network and the revenue received is claimed back by Westrail from the Department of Transport and is not classed as a CSO. Information on the total costs of providing the urban passenger service is provided in Appendix 14.

The issue of whether the urban passenger railway services should be considered a CSO is the subject of some debate. When asked in evidence why Westrail’s country services were considered CSOs, whereas its suburban (or urban) services were not, Westrail replied that:

The CSO to Treasury is to provide country passenger services from which we do not fully recover the cost. In the urban network, Westrail operates the network for the Department of Transport under a formal agreement to operate. We are the department’s operator of the urban network; whereas, under the country bus service, we are the provider of the service, if one takes the definition of CSOs with [*sic*] Treasury.¹⁴⁴

In evidence, Treasury argued that:

In effect, both the urban passenger rail services and the country passenger services are being treated in the same way. The funding provided to Westrail for its urban transport services – that is through the arrangements created through the Department of Transport . . . is treated as though they were CSOs . . . over time we would like to define further the CSO policy so that we have consistent treatment across all enterprises . . . In a perfect world they [urban rail financial arrangements] would be treated fully as CSOs and would be called that; however at the moment we still have a mixed approach.¹⁴⁵

¹⁴³ Correspondence from Mr Mike Harris, Acting Director General of Transport, to the Chairman of the PAC, Mr Max Trenorden, MLA, 27 June 2000.

¹⁴⁴ Transcript of Evidence, 15 June 1998, p. 79.

¹⁴⁵ *ibid.*, pp. 3-4.

In addition, Treasury pointed out that at the time the CSO policy was introduced, Westrail's rail service was operated as part of an integrated public transport system with different funding arrangements existing between a number of different parties such as Transport, MetroBus, Transperth (as it was then called) and Westrail.¹⁴⁶

The Department of Transport, in response to a question from the Committee relating to why country passenger services were considered a CSO and urban passenger railway services were not, stated that:

The treatment of country passenger services as a CSO has been determined by Treasury in association with Westrail. The determination of CSOs is a whole of government issue managed by Treasury.¹⁴⁷

STATE RAIL REFORMS

Under NCP, all Australian Governments are committed to implement reforms which include the:

- application of competitive neutrality principles to Government business enterprises;
- restructuring of public sector monopoly businesses; and
- provision of third party access to nationally significant infrastructure.

Reforms to the State's rail system nearing finalisation include:¹⁴⁸

- the implementation of the State rail access regime to open the intrastate network to rail competition;¹⁴⁹
- the appointment of an independent regulator to ensure fairness and equity of access to the railway network;¹⁵⁰ and
- the sale and lease of the Westrail freight business.¹⁵¹

¹⁴⁶ Transcript of Evidence, 15 June 1998, pp. 3-4.

¹⁴⁷ Correspondence from Mr Mike Harris, Acting Director General of Transport, to the Chairman of the PAC, Mr Max Trenorden, MLA, 27 June 2000.

¹⁴⁸ The Government of Western Australia, Budget Paper No. 3, *2000-01 Economic and Fiscal Overview*, 11 May 2000, p. 161.

¹⁴⁹ The *Government Railways (Access) Act 1998* was assented to on 30 November 1998 and provides for, amongst other things, the establishment of a rail access code to govern the use of government rail operations by persons other than Westrail. The legislation establishes a regime governing the negotiation of access to the rail network and a regulator to oversee the process. Parts 1-4, 5 and 7 are still to be proclaimed. The short title of the Act was consequently amended to the *Railways (Access) Act 1998* by way of Section 62 of the *Rail Freight System Act 2000*.

¹⁵⁰ In May 2000, the *Government Railways (Access) Amendment Bill 2000* was introduced, seeking primarily to redefine Part 3 of the *Government Railways (Access Act) 1998* in relation to the "Regulator". On 19 October 2000, this Bill was read a third time on motion by the Hon. Murray Criddle, MLC, Minister for Transport and was returned on 14 November 2000 to the Legislative Assembly with amendments.

¹⁵¹ The *Rail Freight System Act 2000* was assented to on 8 June 2000 and provides for the sale of Westrail's freight business and lease of the freight railway. It was intended that the lease of the track and corridor to the purchaser of the freight business would permit a vertically integrated rail freight operation. On 30 October 2000, the Minister for Transport, the Hon. Murray Criddle, MLC, announced the sale of Westrail's freight business to the Australian Railroad Group (ARG) Pty Ltd. The track network itself will remain an asset of the State and will be leased to ARG for 49 years.

Implications for Westrail's CSOs

Westrail considers that the provision of third party access to track and infrastructure would not impact on it delivering the required services under agreed CSO arrangements. In addition, Westrail stated that:

. . . the only competition between above rail operators is on interstate freight routes where there are 3 operators providing train services. Westrail is not a competitor in this market.

. . . There is no proposal to allow competition in a market where CSOs exist. There are no CSOs for Westrail's freight business.¹⁵²

From an intrastate perspective, Westrail anticipated that competition would be centred on standard gauge routes such as that between Perth and Kalgoorlie. Westrail also claimed that road coaches were regulated to the advantage of Westrail in order to guarantee continuity of service and were operated in markets where commercial operations could not be sustained.¹⁵³

The implementation of third party access will not impact on current commercial agreements that Westrail has in place with companies such as the National Rail Corporation, GSRL and Hotham Valley Tourist Railway. These commercial agreements were in place prior to the implementation of third party access.¹⁵⁴

On the issue of whether third party access would enable third party operators to legitimately claim CSOs in the future, Westrail were of the opinion that:

Third party operators could compete with Westrail for the right to provide government subsidised services, should the Government decide to tender for those services. However, the payment in those cases would be arranged under a commercial contract.¹⁵⁵

With respect to whether the sale of the freight business would enable a given rail service provider to claim a CSO in future, Westrail replied:

No. The Government has the right to decide, for social, environmental or regional development reasons, that a particular rail service should be provided even though it may not be commercially viable, and that the service should be subsidised to ensure it is provided. In such a case, the subsidy would be paid to whoever the Government chooses (whether by tender or other mechanism). However, it would not be a "CSO" and would be offered by the Government, not claimed by [the] provider. Under current Government policy it would be subject to a commercial contract.¹⁵⁶

¹⁵² Supplementary Information provided by Mr Wayne James, Acting Commissioner of Railways, to the PAC, 25 September, 1998.

¹⁵³ *ibid.*

¹⁵⁴ Transcript of Evidence, 15 June 1998, pp. 88-89.

¹⁵⁵ Supplementary Information provided by Mr Wayne James, Acting Commissioner of Railways, to the Chairman of the PAC, Mr Max Trenorden, MLA, 21 July, 2000.

¹⁵⁶ *ibid.*

COSTING AND FUNDING OF CSOs

FUNDING OF CSOs

Westrail is directly funded each quarter from Treasury for the net cost of CSOs. In evidence, Treasury stated that, generally speaking, CSO payments are:

. . . structured to minimise the impact on the Budget of timing differences in payments. With Western Power and Westrail for example, the flow is between the consolidated fund and the agency. That tends to smooth out for the entire year and we can get away with the quarterly payments.¹⁵⁷

METHOD OF CALCULATION OF CSOs

Consistent with Treasury's guidelines, the long-run avoidable cost method is used to calculate all of Westrail's passenger services CSOs with the exception of pensioner concessions, which are costed as foregone revenue. Using this method, the CSOs are calculated by measuring the operating and capital costs of providing the services on a long-run avoidable cost basis and then deducting revenue received. The difference becomes a CSO. The capital calculation includes a rate of return on assets but only sufficient to cover the interest for Country Passenger-related assets.

In calculating the Country Passenger loss, the deprival value framework is used to determine the value of the assets.

Furthermore, differences exist in calculating the cost of the country passenger service and the urban passenger network. As Westrail explained in evidence:

The difference essentially is that the depreciation rates are the accounting depreciation rates for urban . . . with country passenger you are looking at a future cost recovery by using the deprival value . . . whereas the urban passenger is recovery of costs that are incurred in the year concerned . . . [the depreciation on] urban is based on the historical cost of the assets involved over an estimated life, so they reflect the accounting depreciation figure.¹⁵⁸

Dividends

As from 1 July 1996, Westrail has been paying annual dividends to Treasury to ensure a neutral impact on the Consolidated Fund (CF).

In evidence, Westrail stated that:

From 1998-99 onwards, the CSOs are less than the dividend. In 1998-99 the ratio of dividend to CSO is 263%; in 1999-00 is 203%; from 2000-01 is 180% and for 2001-02 it is 164%. It is possibly relevant to state that the effect of CSO payments and land sale proceeds on the CF is neutral because of the combined effects of the dividends Westrail pays and the tax equivalent regime.¹⁵⁹

¹⁵⁷ Transcript of Evidence, 15 June 1998, p. 6.

¹⁵⁸ Transcript of Evidence, 4 July 2000, pp. 36-37.

¹⁵⁹ Transcript of Evidence, 15 June 1998, p. 80.

The ratio of CSO to dividend for 2000-01 has been subsequently revised to 240%, with dividends of \$49.5 million.¹⁶⁰

The table below shows the annual dividend payments made by Treasury from 1996-97 to 1999-00:

Year	Dividend
1996-97	\$ 1 508 000
1997-98	\$ 32 868 000
1998-99	\$ 44 744 000
1999-00	\$ 53 790 000

Tax Equivalent Regime

From 1 July 1996, Westrail became subject to the State Government's Taxation Equivalent Regime. Under the regime, Westrail pays to the State Government the equivalent of the income tax, sales tax and rates it would have to pay to the Commonwealth Government if it were a private company.

The Committee noted that in the 2000-01 Budget Papers, Westrail is not forecast to pay tax equivalents. On querying this, the Committee was told by Westrail that the tax payable was offset against tax losses carried forward. The tax losses derive from the difference between the accounting treatment and the tax treatment of works in progress. Essentially, the accounting treatment would be to capitalise the costs, whereas the tax treatment would be to classify them as an expense. The result of expensing the tax treatment is a tax loss position and the small tax payable result is as a result of profit. Westrail is thus able to claim that back or offset that against the carried forward tax loss. This has occurred in previous years. Hence, due to the entitlement to claim against the previous year's tax losses, no cash payment has been made.¹⁶¹

ACCOUNTABILITY REQUIREMENTS

REPORTING REQUIREMENTS

Westrail's CSOs are disclosed in its annual report and the Budget Papers. Westrail also reports CSOs in its SCI, SDP and quarterly reports to the Minister and the Treasury. The SCI and SDP are prepared in the same manner as those produced by the Water Corporation and Western Power except that Westrail has no legislative requirement to provide them. The last publicly available SCI was for 1997-98 and was not tabled in Parliament. Although an SCI was prepared for 1999-00, it was not released by the Minister due to the impending sale of the Westrail freight division.¹⁶²

The SDP requires the approval of the Minister for Transport and covers the budget year and the following five years. As it contains commercially sensitive information, it is treated as confidential to the Minister for Transport, Westrail and Treasury.

¹⁶⁰ Transcript of Evidence, 4 July 2000, p. 30.

¹⁶¹ *ibid.*, pp. 30-31.

¹⁶² *ibid.*, p. 39.

REPORTING IN BUDGET PAPERS

CSO payments made to Westrail are reported in the Budget Papers under Treasury's administered transaction expenditure. These line item figures also include the value of land sales revenue credited to the Consolidated Fund, which in turn overstates the value of Westrail's CSO payments (actual, estimated actual, budget and forward estimates).

In evidence, Westrail explained that:

The appropriations we receive are part of the land rationalisation project which are [*sic*] currently underway. That is expected to be finalised by 2003 to 2004. Essentially that project will stop.

Under the modernisation program for Westrail, we were given the entitlement to sell surplus land and pay off debt. That has been determined as the land rationalisation program. Obviously it has a life of surplus land, which at this stage is about 2003-04.¹⁶³

MONITORING OF CSOS

Treasury monitors Westrail's CSOs during the course of assisting the Minister in approving the SCI and SDP. CSO figures are included in the Annual Report as a note which is included in the opinion given by the Auditor General.

In evidence, Treasury stated that:

We meet with agencies annually and ask them questions and impress on them the need to adhere to detailed costing guidelines . . . We have a relatively light handed regulatory approach.¹⁶⁴

In addition, Westrail stated that:

Periodic discussions between Westrail and Treasury focus on ensuring that only CSOs that have been approved by Government are included in the appropriation to Westrail. There are detailed discussions between Westrail and Treasury in relation to the variations from budget and also in relation to each of the services and any significant cost elements. We give reports that look at variations to budget and we report on anything that is significant.¹⁶⁵

Treasury has also indicated that due to an agreement on the financial arrangements in place with Westrail, they are comfortable with their level of access to information from the entity.¹⁶⁶

Finding 14

CSO payments figures to Westrail disclosed in the Budget Papers also include the value of land sales revenue credited to the Consolidated Fund.

¹⁶³ Transcript of Evidence, 15 June 1998, p. 75.

¹⁶⁴ *ibid.*, p. 7.

¹⁶⁵ *ibid.*, p. 83.

¹⁶⁶ *ibid.*, p. 12.

Recommendation 14

That for reasons of transparency, the Budget revenue from land sales be separately disclosed so as to more accurately reflect Westrail's CSO payment figures.

CHAPTER SEVEN

LANDCORP

BACKGROUND

The Western Australian Land Authority, which trades as LandCorp, is the State Government's land and project development agency. It was established under the *Western Australian Land Authority Act 1992* to:

. . . provide, or promote the provision of, land, infrastructure, facilities and services for the social and economic needs of the State and to dispose of surplus Government land assets.

LandCorp was formed out of the operations of the previous Joondalup Development Corporation and Industrial Lands Development Authority and acquired various land assets previously held by the Western Australian Development Corporation. Its roles range from ' . . . equity participation, project management to consulting'¹⁶⁷ and it works with a variety of bodies, including regional development commissions, the Western Australian Tourism Commission, the Ministry of Planning, local government authorities and local communities.

In 1997-98, a statutory Ministerial review examined the operations and effectiveness of LandCorp. Changes arising from the Review included:

- introducing new accountability requirements, including the preparation of an annual SCI and SDP;
- clarifying commerciality provisions to ensure strategic Government projects could be undertaken in a transparent framework; and
- implementing competitive neutrality reforms, such as discontinuing LandCorp's exemption from rates and taxes.¹⁶⁸

Since the Ministerial Review, LandCorp's focus has shifted to developing statewide strategic industrial land and major urban and regional projects, which provide less than commercial financial returns.¹⁶⁹

LEGISLATION

LandCorp operates under the *Western Australian Land Authority Act 1992*, which was amended in 1998 following the Ministerial review. It is also governed by the *Western Australian Land Authority Regulations 1999* which, amongst other things, prescribe what CSO details are to be included in the Authority's SCI:

- (j) the nature and extent of community service obligations that are to be performed;
- (k) the costings of, funding for, or other arrangements to make adjustments relating to community service obligations; and

¹⁶⁷ LandCorp, Statement of Corporate Intent 1999-00, p.1.

¹⁶⁸ *ibid.*

¹⁶⁹ LandCorp Worldwide Web site: <<http://www.landcorp.com.au/chairman.html>>, p. 1 of 1 (Accessed 13 April 2000).

- (l) the ways in which, and the extent to which, compensation will be made for performing community service obligations.¹⁷⁰

These requirements are the same as for Western Power and the Water Corporation under their respective Acts.

COMMERCIAL REQUIREMENTS

In 1992, when LandCorp was first formed, it was required to operate on a commercially prudent basis, although the term “commercially prudent” was not defined in the Act. At that time, LandCorp received Crown Solicitor’s advice that its legislation required it not to take on projects that would generate a loss. As LandCorp noted:

As a result, in the mid to early 1990s we entered into CSO arrangements for those projects which were government priorities, but which would, if not for the CSO funding, have resulted in a loss.¹⁷¹

Hence, LandCorp received CSOs prior to 1998, but they were handled slightly differently to now, in that the interpretation of LandCorp’s original legislation caused it to avoid making normal losses. As a result, the CSO calculation did not take into account the full time-value of money as it does now. As Mr Graham Lewis, LandCorp’s General Manager, Finance and Corporate noted, ‘it was merely a way of causing the CSO identified projects to break even in normal terms.’¹⁷²

Following the 1997-98 review, which recommended that LandCorp’s corporate status should be based on a “soft” commercialised statutory authority model,¹⁷³ new sections were inserted in the Act, which defined those things that represented commercial prudence. For example, Section 19 of the revised Act states that LandCorp has to act on commercial principles in order to:

- (a) perform its functions in a cost-efficient manner;
- (b) endeavour to achieve or surpass the long term financial targets specified in its strategic development plan as existing from time to time; and
- (c) ensure that no individual project undertaken by the Authority has an expected internal rate of return that is less than the minimum rate of return specified in its strategic development plan as existing from time to time.

As LandCorp explained:

We have to endeavour to exceed or achieve long-term financial targets specified in the strategic development plan and we need to make sure that any project that we go into at least achieves a minimum rate of return, or a minimum hurdle rate.¹⁷⁴

However, the minimum rate of return requirement is not as high as it would be for the private sector. LandCorp’s hurdle rate is based on weighted average cost of capital and is substantially less than would apply for a private operation.¹⁷⁵

¹⁷⁰ *Western Australian Land Authority Regulations 1999*, Section 12(3): Period and content of statement of corporate intent.

¹⁷¹ Transcript of Evidence, 6 July 2000, p. 2.

¹⁷² *ibid.*, p. 4.

¹⁷³ Ministerial Review Findings, *Western Australian Land Authority Act 1992*, June 1998, p. 2.

¹⁷⁴ Transcript of Evidence, 6 July 2000, p. 3.

¹⁷⁵ *ibid.*, pp. 3-4.

In evidence to the Committee, Treasury confirmed that the hurdle it requires LandCorp to reach on any of its projects, which would also be the basis of any CSO funding, is a nominal 8.9% for the coming year.¹⁷⁶

LandCorp claimed that Section 19 of the new Act, which detailed what LandCorp could and could not do and specified the hurdle rate requirements, actually increased the amount of CSO payments:

If anything, compared to what happened before, it has increased the amount of CSO payments because, rather than having a hurdle rate of, say, 7, 8 or 9 per cent, previously it was zero. Treasury would fund the difference between the negative amount and zero. Now it is from whatever it is, up to our hurdle rate between 7 and 9 percent.¹⁷⁷

As a commercialised agency, LandCorp is subject to the same requirements as other commercialised and corporatised entities, such as tax equivalents, dividend requirements, return requirements, SCIs and SDPs. It also has a Board of Directors who are responsible to the Minister for Lands.

While the Committee is not interested in determining or defining what should be an agency's rate of return, it is concerned in having a transparent process.

MINISTERIAL DIRECTIONS

Under Section 24(1) of the *Western Australian Land Authority Act 1992*, provision is made for the Minister to give written directions to the Authority '... with respect to the performance of its functions, either generally or in relation to a particular matter and the Authority is to give effect to any such direction'. Any such direction is to be published in the *Government Gazette*, laid before each House of Parliament and included in the annual report.

However, if there is any conflict between a Ministerial Direction and the requirement to act on commercial principles, the former prevails. To date, LandCorp has never received a Ministerial Direction.

COMMUNITY SERVICE OBLIGATIONS

DEFINITION OF A CSO

Section 25A(3) of the *Western Australian Land Authority Act 1992* defines "Community service obligation" as a commitment that arises because:

- (a) the Minister specifically requests the Authority to do something or specifically approves of the Authority doing something;
- (b) the Authority could not do the thing and comply with Section 19(1)(c); and
- (c) things of that kind are not required to be done by businesses in the public or private sector generally.

¹⁷⁶ Transcript of Evidence, 4 July 2000, p. 7.

¹⁷⁷ Transcript of Evidence, 6 July 2000, p. 14.

At first glance, LandCorp's CSOs appear to be more economic than social. For example, the 1997-98 Ministerial Review highlighted the following broad categories of CSOs envisaged by LandCorp:

1. Where LandCorp is required to purchase/develop land which is not expected to yield a commercial rate of return.
2. Where LandCorp is required to identify and evaluate potential sites for development on behalf of Government, or provide project facilitation resources to Government on less than commercial terms.
3. Where the Government requires LandCorp to undertake a project sooner or later than is commercially prudent to do so, with a negative impact upon the project's rate of return.
4. As a transitional arrangement to cover strategic projects and associated long term land holdings for the impact of the Tax Equivalence Regime (TER) where such existing projects do not have a CSO in their own right to cover holding costs.¹⁷⁸

However, LandCorp believed that the Treasury definition of a CSO included the social factor relating to an activity that the government wants provided, but which a public or private sector business would not normally undertake. It was further noted that:

. . . most of our CSO arrangements have an element of social factors. The projects enhance lifestyle opportunities; for example, the Carnarvon fascine development was about improving the social opportunities, as well as economic spin-offs and investment opportunities for the region and so on. CSOs are all about economic and social opportunities.¹⁷⁹

IDENTIFICATION OF CSOS

In relation to determining which development proposals would not be viable for a private developer, LandCorp conducts its own feasibility studies, which are in turn checked by Treasury. These studies involve a due diligence process which teases out the feasibility and the key sensitivities of a project and identifies where the risks relating to the project lie. This process results in obtaining a risk-weighted measure of the internal rate of return for the project, using a discounted cash flow analysis.¹⁸⁰ Treasury, in turn, must be satisfied that the underlying assumptions of the analysis are reasonable. The CSO arrangements can thus accommodate a high element of uncertainty through various forms of CSO payments and can thereby be reviewed and evaluated over time.¹⁸¹

Under its Act, LandCorp cannot enter into any projects that do not at least achieve a minimum hurdle rate. Thus, if a project has less than a minimum rate of return outcome, there is a requirement to go back through the government process to identify whether government wants that activity to be undertaken. If so, then in conjunction with Treasury, CSO arrangements will be put in place.¹⁸²

¹⁷⁸ Ministerial Review, *Western Australian Land Authority Act 1992*, November 1997, p. 19.

¹⁷⁹ Transcript of Evidence, 6 July 2000, p. 3.

¹⁸⁰ *ibid.*, p. 5.

¹⁸¹ *ibid.*, p. 2.

¹⁸² *ibid.*, p. 5.

Through the process identified, LandCorp carries out the feasibility, while Treasury verifies the assumptions, numbers, etc. Both LandCorp and Treasury must agree on the methodology and CSO funding approach:

The CSO funding is just the gap in funding required to achieve our minimum hurdle rate. We may need \$30m revenue; we have \$28m, but we need the extra \$2m to achieve the hurdle rate. CSO funding will cover the \$2m and we will generate the \$28m revenue.¹⁸³

LandCorp does not normally include administration costs in any of its CSO arrangements.

Sharing a similar concern with Western Power, LandCorp commented on the recognition of previous activities of CSOs, which do not currently satisfy its legislation:

There needs to be some transitional arrangements entered into to regularise those. Again, a lot are in the heavy industrial estates. All of those are CSO-type projects. You would not find a private developer doing any of them and yet, for some of them, CSO arrangements are not yet in place and should be put in place.¹⁸⁴

When questioned whether a formal Agreement would be useful for LandCorp, as has been informally negotiated between the Water Corporation and Treasury, Mr Holt, Chief Executive Officer of LandCorp, did not think one was needed, as LandCorp was involved in a more diverse range of projects than Water Corporation and thus did not know up-front what its key CSO project or involvement might be.¹⁸⁵

LANDCORP'S CSOs

While LandCorp has a commercial focus, it is also required at times to carry out the Government's non-commercial economic and social objectives. As LandCorp noted:

CSOs for LandCorp are about enabling the authority to undertake projects that would not stack for a private developer. The process enables the business of government to be proceeded with, so that those matters of strategic benefit, in terms of economic or community benefit, can be undertaken by LandCorp subject to its receiving CSO funding.¹⁸⁶

Hence, as LandCorp often performs activities which are not commercially viable, CSOs are used to cover non-commercial land development projects. While CSOs only account for about 9% of LandCorp's revenue, many of its projects require some CSO funding to make them viable. LandCorp has specified that it will continue to undertake heavy/special industry and regional centre projects where supported by Government.¹⁸⁷

LandCorp's 2000-01 SCI lists a number of CSO projects, including those that have associated payments in 2000-01 and those that do not. Both are included in the interests of transparency. Those projects that do not have associated payments in 2000-01 are the Albany Woodchip Mill, Carnarvon Northwater, Karratha/Burrup West Service Corridor and the Omex Site Bellevue.

¹⁸³ Transcript of Evidence, 6 July 2000, p. 13.

¹⁸⁴ *ibid.*, p. 16.

¹⁸⁵ *ibid.*, p. 11.

¹⁸⁶ *ibid.*, pp. 1-2.

¹⁸⁷ LandCorp, Statement of Corporate Intent, 1999-00, p. 4.

CSO Projects that have associated payments in 2000-01:

Projects Approved by Cabinet	Amount (\$)
Albany Foreshore Redevelopment	900 000
Breton Bay Acquisition	1 000 000
Exmouth Resort Development	6 600 000
Jervoise Bay Commercial Yard Improvements	1 274 000
Mandurah Ocean Marina	1 440 000
Petrochemical Industries Limited Land - Kwinana	510 000
Subtotal	11 724 000
Potential CSO Projects	
Albany Foreshore Redevelopment	1 500 000
Exmouth Resort Development	3 000 000
Subtotal	4 500 000
Funding Through Other Agencies	
Fremantle Rockingham Industrial Areas Region Study	5 000 000
Geraldton Batavia Coast Marina	3 357 000
Kemerton Expansion	2 000 000
Munster Marine Industry Technology Park	6 600 000
Oakajee Industrial Estate Expansion	2 820 000
Thomsons Lake Masterplan	250 000
Subtotal	20 027 000
Grand Total	36 251 000

COSTING AND FUNDING OF CSOs

From the table above, it can be seen that some of LandCorp's CSOs are funded directly by Treasury, while others are funded through other agencies. LandCorp noted that in the last 12 months, the Mid West Development Commission, Peel Development Commission, DCT and Department of Resources Development were involved in funding some of LandCorp's CSOs. LandCorp noted that the existing arrangements worked fairly well, as final approval on CSO arrangements is still required from Cabinet.¹⁸⁸

LandCorp first received direct funding for CSOs in 1998-99. It should be noted that none of LandCorp's projects are solely funded by CSOs. In relation to the methodology for calculating CSOs, LandCorp follows Treasury's policy of long-run avoidable costs applied to a risk-weighted discounted cash flow analysis. This gives the internal rate of return and the net present value as opposed to what is required under the hurdle rate arrangements in the Act. The difference is the CSO.¹⁸⁹ In other words, the CSO is used to bridge the gap.

¹⁸⁸ Transcript of Evidence, 6 July 2000, p. 5.

¹⁸⁹ *ibid.*, p. 7.

As a CSO project is one that, in the absence of CSO funding would not be undertaken because the project would not achieve the hurdle rate, there is no difference between the rate of return for CSO projects, as opposed to non-CSO projects.¹⁹⁰

In relation to its assets, LandCorp generally applies normal accounting standards. Depreciation rates do not normally apply to CSO projects, as most are land development projects. In the event that depreciation was involved, LandCorp would apply normal depreciation rates as they would to any of their other assets. The most likely scenario in which depreciation would apply would be to buildings, which would normally be over the effective life of the building, most likely at 2.5%.¹⁹¹

LandCorp has negotiated two types of CSO mechanisms with Treasury:

- (a) upfront payment to ensure a financial return commensurate with risk; and
- (b) cost recoupment arrangements.¹⁹²

LandCorp explained that for urban-type projects, the arrangement would be an upfront payment, while for industrial projects it would be cost recoupment, because of the inherent risks and uncertainty involved:

The Mandurah ocean marina, for example, on the basis of the feasibility, could reasonably be worked out on a commercial basis; what the development costs will be, what the sales rights will be, what the timing of sales will be. You could work out the internal rate of return. That could be compared with the hurdle rate return requirement and you could work out on discounted cashflow terms what the CSO funding requirement was . . . For other projects, we do not know what the take-up rate will be.¹⁹³

ACCOUNTABILITY REQUIREMENTS

As part of its new accountability requirements, LandCorp is required to prepare SDPs (confidential) and SCIs (public) to be approved by the Minister for Lands and the Treasurer. From 1 July 1999, the Authority also commenced reporting on its operations on a six monthly basis, in addition to its annual reporting requirements.

LandCorp's CSOs are reported in its annual report and SCI, in addition to the Budget Papers, ' . . . potentially under various other government agencies.'¹⁹⁴ LandCorp believes that if someone were to peruse LandCorp's annual report and SCI, they would be able to obtain information relating to every CSO – both what has occurred in the past and what is proposed for the future.¹⁹⁵ LandCorp is obliged to report CSO project annulments through the SCI for the entire life of the project when a CSO has been received. For example, the Marlston Hill Development in Bunbury, which received a very small CSO for cleanup of contaminated areas, is reported as a CSO project, despite the fact that the CSO component was a tiny fraction of the essentially commercial project.¹⁹⁶

¹⁹⁰ Transcript of Evidence, 6 July 2000, p. 7.

¹⁹¹ *ibid.*, p. 9.

¹⁹² LandCorp, Statement of Corporate Intent 1999-00, p. 4.

¹⁹³ Transcript of Evidence, 6 July 2000, p. 10.

¹⁹⁴ *ibid.*, p. 14.

¹⁹⁵ *ibid.*

¹⁹⁶ *ibid.*

While the actual figure for the total amount of LandCorp's CSO funding is provided retrospectively in the SCI, an aggregate is provided in the annual report, which was a measure of how their CSO projects were performing. This was termed "segment reporting".¹⁹⁷

Under Treasury's new CSO policy, there is a requirement that all new and existing CSOs must be reviewed every five years.

For LandCorp, the problem was not so much in collating the information, as they kept that anyway for internal management purposes: rather, the issue with the annual report was that if they reported on every project, because of their sheer volume, there would be no space left to report on anything else. Hence, they felt annual reporting to be too onerous. In LandCorp's view, the SCI, which was a publicly available document, was enough. As LandCorp questioned:

In how many places does this material need to be put and at what level of detail? Unless the level of detail is very clearly identified, or maybe not clearly identified, there can be pages and pages in an annual report that is increasingly seen as the place to put a lot of other things.¹⁹⁸

The Committee agrees that too much is made of annual reports and that there tends to be an information overload at the moment.

LandCorp believed that the current system could be improved in a number of respects. For example, it was noted that normally only a one or two year duration is looked at, although many of LandCorp's projects go for a lot longer, e.g. 20, 30 or 40 years.

As LandCorp suggested:

The Board and the Government, if it wants these things to be done well need to recognise that. Treasury as the keeper of the policy needs to identify with LandCorp some strategies through which we can deal with the long-term situation.¹⁹⁹

LandCorp further suggested that there is a requirement for a means of dealing with longer-term projects. Without this, LandCorp could potentially suffer from exposure because of its CSO projects:²⁰⁰

For example, in acquiring land for the Breton Bay industrial estate, the arrangement is that LandCorp will fund the land acquisition and Treasury Department will appropriate to LandCorp each year an equivalent of the holding costs – the interest and rates and taxes and the like. However, meanwhile sitting on LandCorp's balance sheet will be this asset and . . . [liability] . . . What happens to that is that a Government of the future could unilaterally say it will not continue that holding cost funding approach and then LandCorp is left wearing it. I suppose that is an element of exposure.²⁰¹

¹⁹⁷ Transcript of Evidence, 6 July 2000, p. 14.

¹⁹⁸ *ibid.*, p. 7.

¹⁹⁹ *ibid.*, p. 16.

²⁰⁰ *ibid.*, p. 10.

²⁰¹ *ibid.*, p. 5.

REPORTING IN BUDGET PAPERS

The Committee found that the reporting of LandCorp's CSOs in the Budget Papers was not clear. LandCorp confirmed that much of the associated payments for CSO projects in the Budget Papers often came through other agencies.²⁰² For example, in relation to three of LandCorp's projects, Breton Bay, the Kemerton Expansion and Carnarvon Northwater, it was explained that:

For Breton Bay, there should be something in the budget papers under the Department of Resources Development for holding costs for the Breton Bay acquisitions. The Kemerton expansion would similarly come through the Department of Resources Development. Nothing was estimated and nothing expected on the Carnarvon Northwater.²⁰³

Treasury explained that LandCorp's SCI provides information relating to total CSO payments from Government, including payments from Treasury and from other agencies.²⁰⁴ Although Treasury has expressed a preference for payments for the types of services provided by LandCorp to come through Treasury, many of the current payments pre-date formal commercialisation of LandCorp and thus are still being made through other agencies. In other cases, the CSO payments were allocated to central government agencies to implement particular projects in which LandCorp may have a role. These other agencies retain flexibility in how to implement the project. As a result, the amounts quoted by LandCorp as CSOs are anticipated payments and may not be made.²⁰⁵

Despite Treasury's explanation, the Committee was concerned with a number of aspects relating to LandCorp's CSO funding. Firstly, the fact that the lifecycle of a whole project was reported, and secondly, other agencies were involved in funding some of LandCorp's CSO projects. As a result, there appeared to be no way of verifying the total amount of CSO funding received by LandCorp in any one year.

The Committee accepts that, due to the complexity of LandCorp's non-commercial activities, it is not possible to provide precise details of CSO funding for any given year. As Treasury pointed out:

The key point intended to be conveyed in relation to LandCorp is that the scope and size of non-commercial projects undertaken by it are quite variable year-on-year, as well as between estimates and actual outturns. This is an ongoing characteristic of LandCorp's activities.²⁰⁶

Treasury noted that CSO payments made to LandCorp are reported in the Budget Papers under Treasury's administered transactions expenditure. Funding received by LandCorp from other government agencies is reported under the administered transactions expenditure of those agencies. However, this assumes that a reader will know which agencies are involved in LandCorp's CSO projects and where to look for the information in the Budget Papers.

Treasury recognised this shortcoming and acknowledged that it was '... currently reviewing the presentation of CSO and other funding provided to agencies for the 2001-02 Budget Papers, so as

²⁰² Transcript of Evidence, 6 July 2000, p. 11.

²⁰³ *ibid.*, p. 12.

²⁰⁴ Supplementary Information provided by Mr J.L. Langoulant, Under Treasurer, to the PAC, 24 July 2000.

²⁰⁵ Transcript of Evidence, 4 July 2000, p. 6.

²⁰⁶ Supplementary Information provided by Mr J.L. Langoulant, Under Treasurer, to the PAC, 24 July 2000.

to clearly differentiate the nature of funding provided and to identify total funding provided to agencies.²⁰⁷ In addition, Mr Langoulant, Under Treasurer, admitted that:

. . . the publication of information relating to the trading enterprises could be improved. We have sought to do that in our budget papers over the last couple of years. The estimates committee process this year drew, particularly to my attention, that we could improve on what we do by giving the Parliament information by agency, by year, and by type of payment . . . If we go down this path of publishing information in our budget papers, we will differentiate between CSO payments and other payments . . .²⁰⁸

Finding 15

The amount of LandCorp's CSOs is not easily determined from the annual Budget Papers without referring to other agencies (if known).

Recommendation 15

That LandCorp's CSOs be both consolidated and clearly identifiable (i.e. source of agency) in the Budget Papers, in line with the Committee's Recommendation 5.

²⁰⁷ Supplementary Information provided by Mr J.L. Langoulant, Under Treasurer to the PAC, 24 July 2000.

²⁰⁸ Transcript of Evidence, 4 July 2000, pp. 15-16.

APPENDIX ONE**Witnesses to Hearings Held**

Date	Witness	Position	Organisation
15 June 1998	Mr John Langoulant Mr Donald Brunker Mr Hew Mortlock Mr Michael Court	Under Treasurer Director, Government Enterprises Division. Assistant Director, Government Enterprises Division Policy Officer, Government Enterprises Division	Treasury Department
15 June 1998	Dr Brian Martin Mr Derek Perez	Coordinator of Water Services Principal Economist	Office of Water Regulation
15 June 1998	Dr James Gill Mr Ernest Roberts	Managing Director General Manager, Finance and Administration	Water Corporation
15 June 1998	Dr Leslie Farrant Mr Kenneth Hodgkin	Coordinator of Energy WA Director, Policy and Projects Division	Office of Energy
15 June 1998	Mr Nenad Ninkov Mr Rohan Griffin	General Manager, Corporate Strategy Manager, Strategic Planning	Western Power
15 June 1998	Mr Wayne James Ms Kaye Mulligan Mr John Powell Mr Graeme Morris	Acting Commissioner of Railways Manager, Management Accounting Manager, Country Passenger Services Manager, Financial Accounting	Westrail
21 June 2000	Dr Brian Martin Mr Derek Perez	Coordinator of Water Services Manager, Economics and Pricing	Office of Water Regulation

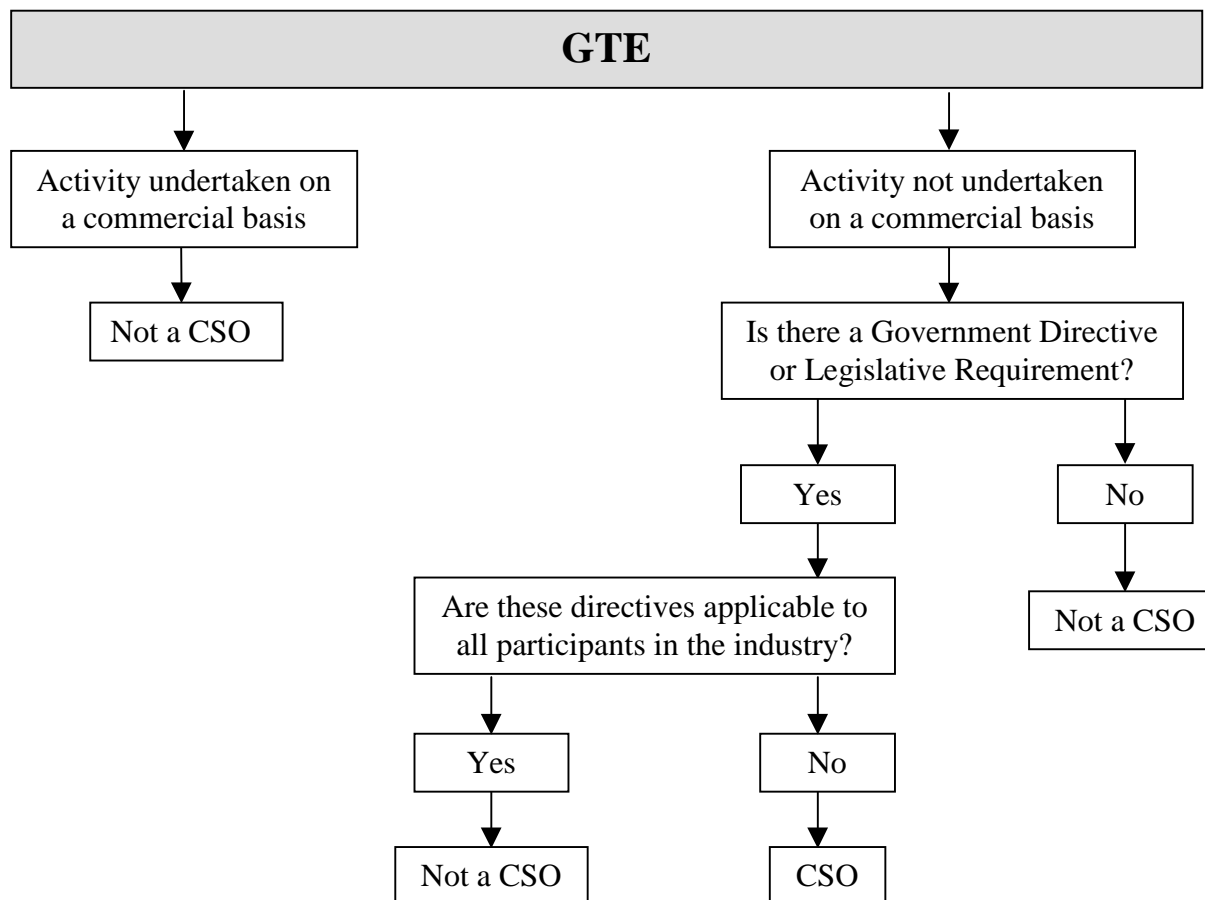
Date	Witness	Position	Organisation
28 June 2000	Dr James Gill Mr Lloyd Werner	Managing Director Manager, Pricing and Agreements	Water Corporation
28 June 2000	Mr Nenad Ninkov Mr John Rhodes	General Manager, Corporate Strategy Principal Business Strategist	Western Power
4 July 2000	Mr John Langoulant Ms Anne Nolan Dr Donald Bruner Mr Corey Dykstra	Under Treasurer Assistant Under Treasurer, Economic Director, Structural Policy Acting Manager, Policy Development	Treasury Department
4 July 2000	Mr Wayne James Mr John Powell Ms Kaye Mulligan Mr Graeme Morris	Acting Commissioner of Railways Manager, Country Passenger Services Manager, Management Accounting Manager, Financial Accounting	Westrail
6 July 2000	Mr Ross Holt Mr Graham Lewis	Chief Executive Officer General Manager, Finance and Corporate	LandCorp

APPENDIX TWO**Submissions Forwarded to the Committee**

Date	Name	Organisation
17 March 2000	Mr Colin Purcell Acting Chief Executive Officer	Goldfields Esperance Development Commission
20 March 2000	Mr Ken Fisher Assistant Director	Peel Development Commission
27 March 2000	Mr Don Punch Chief Executive Officer	South West Development Commission
31 March 2000	Mr David Singe Chief Executive Officer	Wheatbelt Region Development Commission
3 May 2000	Mr Ed Willett Executive Director	National Competition Council
12 May 2000	The Hon. Dexter Davies, MLC President	National Party of Australia – WA Incorporated
May 2000	Mr Stuart Morgan Chairman	Regional Development Council
22 June 2000	Mr Wayne Sheggia Director, Policy and Advocacy	Western Australian Municipal Association (WAMA)

APPENDIX THREE

DEFINING CSOs²⁰⁹



²⁰⁹ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 4.

APPENDIX FOUR

Principal Government CSO Policy Documents²¹⁰

Jurisdiction	Policy Document	Year
Commonwealth	<i>Guide to Commercialisation in the Commonwealth Public Sector.</i>	1996
New South Wales	<i>A Social Policy Program for NSW Government Trading Enterprises.</i>	1994
Victoria	<i>Community Service Obligations: policy statement and background to policy.</i>	1994
Queensland ^a	<i>Corporatisation in Queensland – policy Guidelines.</i>	1992
	<i>Commercialisation of Government Services Functions in Queensland: Policy Framework.</i>	1994
South Australia ^b	<i>Community Service Obligations Position paper (Draft).</i>	1995
Western Australia	<i>Community Service Obligations in Western Australia.</i>	2000
Tasmania ^c	<i>Guidelines: Community Service Obligations.</i>	1996
ACT	<i>Community Service Obligations: definition and Guidelines for Consideration within the ACT Public Sector.</i>	1996
NT	<i>1996 – 97 Issues in Public Finance Budget Paper No. 5.</i>	1996

a The *Government Owned Corporations Act 1993* also relates to CSOs.

b It should be noted that the South Australian Government is currently reviewing its Community Service Obligations Position Paper, with much of the current work by the government directed towards developing detailed implementation procedures. Also, a broad CSO policy was endorsed by State Cabinet and is detailed in the March 1995 *Structure of Business Activities* paper.

c In addition to the CSO policy document, Tasmania has a section on CSOs in its *Government Business Enterprises Act 1995*.

²¹⁰ Industry Commission. *Community Service Obligations: Policies and Practices of Australian Governments*. Information Paper, February 1997.

APPENDIX FIVE

Australian Government Policies on CSOs²¹¹

	SCNPMGTE Definition of CSOs	Identification Procedure	Costing Method	Funding Method	CSOs Provided Under “contract” between the GTE and the Relevant Policy Department	Monitoring of CSOs
New South Wales	Yes ^a	Yes	AC, FDC and FR ^c	DF and CS	Yes	Yes
Victoria	Yes ^a	Yes ^b	AC ^d	DF and CS	Yes	Yes
Queensland	Yes ^a	Yes ^b	AC, FDC and FR	DF, LRR and CS ^e	Yes	Yes
South Australia	Yes	Yes ^l	AC ^f	IF and DF ^e	No	No
Western Australia	Yes	Yes ^b	AC and FR	DF ^g	No	Yes
Tasmania	Yes ^a	Yes	AC ^d	CS and LRR ^{he}	No	Yes
ACT	Yes ^a	Yes	AC, FDC and FR	DF ^{ie}	Yes	Yes
NT	Yes	Yes	AC, FDC and FR	DF and LRR ^{je}	na	Yes
Commonwealth	Yes ^a	Yes ^m	AC and other	CS and DF	No	No ^k

a Minor variations apply.

b The identification procedure has been undertaken sector by sector as part of the commercialisation of government business operations.

c The NSW Government has also advocated the use of the 'activity based costing' method.

d Departures from the avoidable cost method are permitted in certain circumstances.

e It is intended that identified CSOs be funded at efficient costs.

f The information provided is based on the Community Service Obligations Position paper (Draft).

g This relates to WA's identified CSOs.

h The policy of the Government is to move towards direct funding of CSOs in the medium term.

i Other funding methods may also be used.

j This is the policy of the NT Government.

k Although explicit CSOs (like those performed by Australia Post) are reviewed periodically, no overall monitoring program is in place.

l SA Government Business Enterprises (GBEs) are required to specify the nature and scope of non-commercial operations in their corporate charter.

m Not all of the identified non-commercial activities performed by GTEs and Business Units are recognised by the Department of Finance as CSOs.

Abbreviations	AC	Avoidable Cost	FDC	Fully Distributed Costs	IF	Internal Funding	LRR	(Accepting a) lower rate of return
	CS	Cross-subsidies	FR	Foregone Revenue	DF	Direct Funding	na	not available

²¹¹ Industry Commission. *Community Service Obligations: Policies and Practices of Australian Governments*, Information Paper, February 1997, p. 4.

APPENDIX SIX

Comparison of CSO Policies from the Different States and Territories

	SA	VIC	QLD	TAS	NT	NSW
Definition	Non-commercial objectives that governments require public businesses to pursue in order to achieve government outcomes. ²¹²	CSOs are the non-commercial programs and activities of GBEs designed to meet community and social objectives determined by Government. ²¹³	An activity performed by a business on behalf of government in order to meet social or other objectives, carried out at the request of government. ²¹⁴	A function service or concession [that] would not have been performed, provided or allowed if the GBE were a business in the private sector acting in accordance with sound commercial practice. ²¹⁵	The means by which the Government . . . can require Government Business Divisions (GBD) to provide services which would not be provided if assessed on a purely commercial basis. ²¹⁶	A Social Program that will be undertaken by a GTE at the request or direction of the Government which would not be pursued by a GTE operating on a purely commercial basis. ²¹⁷
Legislation	Application of CSO Policy is extended to those corporations established under the <i>Public Corporations Act 1993</i> – the SA government’s preferred model. ²¹⁸	CSO Policy is regulated by the <i>State Owned Enterprises Act 1992</i> . ²¹⁹	CSO policy is regulated by each entity’s enabling legislation and the <i>Government Owned Corporations Act 1994</i> . ²²⁰	CSOs are identified and regulated under the <i>Government Business Enterprises Act 1995</i> , and the Ministerial Charter may also require a GBE to carry out certain activities required by Government. ²²¹	GBDs are defined in the <i>Financial Management Act 1995</i> and CSOs are identified and regulated under each GBD’s enabling legislation. ²²²	The pricing of Government monopoly services is regulated under the <i>Government Pricing Tribunal Act 1992</i> . ²²³

²¹² Government of South Australia, *CSO Policy Framework*, December 1996, p. 2.

²¹³ Victorian Government, *CSO Policy Statement*, August 1994, p. 1.

²¹⁴ Queensland Electricity Supply Industry, Volume II – Main Report, December 1996, pp. 44-45.

²¹⁵ Tasmanian Government, *Government Business Enterprises Act 1995*, Section 61(2)(b).

²¹⁶ Northern Territory of Australia, Budget Paper No. 5, 1996, *Issues in Public Finance*, p. 95.

²¹⁷ NSW Government, *A Social Program Policy for NSW Government Trading Enterprises*, July 1994, p. 54.

²¹⁸ Correspondence from the Hon. Rob Lucas, MLC, South Australian Treasurer, to the Chairman of the PAC, Mr Max Trenorden, MLA, 8 September 1998.

²¹⁹ Victorian Government, *CSO Policy Statement*, August 1994, p. 9.

²²⁰ Queensland Electricity Supply Industry, Volume II – Main Report, December 1996, p. 44.

²²¹ Government Prices Oversight Commission – Tasmania, Annual Report, Year End June 1999, p. 3.

²²² Northern Territory of Australia, Budget Paper No. 5, 1996, *Issues in Public Finance*, p. 104.

²²³ NSW Government, *A Social Program Policy for NSW Government Trading Enterprises*, July 1994, p. 9.

	SA	VIC	QLD	TAS	NT	NSW
Funding	CSOs are funded primarily from the Consolidated Account/Fund, with a view to maintaining Budget Neutrality. ²²⁴	CSOs are funded primarily from the Consolidated Fund, consistent with the provisions in the <i>State Owned Enterprises Act 1992</i> . ²²⁵	CSOs financed through a combination of cross-subsidies, transfer payments between distributors and direct funding from the State Budget. ²²⁶	The Stakeholder Minister, Portfolio Minister and Treasurer, jointly, must determine the method and basis on which a GBE will be funded in whole or in part for undertaking a CSO after consulting with the GBE. ²²⁷	Treasury negotiate the price to be funded directly from the Budget. ²²⁸	Direct Funding through the Consolidated Revenue allocations; or indirect or continued internal funding through cross-subsidies. ²²⁹

²²⁴ Government of South Australia, *CSOs Policy Framework*, December 1996, p. 7.

²²⁵ Victorian Government, *CSO Policy Statement*, August 1994, p. 9.

²²⁶ Queensland Electricity Supply Industry, Volume II – Main Report, December 1996, p. 44.

²²⁷ Tasmanian Government, *Government Business Enterprises Act 1995*, Section 63.

²²⁸ Northern Territory of Australia, Budget Paper No. 5, 1996, *Issues in Public Finance*, p. 96.

²²⁹ NSW Government, *A Social Program Policy for NSW Government Trading Enterprises*, July 1994, p. 36.

APPENDIX SEVEN

COSTING AND FUNDING OF CSOs

COSTING OF CSOs

Marginal Cost Approach

In theory, optimal economic efficiency occurs when price is set so as to recover long-run marginal cost. Whilst this would most likely produce the most accurate measure of CSO costs, in practice, there are a number of difficulties associated with the measurement of long-run marginal cost:

- judgement is required to determine the appropriate unit of output;
- the size of the unit of additional output is difficult to determine due to the problem of allocating fixed costs to the different services provided;
- marginal costs can vary considerably over a short period of time as a result of changes in demand (e.g. electricity demand varies considerably with respect to the time of day, weather conditions, etc) and thus the ability to distinguish between short- and long-run marginal costs becomes difficult.²³⁰

Long-Run Avoidable Cost Approach

Whilst similar to the marginal cost approach in that it identifies the economic cost of a particular service as the change in cost associated with an increase or decrease in the production of that service, this approach examines the cost as an additional range or block of output (rather than a unit of output). In addition, this approach includes the incremental variable costs of the extra output and additional capital costs where increased capacity is required. Thus, this approach uses a mix of short- and long-run marginal costs, thereby alleviating the need for distinguishing between these costs and allowing for changes in scale and scope.²³¹

The drawbacks with using this approach for calculating the cost of CSOs include the need to value the contribution of the capital costs of providing the CSO (i.e. whether it should be based on historical cost or current costs) and the method of allowing for depreciation. Other issues, such as the allocation of common (or fixed) costs and the ability to obtain the disaggregated cost data in the first place are common to both this approach and that of the marginal cost approach.

Fully Distributed Cost Approach

Using this approach, the total cost of the GTE is allocated to all the different activities it undertakes. Thus, some joint or common costs relating to all activities undertaken by the GTE are apportioned to the CSO, even though these costs would have occurred regardless of the provision of the CSO. Errors in deriving this cost may also occur when economies (or diseconomies) of scale or scope exist. As a result, the key concept of causality is not met using this method of calculation.²³²

²³⁰ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 17.

²³¹ *ibid.*, p. 19.

²³² *ibid.*, p. 18.

Stand Alone Cost Approach

Stand-alone costs are the total existing costs of the enterprise less those costs that would be avoided by deleting the supply of all other, non-CSO, products or services. Thus, this method of costing provides a measure of the cost of providing a product or service in isolation from other products. However, as with the Fully Distributed Cost Approach, errors in measuring this cost can occur when economies (or diseconomies) of scale or scope exist and thus the key criteria of causality may not be met.²³³

Of these methodologies for determining the cost of CSOs, the long-run avoidable cost approach is the preferred approach. Whilst the marginal cost approach would yield a more accurate measurement, the practical application of this method is more difficult than that for the long-run avoidable cost approach. In addition, the long-run avoidable cost approach allows for provision of the cost of capital employed and the cost of consuming the assets involved in providing the CSO.

FUNDING OF CSOs

In order to determine the most appropriate method of funding CSOs, a number of criteria must be met:

- the funding method adopted should improve the allocation of resources, reduce the cost of providing the service and stimulate the development of new technologies and products;
- the funding approach should facilitate accountability, public scrutiny and regular review;
- the funds raised to meet the costs of the CSOs should be raised in an equitable manner; and
- the cost of administering the funding scheme should be relatively low.²³⁴

Government funding of CSOs can thus be accomplished in a variety of ways:

Cross-Subsidisation

Using this approach, some customers of a product or service are charged a higher price than the cost of supply in order to subsidise other customers who receive the same product or service, but at a price lower than the cost of supply. In other types of cross-subsidisation, a uniform price may be charged to all customers despite differing costs in the production of the products or services being provided.²³⁵

Some of the problems associated with this approach include:

- some distortion of consumption and production decisions may result from the inefficient allocation of resources;
- difficulties in targeting recipients of cross-subsidies to ensure that benefits are gained through the subsidies;
- over-consumption of subsidised services may result in pressure to invest in additional capacity for which the GTE will receive an inadequate rate of return;

²³³ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 20.

²³⁴ *ibid.*, p. 21.

²³⁵ *ibid.*

- the necessary provision of protection from competitive pressures within the markets that fund the cross-subsidy may reduce the incentive for the enterprise to be innovative and efficient and thus impede economic growth;
- reduction in transparency in the provision of CSOs and inhibition of performance monitoring of the GTE; and
- the pursuit of equitable funding objectives will be adversely affected.²³⁶

Furthermore, the use of cross-subsidies makes it more difficult to determine the actual cost to the community of providing the service.²³⁷

Direct Funding of GTEs

This method of funding involves a payment directly from general Government revenue to the GTE to compensate it for the cost of CSOs performed. The funding provided may be reviewed as part of the Government budgetary process or detailed in a performance contract between the Government and GTE where the type and price of the products or services to be provided are specified, along with the amount to be paid for a specified period. In addition to reducing the inefficiencies associated with cross-subsidisation, this method of funding has other benefits:

- it facilitates assessment of a GTE's commercial performance on an 'actual' rather than adjusted basis;
- it improves the cash flow of GTEs; and
- it removes barriers to entry that are necessary to support cross-subsidisation.²³⁸

Indirect Funding of GTEs

As an alternative to direct funding, the Government could accept a lower actual rate of return on assets from the GTE to compensate it for the cost of its CSOs. The advantage with this system is that it takes into account the higher asset base required to meet the increased demand resulting from the lower prices arising from the CSO. The chief disadvantage is that the CSOs are not subject to the same level of Budget scrutiny as they are under the direct funding approach.²³⁹

Direct Levies on Customers

In the situation where it may be more appropriate to internally fund the cost of providing CSOs, a specific levy to cover the cost internally may be imposed on customers. In this way, each customer would contribute directly to the costs incurred through the provision of the CSO. The advantages of this approach lie in the high degree of transparency, the lack of need for entry barriers to protect the GTE and the equitable nature of having those taxpayers that use the product or service being the ones responsible for paying for it. The chief disadvantage in this method is the need for an accurate estimate for the cost of the CSO service²⁴⁰ and that it penalises people in remote regional areas.

Based on the degree to which the criteria mentioned above are met by each of the funding approaches, the Direct Government Funding of GTEs approach is generally deemed to be the

²³⁶ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 22.

²³⁷ Productivity Commission. *Impact of Competition Policy Reforms on Rural and Regional Australia*. Inquiry Report No. 8, 8 September 1999, p. 351.

²³⁸ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, pp. 22-23.

²³⁹ *ibid.*, pp. 23-24.

²⁴⁰ *ibid.*, p. 24.

preferred choice. Using this method, the issue arises regarding the timing and frequency of payments to the GTEs. Generally, the timing and frequency of payments should reflect that of the incurring expenses such that CSOs provided on an ongoing basis are funded on a recurrent basis and those that are more one-off in nature such as start-up infrastructure, are more appropriately funded on a lump sum capital basis.²⁴¹

COSTING ISSUES

There are a number of dynamic factors that impact on the country loss model used in Western Australia to determine the opportunity cost to the GTE of providing the CSO.

Whilst it is almost impossible, or at least incredibly resource intensive, to determine if the entity has accurately costed its CSO, it is possible to look at the basic methodology and the definitions and standards used by the entity to calculate its CSO. Similarly, it is of value to learn enough about the CSO to pose questions and then recommend that the questions be addressed by a more extensively resourced examination. For example:

Revenue

What is the entity including in revenue? There are many more components in revenue than simply payments from customers. The inclusion or exclusion of components will affect the calculation.

Apportioning Overheads

How does the entity apportion overheads throughout its many cost centres? Is there a risk that costs could be disproportionately attributed to loss-making areas where the enterprise will receive a CSO payment from government?

Asset Valuation and Calculation of Depreciation

How does the entity value its assets and calculate depreciation? In Western Australia, the Water Corporation has property, plant and equipment valued in excess of \$8.5 billion and an annual depreciation charge of around \$170 million. Given the impact of depreciation and rates of return on the CSO calculation, the importance of scrutinising asset valuation and depreciation policies is obvious.

Rates of Return

Is there a difference in the rate of return in the CSO formula between new capital and old capital? If a higher rate of return has been agreed upon for new capital, is there an incentive for the GTE to overcapitalise? Are agreed rates of return comparable with market standards and set at a rate that will encourage competition if that is the policy of the Government?

Adequacy of Information

The Office of Water Regulation divides the State into Controlled Areas upon which water service licences are based. However, the cost centre structure of the Water Corporation, upon which it bases its cost of service and which are referred to as “operating areas”, are not consistent with the

²⁴¹ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 25.

Controlled Areas. Hence, it is almost impossible to cost a service to an area and is compounded by the fact that the Office of Water Regulation has difficulty in obtaining information from licensees.²⁴²

²⁴² Transcript of Evidence, 21 June 2000, pp. 10-11.

APPENDIX EIGHT

CSOs Identified and Funded in Western Australia in 1998-99²⁴³

Entity	Reform Undertaken	Major Identified CSOs	Costing Method	Commencement of Direct Funding	CSO Payments in 1998-99
Western Power	Corporatisation 1995	Pensioner and seniors concessions	Foregone revenue	1996-97	\$ 32.8m
Water Corporation	Corporatisation 1996	Pensioner and seniors concessions Country water, sewerage, drainage and irrigation operations Infill sewerage	Foregone revenue Long-run avoidable cost Long-run avoidable cost	1996-97	\$192.1m
Westrail	Commercialisation 1996	Pensioner and senior concessions. Prospector, Australind rail passenger services and country inter-town coach services	Foregone revenue Long-run avoidable cost	1996-97	\$ 19.7m
LandCorp	Commercialisation 1998	Non-commercial land development activities	Long-run avoidable cost	1998-99	\$ 2.8m

²⁴³ Western Australia, Treasury Department. *Community Service Obligations Policy in Western Australia*, April 2000, p. 16.

APPENDIX NINE

Comparison of CSO Provisions Among Agencies

Description	Water Corporation	Western Power	Westrail	LandCorp
Commercial Requirements	Governed by own Act. Required to operate in accord with commercial principles.	As for the Water Corporation.	No legislation specifically requires Westrail to operate in a commercial manner but they do so as if this were the case.	As for the Water Corporation and Western Power.
Definition of a CSO	Both the OWR and the Water Corporation agree with the definition proposed by Treasury.	Follow definition put out by Treasury.	Follow definition put out by Treasury.	Agree with definition put out by Treasury.
Recognition of previous CSO and identifying new CSO	<p>CSOs identified in a Working Party. Documented in the SCI and draft CSO Agreement.</p> <p>Satisfied with previous activities being recognised and approved as CSOs through the SCI.</p> <p>A process to deal with new CSOs is documented in the draft CSO Agreement.</p>	<p>Current CSOs documented in SCI. In addition, those activities Western Power believe they should receive a CSO for, but do not, are also documented in the SCI.</p> <p>There is no CSO Agreement.</p>	<p>CSOs are approved by the Minister with the concurrence of the Treasurer via the SCI.</p> <p>Currently, Westrail has no CSO Agreement in place and therefore there is no documented process to deal with identifying new CSOs.</p>	<p>CSOs are examined by due diligence and approved by Treasury.</p> <p>There is no formal CSO agreement and LandCorp sees no need for one.</p>
Reporting of CSO.	CSOs are reported in the SCI, SDP, annual report, quarterly reports and the Budget Papers.	CSOs are reported in the SCI, SDP, annual report and Budget Papers.	Westrail's CSOs are reported in the same manner as for Water Corporation and Western Power except that Westrail is under no legislative	<p>LandCorp's CSOs are reported in its annual report and SCI.</p> <p>In the Budget Papers, LandCorp's CSOs are reported,</p>

Description	Water Corporation	Western Power	Westrail	LandCorp
			<p>requirement to produce a SCI or a SDP.</p> <p>Westrail's CSOs in the Budget Papers include land sales revenue which therefore overstates Westrail's previous and future CSOs.</p>	although often under different government agencies.
Monitoring of CSOs.	Reviewed by Treasury and the Office of the Auditor General.	Reviewed by Treasury and the Office of Energy.	Reviewed by Treasury and the Office of the Auditor General.	Reviewed by Treasury and the Office of the Auditor General.
Funding of CSOs.	Funded directly from Treasury.	Funded directly from Treasury	Funded directly from Treasury	Funded directly from Treasury
Costing methods for CSOs.	CSOs calculated in order to optimise deprival value. ²⁴⁴ Based on long-run and foregone revenue.	Method used to calculate CSOs is consistent with Treasury Guidelines. Based on foregone revenue.	Method used to calculate CSOs is consistent with Treasury Guidelines (i.e. the long-run avoidable cost method). Pensioner concessions are calculated as foregone revenue.	Method used to calculate CSOs is consistent with Treasury Guidelines (i.e. the long-run avoidable cost method applied to a risk-weighted discounted cash flow analysis).

²⁴⁴ Transcript of Evidence, 28 June 2000, p. 1.

APPENDIX TEN

Information Regarding the Supply of Water to the Port Hedland Region²⁴⁵

(a) The costs involved in supply

Town	Total cost per kl ²⁴⁶				
	1998/99	1997/98	1996/97	1995/96	1994/95
Karratha	\$ 1.85	\$ 1.92	\$ 2.11	\$ 1.96	\$ 1.79
Roebourne	\$ 3.37	\$ 2.86	\$ 3.26	\$ 3.24	\$ 2.64
Wickham	\$ 3.98	\$ 3.57	\$ 4.11	\$ 4.23	\$ 3.11
Pt Samson	\$ 3.13	\$ 3.86	\$ 4.38	\$ 4.55	\$ 4.96
Port Hedland	\$ 1.21	\$ 1.15	\$ 1.31	\$ 1.41	\$ 1.69
Marble Bar	\$ 4.56	\$ 3.24	\$ 3.46	\$ 2.98	\$ 3.72
Onslow	\$ 9.78	\$ 6.47	\$ 6.91	\$ 8.23	\$ 7.13
Nullagine	\$ 6.04	\$ 5.16	\$ 6.06	\$ 4.79	\$ 7.70
Paraburdoo	Not calculated				
Tom Price	Not calculated				
Dampier	Not calculated				

(b) The price of water charged

Every year each country town is allocated to one of five classes on the basis of the cost of supplying water to that country town. The class classification is based on the average of the last three years using the most recent data available. For example, Class classifications for 2000/01 are based on the average of the total cost per kl for 1998/99, 1997/98 and 1996/97.

The following classes apply to each country town:

Town	Town Class
Karratha	Class 1
Roebourne*	Class 3
Wickham	Class 3
Pt Samson*	Class 3
Port Hedland	Class 1
Marble Bar	Class 3
Onslow	Class 4
Nullagine	Class 4
Paraburdoo	Class 1
Tom Price	Class 1
Dampier	Class 1

* In 1998/99 Roebourne changed from a Class 2 town to a Class 3 town

** In 1998/99 Pt Samson changed from a Class 4 town to a Class 3 town

²⁴⁵ Attachment to correspondence from Mr Jim Gill, Managing Director, Water Corporation, 21 July 2000, op. cit.

²⁴⁶ These numbers are based on the operating cost, the replacement cost depreciation and the return on the written down replacement value of the assets. The assets are valued based on achieving 4% on the written down value over the total life of the asset (equates to 2.5% on replacement value for each year over the life of the asset).

**Consumption Charges: Residential
2000/01**

	Class 1	Class 2	Class 3	Class 4	Class 5
	c/ckl	c/kl	c/kl	c/kl	c/kl
First 150 kl	37.9	37.9	37.9	37.9	37.9
next 400 (550)	61.3	61.3	61.3	61.3	61.3
next 100 (650)	69.1	74.0	74.0	74.0	74.0
next 100 (750)	86.1	113.8	131.1	144.9	158.6
next 400 (1150)	138.6	188.0	209.6	238.5	267.4
next 400 (1550)	199.3	274.7	317.9	433.7	534.7
next 400 (1950)	229.7	339.7	429.2	520.4	621.5
over 1950	267.0	433.7	505.9	607.0	693.7

**Consumption Charges: Non-Residential
2000/01**

	Class 1	Class 2	Class 3	Class 4	Class 5
	c/ckl	c/kl	c/kl	c/kl	c/kl
First 300kl	73.6	97.8	107.3	117.4	120.6
over 300kl	128.5	174.3	194.3	221.2	247.9

**Consumption Charges: Residential
1999/00**

	Class 1	Class 2	Class 3	Class 4	Class 5
	c/ckl	c/kl	c/kl	c/kl	c/kl
First 150 kl	37.2	37.2	37.2	37.2	37.2
next 400 (550)	60.1	60.1	60.1	60.1	60.1
next 100 (650)	67.7	72.5	72.5	72.5	72.5
next 100 (750)	84.4	111.6	128.5	142.1	155.5
next 400 (1150)	135.9	184.3	205.5	233.9	262.1
next 400 (1550)	195.4	269.3	311.7	425.2	524.3
next 400 (1950)	225.2	333.0	411.0	510.2	609.3
over 1950	261.8	425.2	496.0	595.1	680.1

**Consumption Charges: non-Residential
1999/00**

	Class 1	Class 2	Class 3	Class 4	Class 5
	c/ckl	c/kl	c/kl	c/kl	c/kl
First 300kl	72.1	95.9	105.2	115.1	118.2
over 300kl	126.0	170.9	190.5	216.9	243.1

**Consumption Charges: Residential
1998/99**

	Class 1	Class 2	Class 3	Class 4	Class 5
	c/ckl	c/kl	c/kl	c/kl	c/kl
First 165kl	36.5	36.5	36.5	36.5	36.5
next 385 (550)	58.9	58.9	58.9	58.9	58.9
next 100 (650)	64.5	69.0	69.0	69.0	69.0
next 100 (750)	80.4	106.3	122.4	135.3	148.1
next 400 (1150)	123.5	167.5	186.8	212.6	238.3
next 400 (1550)	177.6	244.8	283.4	386.5	476.6
next 400 (1950)	204.7	302.7	373.6	463.8	553.9
over 1950	238.0	386.5	450.9	541.0	618.3

**Consumption Charges: non-Residential
1998/99**

	Class 1	Class 2	Class 3	Class 4	Class 5
	c/ckl	c/kl	c/kl	c/kl	c/kl
First 300kl	70.7	94.0	103.1	112.8	115.9
over 300kl	123.5	167.5	186.8	212.6	238.3

**Consumption Charges: Residential
1997/98**

	Class 1	Class 2	Class 3	Class 4	Class 5
	c/ckl	c/kl	c/kl	c/kl	c/kl
First 150kl	35.4	35.4	35.4	35.4	35.4
next 400 (550)	57.2	57.2	57.2	57.2	57.2
next 100 (650)	62.6	67.0	67.0	67.0	67.0
next 100 (750)	73.1	94.1	108.3	119.7	131.1
next 400 (1150)	119.9	148.2	165.3	188.1	210.9
next 400 (1550)	172.4	216.6	250.8	342.0	421.8
next 400 (1950)	198.7	267.9	330.6	410.4	490.2
over 1950	231.1	342.0	399.0	478.8	547.2

**Consumption Charges: non-Residential
1997/98**

	Class 1	Class 2	Class 3	Class 4	Class 5
	c/ckl	c/kl	c/kl	c/kl	c/kl
First 300kl	62.6	83.2	91.2	99.8	102.6
over 300kl	119.9	148.2	165.3	188.1	210.9

**Consumption Charges: Residential
1996/97**

	Class 1	Class 2	Class 3	Class 4	Class 5
	c/ckl	c/kl	c/kl	c/kl	c/kl
First 150kl	34.0	34.0	34.0	34.0	34.0
next 400 (550)	55.0	55.0	55.0	55.0	55.0
next 100 (650)	60.2	64.4	64.4	64.4	64.4
next 100 (750)	70.3	82.5	95.0	105.0	115.0
next 400 (1150)	115.3	130.0	145.0	165.0	185.0
next 400 (1550)	165.7	190.0	220.0	300.0	370.0
next 400 (1950)	191.1	235.0	290.0	360.0	430.0
over 1950	222.2	300.0	350.0	420.0	480.0

**Consumption Charges: non-Residential
1996/97**

	Class 1	Class 2	Class 3	Class 4	Class 5
	c/ckl	c/kl	c/kl	c/kl	c/kl
First 300kl	60.2	73.0	80.0	87.5	90.0
over 300kl	115.3	130.0	145.0	165.0	185.0

**Consumption Charges: Residential
1995/96**

	Class 1	Class 2	Class 3	Class 4	Class 5
	c/ckl	c/kl	c/kl	c/kl	c/kl
First 150kl	34.0	34.0	34.0	34.0	34.0
next 400 (550)	51.8	51.8	51.8	51.8	51.8
next 100 (650)	60.2	64.4	64.4	64.4	64.4
next 100 (750)	70.3	77.5	82.5	87.5	92.5
next 400 (1150)	115.3	122.5	130.0	140.0	150.0
next 400 (1550)	165.7	172.5	190.0	250.0	300.0
next 400 (1950)	191.1	210.0	250.0	300.0	350.0
over 1950	222.2	250.0	300.0	350.0	400.0

**Consumption Charges: non-Residential
1995/96**

	Class 1	Class 2	Class 3	Class 4	Class 5
	c/ckl	c/kl	c/kl	c/kl	c/kl
First 300kl	60.2	67.5	72.5	77.5	77.5
over 300kl	115.3	122.5	130.0	140.0	150.0

(c) The value of assets held and/or accounted for

Town	Replacement Cost of Assets \$m				
	1998/99	1997/98	1996/97	1995/96	1994/95
Karratha	\$ 27.260	\$ 27.260	\$ 26.539	\$ 26.093	\$ 25.325
Roebourne	\$ 3.116	\$ 3.116	\$ 3.049	\$ 2.965	\$ 2.883
Wickham	\$ 8.490	\$ 8.490	\$ 7.955	\$ 7.834	\$ 7.357
Pt Samson	\$ 1.633	\$ 1.633	\$ 1.598	\$ 1.570	\$ 1.525
Port Hedland	\$ 112.889	\$ 112.889	\$ 109.98	\$ 108.507	\$ 105.604
Marble Bar	\$ 3.315	\$ 3.315	\$ 3.199	\$ 3.144	\$ 3.056
Onslow	\$ 27.287	\$ 27.287	\$ 26.480	\$ 25.592	\$ 25.015
Nullagine	\$ 1.876	\$ 1.876	\$ 1.803	\$ 1.737	\$ 1.686
Paraburdoo	*	*	*	*	*
Tom Price	*	*	*	*	*
Dampier	\$ 43.640	\$ 43.460	\$ 42.356	\$ 41.778	\$ 40.564

* Connections and meters owned by the Corporation, but recorded as zero in the Asset Register

** The additional expenditure on the Port Hedland scheme to service the BHP DRI plant is not included in the above assets as they were not commissioned in 1998/99.

(d) The nature of the tariff reforms

In 1995/96 a six year phase in program was established to replace valuation based water service charges for country businesses with the same meter-size tariff as metropolitan business customers. This resulted in some business customers experiencing increases in their service charges, while others experienced decreases. Thirteen thousand country customers benefited as a result of the reform to water service charges by a total of \$6.525m.

Consumption charges based on the cost of supply were introduced in 1995/96. While standard charges apply for normal levels of residential consumption, customers using more than the average are making a greater contribution to the cost of supply.

Business charges were also partially related to the cost of supply when Town Classes were introduced. All of the additional revenue from the additional residential and business charges has been used to reduce the service charge for country business.

APPENDIX ELEVEN

Estimated Capital Cost and CSO Impact of Water Corporation Programs²⁴⁷

Program Description	Capital Cost (December 1998 \$'000)			Estimated CSO Impact (Outturn \$'000)	
	Pre 1998-99	1998-99	1999-00	1998-99	1999-00
WWTP Upgrades*	9 448	18 974	23 360	876	4 047
Rural Water Supply Improvement/Farm Water	4 135	4 320	3 331	577	652
New Services	2 594	344	290	29	38
Service Improvements	1 272	2 500	1 801	87	505
Water Supply Quality Upgrades	256	1 395	3 363	24	105
Miscellaneous Government Requirements	1 469	3 002	500	654	459
Dam Safety	1 746	4 246	12 001	123	338
Abnormal Cost Growth	407	307	1 954	-	165
Available for unidentified CSO and abnormal costs				3 498	3 001
TOTAL	21 327	35 088	46 600	5 868	9 313

* WWTP Upgrades refers to the upgrading of wastewater treatment plants to comply with the higher standards required by the Department of Environmental Protection. Minor discrepancies in additions due to rounding.

²⁴⁷ Water Corporation, *Statement of Corporate Intent 1999-00*, pp. 21-22.

APPENDIX TWELVE

TIMETABLE FOR OPEN ACCESS TO WESTERN POWER'S ELECTRICITY
TRANSMISSION AND DISTRIBUTION NETWORKS²⁴⁸

Effective Date	Network	Description
1 January 1997	Transmission	All consumers taking supply at 66 kV and above are able to purchase electricity from the supplier of their choice. About 33 customers connect directly to the transmission network and became contestable at this date.
1 July 1998	All Distribution Systems (SWIS, NWIS & Regional)	Consumers within the SWIS, NWIS and regional non-interconnected distribution systems with an average load exceeding 5 MW (43 800 megawatt hours) in any period of 12 consecutive months at a single site are able to contract directly with the supplier of their choice. Annual consumption of 5 MW may equate to a yearly electricity bill of around \$3.6 million.
1 January 1999	Regional	Consumers within the regional non-interconnected systems with an average load exceeding 300 000 kWh in any period of 13 consecutive months at a single site are able to contract directly with the supplier of their choice. Annual consumption of 300 000 kWh may equate to an annual electricity bill of around \$48 000.
1 January 2000	SWIS & NWIS	Consumers within the SWIS and NWIS with an average load exceeding 1 MW (8 760 megawatt hours) in any period of 12 consecutive months at a single site will be able to contract directly with the supplier of their choice. Annual consumption of 1 MW may equate to an annual electricity bill of around \$800 000.
1 October 2000	SWIS & NWIS	Commercial consumers with an average load of at least 300 000 kWh can elect to take supply from independent power producers with renewable generation. Independent power producers are also able to supply 100 kW of green power "over the fence" to immediately adjacent customers, by passing Western Power's networks.

²⁴⁸ Supplementary Information provided by Ms Shona Kennealy, manager Business Strategy, Western Power, to the PAC, 2 November 2000.

APPENDIX THIRTEEN

**WESTERN POWER DISTRIBUTION ACCESS CHARGES FOR DIFFERENT REGIONS
(Greater than 1 MW Average Load)²⁴⁹**

SOUTH WEST INTERCONNECTED GRID (SWIS)

Locational Area	Maximum Demand 1000 to 7000 kVA			
	Demand-Charge ²⁵⁰		Demand-Length Charge	
	Fixed Charge for first 1000 kVA (\$ per annum)	For kVA > 1000 (\$ / kVA / annum)	For kVA > 1000 and first 10 km length. (\$ / kVA.km / annum)	For kVA > 1000 and length in excess of 10 km (\$ / kVA.km / annum)
CBD	40 169	3.32	0.00	0.00
Urban	40 169	1.44	1.88	1.32
Mining	40 169	10.20	0.82	0.57
Mixed	40 169	8.33	1.00	0.70
Rural	40 169	10.83	0.88	0.61

Locational Area	Maximum Demand > 7000 kVA			
	Demand-Charge		Demand-Length Charge	
	Fixed Charge for first 7000 kVA (\$ per annum)	For kVA > 7000 (\$ / kVA / annum)	For first 10 km length (\$ / kVA.km / annum)	For length in excess of 10 km (\$ / kVA.km / annum)
CBD	60 088	0.54	0.00	0.00
Urban	48 822	0.44	1.61	1.13
Mining	101 399	0.90	0.70	0.49
Mixed	90 132	0.80	0.86	0.60
Rural	105 154	0.94	0.75	0.53

²⁴⁹ Figures are current for the period commencing 1 July 2000 and were obtained from the Western Power Website: <http://www.wpcorp.com.au/tariff/network_access/dis_summary.html> (Accessed 2 November 2000).

²⁵⁰ All charges shown are Goods and Services Tax (GST) inclusive.

NORTH WEST INTERCONNECTED SYSTEM (NWIS)

	Maximum Demand 1000 to 7000 kVA			
Locational Area	Demand-Charge²⁵¹		Demand-Length Charge	
	Fixed Charge for first 1000 kVA (\$ per annum)	For kVA > 1000 (\$ / kVA / annum)	For kVA > 1000 and first 10 km length. (\$ / kVA.km / annum)	For kVA > 1000 and length in excess of 10 km (\$ / kVA.km / annum)
NWIS (Karratha / Port Hedland)	53 199	1.91	2.52	1.77

	Maximum Demand > 7000 kVA			
Locational Area	Demand-Charge		Demand-Length Charge	
	Fixed Charge for first 7000 kVA (\$ per annum)	For kVA > 7000 (\$ / kVA / annum)	For first 10 km length (\$ / kVA.km / annum)	For length in excess of 10 km (\$ / kVA.km / annum)
NWIS (Karratha / Port Hedland)	64 659	0.58	2.15	1.51

²⁵¹ All charges shown are GST inclusive.

APPENDIX FOURTEEN

WESTRAIL'S TOTAL COST OF PROVIDING THE URBAN PASSENGER SERVICE

	ACTUAL ²⁵²			PROJECTED	ESTIMATED ²⁵³
	1996/97 \$'000	1997/98 \$'000	1998/99 \$'000	1999/2000 \$'000	2000/01 \$'000
Revenue	18 311	21 238	20 875	21 174	21 000
Recoup from Dept. of Transport	88 989	87 245	87 517	89 950	91 396
Total	107 300	108 483	108 392	111 124²⁵⁴	112 396

²⁵² Obtained from respective Annual Reports.

²⁵³ Estimated on pre-Freight sale basis.

²⁵⁴ Westrail's Annual Report 2000 notes that the total recoup from the Department of Transport for 1999-2000 was actually \$111 652 000.