KPMG

Transport Asset Holding Entity (TAHE)

Assessment of assumptions used for accounting estimates

Cabinet in Confidence

3 November 2020

kpmg.com.au

Disclaimer

Inherent limitations

This report has been prepared at the request of NSW Treasury in accordance with the terms of the Consultancy Agreement executed 17 April 2020 and based on the scope outlined in the Scope section this report. The ultimate responsibility for the accounting treatment of any matter rests with the preparers of the financial statements.

The services provided in connection with this engagement comprise an advisory engagement, which is not subject to auditing, review or assurance standards issued by the Australian Auditing and Assurance Standards Board and, consequently no opinions or conclusions intended to convey assurance have been expressed. Any reference to 'review' throughout this contract has not been used in the context of a review in accordance with auditing, review or assurance standards issued by the Australian Auditing and Assurance Standards Board.

The advice provided in this report is based upon the facts and circumstances provided to us and the assumptions we were asked to make, as outlined in this report. Management is responsible for ensuring:

- *the facts, circumstances or assumptions regarding the transfer do not differ from those provided to us; and*
- *complete and accurate information has been provided to us, including details of other contracts or arrangements, whether documented or orally agreed, which impact upon the overall substance of the subject matter.*

If management has not fulfilled these responsibilities, our advice may not be valid. We have not sought to independently verify any information provided to us.

The advice in this report is based on interpretations of accounting standards and other relevant professional pronouncements and legislation current at the date of preparing the advice, as outlined in the Documentation section of this report. Should the accounting standards, other relevant professional pronouncements or legislation change, the advice in this report may not be valid. KPMG is under no obligation in any circumstances to update this report, in either oral or written form, for events occurring after the report has been issued in final form.

The advice in this report is based on Estimated Financial Statements prepared in accordance with the applicable budgetary reporting framework and conventions, and do not reflect decisions that may occur in the future. Actual results are likely to be different from the estimated financial impacts since anticipated events or transactions frequently do not occur as expected and the variation could be material, and estimated outcomes may be different from prospective financial information prepared for other purposes. Our assessment excludes any assessment as to the achievability of the results indicated by the estimated financial impacts.

Third party reliance

This report is solely for the purpose set out in the Scope section and for NSW Treasury's information, and may not be used for any other purpose or provided or distributed to, or accessed or relied upon by, any other party without KPMG's express written consent. Other than our responsibility to NSW Treasury neither KPMG nor any member or employee of KPMG undertakes responsibility arising in any way from reliance placed by a third party on this report. Any reliance placed is that party's sole responsibility. We note that under the terms and conditions applicable to the Consultancy Agreement, other NSW government agencies are not considered third parties.

We understand that this report may be provided to the external auditors of NSW Treasury or other relevant agencies. These external auditors are not parties to our respective engagement contract with NSW Treasury and our engagement was neither planned nor conducted in contemplation of the purposes for which the external auditors may access this report. The external auditors are responsible for forming their own audit opinions. Accordingly, these external auditors may not place reliance on this report. KPMG is not liable for any losses, claims, expenses, actions, demands, damages, liabilities, or any other proceedings arising out of any reliance by any external auditors on this report.

Level 38, Tower Three
International Towers Sydney
300 Barangaroo Avenue
Sydney, NSW 2000
Australia

ABN 51 194 660 183
Telephone: +61 2 9335 7000
Facsimile: +61 2 9335 7001
DX: 1056 Sydney
www.kpmg.com.au

Cassandra Wilkinson
NSW Treasury
52 Martin Pl
Sydney
NSW 2000

3 November 2020

Dear Cassandra

Engagement for Accounting Advisory services for NSW Treasury

We appreciate the opportunity to have assisted NSW Treasury in the provision of Accounting Advisory services as set out in our Engagement Letter with you dated 17 April 2020. We set out below our advice for NSW Treasury's consideration.

As at 3 November 2020, we have completed all services as provided in our Engagement Letter. This deliverable is in final form and supersedes all draft versions of this advice.

We thank you for the assistance provided in conducting the engagement. Please do not hesitate to contact me should you require any further assistance.

Yours sincerely

Heather Watson

Partner

Contents

Glossary

AASB	Australian Accounting Standards Board
ABS	Australian Bureau of Statistics
ALC	Airport Link Company
ASIC	Australian Securities and Investments Commission
ATO	Australian Tax Office
COAG	Council of Australian Governments
CPF	Commercial Policy Framework
CRN	Country Rail Network
CSO	Community Service Obligation
ERC	Expenditure Review Committee of Cabinet
FIS	Financial Impact Statement
GBE	Government Business Enterprise
GFS	Government Finance Statistics
GGS	General Government Sector
IPART	Independent Pricing and Regulatory Tribunal
MPM	Major Periodic Maintenance
MPN	Metropolitan Network
NOB	Net Operating Balance
NPP	New policy proposals
NTER	National Tax Equivalent Regime
PFC	Public Financial Corporation
PNFC	Public Non-Financial Corporation
PTA	Parameter and technical adjustments
Rail Operators	Sydney Trains and NSW Trains
RSA	Rail Services Agreement
SCI	Statement of Corporate Intent
SOC	State Owned Corporation
TAHE	Transport Asset Holding Entity
TBS	Treasury Banking System
TER	Tax Equivalent Regime
TfNSW	Transport for NSW
The State / the Government	NSW Government
TSS	Total State Sector
TSSA	Total State Sector Accounts

1 Executive summary

On 1 June 2020, NSW Government endorsed the establishment of TAHE as a statutory State Owned Corporation. NSW Treasury's GGS FIS in respect of TAHE's establishment indicated proceeding with establishment would result in zero fiscal impacts.

Financial Impact Statement	2019-20	2020-21	2021-22	2022-23	2023-24
TAHE as a SOC	No Impact	No Impact	No Impact	No Impact	No Impact

In October 2020, NSW Treasury's GGS FIS in respect of ongoing implementation of TAHE indicates that there are still no impacts.

Impacts within a GGS FIS are determined having regard to a variety of accounting estimates. These accounting estimates are based on assumptions. NSW Treasury engaged KPMG to perform an assessment of the reasonableness of the key assumptions applied. We have concluded that NSW Treasury's key assumptions are reasonable.

We assessed assumptions:

- about a phased approach to ongoing implementation of reforms, including an initial transition period (2020-21) and an extended implementation period (2021-22 – 2024-25), prior to full implementation
- supporting the conclusion that existing provisions within the forward estimates for the net impact of TAHE implementation would be sufficient to cover new funding arrangements related to the ongoing implementation, including additional access fees, during the period 2021-22 – 2023-24
- supporting the treatment of funding for heavy rail capital expenditure as equity injections, including supporting assumptions about financial returns and TAHE's PNFC status (and Rail Operators' PNFC status)
- applied to estimating depreciation, which is a function of assumptions supporting infrastructure asset measurements
- applied to TAHE's future additional commercial revenues and tax equivalent payments
- supporting exclusion of any potential additional top up funding for Rail Operators in order to achieve an accounting break-even position.

Our assessment that NSW Treasury's key assumptions are reasonable has been made having regard to the basis of preparation required to be applied to the State's Budget and Forward Estimate information i.e. having regard to the requirements of the reporting framework and reporting conventions applied. We considered whether NSW Treasury's assumptions were consistent with the requirements of:

- Australian Accounting Standards, including but not limited to AASB 1049 *Whole of Government and General Government Sector Financial Reporting*
- Government Finance Statistics, specifically the Australian Bureau of Statistics (ABS) 'Australian System of Government Finance Statistics: Concepts, Sources and Methods' 2015
- legislative frameworks, including the *Government Finance Act 2018, Transport Administration Act 1988* and the *State Owned Corporations Act 1989*
- relevant financial, budgetary and commercial policy frameworks published by NSW Treasury
- current expectations as to the potential timing, nature and quantum of future TAHE funds flows, and government's decisions to date in respect of TAHE establishment.

The State Budget and Forward Estimates relate to anticipated events and actions that have not yet occurred, and which may not occur. As such, this financial information is prepared based on accounting estimates. Actual results are likely to be different from the accounting estimates made by NSW Treasury since anticipated events or transactions frequently do not occur as expected and the variation could be material. Accordingly, our assessment excludes any assessment as to the achievability of the results indicated by the accounting estimates.

An accounting estimate is subject to estimation uncertainty due to inherent limitations in knowledge or data. The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. That said, it is recognised that prospective financial information ordinarily becomes more speculative and less verifiable as the length of the period covered increases.

Given the relatively early stage of TAHE implementation, information available to inform the assumptions and accounting estimates is limited. It is expected that TAHE's pathway to profitability over time (2025-26 and beyond) will gain more specificity as a number of factors are resolved, including full implementation of new commercial access agreements, additional commercial revenue sources and achievement of productivity gains. New and detailed information will arise as such items continue to be resolved in the initial transition and extended implementation periods, stemming from progress in agreeing TAHE's SCI and further defining its business plan and commercial strategies. As TAHE's implementation progresses, availability of this new information will enable revision of existing estimates.

2 Scope of this report

2.1 Background

Estimated Financial Statements

The State prepares prospective financial information in the form of its State Budget in accordance with the requirements of the *Government Finance Act 2018*. The prospective financial information is frequently referred to in Budget Papers as 'Estimated Financial Statements'. NSW Treasury is responsible for the preparation of the Estimated Financial Statements.

Basis of preparation

The Estimated Financial Statements need to reflect the following legislative requirements:

1) prepared for the New South Wales General Government Sector (GGS)
2) prepared in a way that is consistent with the Australian Accounting Standards for the annual reporting period to which the Budget relates and are presented in a format that is consistent with those Standards
3) include a Statement of Financial Position, an Operating Statement and a Cash Flow Statement and a 'Statement of Significant Accounting Policies and Forecast Assumptions'.

Being prospective in nature, various assumptions are applied to develop the accounting estimates within the Estimated Financial Statements. Assumptions mean expectations made by NSW Treasury as to future events and actions expected to take place as at the date the prospective financial information is prepared and exclude hypothetical assumptions. Hypothetical assumptions take the form of future events and management actions that may not necessarily be expected to take place or may not be based on reasonable grounds.

Noting the need for assumptions, the Estimated Financial Statements:

- are prepared using the accrual basis of accounting; this basis recognises the effect of transactions and events when they are forecast to occur
- are prepared to reflect existing operations and the impact of policy decisions taken by the NSW Government, where their financial effect can be reliably measured
- take into account other economic and financial data available to NSW Treasury up to a specified date that is slightly before the Budget Papers are tabled in Parliament, recognising the need for some lead time for preparation

- do not reflect impacts of policy decisions or planned events when the impact cannot be reliably estimated (e.g. when there are uncertainties regarding the timing and amount of future cash flows)
- require the use of estimates and assumptions when measuring revenue, expenses, other economic flows, assets or liabilities, which are based on the latest information available at the time, professional judgements derived from experience and other factors considered to be reasonable under the circumstances; it is recognised that actual results may differ from such estimates
- do not include the impact of major asset transactions until they are finalised; the financial impact of these future planned discontinuing operations or restructuring transactions are not recognised due to their commercial-in-confidence nature.

The Estimated Financial Statements for the GGS reflect transactions with NSW government entities within the Public Non-Financial Sector (PNFC), including those related to heavy rail operators and TAHE. Various accounting estimates, determined by applying assumptions, inform those transactions.

Financial Impact Statements

The Estimated Financial Statements are prepared using Prime. A Financial Impact Statement is used to brief government on the estimated impact on the Estimated Financial Statements of developments, decisions and other changes in circumstances. Once estimated financial impacts are confirmed, data in Prime is adjusted. A Financial Impact Statement includes information about the current Budget year, plus three years of forward estimates.

2.2 Scope

NSW Treasury sought a documented assessment of the reasonableness of key assumptions used to calculate accounting estimates that inform estimated financial impacts. The estimated financial impacts are those arising from ongoing implementation of TAHE reforms. In other words, NSW Treasury is preparing a Financial Impact Statement and sought an assessment of the reasonableness of assumptions used in its development. The list of specified key assumptions was provided by NSW Treasury, and included key assumptions supporting:

- the treatment of funding for heavy rail capital expenditure as equity injections, including supporting assumptions about financial returns and TAHE's PNFC status (and Rail Operators' PNFC status)
- depreciation, which is a function of assumptions supporting infrastructure asset measurements.

The full list of key assumptions provided by NSW Treasury is listed in Section 3.

The assessment in this report considers whether the specified assumptions are reasonable having regard to the basis of preparation required to be applied to the Estimated Financial Statements i.e. having regard to the requirements of the reporting framework and reporting conventions applied.

In undertaking this scope, we have applied the relevant requirements of the financial and budgetary reporting framework to the facts and circumstances in order to form conclusions. This included having regard to the following:

- requirements of relevant Australian Accounting Standards, including but not limited to AASB 1049 *Whole of Government and General Government Sector Financial Reporting*
- Government Finance Statistics as it applies to the preparation of Estimated Financial Statement for the GGS and is relevant to the TAHE reforms, specifically the Australian Bureau of Statistics (ABS) 'Australian System of Government Finance Statistics: Concepts, Sources and Methods' 2015
- legislative frameworks, including the *Government Finance Act 2018, Transport Administration Act 1988* and *the State Owned Corporations Act 1989*
- relevant financial, budgetary and commercial policy frameworks published by NSW Treasury
- NSW Treasury's current expectations as to the potential timing, nature and quantum of future TAHE funds flows, and the Government's decisions to date in respect of TAHE establishment.

Our assessment considered whether the specified assumptions are reasonable having regard to the basis of preparation required to be applied to the Estimated Financial Statements i.e. having regard to the requirements of the reporting framework and reporting conventions applied.

This report documents our assessment of the reasonableness of the assumptions, which includes our advice as to whether the assumptions are consistent with the requirements of Australian Accounting Standards and Government Finance Statistics.

Limitations and exclusions of KPMG's scope

TAHE's operating model is expected to evolve over time. Changing facts and circumstances could impact the findings and conclusions within our deliverable. Once we have finalised our deliverable, we are under no obligation to revise it for future developments.

Our assessment is limited to the key assumptions used in the preparation of the estimated financial impacts in respect of TAHE and excludes any assessment or conclusion as to whether the basis of preparation applied to the overall Estimated Financial Statements (i.e. State Budget and Forward Estimates within Budget Papers or a Half Yearly Budget Review) is appropriate, or whether the Estimated Financial Statements themselves are reasonable.

Our assessment is limited to the key assumptions listed in Section 3.

Actual results are likely to be different from the estimated financial impacts since anticipated events or transactions frequently do not occur as expected and the variation could be material. The budgetary reporting framework and conventions applicable to

Estimated Financial Statements mean that Estimated Financial Statements do not reflect decisions that may occur in the future, and therefore may differ from prospective financial information prepared for other purposes. Our assessment excludes any assessment as to the achievability of the results indicated by the estimated financial impacts.

The services provided in connection with this scope comprise an advisory engagement, which is not subject to auditing, review or assurance standards issued by the Australian Auditing and Assurance Standards Board and, consequently no opinions or conclusions intended to convey assurance have been expressed. Any reference to 'review' in deliverables will not be used in the context of a review in accordance with auditing, review or assurance standards issued by the Australian Auditing and Assurance Standards Board.

3 NSW Treasury key assumptions

Background

On 1 June 2020, NSW Government endorsed the establishment of TAHE as a statutory State Owned Corporation (SOC).

We understand from NSW Treasury that financial impacts of this decision were reflected in the June Cabinet submission via a GGS FIS. This June GGS FIS compared the financial impacts of TAHE scenarios against the 2019-20 Half Year Estimates position, and outlined that there would be no Budget Result impact of the 'TAHE as a SOC' scenario in the 2019-20 financial year or over the 2020-24 forward estimates.

As at October 2020, NSW Treasury has prepared a further GGS FIS in respect of TAHE. To arrive at the impacts identified in this October GGS FIS, NSW Treasury has applied various assumptions to develop accounting estimates. Based on the accounting estimates, amounts included in the October GGS FIS are zero (i.e. there is still no Budget Result impact of the 'TAHE as a SOC' scenario).

The accounting estimates that inform the October GGS FIS are generated in an excel spreadsheet and presented in supporting materials to the GGS FIS. As previously outlined, accounting estimates rely upon assumptions. The key assumptions that underpin the accounting estimates are listed below:

Key assumptions

NSW Treasury assumes that TAHE will have a phased approach to ongoing implementation of reforms:

- TAHE will have an initial transitional period in which its operations and associated funding reflect that of RailCorp (2020-21)
- TAHE will have an extended implementation period in which commercial models will be progressively developed and implemented by its Board (2021-22 – 2024-25)
- TAHE reforms will eventually be fully implemented, reflecting increased commerciality and on a pathway to profitability (2025-26 and beyond).

NSW Treasury assumes a phased approach to TAHE's implementation of commercial access fees and pathway to profitability, with prices charged by TAHE expected to increase over time. In addition, NSW Treasury assumes that:

- during TAHE's initial transitional period (2020-21), there will be no additional access fees charged by TAHE to Rail Operators
- during TAHE's extended implementation period (2021-22 – 2023-24), amounts already provided within the Crown Finance Entity will be sufficient to cover new funding

arrangements related to the ongoing implementation of the TAHE reforms, including access fees.

NSW Treasury assumes TAHE's current PNFC classification will continue for the foreseeable future.

NSW Treasury assumes that annual funding to TAHE for heavy rail capital expenditure is treated by the GGS as an acquisition of additional equity within TAHE.

NSW Treasury assumes that the existing measurement basis applied to TAHE's rail infrastructure assets will continue for the foreseeable future. That is:

- the replacement cost approach in relation to asset valuation is assumed to continue to apply to TAHE's whole asset base indefinitely from 1 July 2020
- consequential depreciation charges are assumed to reflect the impact of applying the cost approach to the measurement of assets.

NSW Treasury assumes that additional commercial revenues generated by TAHE during the initial transition and extended implementation periods are zero.

NSW Treasury assumes that in relation to tax equivalent regimes, TAHE:

- will enter the TER in the next financial year
- will not enter the NTER until it completes the extended implementation period noted earlier
- Once in the NTER, NTER payments are assumed to equal 30% of accounting profit.

NSW Treasury assumes that Rail Operators are not 'topped up' with additional cash funding to an accounting break-even position.

Application of assumptions

NSW Treasury has used the assumptions listed above in the preparation of the following NSW Treasury documents:

- "TAHE Access fee and GG impact simple calc 16 Oct.xlsx" document received on 20 October 2020.
- "TAHE high level simple calc draft 15 Oct sent.pptx" document received on 20 October 2020.
- "Treasury Position – TAHE Financial Impact.docx" document received on 22 October 2020.

Limitations of NSW Treasury key assumptions

NSW Treasury has advised of limitations associated with assumptions used in the preparation of the accounting estimates supporting the FIS, which are contained in Appendix E.

Prospective financial information (i.e. the State Budget and Forward Estimates and FIS) relies on the use of accounting estimates. Accounting estimates are used precisely because there are inherent limitations in knowledge or data. The applicable reporting framework recognises that estimates are essential and their use does not undermine their reliability[1]. In accordance with the applicable reporting framework, as new information becomes available, accounting estimates and the assumptions underpinning them, are updated[2].

It is noted that the State publishes a Budget plus three years of Forward Estimates and gathers data for a longer period. The time period for published data reflects that it is recognised that prospective financial information ordinarily becomes more speculative and less verifiable as the length of the period covered increases[3] As the time period increases, the level of uncertainty in accounting estimates increases, eventually to the point at which it is not particularly useful[4]. The applicable financial reporting framework even contains specific requirements that limit use of projections based on the most recent financial budgets/forecasts approved by management to a maximum period of five years[5]. Beyond the Forward Estimates, accounting estimates have increased limitations.

---

[1] Conceptual Framework, paragraph 86
[2] NSW Budget Statement 2018-19: Appendices A2. Statement of Significant Accounting Policies and Forecast Assumptions, 'Basis of preparation'
[3] ASAE 3450.114(a)
[4] Conceptual Framework, paragraph QC 16
[5] AASB 136 33(b)

4 KPMG assessment of assumptions

This section further outlines key assumptions provided to us by NSW Treasury and our assessment of those assumptions. Where NSW Treasury has exercised judgements in the application of the assumptions, we have also assessed the key judgements within the assumptions.

4.1 Reform implementation timeframes

Treasury assumption

Reform of heavy rail infrastructure asset management is complex; timeframes for implementation reflect this complexity. NSW Treasury assumes that:

- TAHE will have an initial transitional period in which its operations and associated funding reflect that of RailCorp (2020-21)
- TAHE will have an extended implementation period in which commercial models will be progressively developed and implemented by its Board (2021-22 – 2024-25)
- TAHE reforms will eventually be fully implemented, reflecting increased commerciality and on a pathway to profitability (2025-26 and beyond).

KPMG analysis

We note the following facts:

- TAHE was established 1 July 2020, when its enabling legislation was proclaimed. Its Board was appointed on the same date
- TAHE has been granted a 12 month operating licence in which it is authorised to undertake the functions of RailCorp; during this period, funding arrangements for TAHE also reflect that of RailCorp
- An Implementation Deed has been agreed between TAHE and other transport agencies to facilitate the initial transitional period[6].

The facts above serve to confirm an initial assumption of an initial transitional period.

We also note that TAHE's data in Prime for 2020-21 reflects the operating licence and largely mirrors RailCorp's data in the prior year. Following the protocols applicable to whole

[6] TAHE Implementation Deed (draft dated 28 June 2020)

of government financial information, data in Prime is only adjusted to reflect approved government decisions[7].

Having regard to the facts and circumstances above, an assumption of an initial transitional period accurately reflects existing operations, and the impact of policy decisions taken by the NSW Government. As such, the assumption is consistent with the conventions applied to the preparation of prospective financial information for State Budget purposes.

The applicable reporting framework requires that assumptions be based on reasonable grounds[8]. Whether something is reasonable considers whether management has the intent to carry out specific courses of action and has the ability to do so[9] (such circumstances can be distinguished from hypothetical assumptions[10].) The convention that Prime data is only adjusted to reflect decisions of government is applied to ensure that the assumptions are consistent with the applicable reporting framework. Given the assumption applied of an initial transitional period is consistent with relevant conventions and in accordance with the applicable reporting framework, it is our view that it is a reasonable assumption.

We now turn to the assumption of an extended implementation period and note:

- that the current operating licence expires 30 June 2021, but that there is an expectation of a new licence to authorise relevant operations in line with the intent and objectives outlined for TAHE by the government[11]
- that TAHE's rail access agreements with the Rail Operators will expire 30 June 2021 and that both TAHE and NSW Treasury have indicated an expectation of negotiation of new access agreements with the Rail Operators that will adhere to commercial principles
- data in Prime includes a provision of $700 million per annum starting the 2021-22 financial year and occurring in each forward estimate year. These provisions were first recognised in the 2017-18 State Budget within the Crown Finance Entity. At the time the amounts were recorded, the provisions reflected an estimate of the expected overall effect upon the Net Operating Balance (i.e. Budget Result) of implementing new funding arrangements related to ongoing implementation of TAHE reforms.

The previous facts and circumstances indicate decisions taken by the Government for an extended implementation phase. From discussions with TAHE and NSW Treasury management, we understand that the existing provisions within the Crown Finance Entity

---

[7] NSW Budget Statement 2018-19: Appendices A2. Statement of Significant Accounting Policies and Forecast Assumptions, 'Basis of preparation', TC 14/28, Page 1
[8] RG 170.16
[9] ASA540.24(d)
[10] ASAE 3450.15(m)
[11] Intent and objectives are outlined in the Second reading speech to the Transport Legislation Amendment Bill 2011 (https://www.parliament.nsw.gov.au/bill/files/657/Transport%20Amdt%20Bill%20-%20LC%202nd%20Reading.pdf) and the enabling legislation *Transport Administration Act 1988*, Part 2 Division 2 Section 10(1) (both explored in Appendix C to this report)

will be adjusted with consequential agency impacts once the TAHE Board has undertaken its strategy and operational planning activity, which is currently occurring, and once expiring access arrangements are renegotiated.

We note that TAHE Board and its shareholders will proceed to agree the initial Statement of Corporate Intent (SCI). The SCI is an agreement that sets out objectives, main undertakings and activities of TAHE, along with performances targets [12]. The SCI is a mechanism of ensuring accountability to shareholders within NSW Treasury's Commercial Policy Framework. The Commercial Policy Framework is used by NSW Treasury to facilitate its role on behalf of SOC shareholders. The Commercial Policy Framework encompasses a suite of policies implemented by NSW Treasury that aims to apply disciplines and commercial practices observed in the private sector to all government owned businesses. The framework includes requirements for annual SCI along with a comprehensive Business Plan.

Having regard to the fact that NSW Treasury's assumptions are based on data in Prime (which means they are based on previous decisions of government) and that relevant stakeholders have indicated consensus around expectations of an extended implementation phase, NSW Treasury's assumption of such a phase is reasonable. This is because the assumption is consistent with intent, which means it is consistent with the applicable reporting framework.

NSW Treasury assumes the extended implementation period will run for 2-3 years. There is no determinative project plan to inform this timeframe, but that does not mean the assumption is unreasonable. We understand that NSW Treasury has taken into account the following factors when assessing the timeframe:

- it is anticipated that implementing new access arrangements will be time consuming and resource intensive and achievement will be no earlier than the expiration date
- changes to access fees will require government decisions due to consequential impacts on the Rail Operators' budgets; the timing of such decisions has not yet been confirmed, but would be unlikely to be before significant progress with negotiating the new access arrangements has occurred
- the terms of new access arrangements have flow on implications for heavy rail infrastructure capital funding arrangements, which will need to be negotiated between the TAHE Board and its shareholders in coming periods.
- based on discussions with TAHE management, new access arrangements (as well as any new other commercial initiatives) are likely to take time to develop and implement before related returns are generated.

We note that the SCI is not yet finalised, which further supports a premise that it is too early to determine final impacts of implementing all commercial arrangements and that the timing and financial impact of such arrangements have a level of uncertainty. We also note that

---

[12] TAHE Corporate Governance Statement, Page 3 (approved July 2020)

established frameworks for assessing prospective information recognise that that information ordinarily becomes more speculative and less verifiable as the length of the period covered increases[13].

Given the above circumstances, whilst there are certain limitations due to lack of specific information, NSW Treasury assumptions are based on past government decisions, which gives them reasonable grounds in the context of prospective financial information[14], and means they are consistent with the applicable reporting framework[15]. As such, the current assumptions are reasonable.

It is our expectation that new information that will emerge over the next 12 months that will mean that current assumptions will materially change. As the current and future SCIs are agreed between the TAHE Board and shareholders, greater certainty around timing will emerge. That the outcomes may not reflect current assumptions does not mean the assumptions are not in accordance with the applicable reporting framework. Prospective financial information relates to anticipated events and actions that have not yet occurred, and which may not occur. As such, prospective financial information is prepared based on accounting estimates. The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

An accounting estimate is a monetary amount for which the measurement, in accordance with the requirements of the applicable financial reporting framework, is subject to estimation uncertainty[16]. Accounting estimates vary widely in nature and are required to be made by management when the monetary amounts cannot be directly observed. The measurement of these monetary amounts is subject to estimation uncertainty, which reflects inherent limitations in knowledge or data. These limitations give rise to inherent subjectivity and variation in the measurement outcomes. The process of making accounting estimates involves selecting and applying a method using assumptions and data, which requires judgement by management[17]. As noted earlier, it is our view that the judgements exercised by management in this instance have been made in accordance with the applicable reporting framework.

4.2 TAHE access prices for Rail Operators

Treasury assumption

Given TAHE's transitional status, Treasury has assumed a phased approach to TAHE's implementation of commercial access fees and pathway to profitability. In line with the

[13] ASAE 3450.114(a), AASB 136.35
[14] RG 170.17-RG170.19
[15] NSW Budget Statement 2018-19: Appendices A2. Statement of Significant Accounting Policies and Forecast Assumptions, 'Basis of preparation'
[16] ASA 540.12
[17] ASA 540.A1 – A6

staged transition phases outlined in Section 4.1, prices charged by TAHE are expected to increase over time. NSW Treasury assumes that:

- during TAHEs initial transitional period, (2020-21) there will be no additional access fees charged by TAHE to Rail Operators
- during TAHE's extended implementation period (2021-22 – 2023-24), amounts already provided within the Crown Finance Entity to meet TAHE implementation funding arrangements will be sufficient to cover any additional access fees.

There is a generally accepted expectation that TAHE will negotiate new commercial access arrangements with the Rail Operators. Further, it is generally accepted that these prices will eventually conform to the principles within the existing RailCorp access undertaking (discussed in Section 8.2). NSW Treasury assumes that the full impact of these new commercial access arrangements will not be implemented until TAHE completes its extended phase of implementation.

KPMG analysis

Under historic and existing access arrangements, the Rail Operators are not charged explicit access fees. A key tenet of the TAHE commercial model is that it will charge fees for access to its assets. Accordingly, there is a need to transition to a new access pricing arrangement for Rail Operators.

Consistent with a need to implement new access pricing arrangements, provision was made within the Prime forward estimates for additional funding to Rail Operators from the 2021-22 financial year. This provision occurred within the Crown Finance Entity's $700 million provisions, which were mentioned previously in Section 4.1.

In forming its conclusion that there is zero impact to be reflected in the Financial Impact Statement as a result of continuing to implement TAHE reforms, NSW Treasury has assumed that the existing provisions of $700 million per annum will be sufficient to cover new funding arrangements related to the ongoing implementation of the TAHE reforms, including access fees, during the period 2021-22 to 2023-24. We now consider the reasonableness of this assumption.

Access pricing assumptions would ordinarily be based upon the access arrangements that will be in place for the relevant period. That is, access revenues are typically a product of contractual arrangements and future assumptions could be developed having regard to those arrangements. Such assumptions would reflect existing operations and past decisions and so would be consistent with the applicable reporting framework and hence be reasonable.

However, it is noted that existing Rail Services Agreements that govern Rail Operators' access will expire on 30 June 2021 and there is a need to negotiate replacement agreements. Terms for the new arrangements are as yet undefined. This means:

- that the accounting treatments (by Rail Operators and by TAHE) of the access agreements that will apply from 1 July 2021 are not determined

- that a quantum in respect of the access fees that will apply from 1 July 2021 has not been agreed between TAHE and Rail Operators.

A consequence of the above facts and circumstances is that there is a level of uncertainty about the future access pricing arrangements and their accounting implications. This means that NSW Treasury needs to use judgement when developing its accounting estimates in relation to access fees and in determining its assumption that existing provisions are sufficient.

In determining its assumption that existing provisions are sufficient, NSW Treasury has effectively compared notional minimum additional access fees with the existing provisions. To develop the notional minimum additional access fee, NSW Treasury has had regard to the pricing principles within the Rail Access Undertaking applicable to TAHE's regulated assets, including the principle that access charges fall within a floor and ceiling price.

NSW Treasury's sufficiency assessment is copied below.

1. Sufficiency of existing provision

Access/license fees can be absorbed within TAHE provision

	[illegible]	[illegible]	[illegible]
TAHE revenue for regulated asset	35	35	39
Revenue inherited from RailCorp for regulated asset	920	949	940
O&M Actual Costs	496	484	488
Indirect and overhead costs	1,451	1,468	1,466
TAHE revenue - regulated asset			
IPART floor	920	949	940
O&M Actual Costs	496	484	488
Indirect and overhead costs	158	228	250
Return of MPM assets	71	120	153
Return on MPM assets	1,646	1,781	1,830
IPART floor			
Floor minus expected revenue			
Additional access/license fee required to meet the 'floor'	195	313	365
	within existing provision		

Source: "IPART floor simple calc 16 Oct sent" document received from NSW Treasury on 16 October 2020

In considering the sufficiency assessment above, we note that the floor calculation approach is consistent with the approach taken to inform existing pricing for private sector access seekers under the current access undertaking. That is, NSW Treasury has applied a building block approach that is consistent with that applied in an existing cost and pricing access model[18] used to inform pricing and which is outlined in Section 8.2.

In other words, in the absence of firm and specific contractual arrangements, to test the sufficiency of its provision, NSW Treasury has:

[18] 2017 TfNSW Cost and Pricing Access Model

- used established pricing principles that are taken from an access undertaking made pursuant to the *Transport Administration Act 1988* and which are applied to other access arrangements
- used an established pricing model, being the 2017 TfNSW Cost and Pricing Access Model, which has been used since then to help demonstrate compliance with pricing principles.

We also note that, based on discussions with TfNSW, TAHE and NSW Treasury personnel, these established principles and model will inform the negotiations of new access pricing arrangements.

The use of existing principles and an existing model indicates that there is reasonable basis underpinning NSW Treasury's sufficiency assessment. Further, the approach has been developed having regard to the circumstances that surround pricing negotiations. These factors indicate consistency with the requirements of the applicable reporting framework for developing accounting estimates.

NSW Treasury has applied an established approach to arrive at a conclusion that additional access fees to achieve the floor will fall within their provision – a sufficiency test. For completeness, we have also considered whether the access fees in the test will exceed the ceiling. The mechanism for determining the ceiling is set out in Section 8.2 and it is clear that the approach does not include the components necessary to achieve the ceiling. TAHE management have also advised that the amounts in NSW Treasury's table will not exceed the ceiling.

We note that the current access arrangements between TAHE and the Rail Operators do not provide for access fees, but that NSW Treasury has exercised a judgement that maintenance costs incurred by Sydney Trains constitute an in-substance access fee. Given the established access fee pricing principles include maintenance, this judgement is internally consistent with the reasonable basis applied to NSW Treasury's sufficiency assessment.

To this point, we have considered additional access fees for the period commencing 2021-22. For 2020-21, NSW Treasury has assumed no additional access fees will be charged. Having regard to NSW Treasury's calculations for subsequent years and extrapolating those to 2020-21, there is a possibility that 2020-21 access fees will fall below the floor.

When assessing the reasonableness of assumptions, established frameworks confirm it is important to consider the regulatory environment. There is a presumption that regulatory compliance supports reasonableness. As such, it is important to consider whether there may be adverse consequences of not meeting the floor, which would in turn suggest that NSW Treasury's assumption for 2020-21 is not reasonable.

The floor and ceiling concept is an established one that has been applied to private sector access seekers for some time. It has not been applied to the Rail Operators to date. However, Section 8.2 identifies that the access agreements with Rail Operators should potentially adhere to the pricing principles within the access undertaking. If this is the case, then 2020-21 pricing below the floor would mean that TAHE was non-compliant with the access undertaking principles in 2020-21.

Having regard to the detailed background information in Section 8.2, we note that the current compliance regime is focused on ensuring that access pricing does not exceed the ceiling and that there is no compliance activity focused on ensuring adherence to the floor. Arguably, the compliance activity focus reflects a need to ensure that the public sector monopoly over rail infrastructure does not restrict access through excessive pricing. As such, there seems a low likelihood that a public sector monopoly that charges another public sector monopoly less than the floor will result in significant compliance action by IPART. Further, the access undertaking does not provide for penalties, which means that, even if compliance action occurred, consequences of non-compliance with the access undertaking are unlikely.

It is accepted that non-compliance with the pricing principles in the access undertaking would arguably be inconsistent with the intent of the 1995 Competition Principles Agreement[19]. However, under the agreed principles, the State is free to determine its own agenda for the reform of public monopolies[20] and for the implementation of competitive neutrality principles[21]. Accordingly, the State has discretion to stage TAHE's transition and application of policies aimed at competitive neutrality, including staging access pricing. Noting the latitude available to the State, an approach that deviates from the Competition Principles is feasible.

A final consideration as to the reasonableness of NSW Treasury's sufficiency test relates to the fact that the access pricing will be a matter for negotiation between TAHE and the Rail Operators. As such, in theory, the negotiated access pricing applicable from 1 July 2021 may vary from the floor, such that the existing $700 million provisions are not sufficient. We have considered this possibility and note that whilst the fees will be negotiated, any financial impact of the negotiated access fees will need approval from government.

The original provisions were determined by government and any access fee that exceeds those provisions would, following processes for the State Budget and expenditure approvals, also require a government approval. Accordingly, the current provisions effectively set a cap on the extent of fees that can be negotiated. It is reasonable for NSW Treasury to apply a sufficiency test based on existing government decisions.

Overall, having regard to the preceding analysis, NSW Treasury's sufficiency test has been developed on a reasonable basis. The sufficiency test has had regard to the State's intent and ability, as well as to the principles relevant to pricing negotiations. Such considerations are what is required of the applicable reporting framework and so the sufficiency test is

---

[19] http://ncp.ncc.gov.au/docs/Competition%20Principles%20Agreement,%2011%20April%201995%20as%20amended%202007.pdf
[20] Competition Principles Agreement, Section 4.(1)
[21] Competition Principles Agreement, Section 3.(2)

reasonable. It follows that the assumptions developed from such a test will also be reasonable.

4.3 ABS GFS classifications

Treasury assumption

TAHE is currently classified by the ABS as a PNFC for Government Finance Statistics (GFS) purposes. NSW Treasury assumes this classification will remain for the period 2020-21 and beyond.

Part of the rationale supporting TAHE's classification as a PNFC is that the Rail Operators are also classified as PNFC. NSW Treasury also assumes these classifications will remain for the foreseeable future.

These PNFC classifications of heavy rail entities create the context for accounting treatments applied by the State. This is due to the fact that historical and prospective financial information prepared for the General Government Sector (GGS) reflect transactions with NSW government entities within the PNFC sector, including those related to heavy rail operators and TAHE.

KPMG analysis

For financial and budgetary reporting and policy purposes, all NSW agencies are classified under a sector for GFS purposes, either GGS, PNFC or PFC (i.e. Public Financial Corporation). NSW Treasury owns the relationship with the ABS. Formal engagement with the ABS about GFS classifications of entities and about GFS treatment of transactions and balances is the role of NSW Treasury.

TAHE classification

RailCorp has historically been classified as PNFC. In 2015, in the context of the plans for asset ownership reform and establishment of TAHE, the ABS classified TAHE[22] as a PNFC entity. ABS classification of TAHE as PNFC was based on whether it met the relevant criteria:

- "The unit's status as an institutional unit in its own right
- Whether the unit is a market or non-market producer; and
- Whether the unit is controlled by government."[23]

NSW Treasury undertook an assessment of TAHE against the PNFC criteria in August 2020. This assessment noted that:

---

[22] RailCorp was converted to TAHE 1 July 2020. The letter from the ABS to NSW Treasury "Re: Final Determination of the classification of Transport Asset Holding Entity" addressed TAHE's classification and confirmed RailCorp's classification
[23] System of National Accounts 2008 (European Commission et al, 2008) https://unstats.un.org/unsd/nationalaccount/docs/sna2008.pdf, paragraphs 4.24 - 4.37

- TAHE's separate institutional unit status had been further strengthened as a result of its establishment as a SOC with an independent board
- The commencement of development of operating model and commercial asset strategy, and intention to implement new access arrangements by 1 July 2021 with Sydney Trains and NSW Trains, further strengthened its status as a market producer
- As a SOC, TAHE is government controlled.

Based on our own understanding of GFS, TAHE and ongoing TAHE reforms, and having regard to precedent classifications in NSW and other jurisdictions, we would agree with NSW Treasury's assessment.

In assuming that TAHE will remain classified as a PNFC entity, we understand NSW Treasury have taken into account that TAHE reforms are expected to continue, including that a new operating licence will be granted from 1 July 2021[24]. There is an expectation that the new operating licence will reflect the intent and objectives outlined for TAHE by the government[25], including that TAHE will be distanced from day-to-day central Government control in order to facilitate commercial management of its assets, and thereby underpinning the separate institutional status of TAHE.

NSW Treasury have also taken into account the following specific TAHE facts and circumstances:

- GFS classification remains until revoked or changed by the ABS; the ABS has not indicated to NSW Treasury any intention to revisit the classification of RailCorp / TAHE since the 2015 determination was made
- the convention applied to classification of NSW entities subject to reforms is that a confirmation of classification is sought once all reforms are implemented; it is not appropriate to engage with the ABS at this juncture
- classification is based on a long-term view[26]; even delays of some years in implementing reforms would not create a need to reconsider classification (nor to "check in" with the ABS, given it is not the ABS's role to monitor government reform progress or endorse government strategy)
- the PNFC status of NSW public transport agencies is generally consistent with the classification of similar agencies in other jurisdictions; heavy rail entities in Queensland and Victoria are also classified as PNFC.

Consistent with the protocol outlined above, we understand that NSW Treasury's intention is to re-engage the ABS once reforms are implemented. Since TAHE implementation is proceeding broadly as planned (notwithstanding a temporary and short-term delay), having regard to the long term view applied by the statistical frameworks, it is reasonable to conclude that there is no need for the ABS to reconsider or re-confirm PNFC classification of TAHE either currently or until reforms complete.

---

24 TAHE Operating Licence period is 1 July 2020 – 30 June 2021 (final dated 26 June 2020)

25 Intent and objectives are outlined in the Second reading speech to the Transport Legislation Amendment Bill 2011 (https://www.parliament.nsw.gov.au/bill/files/657/Transport%20Amdt%20Bill%20-%20LC%202nd%20Reading.pdf) and the enabling legislation *Transport Administration Act 1988*, Part 2 Division 2 Section 10(1) (both explored in Appendix C to this report)

26 IMF GFSM 2014, paragraph 2.70 & p21, Footnote 22

As noted earlier, NSW Treasury is assuming a pathway to profitability (2025-26 and beyond). Given the GFS classification criteria for PNFC does not include whether an entity is profitable, or how profitable an entity is, we note that there is no implication arising from the earlier assumption. That is, the timing of TAHE's profitability or the extent of it, is not relevant to determination of PNFC classification.

We note that the ABS receives data from the NSW public sector as part of their regular quarterly reporting[27]. This reporting includes data on transactions of agencies, including data relevant to PNFC criteria. This would indicate that the ABS has information upon which to reconsider GFS classification if it thought it necessary or appropriate, which it has not done, further supporting the reasonableness of NSW Treasury's PNFC assumption.

We also note that statistical series maintained by the ABS benefit from consistency across jurisdictions and time series. This has the following implications:

- the ABS has historically sought to maintain consistency in the treatment of transport operators across Australian government jurisdictions to continue to facilitate comparison
- given the preference for consistency, reclassification of TAHE could necessitate consideration of reclassification of all jurisdictions because NSW has the largest heavy rail operations of the jurisdictions
- consideration of reclassification of some or all other jurisdictions' heavy rail entities would necessitate significant consultation, given the public financial and budgetary reporting implications of a reclassification
- time would be required to implement changes in GFS ABS reporting processes and systems to facilitate relevant time series comparisons during and after reclassification.

NSW Treasury confirmed they are unaware of any consultation by the ABS with other jurisdictions about heavy rail reclassifications.

Having regard to the analysis above, it is reasonable to assume that a reclassification of TAHE from PNFC to GGS is not imminent. Further, it seems the most likely outcome at this point in time is that the GFS classification of TAHE will not be considered until such time as NSW Treasury considers the TAHE reforms sufficiently implemented so as to facilitate a request for formal consideration by the ABS, which is unlikely to be until completion of the next stage of transition per Treasury's expected timetable (i.e. post 2024-25). In summary, it is our view that NSW Treasury's assumption about the ongoing PNFC classification of TAHE is reasonable.

Rail Operators' classification

The Rail Operators have always been classified as PNFC for GFS purposes. This reflects that their role is to provide public passenger services. NSW Treasury has exercised a judgement that this classification will also remain for the foreseeable period.

---

[27] ABS GFSM 2015, paragraph 14.4

When forming this judgement, we understand NSW Treasury has taken into account the following considerations, many of which are similar to those applied to TAHE earlier:

- the ABS has signalled no intention to reconsider the GFS classification of Rail Operators
- classification of the Rail Operators is likely only to be assessed by the ABS when TAHE is assessed
- the classification of the Rail Operators is consistent with other jurisdictions
- NSW Treasury provides regular data about the transactions of the Rail Operators to the ABS
- the ABS is likely to prefer consistency over time and with other jurisdictions and this creates a likely long lead time for implementing any reclassification.

As with TAHE, the factors above support the reasonableness of NSW Treasury's judgement about the PNFC classification of the Rail Operators.

We understand that current government policy is for the Rail Operators to continue operating on the same basis as they have been since their classification as PNFC entities[28]. This includes remaining as separate institutional units and market producers, the key criteria of PNFC classification under GFS. As such, there is no apparent reason for the ABS to reconsider the classification of these entities.

We note that the relatively low level of farebox revenue compared to production costs could arguably be considered an indicator that the Rail Operators do not meet the "market producer" criteria for PNFC classification. However, under GFS, being a "market producer" is a function of charging economically significant prices.[29] When assessing the Rail Operators in this context, we note that the Rail Operators continue to charge prices that have an effect on amount of services that the public consumes (i.e. prices are not nil or nominal), and that the public is free to consume or not consume services provided by the Rail Operators, and would have some regard to prices charged when doing so.[30] As such, the current pricing arrangements support that the Rail Operators are market producers.

Further, when assessing the level of revenue over production costs (another consideration in the economically significant prices and "market producer" assessment), subsidies can be included in revenue to the extent that other market participants would also receive them.[31] In NSW, all modes of transport are heavily subsidised. Private sector public transport operators receive subsidies to operate. Accordingly, that subsidies are received by the Rail Operators does not preclude their market producer status.

We also note that the Rail Operators' farebox revenue is currently adversely impacted by COVID-19, which is the same outcome experienced by other operators, including private sector operators. Private sector operators are receiving additional subsidies as are the Rail Operators. Following the principle above, current additional COVID-19 subsidy does not present a risk to PNFC classification of the Rail Operators.

---

[28] Second reading speech to the *Transport Administration Amendment (Transport Entities) Bill 2017*, Explanatory note to the *Transport Administration Amendment (Transport Entities) Bill 2017*
[29] ABS GFSM 2015, paragraph 2.59 & IMF GFSM 2014, paragraph 2.65-2.67
[30] ABS GFSM 2015, paragraph 2.59 & IMF GFSM 2014, paragraph 2.65-2.67
[31] ABS GFSM 2015, paragraph 2.61 & IMF GFSM 2014, paragraph 2.73

Having regard to the analysis above, it is reasonable to conclude that a reclassification of the Rail Operators from PNFC to GGS is not imminent. Further, it seems that the classification of the Rail Operators would be considered when TAHE's classification is considered. Accordingly, it is our view that NSW Treasury's judgement about the ongoing PNFC classification of the Rail Operators is reasonable.

4.4 Accounting treatment of heavy rail infrastructure capital funding

Treasury assumption

The State provides annual funding to TAHE for the acquisition of heavy rail infrastructure. NSW Treasury assumes this funding is treated by the GGS as an acquisition of additional equity within TAHE.

By way of background, in accordance with AASB 1049 *Whole of Government and General Government Sector Financial Reporting*,[32] the GGS records on its balance sheet a notional investment in the PNFC sector. This financial asset represents an equity interest in the PNFC sector that entitles the holder to a share of the income and a right to the residual assets of the PNFC entity, should it be wound up.

Since 2015-16 and up to 2019-20, annual funding to TAHE for the acquisition of heavy rail infrastructure has been treated by the GGS as an acquisition of additional equity within TAHE. NSW Treasury effectively assumes this treatment continues.

KPMG analysis

Treatment by TAHE

From TAHE's point of view, following the requirements of Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities* and TPP 09-03 Accounting Policy: Contributions by owners made to wholly-owned Public Sector Entities, the amounts are treated as 'equity injections' i.e. acquisition of equity by the shareholders. Further detail on how these pronouncements within the applicable reporting framework apply to TAHE's circumstances is set out in Section 8.2.

On the basis treatment as an equity injection by TAHE is in accordance with the applicable reporting framework, this assumption about TAHE's accounting treatment is reasonable.

Treatment by the GGS

From the GGS perspective, funding provided by the GGS to TAHE can be treated one of two ways:

[32] AASB 1049.20

- acquisition of additional equity in TAHE, which increases the GGS's notional investment in the PNFC sector
- grants to TAHE, which are treated as an expense (grants and subsidies – capital transfer).

Following the rationale set out above in respect of TAHE's accounting treatment and a need to maintain symmetry[33], the funding provided to TAHE to acquire heavy rail infrastructure is treated as acquisition of additional equity by the GGS. As such, prima facie, the assumption that funding to TAHE to acquire heavy rail infrastructure is treated as acquisition of equity is reasonable. However, it is important to also consider the treatment of such funding under GFS. GFS treatment is relevant because the GGS's reporting in accordance with AASB 1049 effectively applies a GFS overlay to Australian Accounting Standards.

GFS considers funding from the GGS to PNFC sector. GFS is consistent with the treatment under Australian Accounting Standards in that if a government makes a transfer to a PNFC to finance its acquisition of non-financial assets, this is recorded as equity[34]. However, GFS identifies an exception to this principle in which the transfer is treated as a capital transfer i.e. expensed as a grant by the GGS. This exception is where there is no reasonable expectation of a realistic rate of return on the investment. If there is no reasonable expectation of a realistic return on the investment[35] made by the GGS, the cash transfer amount will be treated as a capital transfer expense by the GGS for GFS purposes.

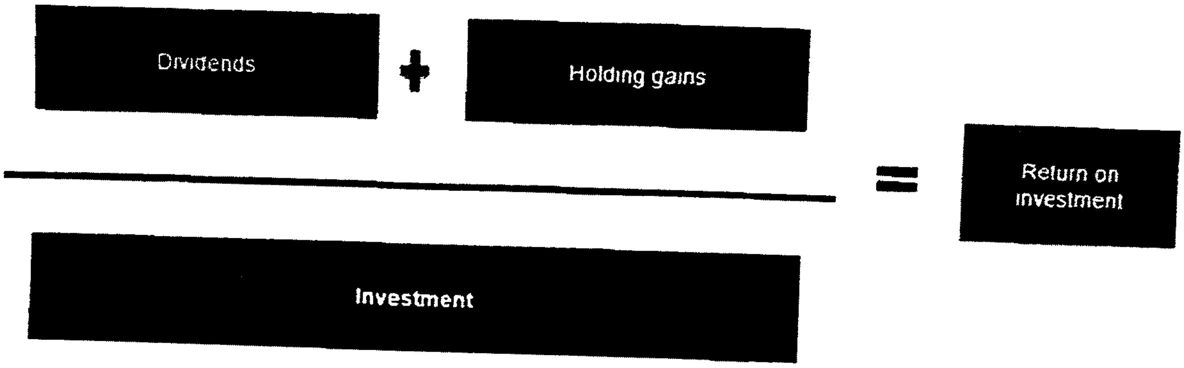
A relevant question then becomes whether there is a reasonable expectation of a realistic rate of return on the funding injected for acquisition of heavy rail infrastructure assets.

From a GFS perspective, a realistic rate of return on the investment is indicated by the intention to earn a rate of return that is sufficient to generate dividends or holding gains at a later date and includes a claim on the residual value of the corporation[36].

Dividends represent the return from the use of the capital invested by the GGS. Holding gains accrue as a result of holding the investment over time and are realised from the disposal of the investment. Dividends are a return <u>on</u> the capital, whereas holding gains are the return <u>of</u> the capital.

In practice, a comparison of the expected returns against the amount of the investment is required. This can be expressed diagrammatically as follows:

33 Interpretation 1038.11
34 ABS GFSM 2015, paragraph 10.49
35 ABS GFSM 2015, paragraph 13.63, IMF ABSM 2014, paragraph A3.50
36 ABS GFSM 2015, paragraph 13.63, Diagram 13.3



The GFS perspective is relevant to assessing assumptions underpinning the accounting treatment of capital injections into TAHE.

It is noted that, as a State Owned Corporation that is a for-profit entity for accounting purposes, there is an inherent expectation that TAHE will generate sufficient revenues in future to recover its costs and provide a realistic rate of return to its shareholders. Further, under TAHE's enabling legislation, the principal objectives of TAHE included to be a successful business[37].

Further, it is noted that NSW Treasury's Commercial Policy Framework applies to TAHE[38] and that this Framework outlines expectations about distributions to shareholders[39]. That the Framework applies to TAHE supports a reasonable expectation of a return. However, the specific requirements of the Framework, including expectations about the quantum of returns, have no further relevance for considering the accounting treatment of capital injections by the GGS (this is further explored in Section 8.2). Instead, it is necessary to consider the accounting requirements, including Australian Accounting Standards and GFS.

We now consider application of the GFS perspective to NSW Treasury's assumption that there is a reasonable expectation of a realistic rate of return on the funding injected for acquisition of heavy rail infrastructure assets. Relevant considerations include:

- which transactions from TAHE to the GGS constitute a 'return' from TAHE (i.e. the 'numerator')
- the amount upon which a return is expected (i.e. the 'denominator')
- sufficiency and timing of the return.

When forming its assumption that funding for acquisition of heavy rail infrastructure is treated by the GGS as an acquisition of additional equity within TAHE, on the basis of a reasonable expectation of a realistic rate of return on the funding, NSW Treasury has considered that the following types of future transactions constitute the return (i.e. the numerator):

---

[37] *Transport Administration Act 1988*, Part 2 Division 2 Section 10(1)
[38] https://www.treasury.nsw.gov.au/information-public-entities/government-businesses/commercial-policy-framework, which confirms that the Framework applies to Government businesses
[39] TPP 16-04 Financial Distribution Policy for Government Businesses

- dividends paid by TAHE to the GGS in accordance with the Commercial Policy Framework
- payments made by TAHE under the State Tax Equivalent Regime (TER) and National Tax Equivalent Regime (NTER)
- holding gains (both realised and unrealised).

The 'Australian System of Government Finance Statistics: Concepts, Sources and Methods' 2015 (ABS GFSM 2015) states that generation of dividends is indicative of a return.[40] Further, the International Monetary Fund Government Finance Statistics Manual 2014 (IMF GFSM 2014) specifies that dividends form part of a government's expected returns.[41] NSW Treasury advised that they follow this GFS principle in respect of dividends received from all NSW SOCs. On the basis it is in accordance with the applicable reporting framework, in our view, it is reasonable for future dividends from TAHE to be included in returns to the GGS.

The TER applies a tax rate to accounting profit and the NTER notionally applies Federal income tax laws to selected government business entities (refer to Section 4.7 for more detail). The ABS GFSM 2015 states that tax equivalents are included within dividend income.[42] That is, from the perspective of GFS, tax equivalent payments form part of the government's return on investment. NSW Treasury advised that they follow this GFS principle in respect of NTER received from all NSW SOCs. Again, on the basis of compliance with the applicable reporting framework, we consider it reasonable to include future tax equivalent payments in returns to the GGS.

The ABS GFSM 2015 states that generation of holding gains is also indicative of a return.[43] Further, the IMF GFSM 2014 specifies that holding gains form part of a government's expected returns.[44] As before, on the basis of compliance with the applicable reporting framework, it is reasonable to include expected holding gains in returns to the GGS.

When forming its assumption that funding for acquiring heavy rail infrastructure is treated by the GGS as an acquisition of additional equity within TAHE, on the basis of a reasonable expectation of a realistic rate of return on the funding, NSW Treasury has considered that the following types of future transactions constitute the amount upon which a return is expected (i.e. the denominator):

- funding injected for the acquisition of heavy rail infrastructure assets post-2015 (recorded as equity)

---

40 ABS GFSM 2015, paragraph 13.63 & p.274, Note 2
41 IMF GFSM 2014, p.134, Box 6.3, p.302, Footnote 14 & p.303, Figure A3.2
42 ABS GFSM 2015, paragraph 6.130
43 ABS GFSM 2015, paragraph 13.63 & p.274, Note 2
44 IMF GFSM 2014, p.302, Footnote 14 & p.303, Figure A3.2

- assets transferred from GGS agencies to RailCorp / TAHE via equity transfer (being any amounts other than those above), but excluding any amounts expensed as a capital grant.

In considering the reasonableness of amounts included in the denominator, we note:

- GFS specifies that if a realistic return can be expected on the investment, an increase in financial assets in the form of equity is recorded. Where there is a portion of an investment on which no realistic return can be expected by the government, it is treated as a capital transfer / capital grant (i.e. expensed).[45] This is a test applied to the investment i.e. the equity contributed; it is not necessary to consider returns on other amounts for which there was no expectation of return (i.e. those previously expensed.)
- The Commonwealth Government, when articulating how they assess whether a funding injection should be recorded as equity, compare the expected returns with the current values of cumulative equity injections provided by the government.[46] Consistent with the GFS principle in the previous point, they do not state that they compare the expected returns with the fair value of the net assets of the entity, and/or the entity's 'enterprise value', or similar.
- Prior to 2015, funding injected for the acquisition of heavy rail infrastructure was expensed (<u>not recorded as equity</u>), as there was no expectation of a return.
- Including the pre-2015 funding that was expensed in the 'denominator' would result in 'double-counting' – this is because these funding amounts were already expensed. Consequently, NSW Treasury have excluded pre-2015 funding from the 'denominator'.

Having regard to the above factors and the requirements of the applicable reporting framework, it is our view that NSW Treasury's judgement in relation to the amounts forming the 'denominator' for the purposes being considered (i.e. accounting treatment under GFS) is reasonable.

So far, we have considered what is appropriate to include in the concept of a "return" and the basis for determining a rate of return, having regard to the applicable reporting framework. In assessing the overall accounting treatment assumption, it is also important to consider what constitutes a realistic rate of return and whether there is a reasonable expectation of achievement.

In performing such an assessment, we note that the ABS GFSM 2015 does not provide a definitive 'bright line' in respect of a minimum percentage rate of return that should be expected on a capital injection in order for the capital injection to be recorded as equity. Equally, there is no bright line in respect of the timing of that return. Rather, both the ABS

---

[45] ABS GFSM 2015, paragraph 13.63 & 13.64, IMF GFSM 2014, paragraph A3.49
[46] https://www.finance.gov.au/publications/advice-paper/ga-equity-investments, p.2 & Parliamentary Budget Office, Alternative Financing of Government Policies, Report No.01/2020, p.18, 3.1 & Note, p19

GFSM 2015 and IMF GFSM 2014 specify that the statistical treatment depends on whether both of the following criteria are achieved:

- there is an intention to earn a rate of return sufficient to generate dividends or holding gains at a later date
- that there is a claim on the residual value of the corporation.[47]

The above requirements of the ABS GFSM 2015 demonstrate that, in effect, the 'bare minimum' performance required to support the statistical treatment of capital injections as equity is simply to be able demonstrate that entity will generate dividends or holding gains at a later date.

For TAHE, given the SOC ownership circumstances, the residual claim criterion is satisfied. Accordingly, the key focus is therefore on whether there is an intention for TAHE to earn a rate of return sufficient to generate dividends or holding gains for the GGS at a later date.

We first consider the matter of "intention" and note that there are a variety of factors that support such an intention:

- The Government has articulated that[48]:
  - a key intent is for TAHE to manage the State's portfolio of transport assets better and more commercially
  - TAHE is aimed at enabling a more effective, efficient and commercial approach to the management of transport assets, particularly property.
- TAHE's objectives include to be a successful business and, to this end[49]:
  - to operate at least as efficiently as any comparable businesses, and
  - to maximise the net worth of the State's investment in TAHE.
- Having regard to the precedent set by other SOCs, establishment as a SOC indicates an expectation of for-profit status for TAHE. This is supported by the fact that the TAHE Board has determined TAHE is for-profit for accounting purposes.
- A profit motive does not equate to always or immediately generating profits. Based on discussions with TAHE management, in reaching its for-profit determination, the TAHE Board recognised that it is not currently profitable but that it had a longer-term profit objective.
- As a SOC, the Commercial Policy Framework applies to TAHE. This Framework seeks to apply disciplines and commercial practices observed in the private sector to all government owned businesses. Private sector businesses are intended to generate returns. Current application of the Framework to TAHE reflects its transitional status, but both TAHE management and NSW Treasury personnel have advised the intention

---

[47] ABS GFSM 2015, paragraph 13.63 & IMF GFSM 2014, p.134, Box 6.3, p.302, Footnote 14 & p.303, Figure A3.2
[48] Second reading speech for *Transport Administration Amendment (Transport Entities) Bill 2017*, Pg 1
[49] *Transport Administration Act 1988*, Part 2 Division 2 Section 10(1)

is for the Framework to eventually apply in full, including provisions addressing returns.

- TAHE's Board is currently developing its commercial strategies, in the context of the previous points.

The circumstances outlined above demonstrate that TAHE's legal and governance structure is aligned with an intention to generate returns and note that the legal and governance structure reflects the decisions and intentions of the government. In other words, the government has introduced legislation that enables generation of returns for the reason being that it intends to do so. It is our view that these circumstances point to an inherent presumption of intent that would need to be rebutted. Accordingly, we now consider the matter of "sufficiency".

The ABS GFSM 2015 and IMF GFSM 2014 both require that there is an intention to earn a rate of return "sufficient" to generate dividends or holding gains at a later date.

Recognising that future returns of a new SOC with a transitioning business model are difficult to predict and subject to a high degree of estimation uncertainty, NSW Treasury has developed a simple sufficiency benchmark to test its judgement. NSW Treasury's threshold for whether there can be a reasonable expectation of a return is 1.5% and it has applied this rate to the 2024-25 year onwards.

Practically, a 'benchmark' 1.5% target allows NSW Treasury to undertake an ongoing assessment of whether the criterion set by the ABS GFSM 2015 is satisfied, in order to determine whether funding to TAHE for heavy rail capital expenditure should be treated by the GGS as an acquisition of additional equity within TAHE. As before, this benchmark is for the purposes of assessing accounting treatments only and it has little bearing on returns expected in a Commercial Policy Framework context.

We note that when exercising judgement to arrive at the 1.5% figure, NSW Treasury has considered:

- the NSW Government 10-year bond rate in September 2020 of 1.31%[50]
- expectations and signals around future general bond rate and cash rate movements, including the fact that cash rates remain at ¼% and consistent signals that cash rates will not increase in the near term[51]
- current rates of (de)inflation and expectations about future inflation rate movements, which are modest[52]

---

[50] https://www.rba.gov.au/statistics/tables/xls/f02hist.xls

[51] Statement by Philip Lowe, Governor: Monetary Policy Decision, 6 October 2020: *"Bond yields are at historically low levels, as are interest rates for most businesses and households... The Board views addressing the high rate of unemployment as an important national priority. It will maintain highly accommodative policy settings as long as is required and will not increase the cash rate target until progress is being made towards full employment and it is confident that inflation will be sustainably within the 2–3 per cent target band"*(https://www.rba.gov.au/media-releases/2020/mr-20-24.html) & https://www.rba.gov.au/statistics/cash-rate/

[52] https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release - June 2020 reference period

- historical returns on other SOCs, especially in earlier years of operation.

When the applicable reporting framework provides options or requires judgement, Australian jurisdictions frequently develop their own policy positions to ensure consistency of approach. NSW has not addressed this issue of returns specifically, largely because there are limited circumstances in which equity injections are made to SOCs. Accordingly, we have had regard to Commonwealth guidance that is in the public domain.

When performing the same assessment of expected returns on government investments, the Commonwealth Government states that it simply requires there to be an expectation that the government will receive a 'real' return of zero at a minimum i.e. a return greater than inflation.[53] Consequently, in our view, NSW Treasury's judgement to use a benchmark of 1.5% to assess sufficiency of return is reasonable. In reaching our view, we have had regard to Treasury's basis for determining the benchmark and practices in other jurisdictions for applying the requirements of the applicable reporting framework.

We now consider NSW Treasury's judgement that the benchmark rate of 1.5% is applied from the 2024-25 year onwards.

As outlined above, the ABS GFSM 2015 states that a return is required that is sufficient to generate dividends or holding gains at a later date.[54] In other words, there is no specific timeframe articulated in the ABS GFSM 2015.

Further, the IMF GFSM 2014 notes that, in the context of a government providing funds and increasing its equity value:

- a government effectively acts in the same capacity as a private shareholder when providing funds and receiving something of equal value in exchange (i.e. increased value of is equity) and expecting to earn a sufficient rate of return on its investment; and
- that treatment of such payments depends on evidence of the corporation's profitability and its ability to pay dividends in the future.[55]

Again, the applicable framework does not provide a specific timeframe. Accordingly, the frameworks confirm that timeframe is a matter of judgement. To assess the reasonableness of NSW Treasury's judgement, we have considered practices in other jurisdictions. In particular, because the IMF GFSM 2014 mentions evidence of profitability, we have sought to identify circumstances somewhat analogous to TAHE's in relation to limited corporate history and/or current losses.

---

[53] Parliamentary Budget Office, Alternative Financing of Government Policies, Report No.01/2020, p.7 & Department of Finance, Finance Advice Paper, Q&A – Equity Investments, August 2018, p.2 & p.37, Figure D1
[54] ABS GFSM 2015, paragraph 13.63 & p.274, Note 2
[55] IMF GFSM 2014, p.134, Box 6.3, p.302, Footnote 14 & p.303, Figure A3.2

We found that there are a number of examples in other jurisdictions of entities where a government has recorded funding injections as equity, despite the fact that the entity has not yet demonstrated profitability, including:

- Moorebank Intermodal Company (MIC) – a Commonwealth Government Business Enterprise (GBE). MIC receives funding from the Commonwealth Government which is recorded as equity, notwithstanding that MIC has incurred losses from operating activities (i.e. accounting losses) since inception[56]
- Australian Rail Track Corporation (ARTC) – a Commonwealth GBE. ARTC had equity contributed in 2018-19, despite making a loss from operating activities in the same year.[57]

What our research indicates is that a history of profitability or current profitability is not the key determinant of whether there can be an expectation of an entity's future ability to generate returns. Rather, a longer-term view can be applied having regard to the nature of the underlying business and maturity of commercial models. Based on historical information on dividends remitted by SOCs provided by NSW Treasury, we note that returns vary significantly across SOCs and over time.

Having regard to the analysis above, it is reasonable to conclude that a government providing funding to an entity does not need to expect or receive a return immediately in order for such payments to be recorded as equity. This would particularly apply to asset-heavy /infrastructure sectors with long-lived assets. Accordingly, NSW Treasury's judgement that TAHE does not need to demonstrate a realistic rate of return on funding for the acquisition of heavy rail infrastructure immediately (in order for such funding to be treated by the GGS as an acquisition of additional equity within TAHE) is reasonable.

Overall, we have undertaken the preceding analysis of various judgements NSW Treasury has exercised in forming its assumption that annual funding to TAHE for heavy rail capital expenditure is treated by the GGS as an acquisition of additional equity within TAHE. Having regard to this analysis, which includes consideration of applicable frameworks and precedents in other jurisdictions, we have concluded that NSW Treasury's judgements are reasonable. The effect of this conclusion about the judgements is that the assumption that the funding is treated as equity is also reasonable, in that it has been developed in accordance with the applicable reporting framework.

This section contains various references to GFS; refer to Section 8.2 for detailed relevant GFS extracts and other supporting documentation and analysis.

---

[56] Moorebank Intermodal Company Annual Report for the year ended 30 June 2019, Pg. 53
[57] ARTC Financial Statements for the year ended 30 June 2019, Pg 21 and 25

4.5 Measurement of TAHE's rail infrastructure assets and depreciation

Treasury assumption

As at 1 July 2020, TAHE's rail infrastructure assets are accounted for as property, plant and equipment under AASB 116 *Property, Plant and Equipment* (AASB 116) and measured at fair value. In estimating fair value, TAHE has applied a cost approach to estimate the assets' fair value. NSW Treasury assumes that this measurement basis will continue to apply indefinitely from 1 July 2020. NSW Treasury further assumes that depreciation charges will reflect measurement applying the cost approach.

KPMG analysis

It is noted that NSW Treasury's asset measurement assumption is consistent with historical financial information that has been subject to audit, which is a strong indicator of reasonableness. It is also noted that the assumption around depreciation is internally consistent, which also supports that the depreciation assumption is reasonable. Both assumptions are consistent with the applicable reporting framework and this further supports reasonableness. However, it is important to recognise that there are a number of uncertainties associated with the future measurement of rail infrastructure assets.

- There is a change in the applicable reporting framework effective 1 July 2020 that affects certain public sector assets. AASB 1059 *Service Concession Arrangements: Grantor* applies from 1 July 2020 and some of TAHE's assets may be subject to this standard.
- Changes to the accounting treatment are highly likely for at least some of TAHE's rail infrastructure assets from 1 July 2021. That is, instead of applying AASB 116, it may be necessary to apply alternative accounting standards. This is because existing rail access arrangements between TAHE and the Rail Operators are due to expire 30 June 2021. Terms and conditions around these access arrangements are yet to be determined. Once these arrangements are agreed, assessment of the accounting treatments and measurement requirements can occur. At these early stages, it seems possible that:
  - Rollingstock could be subject to a finance lease[58], which would mean a change in the applicable standard and measurement basis away from one of fair value in favour of a financial receivable reflecting the present value of future cash flows. Whether the present value of future cash flows will be equal to the carrying value of assets when applying the cost approach to fair value estimation is unlikely based on past experience with government owned businesses.

[58] AASB 16 *Leases* Appendix A

- Below rail infrastructure could still be accounted for as property, plant and equipment, but further information would be available that would mean that instead of applying a cost approach, TAHE would apply an income approach. Applying income approaches typically results in lower carrying values than when applying cost approaches in government owned regulated businesses[59]. A lower carrying value would create consequential changes in depreciation charges.
- Alternatively, below rail infrastructure could be subject to service concession accounting[60], which would mean carrying values would be required to remain at a fair value applying the cost approach to estimation.

- As TAHE develops and implements its commercial asset strategy, a consequence could be significant changes to expectations about useful lives, with resulting impacts on depreciation charges and carrying values[61].

Given the above circumstances, there are limitations with relying upon historical carrying values as the basis for an assumption about future carrying values. That said, due to data limitations at the present time, an alternative assumption lacks reliability of measurement. Further, these limitations mean developing a probability weighted best estimate based on a range of possible accounting outcomes is also unlikely to result in a reliable estimate.

Accordingly, whilst there are significant limitations with the current assumption, it is the most reliable assumption available at this point in time and so is reasonable having regard to the applicable reporting framework.

In forming our view, we have had regard to the fact that historical information in Prime reflecting measurement of assets would ordinarily serve as the basis for future measurement assumptions. Further, following the established processes for effecting changes in Prime data, a 'PTA' would be required to request adjustments as facts and circumstances in respect of asset measurement develop. Only after approval of the PTA would the Prime data be adjusted. In other words, the current basis of the assumption reflects approved data.

It is our expectation that, given the new information that will emerge over the next 12 months, that asset measurement and depreciation assumptions are likely to materially change. Further, based on our experience with accounting for public sector assets, it is our view that the impact of updated assumptions would be limited to a reduction in carrying values and depreciation charges rather than an increase or stable carrying value.

---

[59] TPP 14-01 Accounting Policy: Valuation of Physical Non-Current Assets at Fair Value, Section 7.2.3
[60] AASB 1059 *Service Concession Arrangements: Grantors*
[61] AASB 116 *Property, Plant and Equipment*, Paragraph 35

4.6 TAHE additional commercial revenues

Treasury assumption

There is an expectation that TAHE will generate additional commercial revenues in the future (i.e. revenues from sources other than access fees). However, NSW Treasury currently assumes that such additional commercial revenue is zero. This is on the basis that such amounts are not currently reliably measurable.

KPMG analysis

TAHE is a SOC[62], which is a "commercially focused business operation"[63].

TAHE's objectives[64] include "to be a successful business" and to this end "to operate at least as efficiently as any comparable businesses". Further:

- A key intent is for TAHE to manage the State's portfolio of transport assets better and more commercially.
- TAHE establishes new arrangements for transport asset management that reflect modern governance and financial practices.
- TAHE is aimed at enabling a more effective, efficient and commercial approach to the management of transport assets, particularly property.
- A dedicated asset holding entity, operating on commercial principles, will provide an efficient base from which to optimise transport services outcomes.[65]

TAHE is for-profit for accounting purposes.

All of the above factors would point to a reasonable expectation that TAHE will generate commercial revenues over and above those that its predecessor agency, RailCorp, generated. However, no additional commercial revenue has been forecast when assessing the financial impact of TAHE.

We note that:

- TAHE was established as a SOC only on 1 July 2020, and its Board was appointed at this date.
- Prime data contains no additional commercial revenue i.e. Treasury's assumption is consistent with Prime.

---

[62] *State Owned Corporations Act 1989*, Schedule 5
[63] TPP 18-02 Commercial Policy Framework: Performance Reporting and Monitoring Policy for Government Businesses, Section 1
[64] *Transport Administration Act 1988*, Part 2 Division 2 Section 10(1)
[65] Second reading speech for *Transport Administration Amendment (Transport Entities) Bill 2017*

- TAHE's board and management is currently developing its commercial asset strategy and as such has not yet developed any internal forecasts for additional commercial revenue that have been approved by its Board
- TAHE's Board and shareholders have not yet finalised a SCI, which is the mechanism in which expectations about financial performance are agreed[66].

Australian Accounting Standards require that amounts are only recorded when they are reliably measurable. Given the early stages of TAHE's establishment, there is no existing basis of developing an assumption around additional commercial revenue. Further, the stage of development of commercial strategy means TAHE's own expectations are not yet formulated. Without a basis for an assumption, it is reasonable in the context of the applicable reporting framework to not record any additional commercial revenue.

The assumption is reasonable given the requirements of the reporting framework and having regard to the intent of TAHE and its enabling governance structure. However, we note that an assumption of zero is arguably conservative, given TAHE is enabled to improve commerciality. As such, as new information emerges, the direction of the assumption would likely be to increase forecast additional commercial revenues from zero.

4.7 TAHE's payments under tax equivalent regime(s)

Treasury assumption

As a SOC, there is an expectation that TAHE will be subject to a tax equivalent regime. Under tax equivalent regimes, government owned businesses remit taxation payments, which are recorded as revenue by the GGS.

NSW Treasury assumes:

- zero tax payments until TAHE enters a tax equivalent regime
- that TAHE enters the TER next financial year
- that whilst in the TER, TAHE's tax payments are 30% of accounting profits
- that TAHE enters the NTER only once it completes the next phase of its transition (i.e. commercial access fee arrangements from 2025)
- that tax payments under the NTER are 30% of accounting profits.

---

[66] TPP 18-02 Commercial Policy Framework: Performance Reporting and Monitoring Policy for Government Businesses, Section 2

KPMG analysis

The *State Owned Corporation Act 1989* (the SOC Act) provides that statutory SOCs must remit tax equivalent payments to the Treasurer, which are paid into the Consolidated Fund[67]. Notwithstanding the legislative requirement to remit tax, the legislation also provides that "The SOC and the Treasurer may enter into agreements regarding the amounts to be paid under this section or the terms on which they are to be paid". The legislation also provides that such agreements have effect despite the legislative requirement to remit tax payments. In effect, the Treasurer has the final say as to whether and how a SOC will be subject to taxation provisions of the SOC Act.

To facilitate the provision of tax payments, NSW Treasury's Commercial Policy Framework includes policy requirements[68] in respect of two tax equivalent regimes, the TER and the NTER. At this point in time, neither the TER or NTER has been applied to TAHE in accordance with this policy and TAHE is not registered for either regime.

We note that:

- in line with advice from NSW Treasury, the TER will not apply to TAHE until it has registered with the Chief Commissioner of Revenue for NSW
- in line with the ATO National Tax Equivalent Regime, we note that NTER will not apply to TAHE until it is on the NTER entity register[69].

In other words, TAHE's SOC status does not mean that it is automatically subject to the TER or NTER. In fact, it is at the sole discretion of the State that an entity may be listed to participate in the TER or NTER[70].

Having regard to the above circumstances, it is reasonable that there will be no tax payments until the relevant Treasury policy under the Commercial Policy Framework is applied and TAHE is added to either the TER or NTER entity register. There is no obligation to make such tax payments until such time.

As to when TAHE enters into the TER or the NTER, it is worth considering the purpose of these tax equivalent regimes, which is to comply with National Competition Policy[71]. Principles within the Competition Principles Agreement include that government owned businesses will be subject to tax equivalent systems, which could be interpreted as suggesting that TAHE should have entered the TER or NTER upon establishment.

However, TAHE is a new government business in the first stage of a transition that is expected to take some years before it achieves its final commercial model. It is noted that under the agreed principles, the State is free to determine its own agenda for the reform of

---

67 *State Owned Corporations Act 1989*, Part 2 Division 2 Section 15(1)
68 TPP 03-04 Tax Equivalent Regime for Government Businesses
69 ATO National Tax Equivalent Regime, Part 2, paragraph 12
70 ATO National Tax Equivalent Regime, Part 2, paragraph 13
71 TPP 03-04 Tax Equivalent Regime for Government Businesses, Executive Summary

public monopolies[72] and for the implementation of competitive neutrality principles[73]. Accordingly, the State has discretion to stage TAHE's transition and application of policies aimed at competitive neutrality.

Application of the TER, being based solely on accounting profits is not significantly onerous. However, it is recognised that the NTER would impose a relatively significant compliance obligation upon the TAHE business. The transition into the NTER is an unusual one with little precedent of a legacy entity transitioning. A degree of effort and resources will be required to effect transition to the NTER. Arguably, from the shareholders' perspective, that effort could be better spent establishing a commercial operation. It is noted that the competition principles recognise that tax equivalent systems need only be implemented when their benefits outweigh costs[74].

Having regard to the flexibility afforded to the State, and that TAHE is not currently registered for either the TER or NTER, but that Treasury's Commercial Policy Framework requires that government businesses not in the NTER apply the TER[75], it is reasonable to assume that TAHE will enter the TER next year.

Further, given an Accounting Profit Model is applied to participating Government businesses to determine the tax equivalent, an assumption that a tax rate be applied to accounting profit is a reasonable one. Finally, that the tax rate applied is 30%, which is the current corporate tax rate, and there are no existing Commonwealth government policies to change this rate, the 30% rate is reasonable.

Having addressed assumptions about the TER, we now turn to assumptions about the NTER.

An NTER entity is effectively subject to federal income tax laws[76]. Such laws specify that where an entity incurs tax losses in a specific year, these losses may be deducted from the income of the entity in a later income year[77]. This means that if TAHE were apply NTER before it is profitable, it will accumulate tax losses which could be used to deduct from future income, thereby reducing tax payments in later years. This would appear to be counterintuitive as it is assumed that the State would choose to maximise tax revenue from entities within the tax equivalent regimes.

It is also worth noting that a delay to NTER entry would result in tax losses not being available. This does not give TAHE a competitive advantage, but rather a potential disadvantage. Accordingly, it seems difficult to imagine an argument that, by deferring entry, the State is not adhering the objective of the National Competition Policy.

---

[72] Competition Principles Agreement, Section 4.(1)
[73] Competition Principles Agreement, Section 3.(2)
[74] Competition Principles Agreement, Section 3.(6)
[75] TPP 03-04 Tax Equivalent Regime for Government Businesses, section 2.4
[76] ATO National Tax Equivalent Regime, Part 2, paragraph 27
[77] *Income Tax Assessment Act 1997*, Chapter 2, Part 2-5, Division 36, Section 36-17

On balance, given the discretion afforded the State, an expectation that NTER entry will align with a medium-term transition period is reasonable.

Regarding the amount of tax payments, once TAHE is in the NTER, NSW Treasury has applied a rate of 30% to accounting profit. Given 30% is the current corporate tax rate, and there are no existing Commonwealth government policies to change this rate, the 30% rate is reasonable.

Whether under the NTER accounting profit is the appropriate base upon which to apply the 30% rate is less straightforward. The rate of tax is applied to taxable income. Accounting profit frequently varies from taxable income due to permanent and timing differences. How TAHE will make the transition into the NTER, including determination of the tax bases of assets has not yet been contemplated, but could create significant differences between accounting profit and taxable income, with consequential impacts on tax payments.

It is noted that until activity commences to transition into the NTER, it is not possible to predict how taxable income might vary from accounting profit. In other words, future taxable income cannot be reliably estimated. The AASB's Conceptual Framework provides that when a reasonable estimate cannot be made, the item is not recognised[78]. Applying this principle by analogy means that where taxable income cannot be reasonably estimated, it is not used as the base to which the tax rate is applied. An alternative base that has a greater reliability is required.

It is generally possible to reconcile between accounting profit and taxable income and there is typically a relatively strong correlation between accounting profit and taxable income in SOCs. Accordingly, notwithstanding the uncertainty associated with determination of taxable income noted above, accounting profit is a reasonable starting point for the base to which the tax rate applies.

4.8 Funding of Rail Operators

Treasury assumption

The Rail Operators traditionally incur operating losses for accounting purposes.
NSW Treasury assumes that these circumstances will continue into the future, rather than assuming that Rail Operators need to break even for accounting purposes.

KPMG analysis

We understand that the Rail Operators are constrained from recovering their costs as a result of pricing decisions by the government. There is essentially a government policy

[78] Conceptual Framework, paragraph 86

position to subsidise heavy rail public transport. This decision is also applied to other modes, including modes operated by private sector operators.

We note:

- The Rail Operators are NSW government agencies[79]. As such, they have the status, privileges and immunities of the Crown[80].
- NSW Treasury provides the Rail Operators with annual letters of support evidencing the government's commitment to financially supporting the Rail Operators
- The Rail Operators do not have a profit motive[81]. There is no obligation imposed by either the *Transport Administration Act 1988* or the *Government Sector Finance Act 2018* for the Rail Operators to 'break-even' for accounting purposes or meet any tests of solvency, such as those that may be imposed upon private sector entities[82].
- The Rail Operators are required to regularly submit prospective financial data to NSW Treasury as part of State Budget processes. We are informed that latest Prime data submitted as part of the 2020-21 State Budget projects a continuation of operating losses and that there is no submission (either PTA or NPP or other proposal – refer Section 6.2 for background) to change funding arrangements within the Transport cluster such that the Rail Operators will achieve alternative results from that reported in previous years.
- NSW Treasury's view that whether the Rail Operators are 'topped up' with additional cash funding to achieve accounting break-even is a matter to be considered by the NSW Government separate from (and regardless of) TAHE, and that such a need for additional cash funding to achieve this outcome would be advised by TfNSW (which has not occurred to date).

We also note that the State has implemented cash management and banking system arrangements to ensure the efficient management of the state's cash resources. The objectives of the cash management and the banking system arrangements are:

- optimise returns on cash surpluses
- minimise borrowings and associated interest costs[83].

An effect of NSW public sector cash management arrangements and the TBS is that agencies do not hold large amounts of cash resources and frequently report 'working capital deficits' (i.e. excess of current liabilities over assets). However, at the consolidated level,

---

[79] *Transport Administration Act 1988*, Part 3B and Part 3C
[80] *Interpretation Act 1987*, Part 2 Section 13A(1)
[81] RailCorp Annual Report 2018-19 Volume 2 (Audited Financial Statements), Note 2.1
[82] For example, section 347A of the *Corporations Act 2001*
[83] https://www.treasury.nsw.gov.au/finance-resource/cash-management

the State holds significant volumes of liquid financial assets[84]. Agencies are provided with sufficient cash via regular allocations to meet cash outgoings.

The Rail Operators operate as part of the Treasury Banking System (TBS), which assists the NSW Government to optimise the State's cash and debt position[85]. Given the sustained operating loss positions and cash management arrangements, the Rail Operators seek annual confirmation of the Government's commitment to ongoing funding. The Treasurer authorises the provision of NSW Treasury correspondence to the Rail Operators "confirming the Government's commitment to ensuring TAHE will be able to meet its financial obligations, including payment of creditors and employees' liabilities"[86].

Having regard to the above circumstances, the Rail Operators are customers of TAHE with financial backing of the NSW Government, and notwithstanding operating losses, TAHE can reasonably expect the Rail Operators will be able to meet any obligations arising in respect of existing rail infrastructure access arrangements. In addition, a decision to change the funding arrangements of the Rail Operators has not occurred; further, such a future decision to change the funding arrangements of the Rail Operators such that they break-even for accounting purposes would be inconsistent with existing State cash management arrangements on the basis that it would likely result in more cash held within the Rail Operators rather than currently. Accordingly, given the conventions applied in the State Budget process, it is a reasonable assumption at this point in time that the funding arrangements will continue as is. That is, the assumption is consistent with conventions applied in the basis of preparation of the State Budget.

[84] The NSW Budget 2019-20 - Half yearly review
[85] TC 15/01 Cash Management – Expanding the Scope of the Treasury Banking System, Page 1
[86] Extract from 2020 letters

5 Appendix A - Approach

In forming a view on the reasonableness of assumptions applied by Treasury, we have had regard to a range of considerations. Considerations included whether:

- the assumptions are appropriate in the context of the applicable financial reporting framework including whether the assumptions take into account appropriate information as required by the applicable financial reporting framework
- assumptions are appropriate in the context of the conventions applied in the State Budget preparation process
- NSW Treasury has a reasonable rationale for the assumption, and/or whether the assumption is hypothetical
- changes in assumptions used in prior periods are appropriate, including having regard to whether the change is as a result of new information, facts and circumstances
- judgements made in selecting the assumptions give rise to indicators of possible management bias
- the assumptions are consistent with each other and with those used in other relevant accounting estimates, or with related assumptions
- the State has the intent to carry out specific courses of action and has the ability to do so, including having regard to the economic circumstances, including implications of existing commitments and legal, regulatory, or contractual restrictions that could affect the feasibility of actions
- there is a limitation in data that affects the assumptions and has a consequential impact on the reliability of the accounting estimate that is generated through application of the assumption.

Not all considerations are relevant to all assumptions and considerations have varying degrees of relevance to assumptions.

In conducting our assessment, we have also referred to information in Appendix A – Approach, Appendix B – Basis of preparation and Appendix C – Background.

6 Appendix B - Basis of preparation

6.1 NSW Treasury's responsibility for the State Budget

NSW Treasury is a department established under the *Government Sector Employment Act 2013*[87]. As a Principal Department in the context of the NSW Public Sector Governance Framework, NSW Treasury is subject to full Ministerial direction and control[88]; it carries out government functions arising from the administration of those acts allocated to the Treasurer, which includes the *Government Sector Finance Act 2018*[89].

The *Government Sector Finance Act 2018* has the following objects[90]:

- to promote and support sound financial management, budgeting, performance, financial risk management, transparency and accountability in the government sector and by GSF agencies and government officers
- to facilitate the effective devolution of roles and responsibilities in connection with financial management to support efficient and effective government
- to require the efficient, effective and economical use and management of government resources and related money in accordance with the principles of sound financial management
- to promote appropriate stewardship of government resources and related money
- to facilitate cooperation and collaboration within and between GSF agencies for the purpose of achieving common objectives and whole of Government objectives
- to facilitate the keeping and sharing of performance information in the government sector for the purposes of decisions about resource allocation.

NSW Treasury is responsible for pursuing these objects through its administration of the legislation. This role includes preparation of the State's financial and budgetary reporting, including the State Budget.

The NSW Public Sector Governance Framework identifies NSW Treasury's specific role in provision of advice when undertaking a new function, establishing a new entity or merging existing entities to determine any implications for the Government's Budget[91].

---

[87] *Government Sector Employment Act 2013*, Schedule 1, Part 1
[88] NSW Public Sector Governance Framework, Section 3.3.1 https://www.dpc.nsw.gov.au/assets/dpc-nsw-gov-au/files/Programs-and-Services/Governance/736f5dc2ba/NSW-Public-Sector-Governance-Framework-2013.pdf
[89] *Allocation of the Administration of Acts*, Treasurer
[90] *Government Sector Finance Act 2018*, Part 1, Division 1.1, Section 1.3
[91] NSW Public Sector Governance Framework, Section 4.3

6.2 State Budget basis of preparation

Legislative requirements for preparation of State Budget

Division 4.1 of the *Government Sector Finance Act 2018* sets out that the Treasurer is responsible for the preparation and presentation of the Budget Papers[92]. The core content of the Budget Papers are as follows:

- The Budget Papers are to be presented on a basis that covers the General Government Sector[93];
- The budget aggregates relating to the General Government Sector are to be for a 6-year period comprising the annual reporting period for the NSW Government to which the Budget relates, the 2 prior years and the 3 forward years and include the following financial statements[94]:
  - a statement of financial position for the General Government Sector
  - an operating statement for the General Government Sector
  - a cash flow statement for the General Government Sector.
- The budget aggregates are to be[95]:
  - prepared in a way that is consistent with the Australian Accounting Standards for the annual reporting period for the NSW Government to which the Budget relates for the General Government Sector, and
  - presented in a format that is consistent with the Australian Accounting Standards.

It is not necessary for the Budget Papers to be presented so as to include notes within the meaning of the Australian Accounting Standards.[96]

Whilst the legislation does not require the presentation of notes to the primary statements, the convention applied is to include a 'Statement of Significant Accounting Policies and Forecast Assumptions'[97]. This statement explains the basis of preparation.

Section 4.3 of the *Government Sector Finance Act 2018* sets out additional content of the Budget Papers:

- a Budget policy statement that includes the following[98]:

---

[92] *Government Sector Finance Act 2018*, Part 4, Division 4.1, Section 4.1(2)
[93] *Government Sector Finance Act 2018*, Part 4, Division 4.1, Section 4.2(1)
[94] *Government Sector Finance Act 2018*, Part 4, Division 4.1, Section 4.2(2)
[95] *Government Sector Finance Act 2018*, Part 4, Division 4.1, Section 4.2(3)
[96] *Government Sector Finance Act 2018*, Part 4, Division 4.1, Section 4.2(4)
[97] NSW Budget Statement 2018-19: Appendices A2. Statement of Significant Accounting Policies and Forecast Assumptions. http://budget.nsw.gov.au/nsw-budget-2019-20-budget-papers
[98] *Government Sector Finance Act 2018*, Part 4, Division 4.1, Section 4.3(1)(a)

- the matters required to be included in the Budget Papers by section 8 of the *Fiscal Responsibility Act 2012*
- 4-year forecasts or projections (being for the annual reporting period for the NSW Government to which the Budget relates and 3 forward years) of all major economic and financial variables

- revised estimates for the year before the annual reporting period for the NSW Government to which the Budget relates, and an explanation of any significant variations in major aggregates from the Budget estimates for that period, for the General Government Sector[99],
- a statement of the expenditure, savings and revenue measures that may have a material impact on the forward estimates for the General Government Sector[100],
- a statement of the risks that may have a material effect on the forward estimates for the General Government Sector[101],
- a statement of the contingent assets and liabilities for the General Government Sector[102],
- information in the form determined by the Treasurer about the performance and activities of GSF agencies[103].

The Budget Papers may include any other matters determined by the Treasurer[104].

Australian Accounting Standards

As noted above, the accounting estimates within the State Budget are prepared consistently with the requirements of Australian Accounting Standards.

There is a specific Standard that applies to consolidated government reporting, being AASB 1049 *Whole of Government and General Government Sector Financial Reporting* (AASB 1049). AASB 1049[105]:

- specifies requirements for whole of government general purpose financial statements and GGS financial statements of each government.
- requires compliance with other applicable Australian Accounting Standards except as specified in this Standard.

---

99 *Government Sector Finance Act 2018*, Part 4, Division 4.1, Section 4.3(1)(b)
100 *Government Sector Finance Act 2018*, Part 4, Division 4.1, Section 4.3(1)(c)
101 *Government Sector Finance Act 2018*, Part 4, Division 4.1, Section 4.3(1)(d)
102 *Government Sector Finance Act 2018*, Part 4, Division 4.1, Section 4.3(1)(e)
103 *Government Sector Finance Act 2018*, Part 4, Division 4.1, Section 4.3(1)(f)
104 *Government Sector Finance Act 2018*, Part 4, Division 4.1, Section 4.3(2)
105 AASB 1049.1

- requires disclosure of additional information such as reconciliations to key fiscal aggregates determined in accordance with the ABS GFS Manual and, for the whole of government, sector information (GGS, PNFC sector and PFC sector).

Whole of government financial statements and GGS financial statements prepared in accordance with AASB 1049 provide users with[106]:

- information about the stewardship by each government and accountability for the resources entrusted to it
- information about the financial position, performance and cash flows of each government and its sectors
- information that facilitates assessments of the macro-economic impact of each government and its sectors.

Prospective financial information

Prospective financial information could take the form of a forecast or projection[107]. Prospective financial information relates to anticipated events and actions that have not yet occurred, and which may not occur. As such, prospective financial information is prepared based on accounting estimates.

Australian Accounting Standards do not contain requirements or provide guidance on the preparation and presentation of prospective financial information. As such, alternative established frameworks that provide useful guidance can be referred to.

It is recognised that prospective financial information is of a higher quality when:

- the assumptions have reasonable grounds
- it is not based on material hypothetical assumptions
- the assumptions are realistic
- any historical financial information used as a source for the prospective financial information has been previously audited[108].

ASIC Regulatory Guide 170 Prospective Financial Information (RG 170) sets out circumstances under which prospective financial information can and should be disclosed in a disclosure document or product disclosure statement. In making an assessment as to whether prospective financial information needs to be disclosed, RG 170 requires an issuer to consider the information value of what is being disclosed by ensuring there are

---

[106] AASB 1049.1(a) – (c)
[107] ASAE 3450 *Assurance Engagements involving Corporate Fundraisings and/or Prospective Financial Information* (ASAE 3450), paragraph 5
[108] ASAE 3450.107

'reasonable grounds' for the inclusion of the information[109] and to consider the risk that the disclosure might be misleading[110].

In the context of prospective financial information, RG170 distinguishes between 'reasonable grounds' and hypothetical assumptions. Hypothetical assumptions take the form of future events and management actions that may not necessarily be expected to take place or may not be based on reasonable grounds[111]. Further, it clarifies that information based on hypothetical assumptions is likely to be misleading[112].

It is also recognised that that information ordinarily becomes more speculative and less verifiable as the length of the period covered increases[113].

Accounting estimates

An accounting estimate is a monetary amount for which the measurement, in accordance with the requirements of the applicable financial reporting framework, is subject to estimation uncertainty[114].

Accounting estimates vary widely in nature and are required to be made by management when the monetary amounts cannot be directly observed. The measurement of these monetary amounts is subject to estimation uncertainty, which reflects inherent limitations in knowledge or data. These limitations give rise to inherent subjectivity and variation in the measurement outcomes. The process of making accounting estimates involves selecting and applying a method using assumptions and data, which requires judgement by management and can give rise to complexity in measurement[115].

There is no single Australian Accounting Standard that deals with prospective information or accounting estimates. However, various pronouncements provide relevant material that invariably supports the use of accounting estimates and provides guidance on how they are used.

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

AASB 137 contains various principles that are relevant to the use of estimates in financial information and so are also relevant to the preparation of the State Budget:

- The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability[116].

---

[109] RG 170.16
[110] RG 170.17-RG170.19
[111] ASAE 3450.15(m)
[112] RG 170.18
[113] ASAE 3450.114(a)
[114] ASA 540.12
[115] ASA 540.A1 – A6
[116] AASB 137.25

- The estimates of outcome and financial effect are determined by the judgement of the management of the entity (i.e. Treasury in the case of the State Budget), supplemented by experience of similar transactions and, in some cases, reports from independent experts[117].
- Uncertainties surrounding the amount to be recognised ... are dealt with by various means according to the circumstances[118].
- Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considers other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount[119].
- The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate[120].
- Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities[121].

AASB Framework for the Preparation and Presentation of Financial Statements

To a large extent, financial reports are based on estimates, judgements and models rather than exact depictions[122]. The AASB Framework for the Preparation and Presentation of Financial Statements (the Conceptual Framework) establishes the concepts that underlie those estimates, judgements and models[123].

Paragraph 86 of the Conceptual Framework also recognises that the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability; in many cases estimates must be used.

The Conceptual Framework also provides that when a reasonable estimate cannot be made, the item is not recognised[124].

The Conceptual Framework goes on to note that an item that, at a particular point in time, fails to meet the recognition criteria, may qualify for recognition at a later date as a result of subsequent circumstances or events[125]. In the context of the State Budget, this aspect of

[117] AASB 137.38
[118] AASB 137.39
[119] AASB 137.40
[120] AASB 137.42
[121] AASB 137.43
[122] Conceptual Framework, paragraph OB11
[123] Conceptual Framework, paragraph OB11
[124] Conceptual Framework, paragraph 86
[125] Conceptual Framework, paragraph 87

the Framework means that whilst it may not be possible to make a reliable accounting estimate in the current year's State Budget, with the passage of time and as more information becomes available, such recognition is possible.

The Conceptual Framework requires that financial information display the qualitative characteristic of faithful representation. Paragraph QC15 of the Conceptual Framework clarifies that this does not mean accuracy in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

Paragraph QC 16 of the Conceptual Framework further clarifies that an estimate can be a faithful representation if the reporting entity has properly applied an appropriate process, properly described the estimate and explained any uncertainties that significantly affect the estimate. However, if the level of uncertainty in such an estimate is sufficiently large, that estimate will not be particularly useful. That said, QC 16 confirms that if there is no alternative representation that is more faithful, that estimate may provide the best available information.

AASB 136 Impairment of Assets (AASB 136)

AASB 136 contains requirements and guidance on estimating future cash flows. Relevant material includes requirements to:

- to base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist and to give greater weigh to external evidence[126]
- base cash flow projections on the most recent financial budgets/forecasts approved by management and exclude the impact of future restructurings or from improving or enhancing performance[127]
- limit projections based on the most recent financial budgets/forecasts approved by management to a maximum period of five years unless a longer period can be justified[128].

---

126 AASB 136.33(a)
127 AASB 136.33(b)
128 AASB 136 33(b)

AASB 136 recognises that the further into the future projections are made, the less likely it is that such projections will be accurate[129]. It specifically states that "Detailed, explicit and reliable financial budgets/forecasts of future cash flows for periods longer than five years are generally not available."[130]

AASB 136 does not allow the use of cash flow projections based on financial budgets/forecasts over a period longer than five years unless management is "confident that these projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period."[131] Noting that TAHE is a newly established SOC with expected changes in commercial models, there is limited ability to demonstrate past experience with accurate long term forecasts..

Assumptions

Being prospective in nature, various assumptions are applied to develop the accounting estimates within the State Budget. Assumptions mean expectations made by NSW Treasury as to future events and actions expected to take place as at the date the prospective financial information is prepared.

Assumptions involve judgements based on available information about matters such as the choice of an interest rate, a discount rate, or judgements about future conditions or events. An assumption may be selected by management from a range of appropriate alternatives[132]. Evidence is often limited to support assumptions when the subject matter is prospective. Any such evidence is itself generally future orientated and, therefore, speculative in nature, as distinct from being factually supportable[133].

As previously noted, it is recognised that prospective financial information is of a higher quality when:

- the assumptions have reasonable grounds
- it is not based on material hypothetical assumptions
- the assumptions are realistic[134].

Conventions applied

Given the prospective nature of the State Budget and reliance on accounting estimates, there are a series of conventions that are consistently applied. The accounting estimates:

---

[129] AASB 136.35
[130] AASB 136.35
[131] AASB 136.35
[132] ASA 540.A2
[133] ASAE 3450 A85(a)
[134] ASAE 3450.107

- are prepared using the accrual basis of accounting; this basis recognises the effect of transactions and events when they are forecast to occur[135]
- are prepared to reflect existing operations and the impact of policy decisions taken by the NSW Government, where their financial effect can be reliably measured[136]
- take into account other economic and financial data available to NSW Treasury up to a specified date[137] that is slightly before the Budget Papers are tabled in Parliament, recognising the need for some lead time for preparation
- do not reflect impacts of policy decisions or planned events when the impact cannot be reliably estimated (e.g. when there are uncertainties regarding the timing and amount of future cash flows)[138]
- require the use of estimates and assumptions when measuring revenue, expenses, other economic flows, assets or liabilities, which are based on the latest information available at the time, professional judgements derived from experience and other factors considered to be reasonable under the circumstances; it is recognised that actual results may differ from such estimates[139]
- do not include the impact of major asset transactions until they are finalised; the financial impact of these future planned discontinuing operations or restructuring transactions are not recognised due to their commercial-in-confidence nature[140].

The prospective financial information for the GGS reflects transactions with NSW government entities within the PNFC Sector[141], including those related to heavy rail operators and TAHE.

Prospective financial information prepared in accordance with these conventions does not reflect hypothetical decisions that may occur in the future, and therefore may differ from prospective financial information prepared for other purposes.

Process

Prime

The State of NSW is comprised of over 200 separate reporting entities, each preparing general purpose financial statements and most preparing individual estimates for State Budget purposes. Individual agency data is aggregated using the State's whole of government reporting system, Prime. Prime is operated by NSW Treasury. Agencies

---

[135] NSW Budget Statement 2018-19: Appendices A2. Statement of Significant Accounting Policies and Forecast Assumptions, 'Basis of preparation'
[136] NSW Budget Statement 2018-19: Appendices A2. Statement of Significant Accounting Policies and Forecast Assumptions, 'Basis of preparation'
[137] NSW Budget Statement 2018-19: Appendices A2. Statement of Significant Accounting Policies and Forecast Assumptions, 'Basis of preparation'
[138] NSW Budget Statement 2018-19: Appendices A2. Statement of Significant Accounting Policies and Forecast Assumptions, 'Basis of preparation'
[139] NSW Budget Statement 2018-19: Appendices A2. Statement of Significant Accounting Policies and Forecast Assumptions, 'Basis of preparation'
[140] NSW Budget Statement 2018-19: Appendices A2. Statement of Significant Accounting Policies and Forecast Assumptions, 'Accounting policies'
[141] As outlined in various sections within the NSW Budget Statement 2018-19: Appendices A2. Statement of Significant Accounting Policies and Forecast Assumptions, 'Presentation of the Estimated Financial Statements

generate their individual historical and prospective financial data using their own standalone financial systems and then upload their data into Prime. Prime aggregates individual agency data and effects intra-sector consolidation adjustments and eliminations.

Agencies can view and access their Prime data. Agencies do not have access to all data in Prime; they cannot access other agencies' data.

Effecting changes in Prime

For State Budget purposes, Prime data from the previous reporting period is rolled to the current period i.e. a 'rolling budget' or continuous updating approach. During the Budget process, General Government Sector data in Prime is adjusted in two key ways:

- parameter and technical adjustments (PTAs), which are a material, non-discretionary change in the net cost or timing of expenditure on existing programs or capital projects under existing policy parameters
- new policy proposals (NPPs), which involve a discretionary decision by Government that changes existing policy and may affect a budget aggregate or require additional funding[142].

All other decisions by Government that are not a PTA can therefore be classified as a measure i.e. NPP[143].

Agencies submit PTAs and NPPs using functionality in Prime. Only once approved is the underlying data in prime adjusted. It follows that only underlying Prime data reflects government decisions.

PNFC and PFC have different processes. These agencies need to ensure their data is in line with approvals and decisions of the Expenditure Review Committee (ERC) of Cabinet.

Financial Impact Statements

A FIS is used to brief government on the estimated impact on Prime Budget data of developments, decisions and other changes in circumstances. Once estimated financial impacts are confirmed, data in Prime is adjusted.

As with the published State Budget prospective financial information, a FIS includes information about the financial impact on the current Budget year, plus three years of forward estimates. A FIS does not list each line item within the prospective financial statements that is impacted; it presents the net impact on key fiscal aggregates.

To effect the approved adjustment per the FIS to the State Budget and/or forward estimate data in Prime, a PTA or NPP is processed. Whether it is a PTA or NPP depends upon the circumstances.

A FIS addresses the Budget year and three years of Forward Estimates; it does not reflect potential changes over the long term.

---

[142] TC 14/28, Page 1
[143] TC 14/28, Page 1

Government decision making

The Cabinet Practice Manual outlines information on government decision making. It confirms that Cabinet is the forum of NSW Government Ministers who deliberate upon and decide major policy for the Government.

All Ministers are members of Cabinet. Cabinet is not established by legislation. It is based on convention. The most significant Cabinet conventions are:

- collective responsibility for decisions of Cabinet
- confidentiality of Cabinet deliberations.

The Premier sets the Cabinet agenda, chairs the Cabinet meetings and establishes Cabinet Committees and appoints Ministers as chairs and members.

Cabinet should determine all significant matters that affect the government as a whole. This includes:

- new policy proposals and significant or sensitive variations to existing policies. These may arise in Government issues papers, discussion papers and position papers that propose new policies
- proposals that require legislation
- proposed responses to recommendations in reports of Parliamentary committees, inquiries and other significant reports that establish or vary policy
- intergovernmental agreements, matters likely to significantly impact intergovernmental relations and significant issues for COAG Councils
- significant or high-level appointments needing Ministerial approval or endorsement
- significant portfolio policy announcements
- matters likely to significantly impact parts of the community
- proposals to refer matters to Parliamentary committees
- matters that may be contentious.

Cabinet Committees derive their powers from the Cabinet and also follow Cabinet conventions. Committees support Cabinet in various ways, for example, by considering some matters in detail before they proceed to Cabinet for broader policy consideration. Otherwise, Cabinet Committee decisions may be submitted to Cabinet for noting or endorsement and become binding to the entire Cabinet. Meetings are convened and chaired by a nominated Minister

The ERC is chaired by the Treasurer. The role of ERC is to assist Cabinet and the Treasurer in framing the fiscal strategy and the Budget for Cabinet's consideration, driving expenditure controls and monitoring financial performance, and considering proposals with financial implications brought forward by Ministers.

Generally, all funding decisions for recurrent and capital proposals, including new proposals, are considered in the Budget process by ERC. All spending, revenue or tax expenditure proposals by Ministers must be considered by ERC prior to final Cabinet approval unless otherwise agreed by the Premier, Deputy Premier and Treasurer.

7 Appendix C - Background

7.1 Background on Transport reforms

Over the past decade, various bills and accompanying materials introduced into Parliament confirm the government's intention in putting in place reforms to the Transport sector, with the objective of coordinating the delivery of transport services in NSW. This section provides background to the Transport reforms undertaken in the past decade.

- The 2010 reforms under the Transport Administration Amendment Bill 2010 are underpinned by these four objectives:
  - to create an integrated approach to the delivery of transport services and infrastructure that results in a greater effort by public sector agencies as to what is best for the community rather than simply complying with their own set of priorities
  - to better coordinate the delivery of transport services to ensure that budgets and resources are allocated to community priorities and can be shifted effectively to meet changing demands
  - to enhance the accountability of public sector agencies to deliver the transport services and infrastructure the community deserves through prioritisation of strategic targets and commitments of the portfolio and placing a greater focus on the customer and a more results-driven culture
  - to ensure that safety for our passengers, our employees and our community as a whole remains the top priority by enabling the Independent Safety Regulator to assist the director general in relation to the regulation of bus safety and by maintaining a strong emphasis on rail safety.[144]

  The Transport Administration Amendment Bill 2010 established a new administration and governance framework for the delivery of transport services and infrastructure by public transport agencies. The examples of such agencies that were cited in the objects included only operators (and not TfNSW) indicating that it is operators who deliver services.

- The 2011 reforms established TfNSW as a statutory corporation with a central governance, non-service delivery role:
  - TfNSW will have the co-ordination, funding allocation, policy and planning and other non-service delivery functions that are currently exercised by the Director-General of the Department of Transport. Those functions include the planning, oversight and

---

[144] Second reading speech to the Transport Administration Amendment Bill 2010 (https://www.parliament.nsw.gov.au/bill/files/497/LA%203110.pdf)

delivery of transport infrastructure, contracting for the delivery of public transport services, transport services co-ordination, incident management, ticketing services and arrangements, and the provision and deployment of staff to public transport agencies[145]

- "With the creation of Transport for NSW, transport agencies will be free to concentrate on delivering a quality service to customers ... The bill provides that each of the publicly owned service delivery entities—RailCorp, the State Transit Authority and the newly created Roads and Maritime Services—will continue to operate under their current statutory functions and powers in respect of service delivery"[146]
- TfNSW is responsible for non-service delivery[147] and that the publicly owned service delivery entities will continue to operate under their existing statutory functions and powers in respect of service delivery.[148]

- The 2017 reforms established TAHE as a commercial dedicated transport asset manager and provided that NSW Trains and Sydney Trains were no longer subsidiaries of RailCorp. The second reading speech for TAHE's enabling legislation outlined the following points:
  - The name and constitution of RailCorp will be changed so that it converts to a SOC by the name of TAHE[149]
  - A key intent is for TAHE to manage the State's portfolio of transport assets better and more commercially[150]
  - TAHE establishes new arrangements for transport asset management that reflect modern governance and financial practices[151]
  - TAHE is aimed at enabling a more effective, efficient and commercial approach to the management of transport assets, particularly property[152]
  - A dedicated asset holding entity, operating on commercial principles, will provide an efficient base from which to optimise transport services outcomes[153]
  - The proposed SOC status of TAHE will provide the necessary distance from day-to-day central Government control to demonstrate its assets are being managed

---

145 Explanatory note to the Transport Legislation Amendment Bill 2011 (https://www.parliament.nsw.gov.au/bill/files/657/Ex%20note%20Transport%20Legislation%20Amendment%20Bill%202011.pdf)
146 Second reading speech to the Transport Legislation Amendment Bill 2011 (https://www.parliament.nsw.gov.au/bill/files/657/Transport%20Amdt%20Bill%20-%20LC%202nd%20Reading.pdf)
147 Second reading speech to the Transport Legislation Amendment Bill 2011, Page 5
148 Second reading speech to the Transport Legislation Amendment Bill 2011, Page 8
149 Second reading speech to the Transport Administration Amendment (Transport Entities) Bill 2017, Page 2 https://www.parliament.nsw.gov.au/bill/files/3378/2R%20Transport.pdf)
150 Second reading speech to the Transport Administration Amendment (Transport Entities) Bill 2017, Page 1
151 Second reading speech to the Transport Administration Amendment (Transport Entities) Bill 2017, Page 1
152 Second reading speech to the Transport Administration Amendment (Transport Entities) Bill 2017, Page 1
153 Second reading speech to the Transport Administration Amendment (Transport Entities) Bill 2017, Page 2

commercially. Clause 11 of schedule 2 to the bill sets out in detail the functions that are required to complement the central asset-holding function of TAHE. These include constructing and developing the transport assets vested in it[154]

- There is no change to the provision of passenger rail services by the operators[155]. Sydney Trains will continue to operate railway passenger services in the Sydney metropolitan area and NSW Trains will continue to operate railway passenger services in regional New South Wales.[156]

- NSW Trains and Sydney Trains were no longer subsidiaries of RailCorp from 1 July 2017 with the proclamation of Schedule 1 of *Transport Administration Amendment (Transport Entities) Act 2017*
- RailCorp was transitioned to TAHE on 1 July 2020 with the proclamation of Schedule 2 of the *Transport Administration Amendment (Transport Entities) Act 2017.*

[154] Second reading speech to the Transport Administration Amendment (Transport Entities) Bill 2017, Page 3
[155] Second reading speech to the Transport Administration Amendment (Transport Entities) Bill 2017, Page 2
[156] Explanatory note to the Transport Administration Amendment (Transport Entities) Bill 2017

7.2 TAHE background

Transition from RailCorp to TAHE

Prior to the commencement of TAHE's enabling legislation[157], RailCorp had the legislated function under the TAA to hold, manage, maintain and establish rail infrastructure facilities vested in or owned by it, or to be vested in or owned by it, on behalf of the State. Upon commencement of TAHE's enabling legislation on 1 July 2020, TAHE effectively replaces RailCorp. That is, the corporate name of RailCorp is converted to TAHE, with the entity continuing in existence under the new name.[158]

Objectives

Under TAHE's enabling legislation, the principal objectives of TAHE are[159]:

- to undertake its activities in a safe and reliable manner
- to be a successful business and, to this end:
  - to operate at least as efficiently as any comparable businesses, and
  - to maximise the net worth of the State's investment in TAHE
- to exhibit a sense of social responsibility by having regard to the interests of the community in which it operates
- where its activities affect the environment, to conduct its operations in compliance with the principles of ecologically sustainable development contained in section 6(2) of the Protection of the *Environment Administration Act 1991*
- to exhibit a sense of responsibility towards regional development and decentralisation in the way in which it operates.

Each of the principal objectives of TAHE is of equal importance[160].

The SOC Act constitutes TAHE as a statutory State Owned Corporation. The SOC Act sets out principal objectives of all statutory SOCs[161]. These principles are consistent with those stated in TAHE's enabling legislation with one exception, being that the SOC Act does not include an objective to undertake activities in a safe and reliable manner.

Functions

Under the TAA, TAHE has various legislated functions[162]:

- to hold, manage, operate and maintain transport assets vested in or owned by it, or to be vested in or owned by it

---

157 *Transport Administration Amendment (Transport Entities) Act 2017*
158 *Transport Administration Act 1988*, Part 2 Division 1Section 4(2)
159 *Transport Administration Act 1988*, Part 2 Division 2 Section 10(1)
160 *Transport Administration Act 1988*, Part 2 Division 2 Section 10(2)
161 *State Owned Corporations Act 1989*, Part 3 Division 2 Section 20E
162 *Transport Administration Act 1988*, Part 2 Division 2 Section 11(1)

- to establish, finance, acquire, construct and develop transport assets to be vested in or owned by it
- to promote and facilitate access to the part of the NSW rail network vested in or owned by TAHE in accordance with any current NSW rail access undertaking or otherwise lease or make available transport assets vested in or owned by TAHE to other persons or bodies
- to acquire and develop land for the purpose of enabling TAHE to carry out its other functions.

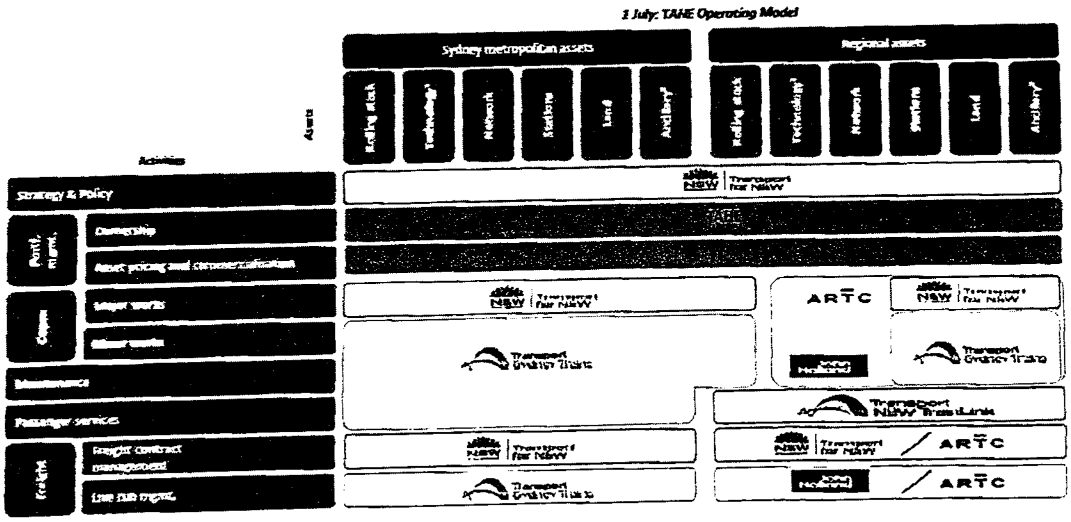
Additionally, TAHE may provide facilities or services that are necessary, ancillary or incidental to its listed functions, and conduct any business or activity (whether or not related to its listed functions) that it considers will further its objectives[163].

Operating licence

TAHE's functions may only be exercised under the authority of, and in accordance with, one or more operating licences[164] issued by the Minister for Transport and Roads. An operating licence authorises TAHE, in accordance with the TAA, to carry out certain functions, subject to terms and conditions determined by the Minister.

The Minister has issued a single operating licence for the period 1 July 2020 - 30 June 2021. The overall effect of this operating licence is that TAHE can exercise its legislated functions in a manner that is generally consistent with the operations of RailCorp. There is an expectation that the operating licence will be renewed, with appropriate changes to enable ongoing implementation of TAHE reforms, including enabling the intent and objectives articulated by Government[165].

How TAHE works in the context of the transport cluster and replicating RailCorp is outlined in the following diagram.



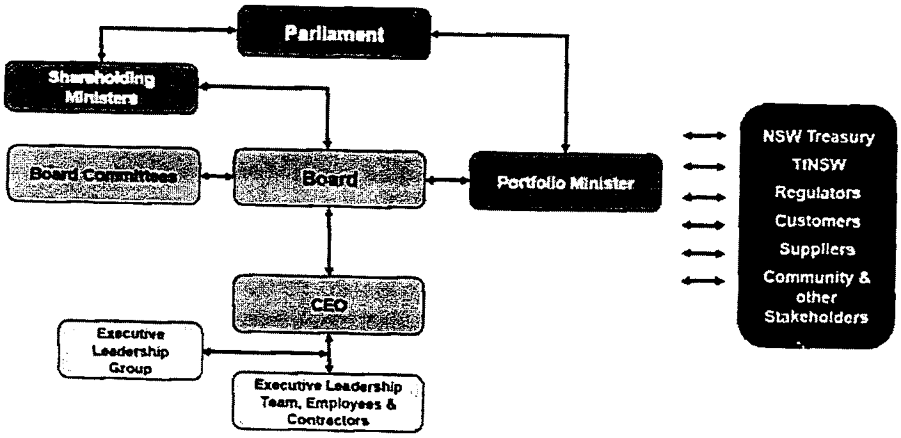
163 *Transport Administration Act 1988*, Part 2 Division 2 Section 11(2)
164 *Transport Administration Act 1988*, Part 2 Division 2 Section 11(3)
165 Second reading speech to the Transport Legislation Amendment Bill 2011 (https://www.parliament.nsw.gov.au/bill/files/657/Transport%20Amdt%20Bill%20-%20LC%202nd%20Reading.pdf)

Governance

TAHE's Corporate Governance Statement outlines TAHE's corporate governance practices, including the governance relationships between the owners, the board and the management. The Corporate Governance Statement also outlines each party's roles and responsibilities.

The governance relationships of TAHE are summarised as follows[166]:

Governance Relationships



The previous diagram recognises that TAHE is accountable to its shareholding Ministers. The Corporate Governance Statement introduces key documents applied to TAHE, including the SCI. The SCI is an agreement that sets out objectives, main undertakings and activities of TAHE, along with performances targets [167]. The SCI is a mechanism of ensuring accountability to shareholders within NSW Treasury's Commercial Policy Framework.

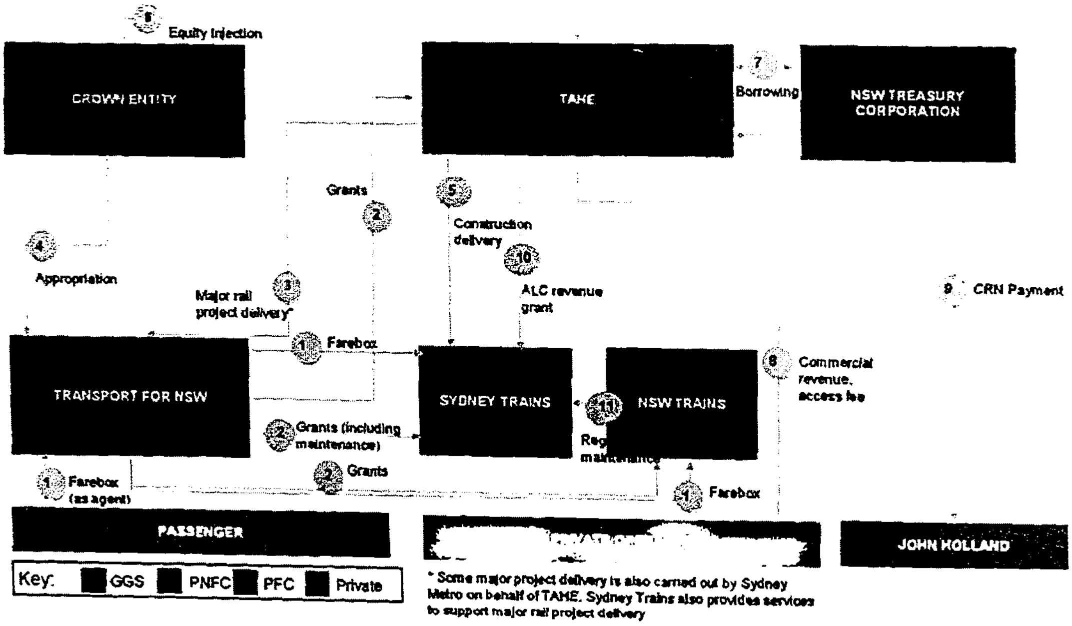
Flow of funds

The flow of funds or funds flow is a way of describing the funding and financing arrangements that will apply to TAHE. Financial performance will be a function of the funds flows and the timing of their implementation.

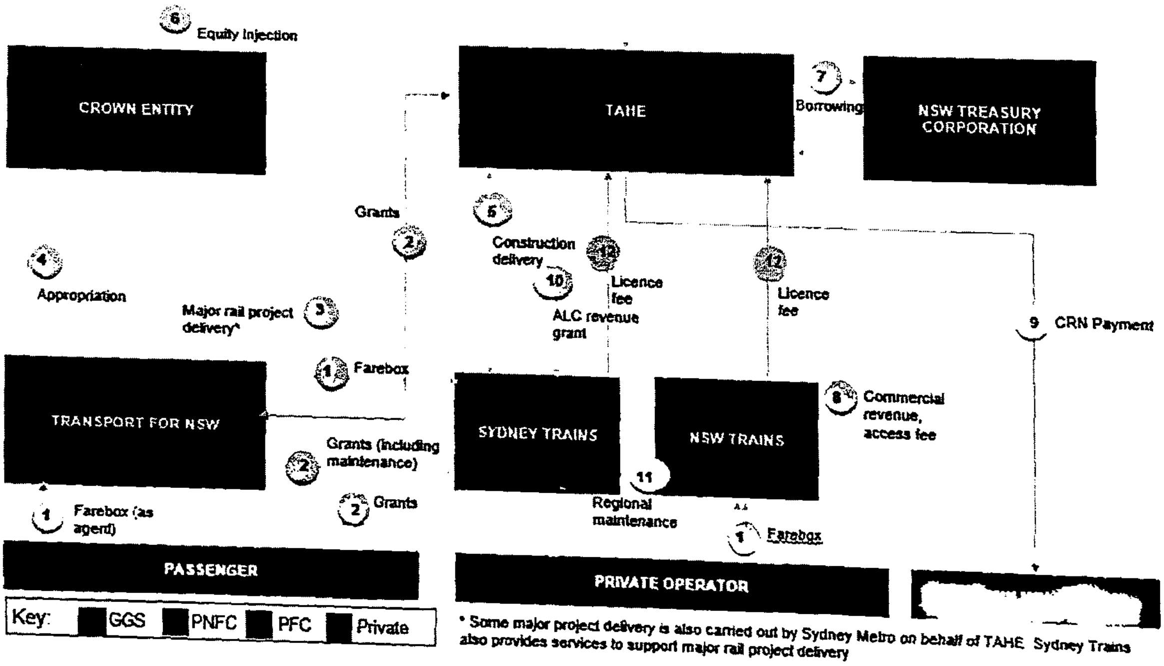
TAHE's fund flows during 2020-21 are expected to be consistent with existing funds flows for RailCorp in 2019-20. The key funds flows between TAHE and other government entities are summarised in the following diagram.

---

[166] TAHE Corporate Governance Statement, Page 5 (approved July 2020)
[167] TAHE Corporate Governance Statement, Page 3 (approved July 2020)



During the transition period, access arrangements are expected to be formalised with operators. This is expected to occur over time in waves of assets with similar characteristics (e.g. non-specialised, non-operational and specialised operational assets). Following the transition period, access pricing is expected to be sufficient to provide a return on equity on the basis that pricing will be subject to IPART regulation. It is assumed that TAHE will be subject to the Commercial Policy Framework and pay dividend, taxes and government guarantee fee when all access arrangements are in place.



A high level description of each of individual fund flows follows.

#	Fund flow	Description
1	Farebox	Farebox revenue will be collected by TfNSW as agent for Sydney Trains and NSW Trains.
2	Grants	TfNSW will provide grant funding to Sydney Trains and NSW Trains for operation of the metropolitan and regional networks respectively. (This is expected to transition to a CSO once all funds flows are in place). The State, via TfNSW, will provide funding to Sydney Trains directly for maintenance based on submissions from the Rail Operators, endorsed by TAHE and assured by TfNSW. TfNSW will also provide grants to TAHE in the transitional period for CRN related maintenance and some other expenses (including settling of employee defined benefit super obligations).
3	Major Rail Project delivery	TAHE will enter into fee for service development agreements with TfNSW for the delivery of capital projects. TfNSW will initially incur the costs of undertaking this work and then recover those costs by issuing an invoice on a monthly basis to TAHE. Sydney Trains also provides services to support major rail project delivery. Some major project delivery is also carried out by Sydney Metro on behalf of TAHE.
4	Appropriation	The Crown will make appropriations to TfNSW to fund the various grants to TAHE, Sydney Trains and NSW Trains during the transition period.
5	Construction delivery	TAHE will also enter into fees for service development agreements with Sydney Trains for the delivery of capital projects. These are primarily for MPM Capex and other minor works.
6	Equity injection	TAHE's capital expenditure will be funded through the injection of additional equity investment into TAHE by the Government, where TAHE cannot fund this expenditure from cash surpluses or borrowings.
7	Borrowings	TAHE will continue to source borrowings through NSW Treasury Corporation, with an expectation of achieving a target gearing ratio over time.

#	Fund flow	Description
8	Commercial revenue	TAHE is expected to generate various commercial revenues in respect of property from entities outside the public sector in the future. Access fee arrangements for the use of regulated rail assets between RailCorp and private sector rail operators are expected to continue. Whilst there are expectations of future commercial opportunities with third parties, at present, these revenues cannot be reliably measured.
9	CRN Payment	TAHE will make payments to John Holland for the maintenance of CRN assets.
10	ALC	The transfer of net trains services fee from received from ALC from TAHE to Sydney Trains (under a section 3G direction which is continued under the Implementation Deed) is expected to remain until the lapse of the section 3G direction on 30 June 2021.
11	Regional maintenance	NSW Trains pays Sydney Trains the maintenance of the regional component of rail network managed by Sydney Trains.
12	Licence fees	Licence arrangements between Sydney Trains and NSW Trains and TAHE in respect of non-specialised operational assets in which a fee is payable to TAHE by the operators.

8 Appendix D - References

In addition to discussions with NSW Treasury personnel and TAHE management and consideration of the background information in Appendix C – Background, we have referred to the various references and sources in conducting our assessment. These include, for example, the requirements of the applicable reporting framework, NSW public sector legislative and policy frameworks, and material from other jurisdictions to aid with interpretation and application of frameworks.

References and sources are listed here. Where material in references and sources is of particular relevance and to support the analysis applied to our assessment, further information follows.

8.1 List of references

Accounting frameworks

We have referred to the requirements under relevant accounting frameworks, including:

- AASB 1049 *Whole of Government and General Government Sector Financial Reporting*
- AASB 116 *Property, Plant and Equipment*
- AASB 1059 *Service Concession Arrangements: Grantors*
- AASB 16 *Leases*
- AASB 136 *Impairment of Assets*
- AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*
- AASB 1004 *Contributions*
- Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities*
- AASB Framework for the Preparation and Presentation of Financial Statements
- TC 14/28 Parameter and Technical Adjustments and Measures (New Policy)
- TC 15/01 Cash Management – Expanding the Scope of the Treasury Banking System
- TPP 09-03 Accounting Policy: Contributions by owners made to wholly-owned Public Sector Entities
- TPP 14-01 Accounting Policy: Valuation of Physical Non-Current Assets at Fair Value
- NSW Budget Statement 2018-19: Appendices A2. Statement of Significant Accounting Policies and Forecast Assumptions. http://budget.nsw.gov.au/nsw-budget-2019-20-budget-papers

- ASIC Regulatory Guide 170 Prospective Financial Information
- Parliamentary Budget Office, Alternative Financing of Government Policies, Report No.01/2020
- Department of Finance, Finance Advice Paper, Q&A – Equity Investments, August 2018.

GFS pronouncements

The following GFS pronouncements have been referred to in undertaking our scope:

- 'Australian System of Government Finance Statistics: Concepts, Sources and Methods' 2015 (ABS GFSM 2015)
- International Monetary Fund Government Finance Statistics Manual 2014 (IMF GFSM 2014).

Legislation

We have referred to the following key items of legislation:

- *State Owned Corporations Act 1989*
- *Transport Administration Act 1988*
- *Transport Administration Amendment (Transport Entities) Act 2017* (plus second reading speech and explanatory note)
- Second reading speech to the Transport Administration Amendment Bill 2010
- Second reading speech and explanatory note to the Transport Legislation Amendment Bill 2011
- *Government Sector Finance Act 2018*
- *Income Tax Assessment Act 1997*
- *Corporations Act 2001*
- *Interpretation Act 1987.*

Commercial Policy Framework

We have specifically referred to the following NSW Treasury policy papers under the Commercial Policy Framework:

- TPP 18-02 Performance Reporting and Monitoring Policy for Government Businesses
- TPP 16-04 Financial Distribution Policy for Government Businesses
- TPP 16-03 Capital Structure Policy for Government Businesses
- TPP 03-04 Tax Equivalent Regime for Government Businesses
- TPP 18-04 Directors and Officers Indemnity Policy for State Owned Corporations.

The full suite of Treasury policies that apply to Government Businesses is located at: https://www.treasury.nsw.gov.au/information-public-entities/government-businesses/commercial-policy-framework.

Relevant precedents:

We have made references to the following relevant precedents in preparing this report:

- ARTC Financial Statements for the year ended 30 June 2019: https://www.artc.com.au/uploads/ARTC-2019-Financials.pdf
- Moorebank Intermodal Company Annual Report for the year ended 30 June 2019: https://static1.squarespace.com/static/57721a5af7e0ab564bcfc84d/t/5da6720332e76a5df11948d2/1571189321277/MIC+Annual+Report+2019.pdf

Other relevant documents / guidance / requirements

We have referred to the following relevant documents / guidance / requirements in undertaking our scope:

- Rail Corp Annual Report 2018-19 Volume 2 (Audited Financial Statements) https://www.transport.nsw.gov.au/system/files/media/documents/2019/RailCorp-Annual-Report-V2-2018-19.pdf
- Competition Principles Agreement – 11 April 1995 (as amended to 13 April 2007) https://www.coag.gov.au/sites/default/files/agreements/competition-principles-agreement-amended-2007.pdf
- NSW Rail Access Undertaking (Pursuant to Schedule 6AA of the *Transport Administration Act 1988* (NSW) https://www.transport.nsw.gov.au/sites/default/files/media/documents/2017/nsw-rail-access-undertaking.pdf
- NSW Public Sector Governance Framework https://www.dpc.nsw.gov.au/assets/dpc-nsw-gov-au/files/Programs-and-Services/Governance/736f5dc2ba/NSW-Public-Sector-Governance-Framework-2013.pdf
- ATO National Tax Equivalent Regime https://www.ato.gov.au/law/view/document?DocID=NTR%2FNTER0000
- System of National Accounts 2008 (European Commission et al, 2008) https://unstats.un.org/unsd/nationalaccount/docs/sna2008.pdf
- ASAE 3450 *Assurance Engagements involving Corporate Fundraisings and/or Prospective Financial Information*
- ASA 540 *Auditing Accounting Estimates and Related Disclosures*
- NSW Public Sector Governance Framework https://www.dpc.nsw.gov.au/assets/dpc-nsw-gov-au/files/Programs-and-Services/Governance/736f5dc2ba/NSW-Public-Sector-Governance-Framework-2013.pdf
- Rail access: Compliance statement RailCorp non-HVCN 2017-18 https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/investigation-compliance-monitoring-transport-publications-review-of-compliance-with-nsw-rail-access-undertaking-201718-non-hunter-valley-coal-networks-railcorp-and-transport-for-nsw/compliance-statement-railcorp-non-hunter-valley-coal-networks-july-2019.pdf.

Treasury-provided documentation

We have made references to the following documentation provided by Treasury in preparing this report:

- ABS's letter titled "Final Determination of the classification of Transport Asset Holding Entity"
- NSW Treasury's ABS Engagement Strategy received on 28 August 2020
- TAHE Implementation Deed (draft dated 28 June 2020)
- "ROE Analysis – CommAssets" document received on 8 September 2020
- TAHE Operating Licence 1 July 2020 - 31 June 2021 (final dated 26 June 2020)
- TAHE Corporate Governance Statement (approved July 2020)
- "TAHE – Slide Pack on limitations of information modelled.pptx" document received on 22 October 2020
- "IPART floor simple calc 16 Oct sent" document received on 16 October 2020.

8.2 Detailed references and supporting analysis

Key Government Finance Statistics (GFS) concepts- relevant extracts from ABS & IMF Manuals and other jurisdictions

Background to GFS

As outlined in NSW Treasury's ABS Engagement Strategy:

"The term 'Government Finance Statistics' refers to statistics that measure the financial activities of governments and reflect the impact of those activities on other sectors of the economy. The Australian system of GFS is designed to provide statistical information on public sector entities in Australia classified in a uniform and systematic way."

GFS enables policy makers and users to analyse the financial operations and financial position of the public sector by the level of government, institutional sector or set of transactions.

ABS data

The ABS GFSM 2015 stipulates that "The ABS obtains the majority of quarterly and annual GFS data as electronic data files that are submitted at specified times during the fiscal year. Accounting data are mapped to a GFS basis at unit level of government by jurisdictions at the Commonwealth, and state and territory levels of government. Local government data is collected through a sample survey collection on a quarterly basis. Annual local government data is collected from financial information provided by the Departments of Local Government and this data is mapped by the ABS to the GFS framework. Data for universities and control not further defined units are collected separately. The GFS-classified data are supplied to the ABS for aggregation and further analysis. In these cases, the role of the ABS is one of assisting with GFS conversion of accounting data, coordinating the provision of data files, and editing the data before they are aggregated as GFS[168]".

NSW Treasury's Prime system is used to generate the GFS data submitted to the ABS. Agency data has GFS identifiers attached such that statistical data for the whole of the State can be aggregated and submitted.

Sector classification

In order to determine the boundary of the GFS system, institutional units and sectors of an economy need to be defined. The first step is to identify the institutional unit. The second step is to allocate the institutional unit to a sector of the economy.[169]

This process results in the classification of government entities into institutional sectors (GGS, PFC, PNFC) to understand their impact on other parts of the economy.

---

[168] ABS GFSM 2015, paragraph 14.4

[169] ABS GFSM 2015, paragraph 2.1 & IMF GFSM 2014, paragraph 2.50

GFS used by the ABS are compiled using standard definitions, classifications and treatment of government financial transactions to facilitate comparisons between levels of government and between states within a level of government.

Consistent with the IMF[170], the ABS:

- assesses an entity's GFS classification based on a number of factors, including the proposed transition plan of the entity
- takes a long-term view when making determinations, such that changes to the specific plan does not in itself necessarily affect their determination – once an entity is classified, only if a change holds for several years or is expected to hold for several years should a reclassification of the entity be considered[171].

PNFC classification criteria

To determine if a public sector unit is a public corporation or a general government unit, it is necessary to classify it as a market producer (public corporation) or non-market producer (general government)[172].

Public corporations are further stratified between non-financial corporations (where the principal activity is the production of non-financial goods and/or non-financial services)[173] and financial corporations (where the principal activity is the provision of financial services).[174]

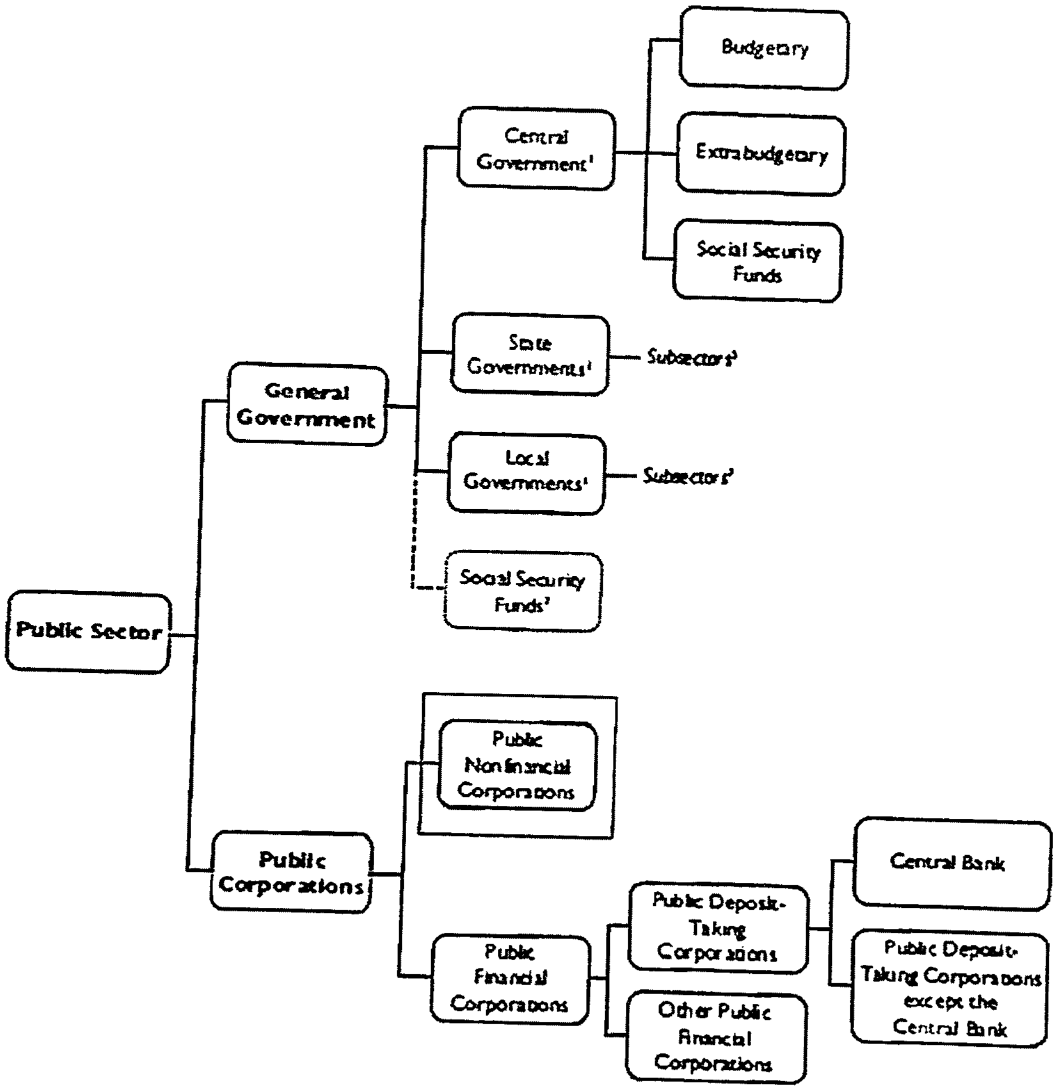
The IMF GFSM 2014 illustrates this via the following diagram (highlight on PNFC added):

---

170 ABS GFSM 2015, p.iv– Preface: *"The statistical concepts and classification principles used in compiling Australian GFS are based on the IMF standard because it is designed to enable preparation of uniform statistics relating to all IMF member countries and is widely recognised in the international statistical community"*
171 IMF GFSM 2014, paragraph 2.70 & p21, Footnote 22
172 ABS GFSM 2015, paragraph 2.58 & IMF GFSM 2014, paragraph 2.64
173 ABS GFSM 2015, paragraph 2.48 & IMF GFSM 2014, paragraph 2.52
174 ABS GFSM 2015, paragraph 2.50 & IMF GFSM 2014, paragraph 2.53

20 Government Finance Statistics Manual 2014

Figure 2.3 The Public Sector and Its Main Components



[1]Includes social security funds.
[2]Alternatively, social security funds can be combined into a separate subsector, as shown in the box with dashed lines.
[3]Budgetary units, extrabudgetary units, and social security funds may also exist in state and local governments.

Therefore, in determining whether an entity is classified as PNFC under GFS, the 'two-step' process referred to previously entails the following:

Step 1 - Identify the institutional unit

Entities that are not institutional units in their own right are treated as part of their parent entity. GFS notes that for an entity to be considered an institutional unit in its own right, a unit must:

- Have the ability to own goods or assets and exchange these in transactions with other institutional units; and
- Be able to make economic decisions and engage in economic activity for which itself it is held responsible and accountable at law; and
- Be able to incur liabilities on its own behalf, take on other obligations or future commitments, and to enter into contracts; and
- Be able to produce a complete set of accounts, including a balance sheet of assets, liabilities and net worth, and operating statement and a cash flow statement, or it would be possible and meaningful from both an economic and legal viewpoint to compile a complete set of accounts if required.[175]

Government entities that cannot act independently and are simply passive holders of assets and liabilities ("artificial subsidiaries") are not treated as separate institutional units, but are classified as components of the level of government that controls them.[176]

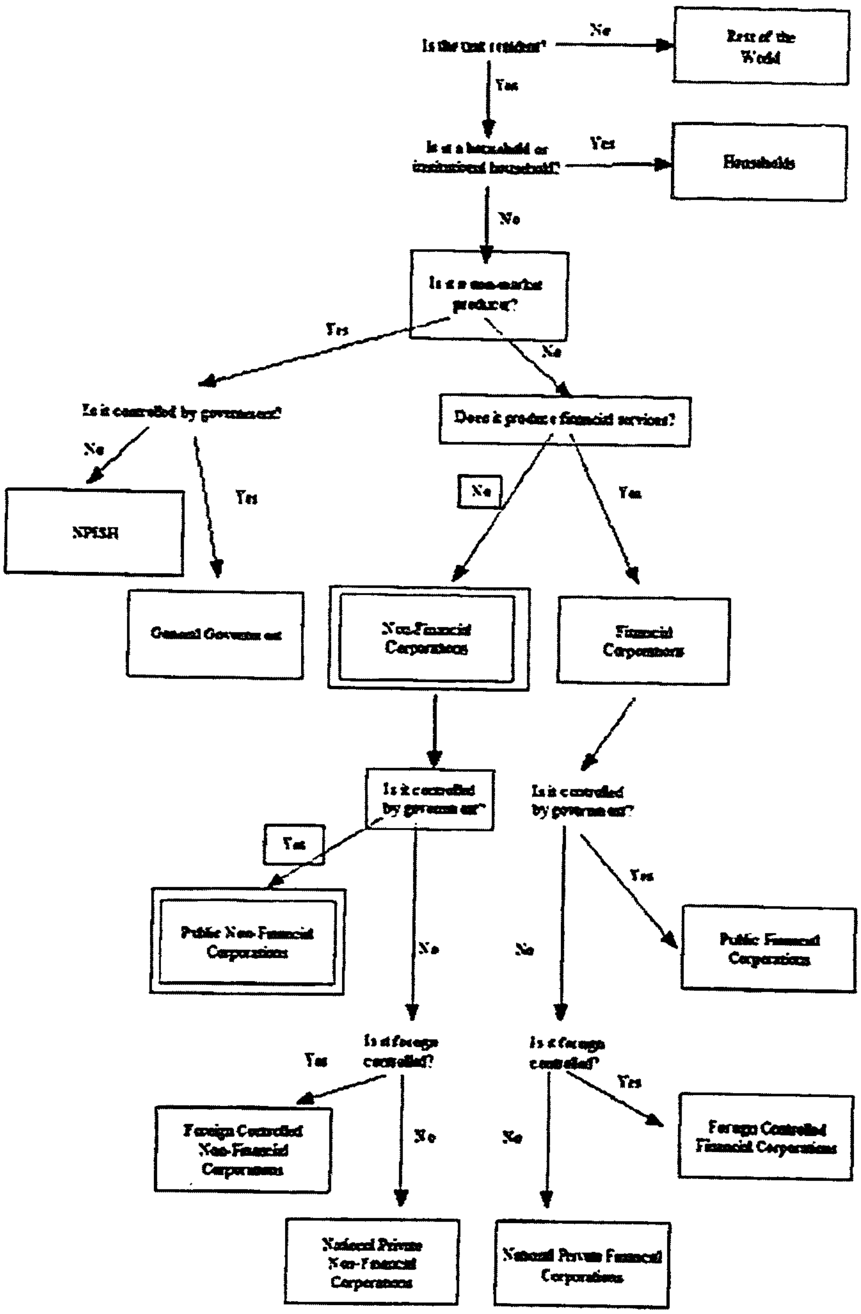
Step 2 – Allocate institutional unit to sector of the economy

Once it is determined that an entity is an institutional unit in its own right (i.e. a 'separate' institutional unit which is not treated as part of its parent), then the entity is classified to a sector of the economy. The ABS GFSM 2015 notes that the Australian economy is divided into five mutually exclusive sectors. Of these five institutional sectors that together make up the total economy, only some units are part of the total public sector and therefore in the scope for GFS[177]. The ABS GFSM 2015 illustrates the sector classification process further via the following decision tree:

175 ABS GFSM 2015, paragraph 2.25 & IMF GFSM 2014, paragraph 2.22
176 ABS GFSM 2015, paragraph 2.27 & IMF GFSM 2014, paragraph 2.42-2.43
177 ABS GFSM 2015, paragraph 2.46

CHAPTER 2: INSTITUTIONAL UNITS AND SECTORS

Diagram 2.1 - Decision tree for sector classification of public entities



Source: System of National Accounts 2008 (European Commission et al, 2008)

Source: ABS GFSM 2015, p15, Diagram 2.1

As the previous diagram shows, the key determinant of whether an institutional unit is allocated to the General Government sector or the Public Corporations sector of the economy is whether the entity is a 'market producer'[178].

Market producer

GFS defines a market producer as an institutional unit that provides all or most of its output to others at prices that are economically significant.[179] GFS specifies that, in principle:

- the distinction between market and nonmarket producers should be made on a case-by-case basis
- the classification of a producer should be considered over a range of years
- once classified, only if a change in pricing holds for several years or is expected to hold for several years should a reclassification of the entity be considered.[180]

GFS defined economically significant prices as prices that have a significant effect on the amounts that producers are willing to supply and on the amounts purchasers wish to buy. These prices normally result when:

- the producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other costs; and
- consumers have the freedom to purchase or not purchase and make the choice on the basis of the prices charged.[181]

Conversely, GFS states that a price is not economically significant when it has little or no influence on how much the producer is prepared to supply and on the quantities demanded. For example, economically insignificant prices may be charged in order to raise some token revenue and/or reduce, but not eliminate, excess demand that may occur if goods and services are provided free of charge. An economically insignificant price may be set on administrative, social or political grounds for goods or services for which the amount to be supplied is fixed.[182]

In determining whether prices are economically significant, GFS recommends a comparison between the receipts from sales and the costs of production of goods and/or services sold by an entity over a number of years, and that this will in turn assist with determining whether an entity should be classified as market or a non-market producer.[183]

In this context, the ABS GFSM 2015 does not specify a 'bright line' in terms of minimum amount of production costs that should be covered by sales to indicate that an entity should

---

178 ABS GFSM 2015, paragraph 2.58 & IMF GFSM 2014, paragraph 2.64
179 ABS GFSM 2015 & IMF GFSM 2014, paragraph 2.65
180 IMF GFSM 2014, paragraph 2.71
181 ABS GFSM 2015, paragraph 2.59 & IMF GFSM 2014, paragraph 2.66
182 IMF GFSM 2014, paragraph 2.67 & ABS GFSM 2015, paragraph 2.64
183 ABS GFSM 2015, paragraph 2.60 & IMF GFSM 2014, paragraph 2.73

be a market producer, but does state that the greater ratio of production of costs covered by sales, the stronger an indicator that the entity is a market producer.[184]

When undertaking such a comparison, GFS specifies that sales of the entity should include subsidies / payments receivable from government in circumstances where any other producer undertaking the same activity would also receive such subsidies / government payments.[185]

The IMF GFSM 2014 notes that "When a newly established unit needs to be classified to a sector, the classification as a market or nonmarket producer should be based on its intent regarding the prices it is to charge for its goods and services[186]". This is particularly relevant to entities with an intent to charge prices which are comparable to those of a market producer, but is implementing such pricing via a phased approach.

Further, the IMF GFSM 2014 states that "In principle, the distinction between market and nonmarket producers should be made on a case-by-case basis. The classification of a producer as a market or nonmarket producer should be considered over a range of years. Once classified, only if a change in pricing holds for several years or is expected to hold for several years should a reclassification of the entity be considered[187].

Accounting treatment of heavy rail infrastructure capital funding

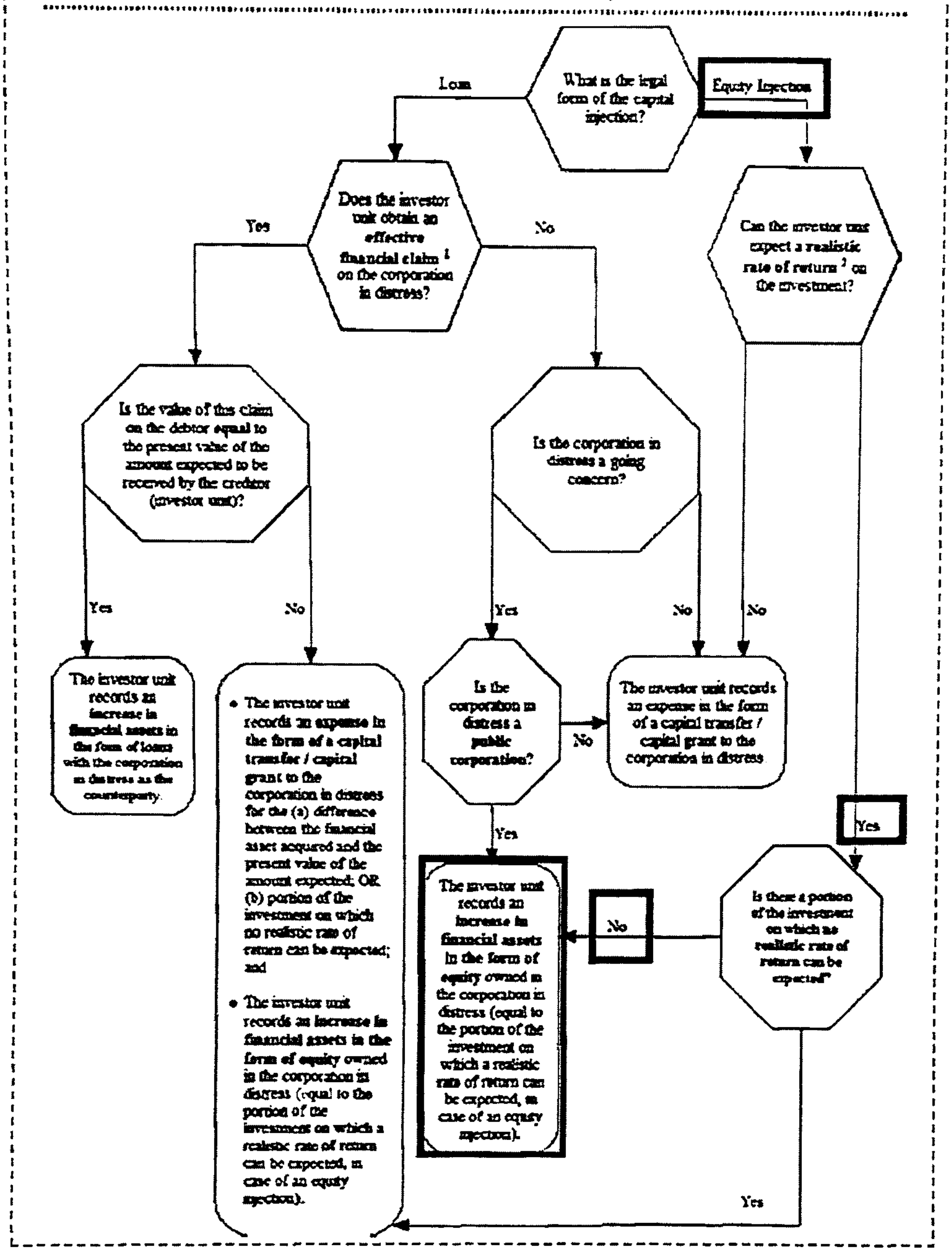
Recorded as transactions in financial assets/liabilities

The IMF GFSM 2014 notes that "There may be cases where the owners agree to make new financing available to permit expansion, and where such financing establishes an effective claim on the public corporation. Such financing could consist of funds for use by the enterprise according to its need, including purchasing fixed assets, accumulating inventories, acquiring financial assets, or redeeming liabilities...Without evidence of a specific financing agreement, such payments are to be included as the acquisition of equity in the public corporation even if no new shares are issued in response to the financial contribution. In such a case, government, acting in the same capacity as a private shareholder, provides funds while receiving contractually something of equal value in exchange (i.e., increased value of its equity) and expecting to earn a sufficient rate of return on its investment, in the form of dividends (as a return on equity). Treatment of these payments as the increase in equity depends on evidence of the corporation's profitability and its ability to pay dividends in future."[188]

---

[184] ABS GFSM 2015, paragraph 2.60
[185] ABS GFSM 2015, paragraph 2.61 & IMF GFSM 2014, paragraph 2.73
[186] IMF GFSM 2014, Pg 21 Footnote 22
[187] IMF GFSM 2014, paragraph 2.70
[188] IMF GFSM 2014, Box 6.3

Diagram 13.3 - Decision tree for the statistical treatment of capital injections



Source: ABS GFSM 2015, p275, Diagram 13.3

"When a public sector unit intervenes by means of a capital injection... the statistical treatment depends on whether a realistic return can be expected on this investment or not"[189]. Paragraph A3.49 of the IMF GFSM 2014 notes that a realistic rate of return on funds is indicated by the intention to earn a rate of return that is sufficient to generate dividends or

[189] ABS GFSM 2015, paragraph 13.62

holding gains at a later date and that there is a claim on the residual value of the corporation. Under this method:

- If the public sector unit (investor unit) can expect a realistic return on the investment, the investor unit records an increase in financial assets in the form of equity and investment fund shares, and a decrease in financial assets (e.g., currency and deposits) or an increase in liabilities, depending on how the acquisition of equity is financed...

- The portion of the investment on which no realistic return can be expected (which may be the entire investment) is treated as a capital transfer / capital grant."[190]

The IMF GFSM 2014 further states that:

"Owners may inject significant financial support to capitalize or recapitalize a corporation. Such financial support may take various legal forms and its economic substance may also vary...These payments from a government unit, often referred to as "capital injections," could be recorded as:

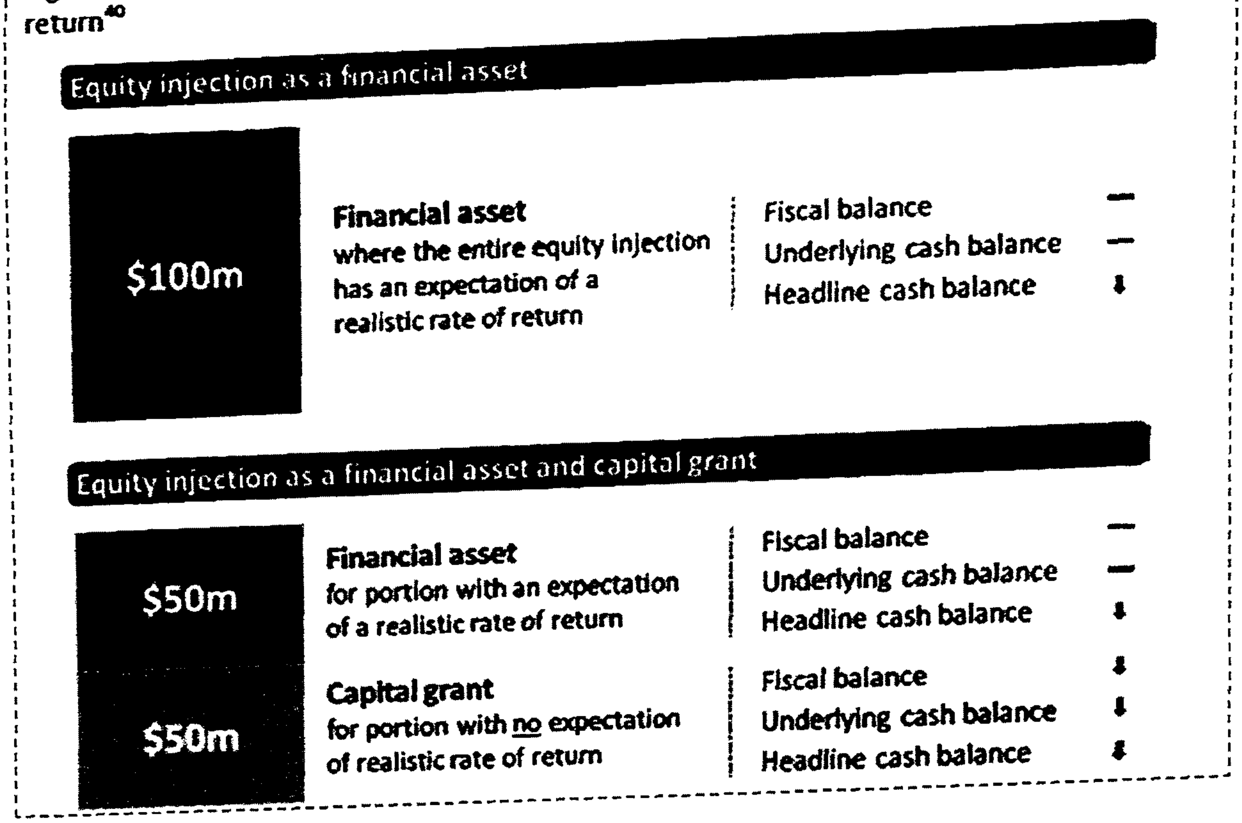
- an expense, either as a subsidy or capital transfer, or
- a transaction in financial assets/liabilities, either as an addition to equity or an issuance of a loan or securities other than shares"[191].

Appendix D within the Parliamentary Budget Office, Alternative Financing of Government Policies, Report No.01/2020 produced by the Commonwealth further supports the view that equity injection is recognised as a financial asset on the balance sheet only if 'a realistic return' is expected from the investment.

Appendix D of this report states that: "According to the GFS, an equity injection in a corporation results in a financial asset on the balance sheet if 'a realistic return' is expected from the investment. Where the equity injection, or a portion of it, does not have an expectation of a realistic rate of return, the equity injection (or the relevant portion of it) is treated as a capital grant."[192] Appendix D of this report illustrates this concept diagrammatically, as follows:

[190] ABS GFSM 2015, paragraph 13.63
[191] IMF GFSM 2014, Box 6.3
[192] Parliamentary Budget Office, Alternative Financing of Government Policies, Report No.01/2020, Appendix D

Figure D1: Treatment of an equity injection depends on the expectation of a realistic rate of return[40]



Definition of return

ABS GFSM 2015 notes that "a realistic rate of return on funds is indicated by the intention to earn a rate of return that is sufficient to generate dividends or holding gains at a later date and that there is a claim on the residual value of the corporation."[193]

Dividends

The ABS GFSM 2015 provides a definition of dividend income as follows:

"Dividend income (including tax equivalents) is a type of revenue which consists of distributed earnings allocated to government or public sector units (as the owners of equity), for placing funds at the disposal of corporations. Dividend income is not funded by the sale of assets, capital restructure, borrowings or other credit arrangements... General government units may receive dividends from private or public corporations... Dividend income is also distinguished from the sale or other divestment of equity holdings, which are sales of financial assets and not revenues."[194]

Holding gains

Holding gains are defined in the ABS GFSM 2015 as follows: "Holding gains and losses (sometimes referred to as revaluations in GFS) are defined as changes in the current market

---

193 ABS GFSM 2015, p.302, Footnote 14 & p.303, Figure A3.2
194 ABS GFSM 2015, paragraph 6.130

value of an asset or liability resulting from changes in the level and structure of prices, assuming that the asset or liability has not changed qualitatively or quantitatively. ...Capital gains and losses made on the sale of assets (other than inventories) are recorded as holding gains and losses in GFS, and not as revenues."[195]

Calculation of return

The Department of Finance "Finance Advice Paper, Q&A – Equity Investments" document produced by the Commonwealth notes the following:

"The government treats an investment in a government-owned business as equity if it meets a minimum level of financial return – the threshold return. This minimum level is that the investee expects to provide the government with a rate of return on its investment of at least the rate of inflation, known as a return in 'real' terms. The return is calculated by comparing the current values of equity injections provided by the government, with the current value of returns that the government will receive in the form of dividends, capital returns and proceeds of sale (if any). If the returns were not expected to meet this threshold, at the time the equity investment was made, some or all of the payment would be treated as a grant, and therefore as an expense, not as equity. The amount treated as a grant would depend on the expected level of return, relative to the investment. This threshold return requirement results from putting into practice the requirements of the accounting and statistical standards."[196]

Sufficiency and timing of return

The ABS GFSM 2015 note that "a realistic rate of return on funds is indicated by the intention to earn a rate of return that is sufficient to generate dividends or holding gains at a later date and that there is a claim on the residual value of the corporation."[197]

Treatment of capital injections in other jurisdictions

The Parliamentary Budget Office's 'Alternative Financing of Government Policies' report further notes that "In order to be recorded as equity, these injections must be assessed as providing a reasonable expectation of a sufficient rate of return to comply with the Australian Bureau of Statistics' guidance for Government Finance Statistics. The Commonwealth Government has defined this as a real return of zero at a minimum."[198]

It is noted that across other jurisdictions, there are various examples of government businesses where the government has recorded funding injections as equity, even though the entity has not yet demonstrated profitability. These include:

- Moorebank Intermodal Company (MIC) – receives funding from the Commonwealth Government which is recorded as equity, although having had accounting losses since inception[199].

---

[195] ABS GFSM 2015, paragraph 11.3
[196] Department of Finance Advice Paper – Q&A – Equity Investments
[197] ABS GFSM 2015, p.302, Footnote 14 & p.303, Figure A3.2
[198] Parliamentary Budget Office, Alternative Financing of Government Policies, Report No.01/2020, Pg 3 Footnote 3
[199] Moorebank Intermodal Company Annual Report for the year ended 30 June 2019, Pg. 53

Consolidated Statement of Profit or Loss and Other Comprehensive Income

For the year ended 30 June 2019

	Notes	2019 $'000	2018 $'000
Revenue			
Finance income		1,065	668
Other operating income		24	1
Total revenue		**1,089**	**669**
Expenditure			
Employee benefits expense	4.1	(3.257)	(1.991)
Occupancy costs		(245)	(225)
Adviser costs	4.2	(2.684)	(1.850)
Contractor costs		(700)	(366)
Recruitment		(110)	(109)
Insurance		(162)	(153)
IT expenses		(176)	(120)
Travel costs		(76)	(67)
Depreciation and amortisation		(50)	(42)
Land and site costs	4.3	(105.135)	(82.050)
Other expenses		(591)	(295)
Total expenditure		**(113.186)**	**(87.268)**
Net finance income/(costs)			
Share of profit/(loss) of equity-accounted investees	12	13.240	(325)
Loss before income tax		**(99.857)**	**(86.924)**
Income tax benefit	5	30.373	25.433
Loss for the year		(69.484)	(61.491)

	Contributed equity $'000	Accumulated losses $'000	Total equity $'000
Balance at 1 July 2017	111,000	(7.546)	103.454
Loss for the year	-	(61,491)	(61,491)
Other comprehensive loss	-	-	-
Total comprehensive loss for the year	-	**(61,491)**	**(61,491)**
TRANSACTIONS WITH OWNERS, IN THEIR CAPACITY AS OWNERS			
Contributions of equity (Note 18)	95,000	-	95,000
Balance at 30 June 2018	206,000	(69,037)	136,963
Balance at 1 July 2018	206,000	(69,037)	136,963
Loss for the year	-	(69,484)	(69,484)
Other comprehensive loss	-	-	-
Total comprehensive loss for the year	-	**(69,484)**	**(69,484)**
TRANSACTIONS WITH OWNERS, IN THEIR CAPACITY AS OWNERS			
Contributions of equity (Note 18)	174,733	-	174,333
Balance at 30 June 2019	[illegible]	[illegible]	[illegible]

- Australian Rail Track Corporation (ARTC) – a Commonwealth GBE with equity contributed in 2018-19, despite making an accounting loss in the same year.[200]

Extract of ARTC's financial statements for the year ended 30 June 2019 as follows:

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2019

	Notes	Consolidated 2019 $'000	2018 $'000
Profit/(Loss) for the year		(448,386)	54,249
Other comprehensive income/(loss)			
Items that may be reclassified to profit or loss - net of tax			
Cash flow hedge charged to equity - foreign exchange	8(b)	-	9
Total items that may be reclassified subsequently to profit or loss		-	9
Items that will not be reclassified to profit or loss - net of tax			
Revaluation adjustment property plant and equipment	8(b)	(136,023)	31,341
Re-measurement (losses)/gains on defined benefit plans	8(c)	(2,485)	762
Total items that will not be reclassified to profit or loss		(138,508)	32,103
Other comprehensive income/(loss) for the year, net of tax		(138,508)	32,112
Total comprehensive income/(loss) for the year, net of tax		(586,894)	86,361
Total comprehensive income/(loss) for the year is attributable to:			
Equity holder of Australian Rail Track Corporation Ltd		(586,894)	86,361

For the year ended 30 June 2019

Consolidated	Notes	Contributed equity $'000	Property, plant and equipment revaluation reserve $'000	Hedging reserve - cash flow hedge - foreign exchange $'000	Profit Reserve $'000	Total Reserves $'000	Retained Earnings $'000	Total Equity $'000
		Attributable to owners of Australian Rail Track Corporation Ltd						
Balance at 1 July 2018		2,827,656	720,868	-	259,675	980,543	(129,453)	3,678,746
Adjustment on adoption of AASB 9 (net of tax) (i)		-	-	-	-	-	(25)	(25)
Adjustment on adoption of AASB 15 (net of tax) (ii)		-	-	-	-	-	(308)	(308)
Restated profit for the year		-	-	-	-	-	(333)	(333)
Total profit for the year as reported in the Financial Statements	8(c)						(448,386)	(448,386)
Re-measurement gains/(losses) on defined benefit plans - (net of tax)	8(c)	-	-	-	-	-	(2,485)	(2,485)
Asset revaluation reserve adjustment - (net of tax)	8(b)	-	(136,023)	-	-	(136,023)	-	(136,023)
Total comprehensive income for the year		-	(136,023)			(136,023)	(450,871)	(586,894)
Dividends provided for or paid	8(b)	-	-	-	(68,312)	(68,312)	-	(68,312)
Asset disposal revaluation reserve adjustment	8(b)	-	(18,397)	-	-	(18,397)	18,397	-
Contributions of equity, net of transaction costs	8(a)	290,705	-	-	-	-	-	290,705
Balance at 30 June 2019		3,118,361	566,448		191,363	757,811	(562,260)	3,313,912

[200] ARTC Financial Statements for the year ended 30 June 2019, Pg 21 and 25

Accounting for contributions by owners

TAHE is a wholly owned public sector entity. Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities* (Interpretation 1038) clarifies that a transfer is recognised by the transferee as a contribution by owners when and only when it satisfies the definition of contributions by owners in AASB 1004 *Contributions* (AASB 1004)[201]. AASB 1004[202] defines contributions by owners as follows:

"Future economic benefits that have been contributed to the entity by parties external to the entity, other than those which result in liabilities of the entity, that give rise to a financial interest in the net assets of the entity which:

a) conveys an entitlement both to distributions of future economic benefits by the entity during its life, such distributions being at the discretion of the ownership group or its representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up and/or

b) can be sold, transferred or redeemed."[203]

Interpretation 1038 clarifies that a transfer's equity nature is evidenced by any of the following:

- issuance of equity instruments that could be transferred, sold or redeemed
- formal agreement establishing a financial interest in the net assets of the transferee that could be transferred, sold or redeemed
- formal designation of the transfer by the transferor or parent of the transferor as forming pat of the transferee's equity, either before the transfer or at the time of the transfer[204].

In NSW, TPP 09-03 Accounting Policy: Contributions by owners made to wholly-owned Public Sector Entities (TPP 09-03) pre-designates certain transfers as contributions by owners, including cash equity injections to for-profit entities.

TPP 09-03 confirms that there are two possible ways a cash equity injection can be made to a for-profit entity, being an equity appropriation or otherwise[205]. Further, in the absence of an equity appropriation, the equity nature of the transfer will be evidenced, before the date of transfer, in the Budget Papers or in writing to each affected entity[206].

---

201 Interpretation 1038.7
202 AASB 1004 applies only to not-for-profit entities. However, AASB 1049.14(g) confirms the relevance of the principles in AASB 1004 to PNFC entities
203 AASB 1004.Appendix A
204 Interpretation 1038.8
205 TPP 19-03 Accounting Policy: Contributions by owners made to wholly-owned Public Sector Entities, Section 3.7.1
206 TPP 19-03 Accounting Policy: Contributions by owners made to wholly-owned Public Sector Entities, Section 3.7.1

The 2015-16 Budget Papers articulates the intention to treat future cash transfers as equity injections[207]. Accordingly, the cash transfers into TAHE are pre-designated as contributions by owners.

Contributions by owners (and distributions to owners, in the event of a return of capital) are accounted for by adjusting the equity of the transferee.

Commercial Policy Framework

The Commercial Policy Framework encompasses a suite of policies implemented by NSW Treasury that aims to apply disciplines and commercial practices observed in the private sector to all government owned businesses[208].

The framework:

- outlines requirements for performance and monitoring for government businesses, including a focus on reporting and monitoring from a shareholder perspective and providing for annual Statement of Corporate or Business Intents and quarterly reporting
- covers the payment of returns to government, being financial distributions in the form of dividends and tax equivalent payments, and the respective methodologies for calculating these payments
- addresses community service obligations, which are paid by government to relevant entities for undertaking non-commercial activities for identified social purposes at the request of government
- includes a framework for determining the target capital structure of government businesses and requires SOCs and nominated government businesses to borrow at a cost reflective of their individual credit worthiness.

NSW Treasury has advised that it is intended that TAHE will move to full compliance with the requirements of Treasury's Commercial Policy Framework over time. Recognising that TAHE is a new SOC, modified requirements currently apply. For example, the performance reporting and monitoring provisions have application but requirements in respect of financial fund flows do not. TAHE's enabling legislation also provides for a transitional provision that TAHE is exempt from State taxes for a period of twelve months, and which can be extended.

Recognising the progressive implementation of TAHE reforms, NSW Treasury's current thinking is that TAHE will be granted concessions under the Commercial Policy Framework until such point that it has implemented access charges in respect of its assets on a commercial basis. That is, until TAHE is operating on a more commercial basis, Commercial Policy Framework requirements for payment of dividends and tax equivalents will not apply. In addition, TAHE's capital structure currently reflects that of RailCorp's, with no changes to the historic basis of determining government guarantee fees payable. It is understood that changes to capital structure will be considered in the context of implementing commercial arrangements in respect of assets.

---

207 2015-16 Budget Paper 1, Box 1.1

208 https://www.treasury.nsw.gov.au/information-public-entities/government-businesses/commercial-policy-framework

Statement of Corporate Intent

TAHE is required to prepare an annual SCI[209]. However, the enabling legislation includes a transitional provision that the first SCI need not be finalised until 90 days from establishment as a SOC and the shareholders have granted an extension of this date. Accordingly, the SCI is currently in draft.

NSW Treasury advises that the final SCI is expected to outline TAHE's strategic direction and objectives from 2020-21 to 2022-23 and set out its financial and non-financial performance objectives. Priorities are expected to include the development of a long-term operating model.

Recognising the progressive implementation of reforms, NSW Treasury has advised that TAHE is not expected to be profitable or distribute any dividends from 2020-21 to 2022-23 and this will inform financial expectations outlined in the SCI.

Dividends

The Government holds an equity investment in various government owned businesses, including in SOCs. This equity investment has accumulated over time through the direct investment of capital and indirectly in the form of retained earnings and other accumulated equity, such as asset revaluation reserves.

Government businesses make dividend payments as a return on the equity investment. These dividend payments are frequently referred to as financial distributions. There is an expectation that TAHE will make such distributions in time.

Section 20S of the SOC Act provides that statutory SOCs must have a share dividend scheme[210]. The operation of the SOC's SCI, in conjunction with the Board's dividends recommendation and shareholder approval, forms the scheme[211].

Treasury policy

Financial distributions transfer a share of the owner's equity in a Government business to the owner. Financial distributions comprise:

- dividends, which represent a return <u>on</u> the owner's equity investment
- capital repayments, which involve a return <u>of</u> the owner's equity investment.

TPP 16-04 Financial Distribution Policy for Government Businesses (TPP 16-04) outlines the Government's expectations for the payment of dividends by Government businesses and covers capital repayments and is linked to the capital structure policies[212] for Government businesses. TPP 16-04 applies to statutory SOCs listed in Schedule 5 of the SOC Act, which includes TAHE.

---

209 Commercial Policy Framework: Performance Reporting and Monitoring Policy for Government Businesses, Section 2
210 *State Owned Corporations Act 1989*, Part 3 Division 2 Section 20S(1)
211 TPP 16-04 Financial Distributions Policy for Government Businesses Appendix 4
212 TPP 16-03 Capital Structure Policy for Government Businesses

Under the policy:

- dividends are paid into the Consolidated Fund[213], which forms part of the General Government Sector
- ordinarily, dividends are paid in arrears in the year after they are declared
- forecast dividend profiles are set taking into account the targeted capital structure and credit rating, where applicable, or expressed by a percentage of distributable net profit after tax[214] (NPAT). A dividend payout ratio of 70% of NPAT is the initial reference point when agreeing a percentage with shareholders. However, specific considerations or Government expectations can be taken into account when determining dividends, which is relevant to TAHE's staged transitional period.

Based on historical information on dividends remitted by SOCs provided by NSW Treasury, dividends vary significantly across SOCs and over time.

Relevance of Treasury policy to GGS accounting implications

Financial distributions in the context of TPP 16-04 exclude tax equivalent payments[215]. This reflects the intention of the policy, that is to subject Government businesses to the discipline of making dividend and capital repayments[216]. However, in the context of GFS, tax equivalent payments are included in the concept of a return on equity[217]. Accordingly, accounting presentation applied to tax equivalent payments by SOCs have no bearing on their accounting treatment by the GGS. At the GGS level, where GFS is a relevant consideration to accounting treatments and presentations due to the requirements of AASB 1049, the GFS principle prevails.

Further, NSW Treasury's assumption that considers returns addresses whether annual funding to TAHE for the acquisition of heavy rail infrastructure can be treated by the GGS as an acquisition of additional equity. This accounting assumption considers expected returns on annual injections of funding; expected returns under GFS are not equated with dividends under TPP 16-04 and annual injections of funding are not equated with a return on net assets of the investee. Accordingly, expectations expressed under TPP 16-04 are not determinative in respect of NSW Treasury's accounting assumption.

National Competition Policy

TPP 03-04 *Equivalent Regime for Government Businesses* references National Competition Policy, which was adopted by Commonwealth, State and Territory governments in 1995.

---

[213] Consolidated Fund established under the *Constitution Act 1902* and reported within the Crown Entity financial statements
[214] NPAT can be adjusted, for e.g. to exclude such things as non-cash actuarial superannuation adjustments to arrive at Distributable NPAT
[215] TPP 16-04 Financial Distribution Policy for Government Businesses, Page 2
[216] https://www.treasury.nsw.gov.au/information-public-entities/government-businesses/commercial-policy-framework
[217] ABS GFSM 2015, paragraph 6.130

The 1995 Competition Principles Agreement[218] contains the following provisions:

- 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. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities[219].
- Each party is free to determine its own agenda for the reform of public monopolies[220].
- Each party is free to determine its own agenda for the implementation of competitive neutrality principles[221].
- As long as the benefits realised from implementation outweigh costs[222], government businesses will be subject to tax equivalent systems[223].

Rail Access Undertaking

Background

The *Transport Administration Act 1988* provides that a rail infrastructure owner may enter into an access undertaking[224]. The purpose of entering into such an undertaking is to implement the 1995 Competition Principles Agreement[225].

An access undertaking was entered into by RailCorp some years ago. The undertaking outlines requirements governing the arrangements between RailCorp and third parties seeking to obtain access to the NSW Rail Network[226]. At the time the undertaking was made, Sydney Trains and NSW Trains were subsidiaries of RailCorp. Legislative change effected in 2017 removed this subsidiary status. There is a general consensus between Transport and TAHE stakeholders that the access undertaking applies to Sydney Trains and NSW Trains from the point at which they were no longer subsidiaries.

---

218 http://ncp.ncc.gov.au/docs/Competition%20Principles%20Agreement,%2011%20April%201995%20as%20amended%202007.pdf
219 Competition Principles Agreement, Section 3.(1)
220 Competition Principles Agreement, Section 4.(1)
221 Competition Principles Agreement, Section 3.(2)
222 Competition Principles Agreement, Section 3.(6)
223 Competition Principles Agreement, Section 3.(4)(b)
224 *Transport Administration Act 1988*, Schedule 6AA (1)(a)
225 *Transport Administration Act 1988*, Schedule 6AA (1)
226 Rail Access Undertaking, Clause 1.1

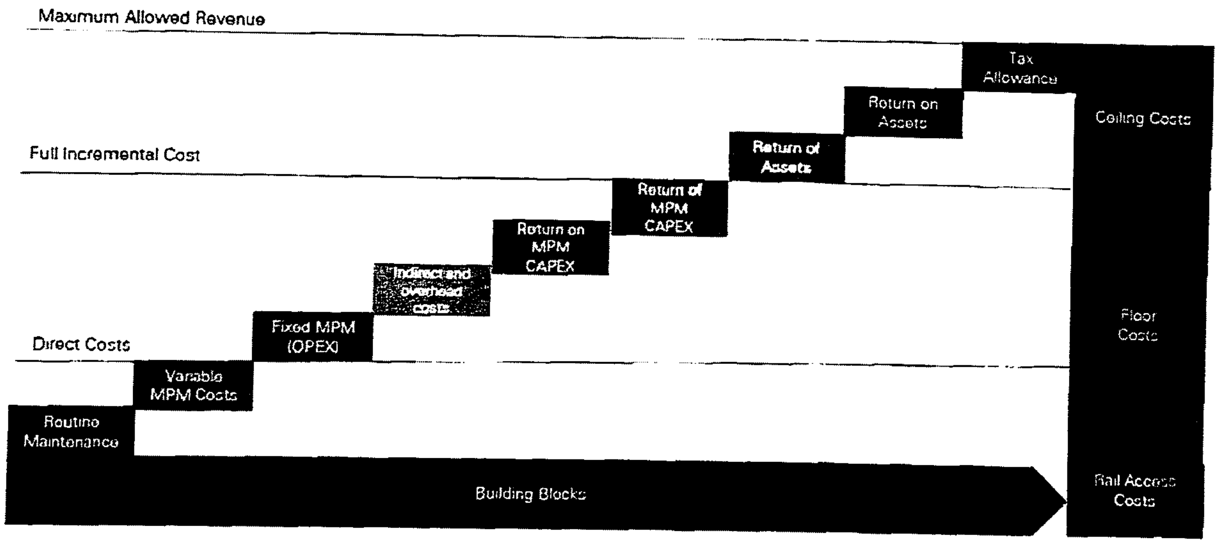
Pricing

Consistent with the 1995 Competition Principles Agreement[227], the RailCorp access undertaking contains pricing principles that aim to ensure that RailCorp, as a public monopoly, is subject to a degree of price oversight.

The RailCorp access undertaking pricing principles include the determination of lower and upper pricing levels (the "floor" and "ceiling"). Under the RailCorp undertaking, the access revenue from every access seeker must at least meet the direct cost imposed by the access seeker. In addition, for any Sector or Group of Sectors, revenue from Access Seeker together with Line Sector CSOs (if applicable) should as an objective meet the full incremental costs of those sectors ("floor tests")[228]. Direct costs are defined as *"efficient forward-looking costs which vary with the usage of a single operator within a 12 month period, plus a levelised charge for major periodic maintenance (MPM) costs, but excluding depreciation"*[229].

In 2017, TfNSW developed a detailed cost and pricing access model for the rail network infrastructure i.e. regulated assets. The purpose of this model included to inform the floor and ceiling prices.

TfNSW engaged KPMG to assist them to develop their model and their model is accepted by transport cluster and NSW Treasury stakeholders as a robust and established pricing mechanism. The model applies a building blocks approach to determining the floor and ceiling as illustrated in the following diagram.



Source: Transport Asset Holding Entity Cost and Pricing Access Model – Summary Document, April 2017

Under the model, the floor comprises:

---

[227] http://ncp.ncc.gov.au/docs/Competition%20Principles%20Agreement,%2011%20April%201995%20as%20amended%202007.pdf
[228] Rail Access Undertaking, Schedule 3, Clause 1
[229] Rail Access Undertaking, Schedule 3, Clause 2.1

- operations and maintenance (O&M) costs
- indirect and overhead costs
- return of major periodic maintenance (MPM) assets
- return on major periodic maintenance (MPM) assets.

The floor and ceiling concepts apply to "below rail" and do not apply to the passenger rollingstock, stations and platforms for example. Such assets are frequently referred to as 'unregulated assets'. However, the 2017 model also calculated pricing for these non-regulated assets applying similar principles as those applied to regulated assets.

Compliance

An access undertaking may confer or impose functions on the Independent Pricing and Regulatory Tribunal (IPART) in connection with the undertaking[230]. The RailCorp access undertaking appoints IPART in the event of a dispute[231], and to monitor pricing compliance[232].

Under the RailCorp access undertaking, there is an ability for an access seeker to raise an access dispute with TAHE, which can be the subject of arbitration by IPART pursuant to the relevant process under Part 4A of the IPART Act[233].

In terms of pricing compliance, TAHE is required to provide information to IPART annually, demonstrating its compliance with the economic regulatory requirements regarding asset valuation and the ceiling test[234]. IPART considers whether TAHE's access revenue is no more than the full economic cost for its network.

IPART's 2017-18 Compliance Statement[235]:

- confirmed that IPART was reasonably satisfied that RailCorp's access revenue was no more than 80% of the full economic cost for its networks
- confirmed that IPART was satisfied that RailCorp had complied with the requirements of the undertaking
- for the next four compliance years, requires TfNSW to confirm that there have been no material changes in cost or revenue for any of these networks that would cause access revenue to approach the 80% threshold in relation to TAHE's networks
- identifies that where there are no material changes in costs or revenues, ceiling test information will be required again for the 2022-23 compliance year.

---

230 *Transport Administration Act 1988*, Schedule 6AA (4)
231 Rail Access Undertaking, Schedule 3, Clause 5
232 Rail Access Undertaking, Clause 6.3
233 Rail Access Undertaking, Clause 6.1
234 Rail Access Undertaking, Schedule 3, Clause 5
235 Rail access: Compliance statement RailCorp non-HVCN 2017-18

In effect, IPART monitoring ensures that TAHE's pricing does not exceed the ceiling[236]. The access undertaking is silent on consequences for non-compliance consequences and TAHE's legal counsel has confirmed there is no penalty or offence regime that applies if TAHE fails to meet pricing requirements of the access undertaking.

Access fees for Rail Operators

Since the point at which the Rail Operators were no longer subsidiaries of RailCorp, i.e. 1 July 2017, the Rail Operators were potentially separate access seekers under the Rail Access Undertaking. Alternatively, the Rail Operators became separate access seekers from 1 July 2020 when TAHE was established as a SOC. Either way, whilst formal legal advice has not been sought to confirm the premise, there is a general consensus that the Rail Operators are likely separate access seekers for the 2020-21 year.

TAHE is a party to Rail Services Agreements (RSAs) with the Rail Operators. The RSAs[237] provide further clarity on roles and responsibilities between the parties in the delivery of railway passenger services as a further extension of the roles and responsibilities assigned to TfNSW and the Rail Operators through legislation.

The RSAs were entered into by RailCorp in June 2013 and have been extended beyond their original term ending in 2018[238] and the current contract term ends on 30 June 2021. It is accepted that the terms will not and cannot be extended again.

On 1 July 2020, the corporate name of RailCorp is changed to TAHE, with the entity continuing in existence under the new name.[239] An implementation deed entered into by RailCorp and TfNSW confirms that a reference in an RSA to RailCorp is to be read as a reference to TAHE[240]. On that basis, the RSAs continue to be effective post-1 July 2020.

Under the current arrangements:

- the Rail Operators access TAHE's heavy rail infrastructure assets in order to deliver railway passenger services
- the Rail Operators pay no fee to TAHE for access to the assets
- Sydney Trains incurs expenditure related to the maintenance of the Metropolitan Network (MPN) and rolling stock
- TAHE incurs expenditure related to the maintenance of the Country Rail Network (CRN).

These current arrangements reflect the intent of TAHE's operating licence i.e. that TAHE should replicate RailCorp. Future arrangements are to be negotiated and terms are as yet unknown.

---

[236] Rail access: Compliance statement RailCorp non-HVCN 2017-18
[237] Rail Services Agreement, clause 2 *Contract Objectives.*
[238] Rail Services Agreement, clause 3 *Contract Term.*
[239] *Transport Administration Act 1988,* Part 2 Division 1 Section 4(2)
[240] TAHE Implementation Deed (draft dated 28 June 2020), Clause 6.2

It is noted that access fees are also charged to other parties who access TAHE assets. These arrangements are expected to continue into the future and do not constitute an impact of any TAHE related reforms.

9 Appendix E - Limitations to NSW Treasury key assumptions

As noted in Section 3, NSW Treasury has informed us that the FIS for TAHE reflects the preliminary stage of TAHE's ongoing reform, with a significant amount of detail required to develop a more accurate and definitive FIS in time. Accounting estimates and related assumptions are expected to change as new information becomes available and FIS calculations are expected to evolve over the implementation period.

The following table outlines the list of NSW Treasury assumptions that underpins the FIS. The table includes the current positions and limitations of these assumptions which will require development.

#	Assumption	Financial Acct	Progress Made	October Position	Subject to change
1	Access and Lease Fees	Revenue	Indicative floor and ceiling price calculated, as per RAU.	Not determinable	Valuations, final balance sheet, IPART strategy and determination and Budget
2	Substance of Fees (Accounting treatment)	Revenue	No Progress. Not possible to determine accounting treatment of agreements based on RACI.	Not determinable	RSCs and commercial agreements need to be redesigned by 1 July 2021.
3	Covid Impacts	Revenue	No progress	Not determinable	Covid impacts on commercial agreements needs to be assessed as part of 2.

4	Commercial Strategy and forecasts	Revenue	Preliminary strategy under development.	Not determinable	Final strategy to be to vary based on 1,2, 9, 10, 11.
5	NTER and Taxes	Expenses	No progress	Not determinable	NTER and other tax liabilities to be assessed over time.
6	TSS Agreement (including I&P)	Expenses	No progress	Not determinable	Risk allocation, funding management and contingency management subject to terms of agreement
7	TAHE Resources	Expenses	Preliminary org. structure still in development	Not determinable	Dependant on scope of access fee agreement.
8	Depreciation	Expenses	Forecasted depreciation will change subsequent to valuation approach	Not determinable	Subject to 1,2 4,5.
9	Debt (Target capital structure)	Liabilities	No progress	Not determinable	Subject to 1,2,3, 4,5.
10	Credit Rating	Liabilities / Expenses	No progress	Not determinable	Subject to 1,2,3, 4,5.
11	Equity Injections	Assets	Still under development – dependant on access and lease fees	Determinable	Carry Forwards, contingency reallocation and over programming budgets
12	CIP Re-profile	Assets	Preliminary work underway	Not determinable	Commercial strategy and item 3.

13	Asset valuation basis	Assets	July 2020 agreed, no progress going forward	Not determinable	Potentially subject to change in future
14	Dividends	Distributions	No progress	Not determinable	Subject to 1,4,5,6 and 11