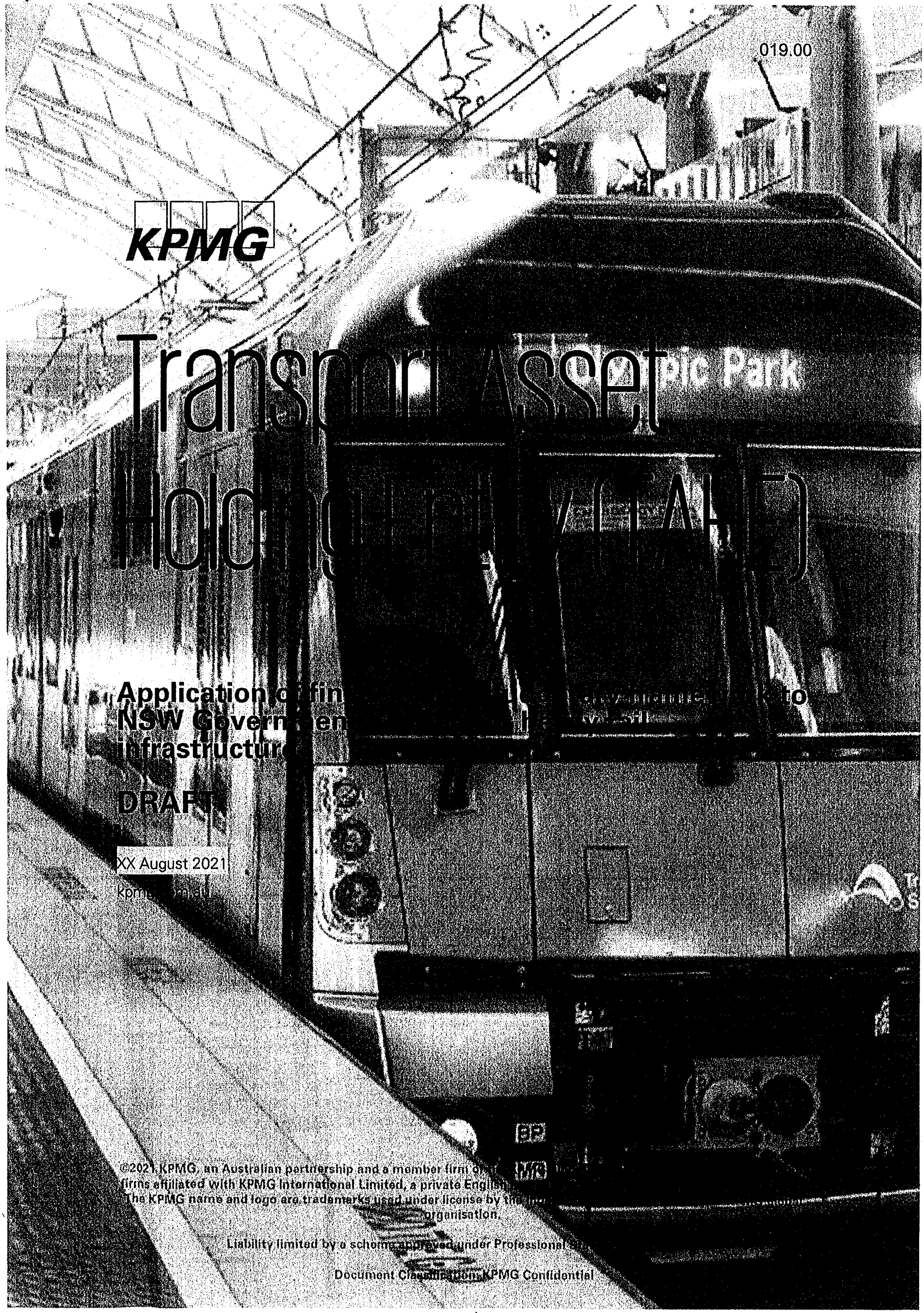


KPMG

Transport Asset Holding Entity (TAHE)

Application of fin... to NSW Governmen... infrastructur...

DRAFT

XX August 2021

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.

Where the advice in this deliverable has been based on:

- *forecasts, projections or other prospective financial estimations prepared by us, we do not warrant that the forecasts, projections or estimations will be achieved; and*
- *the analysis or use of forecasts, projections or other prospective financial estimations supplied or prepared by you, we do not warrant that:*
  - *a) the forecasts, projections or estimations are reasonable;*
  - *b) the forecasts, projections or estimations will be achieved; and*
  - *c) the underlying data and assumptions provided to us are accurate, complete or reasonable.*

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

XX August 2021

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.

We understand that your purpose in requesting a draft of our deliverable at this stage is to enable you to give preliminary consideration to the advice. You may not place any reliance on the advice contained in this draft deliverable in the absence of written confirmation from us because our preliminary advice may be amended or refined as our work progresses.

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
ARTC	Australian Rail Track Corporation
CPF / the Framework	Commercial Policy Framework
CRC	Current replacement cost
DCF	Discounted cash flow
GBE	Government Business Enterprise
GFS	Government Finance Statistics
GGS	General Government Sector
NTER	National Tax Equivalent Regime
PFC	Public Financial Corporation
PNFC	Public Non-Financial Corporation
Rail Operators	Sydney Trains and NSW Trains
SCI	Statement of Corporate Intent
SOC	State Owned Corporation
TAHE	Transport Asset Holding Entity
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

NSW Treasury engaged KPMG to provide advice in relation to the accounting treatment of the NSW Government's annual funding to TAHE for the acquisition of heavy rail infrastructure.

We have concluded that the 2020-21 funding to TAHE should be treated by the General Government Sector (GGS) as the acquisition of additional equity in TAHE. This report explains the criteria relevant to our conclusion as well as the basis for our conclusion.

Determining the appropriate treatment

In the General Government Sector's (GGS) financial statements, the annual funding can be recorded as an acquisition of additional equity in TAHE or it can be expensed as a capital transfer.

We have concluded that the determination as which accounting outcome occurs is based on whether there is reasonable expectation of a sufficient rate of return on the investment. This is a specific criterion within the applicable financial and budgetary reporting framework (i.e. a Government Finance Statistics (GFS) requirement):

If the NSW Government provides funding to TAHE to finance its acquisition of non-financial assets:

- when there is a reasonable expectation of a sufficient rate of return on the investment, the annual funding is recorded as an acquisition of additional equity
- when there is no reasonable expectation of a sufficient rate of return on the investment, the annual funding is expensed.

Reasonable expectation of a sufficient rate of return on the investment

We considered how to apply the criterion of a reasonable expectation of a sufficient rate of return and report:

- Returns in this GFS context include dividends from profits paid by TAHE to shareholders and income tax equivalent payments remitted by TAHE to NSW Treasury (because GFS effectively considers tax equivalent payments a component of TAHE's profits). TAHE projects generation of profits commencing in the 2021-22 financial year and there is an expectation it will remit dividends and income tax equivalents for 2021-22 and future years.
- Returns under GFS also include:
  - the NSW Government's claim on the residual value of TAHE, which is established through its shareholding
  - the potential for holding gains, in the form of repatriation of 'surplus' cash for example; TAHE incurs significant non-cash expenses creating free cash flow that could be made available for return to shareholders.

- GFS does not establish a quantitative threshold for what is considered a 'sufficient' return. The Commonwealth has published guidance on this concept of sufficiency, which can be used as a form of benchmark. Expectations of returns in respect of the 2020-21 investment in TAHE are commensurate with this benchmark.
- TAHE is a State Owned Corporation (SOC), which establishes a legal and governance structure that promotes commercial disciplines and enables returns to shareholders. When combined with TAHE's projections of future profitability, this creates a presumption of a reasonable expectation of a return on the annual investment made to fund infrastructure acquisition.

Having regard to the previous points, in our view, the criterion of 'reasonable expectation of a sufficient rate of return on the investment' is satisfied. Returns are forecast and the Government has a residual claim on TAHE, a SOC that is enabled to provides returns to its shareholders.

On the basis that there is a reasonable expectation of a sufficient rate of return on the funding provided to TAHE to acquire infrastructure (i.e. non-financial assets), the appropriate accounting treatment by the GGS in 2021-22 is to record an acquisition of equity in TAHE.

Other considerations

We note that TAHE revalued its assets as at 30 June 2021 using a new technique to estimate the fair value of its infrastructure assets. TAHE applied a present value technique referred to as a discounted cash flow method whereas it previously applied a cost approach. The outcome of this change in valuation technique is a write-down of TAHE's assets resulting in a negative retained earnings balance. We make the following observations:

- A write-down resulting from a change in valuation technique is excluded from the composition of returns for the purposes of the earlier criterion used to determine the accounting treatment of the funding to TAHE. That is, the write-down does not affect the conclusion that there is a reasonable expectation of returns nor does the write-down mean the funding is expensed instead of treated as an acquisition of equity in TAHE.
- The framework that applies to TAHE's payment of dividends does not require that TAHE maintain positive retained earnings, nor does it limit dividends to the balance of retained earnings. Accordingly, TAHE's shareholders can expect dividends notwithstanding TAHE's negative retained earnings.

Scope of our work

Our accounting advice considered the requirements of the relevant financial and budgetary reporting frameworks, including but not limited to:

- Government Finance Statistics (GFS), specifically the Australian Bureau of Statistics (ABS) 'Australian System of Government Finance Statistics: Concepts, Sources and Methods' 2015
- requirements of relevant Australian Accounting Standards.

Our conclusions rely upon TAHE's projected financial information, which is inherently uncertain. Advice on accounting treatments does not include an assessment of the reasonableness of TAHE's projections nor do we warrant the projections will be achieved.

2 Scope of this report

2.1 Background

The NSW Government (the State) provides annual funding to the Transport Asset Holding Entity (TAHE) for the acquisition of heavy rail infrastructure.

2.2 Purpose of this report

The purpose of this report is to assist NSW Treasury with the application of the relevant financial and budgetary reporting framework to the NSW Government's annual funding amounts provided to TAHE for the acquisition of heavy rail infrastructure.

2.3 Scope

Noting the background and purpose, this report provides advice in relation to the accounting treatment of the State's capital funding to TAHE for the acquisition of non-financial assets.

Specifically, this report explores the following concepts and requirements under the relevant financial and budgetary reporting frameworks:

- what is meant by the term 'reasonable expectation of a sufficient rate of return on the investment'
- what constitutes returns in the GFS context
- what is meant by the term 'a claim on the residual value of the corporation'
- how asset revaluation increments and decrements impact on returns
- acquisitions of additional equity versus capital transfer expenses (i.e. amounts upon which a return is expected versus amounts upon which no return is expected)
- timeframes relevant to making GFS assessments of returns expectations.

Whilst the key considerations in undertaking this specific scope of work are the relevant requirements of the GFS framework, when considering the facts and circumstances, we have also had regard to the following in order to form conclusions:

- requirements of relevant Australian Accounting Standards
- legislative frameworks, including the *Government Sector Finance Act 2018*, *Transport Administration Act 1988* and the *State Owned Corporations Act 1989*
- material within relevant financial, budgetary and commercial policy frameworks published by NSW Treasury and other jurisdictions
- relevant precedents within New South Wales and other jurisdictions.

This report contains the following:

- an outline of relevant background information in respect of the State's heavy rail infrastructure funding arrangements
- an outline of factors and concepts relevant to the State's accounting treatment of funding to TAHE for the acquisition of non-financial assets, including:
  - requirements of the financial and budgetary reporting framework (i.e. Australian Accounting Standards, GFS and the State's accounting policies)
  - policies and conventions applied in other jurisdictions
  - relevant precedents
- application of the above factors and concepts to the State's circumstances relating to its annual funding to TAHE, including analysis and rationale for conclusions.

Limitations and exclusions of KPMG's scope

The scope of this report excludes:

- analysis of any accounting standard or pronouncement other than those listed in section 7
- valuation services and determination of asset revaluation increments or decrements
- disclosure requirements.

Please note, changing facts and circumstances could impact the findings and conclusions within our deliverable. Upon finalisation of this deliverable, we are under no obligation to revise it for future developments.

Our conclusions rely upon TAHE's projected financial information. Projections are future oriented, which makes them inherently uncertain. Accounting treatments consider expectations of future events. However, advice on accounting treatments does not include an assessment of the reasonableness of TAHE's projections nor do we warrant the projections will be achieved.

3 Applicable financial and budgetary reporting framework

3.1 Whole of government financial reporting

Part 7 Division 7.4 of the *Government Sector Finance Act 2018* (GSF Act) requires that the Treasurer prepare Consolidated State Financial Statements. These financial statements:

- must include consolidated financial statements for the Total State Sector (TSS)
- must include consolidated financial statements for the General Government Sector (GGS)
- be prepared in accordance with Australian Accounting Standards, including AASB 1049 *Whole of Government and General Government Sector Financial Reporting* (AASB 1049)
- present fairly the financial position, financial performance and cash flows for the TSS or GGS (as the case requires).

These financial statements are referred to as the Total State Sector Accounts (TSSA) by convention and are included in an annual Report on State Finances.

3.2 Budgetary reporting

Part 4 Division 4.1 of the GSF Act requires that the Treasurer prepare and present Budget Papers. These budget papers:

- must be prepared on a basis that covers the GGS
- must include aggregates that are prepared and presented in a format that is consistent with the Australian Accounting Standards.

In other words, the State's budgetary reporting framework is aligned with the State's financial reporting framework.

3.3 Government Finance Statistics

AASB 1049 specifies requirements for whole of government general purpose financial statements and General Government Sector (GGS) financial statements of each government[1]. The implementation of AASB 1049 sought to harmonise Government Finance Statistics and generally accepted accounting principles (GAAP)[2].

The term 'Government Finance Statistics' (GFS) refers to statistics that measure the financial activities of governments and reflect the impact of those activities on other sectors of the economy[3]. The Australian system of GFS is designed to provide statistical information on public sector entities in Australia, classified in a uniform and systematic way[4]. 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[5].

In Australia, the key document that outlines GFS principles and requirements is the Australian Bureau of Statistics' (ABS) publication *Australian System of Government Finance Statistics: Concepts, Sources and Methods 2015* (the ABS GFSM 2015). The ABS GFSM 2015 makes references to the *International Monetary Fund Government Finance Statistics Manual 2014* (IMF GFSM 2014).

AASB 1049 requires application of Australian Accounting Standards[6] to TSS and GGS consolidated financial statements. AASB 1049 further states that where compliance with the GFS would not conflict with Australian Accounting Standards, the principles and requirements of GFS must be applied.[7]

---

[1] AASB 1049.1
[2] AASB 1049.BC2-4
[3] ABS GFSM 2015, paragraph 1.1
[4] ABS '*Government Finance Statistics, Australia methodology*' available online at: https://www.abs.gov.au/methodologies/government-finance-statistics-australia-methodology/dec-2020#:~:text=The%20system%20of%20GFS%20provides%20details%20of%20revenues%2C,controlled%20by%20the%20Commonwealth%2C%20state%20and%20local%20governments. (ABS Government Finance Statistics, Australia methodology) 2020
[5] ABS Government Finance Statistics, Australia methodology 2020
[6] AASB 1049.9
[7] AASB 1049.13

4 Background, facts and assumptions

4.1 Background on TAHE

Transport reform

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.

In 2017, amendments to the *Transport Administration Act 1988* (TAA) established TAHE as a dedicated commercial asset manager for the NSW transport sector. TAHE has various legislated functions set out in the TAA, these functions include:

- to hold, manage, operate and maintain transport assets vested in or owned by it, or to be vested in or owned by it
- 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[8].

The second reading speech for the 2017 TAA amendments outlined the following points:

- the name and constitution of RailCorp will be changed so that RailCorp converts to a statutory State owned corporation (SOC) by the name of TAHE[9]
- a key legislative intent is for TAHE to manage the State's portfolio of transport assets "better and more commercially"[10]
- TAHE establishes new arrangements for transport asset management that reflect "modern governance and financial practices"[11]
- TAHE is aimed at enabling a "more effective, efficient and commercial approach to the management of transport assets, particularly property"[12]
- a dedicated asset holding entity, operating on commercial principles, will provide an "efficient base from which to optimise transport services outcomes"[13]

---

[8] *Transport Administration Act 1988*, Part 2 Division 2 section 11(1)
[9] Second reading speech to the *Transport Administration Amendment (Transport Entities) Bill 2017* <https://www.parliament.nsw.gov.au/bill/files/3378/2R%20Transport.pdf> (Second reading speech to the Transport Administration Amendment) page 2
[10] Second reading speech to the Transport Administration Amendment, page 1
[11] Second reading speech to the Transport Administration Amendment, page 1
[12] Second reading speech to the Transport Administration Amendment page 1
[13] Second reading speech to the Transport Administration Amendment, page 2

- 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 commercially"[14].

The aforementioned amendment to the TAA commenced on 1 July 2020 with the proclamation of Schedule 2 of the *Transport Administration Amendment (Transport Entities) Act 2017*. On that date, RailCorp was transitioned to TAHE.

TAHE's objectives

Under TAHE's enabling legislation, the principal objectives of TAHE are:[15]

- 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[16].

The *State Owned Corporation Act 1989* (SOC Act) constitutes TAHE as a statutory SOC. The SOC Act sets out the principal objectives of all statutory SOCs[17]. 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.

TAHE is required under the SOC Act to prepare and submit a statement of corporate intent (SCI) to its voting shareholders.[18]

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. NSW Treasury's Commercial Policy Framework applies to TAHE.[19]

---

[14] Second reading speech to the Transport Administration Amendment, page 3
[15] *Transport Administration Act 1988*, Part 2 Division 2 section 10(1)
[16] *Transport Administration Act 1988*, Part 2 Division 2 section 10(2)
[17] *State Owned Corporations Act 1989*, Part 3 Division 2 section 20E
[18] *State Owned Corporations Act 1989*, Part 4 section 21
[19] https://www.treasury.nsw.gov.au/information-public-entities/government-businesses/commercial-policy-framework, which confirms that the Framework applies to Government businesses

The Framework outlines expectations about distributions to shareholders[20], with TPP 16-04 Financial Distribution Policy for Government Businesses providing flexibility to the shareholders around expectations of dividends.[21]

The Framework also includes policy requirements[22] in respect of two tax equivalent regimes, the State Tax Equivalent Regime (TER) and the National Tax Equivalent Regime (NTER). As detailed in TPP21-04, the State TER applies a tax rate to accounting profit and the NTER notionally applies Federal income tax laws to selected government business entities[23].

The NSW Government's annual funding to TAHE

In accordance with the financial and budgetary reporting framework, the GGS balance sheet includes a financial asset that represents the State's equity interest in the Public Non-Financial Corporation (PNFC) Sector. This equity interest entitles the holder to ownership distributions as well as a right to the residual assets of the PNFC entities, should any be wound up.

The NSW Government provides annual funding to TAHE for the acquisition of heavy rail infrastructure. Since 2015, such amounts have been recorded in the GGS balance sheet as the acquisition of additional equity in the PNFC Sector.[24] Prior to 2015, capital funding provided was expensed by the State and recorded as an expense in the GGS operating statement. The change in treatment corresponded with a stated intention to effect reforms in heavy rail infrastructure management, including establishment of a SOC that would provide returns to its shareholders.

TAHE access charges and impacts

On 30 June 2021, TAHE executed new commercial arrangements with Sydney Trains and NSW Trains (collectively, the Rail Operators) to facilitate access charges in respect of TAHE's assets used by the Rail Operators. These new arrangements replaced previous 'peppercorn' arrangements that were a legacy of the not-for-profit RailCorp.

Expectations of TAHE's financial performance

Based on the implementation of commercial access pricing, it is anticipated that TAHE will record a profit in the 2021-22 financial year and will continue to record profits thereafter. Based on expectations of profitability, there is also an expectation that TAHE will remit distributions to shareholders in the form of dividends and tax equivalent payments.

Profitability expectations take into account cash and non-cash expenses, including depreciation. Depreciation is a function of TAHE's property, plant and equipment carrying

---

[20] TPP 16-04 Financial Distribution Policy for Government Businesses
[21] TPP 16-04 Financial Distribution Policy for Government Businesses, pages 2-3
[22] TPP21-04 Tax Equivalent Regime Policy and Guidelines Paper
[23] TP TPP21-04 Tax Equivalent Regime Policy and Guidelines Paper
[24] NSW Budget Statement 2015-16, Budget Paper No.1, Chapter 2, 2-1

value. TAHE applies the revaluation model to its property, plant and equipment assets and measures them at fair value.

At 30 June 2021, TAHE applied an income approach to estimating the fair value of its property, plant and equipment assets. TAHE has previously applied a cost approach (current replacement cost or 'CRC') to estimating fair value. The execution of commercial access agreements with the Rail Operators generated information suitable for use in an income approach (e.g. discounted cash flow (DCF)

The change in fair value estimation technique resulted in a significant, one-off reduction in the carrying value of TAHE's property, plant and equipment assets.

5 Accounting framework

Both the ABS GFSM 2015 and IMF GFSM 2014 (collectively the GFS framework) contain literature relevant to the accounting treatment of a government's financing of the acquisition of non-financial assets in a public corporation. This section outlines key requirements of the GFS Framework as relevant to the scope of this advice.

5.1 Overview of GFS treatment of capital injections

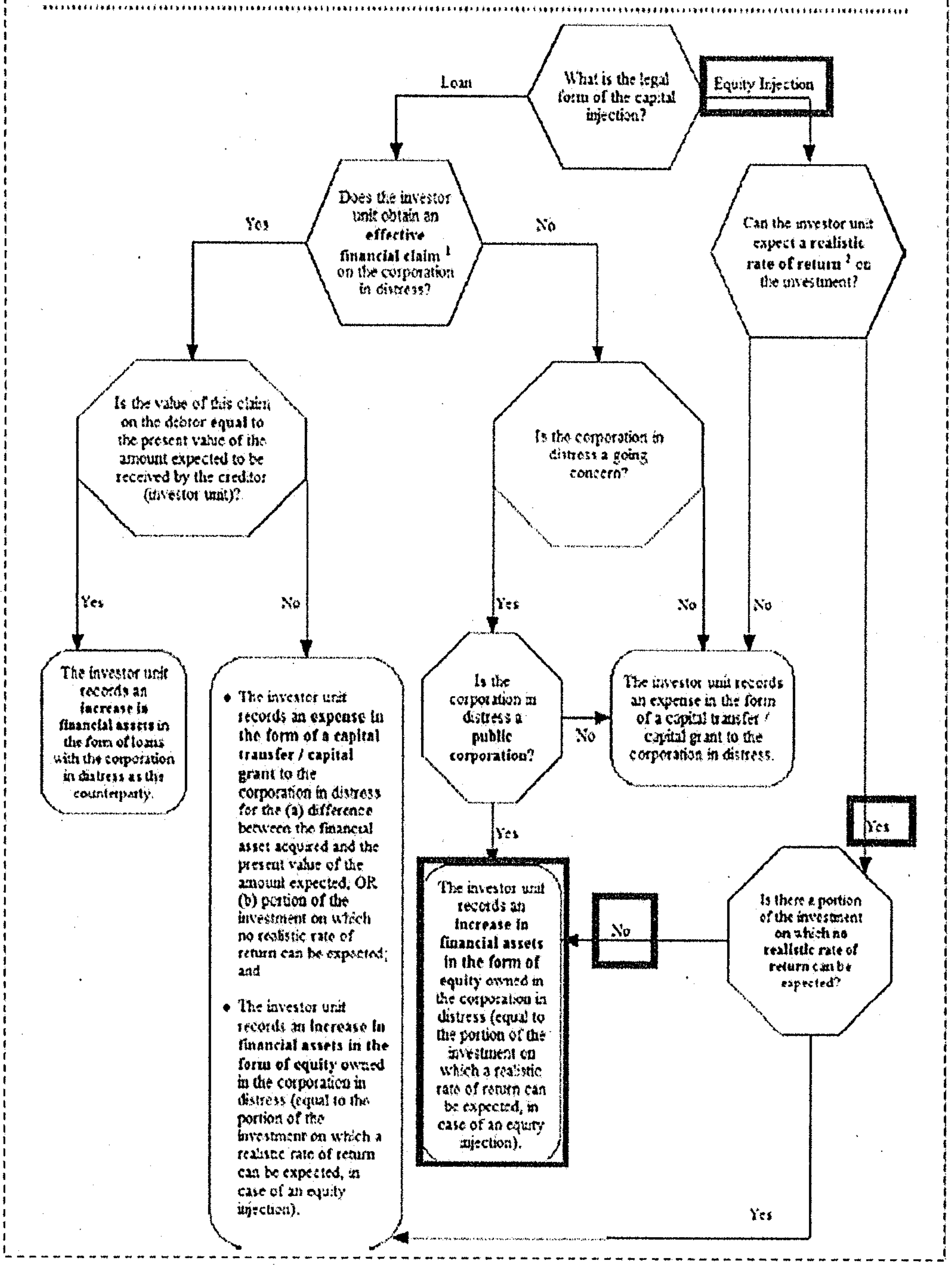
On the topic of capital injections from general government to public corporations, the ABS 2015 GFSM sets out the following:

> *"If government makes a transfer to a public corporation to finance all (or part) of the costs to finance its acquisition of non-financial assets, this also is recorded as equity unless there is no reasonable expectation of a sufficient rate of return on the investment, in which case the transfer is recorded as capital transfer expenses not elsewhere classified"*[25]
>
> *"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"*[26].

The ABS GFSM 2015 expresses these requirements using the following decision tree:

[25] ABS GFSM 2015, paragraph 10.49, emphasis added
[26] ABS GFSM 2015, paragraph 13.63

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



Source: ABS GFSM 2015, page 275, Diagram 13.3

5.2 Reasonable expectation of a sufficient rate of return on the investment

A 'sufficient' (or 'realistic' – the ABS GFSM 2015 uses the terms interchangeably within the context of this topic) rate of return on the investment under GFS is further explained as follows:

> *"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 includes a claim on the residual value of the corporation".*[27]

5.3 What constitutes returns under GFS?

As previously set out, ABS GFSM 2015 states that a realistic rate of return on funds is indicated by both:

- the intention to earn a rate of return that is sufficient to generate dividends or holding gains[28]
- a claim on the residual value of the corporation.[29]

These relevant components of a realistic rate of return on funds are explored in the following sections.

Dividends under GFS

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"*[30].

Further, the IMF GFSM 2014 specifies that dividends form part of a government's expected returns[31].In addition, the ABS GFSM 2015 notes that *"the concept of dividends includes income from dividends to public enterprises from subsidiaries; dividends from shares held as investments in private and public corporations; transfers of income from public non-financial corporations and public financial corporations...and issues of shares as a dividend."*[32]

[27] ABS GFSM 2015 paragraph 13.63, IMF GFSM 2014, paragraph A3.49
[28] ABS GFSM 2015, paragraph 1.11, IMF GFSM 2014, pages 302-303.
[29] ABS GFSM 2015, paragraph 13.63
[30] ABS GFSM 2015, paragraph 6.130, emphasis added
[31] IMF GFSM 2014, page 134, box 6.3, IMF GFSM 2014, page 302, footnote 14, page 303, IMF GFSM 2014, figure A3.2
[32] AASB GFSM 2015, paragraph 6.131, emphasis added

It is noted that NSW Treasury's Commercial Policy Framework (the Framework or CPF) applies to TAHE[33] and that this Framework outlines expectations about distributions to shareholders. The existence of expectations of a return is informed by the application of the Framework but the Framework does not determine the accounting treatment of returns nor does it prescribe requirements for the accounting treatment of funding provided to TAHE. Accounting treatments are determined with reference to the financial and budgetary reporting framework, which includes AASBs and GFS requirements.

Under GFS, income tax equivalents (like dividends) are regarded as a form of property income that is accrued as a result of ownership of financial assets[34] (in this case a shareholding in TAHE).

Holding gains

The IMF GFSM 2014 specifies that holding gains form part of a government's expected returns[35].

The ABS GFSM 2015 defines holding gains as:

> *"Holding gains and losses (sometimes referred to as revaluations in GFS) are defined as changes in the current market 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"*[36].

In accordance with the requirements of the financial and budgetary reporting framework, the GGS records an investment in government-controlled entities that are within the PNFC sector (including in TAHE) as an asset in the GGS statement of financial position[37].

This asset is measured as the government's proportional share of the net assets of the PNFC sector[38]. A change in the carrying amount of the asset over the reporting period that does not arise from the government acquiring or disposing of an interest or undistributed dividends is classified as a gain or loss in accordance with AASB 9 *Financial Instruments* and included in other comprehensive income.[39] [40]

Items in other comprehensive income are presented as 'other economic flows' for GFS purposes[41]. Under GFS, there are two major categories of 'other economic flows'. These are:

---

[33] https://www.treasury.nsw.gov.au/information-public-entities/government-businesses/commercial-policy-framework, which confirms that the Framework applies to Government businesses
[34] ABS GFSM 2015, paragraph 6.125
[35] IMF GFSM 2014, page 302, IMF GFSM 2014, Footnote 14, IMF GFSM 2014, page 303, Figure A3.2
[36] ABS GFSM 2015, paragraph 11.3
[37] AASB 1049, paragraph 20
[38] NSW Total State Sector Accounts 2019-2020: Audited Consolidated Financial Statements of the NSW General Government and Total State Sectors, Note 1: Statement of Significant Accounting Policies, page 4-19
[39] NSW Total State Sector Accounts 2019-2020: Audited Consolidated Financial Statements of the NSW General Government and Total State Sectors, Note 11: Equity Investments, page 4-61
[40] AASB 1049, paragraph 22
[41] NSW Total State Sector Accounts 2019-2020: Audited Consolidated Financial Statements of the NSW General Government and Total State Sectors, page 4-11

- 'holding gains and losses': in short, these are changes in the monetary value of assets or liabilities resulting from changes in prices[42]
- 'other changes in the volume of assets and liabilities' (also known as 'other volume changes'): these changes result from events that change the quality and quantity of existing assets and liabilities, and include where there is a change in the use or purpose of an asset[43]; the ABS GFSM 2015 also states that changes resulting from reclassifications of pre-existing assets or liabilities are included in other volume changes[44].

As previously outlined, holding gains (and losses) are included in the GFS assessment of expectation of returns[45]. However, other volume changes are a different type of GFS transaction to holding gains and are not included in GFS assessment of expectation of returns.

The ABS GFSM 2015 sets out that only dividends (including tax equivalents) and holding gains are included in the concept of returns; other volume changes are not included in this definition. As such, any transaction that meets the definition of an 'other volume change' under GFS is excluded from any GFS assessment of expectation returns[46].

Claim on the residual value of the corporation

As the ABS GFSM 2015 notes above, a realistic return on funds also includes a claim on the residual value of the corporation.[47] On the topic of a claim on the residual value of the corporation the ABS GFSM 2015's definition of equity provides further guidance on this concept:

> *"Equity including contributed capital...record the current market value of equity...in the form of financial assets... and liabilities. Equity refers to claims on other entities, which entitle the holder to a share of the income of the entity and a right to a share of the residual assets of the entity, should it be wound up."*[48]

In addition, the ABS GFSM 2015's definition of holding gains and losses on equity highlights how this applies in practice when dealing with equity in public corporations:

> *"Public sector units hold financial assets (or liabilities) representing equity including contributed capital in PNFCs, PFCs and possibly in private sector entities. For listed entities, the current market value of equity is the number of shares held by the public sector unit multiplied by the market price of each share. Increases and decreases in the current market value results in holding gains or losses on equity held in listed entities. Since there is no current market value for the equity of unlisted entities, this value is set to be equal to the assets less liabilities of the entities in question, since in the event of being folded up, this 'residual' is what the owner unit has a claim over."*[49]

---

[42] ABS GFSM 2015, paragraph 11.3
[43] ABS GFSM 2015, paragraph 11.9 – 11.11
[44] ABS GFSM 2015, paragraph 11.10
[45] ABS GFSM 2015, paragraph 8.27
[46] ABS GFSM 2015, paragraph 8.28
[47] ABS GFSM 2015, paragraph 13.63
[48] ABS GFSM 2015, paragraph 8.169
[49] ABS GFSM 2015, paragraph 11.44

5.4 Timing of GFS returns

The ABS GFSM 2015 states that a rate of return is required sufficient to generate dividends or holding gains 'at a later date'[50]. In other words, there is no specific timeframe articulated in the ABS GFSM 2015 in respect of the return.

The IMF GFSM 2014 is consistent with this lack of specificity; it 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 its equity) and expecting to earn a sufficient rate of return on its investment
- that treatment of such payments depends on evidence of the corporation's profitability and its ability to pay dividends in the future[51].

The ABS GFSM 2015 refers to 'at a later date' and the IMF GFSM refers to 'in the future'. Neither prescribes a timeframe in which returns must occur; each is focused on events subsequent to the provision of funds.

[50] ABS GFSM 2015, paragraph 13.63, page 274, note 2
[51] IMF GFSM 2014, page134, box 6.3, page 302, footnote 14, page 303, figure A3.2

6 Analysis

6.1 Accounting treatment of the NSW Government's funding to TAHE

The NSW's Government's funding to TAHE is provided for the purpose of acquiring non-financial assets, being heavy rail infrastructure. This funding can be considered a transfer under GFS. GFS defines a transfer as a transaction in which one institutional unit provides a good, service, or asset to another unit without receiving from the latter any good, service, or asset in return as a direct counterpart.[52]

GFS treatment of transfers to public corporations

The ABS GFSM 2015 is clear on how a transfer from government to a public corporation is recorded.

> *"If government makes a transfer to a public corporation to finance all (or part) of the costs to finance its acquisition of non-financial assets, this also is recorded as equity <u>unless</u> there is no reasonable expectation of a sufficient rate of return on the investment, in which case the transfer is recorded as capital transfer expenses not elsewhere classified"*[53]

The above extract from the ABS GFSM 2015 effectively establishes two key principles that are relevant to determining the accounting treatment of transfers to TAHE from the NSW Government.

- The 'default' accounting treatment for government transfers to a public corporation to finance the acquisition of non-financial assets is to record such transfers as an acquisition of equity in the corporation.
- Transfers to finance the acquisition of non-financial assets by the public corporation are only treated as an expense by government where there is no reasonable expectation of a sufficient rate of return on the investment[54].

Following these principles, unless there is no reasonable expectation of a sufficient rate of return on funding provided, the funding provided to TAHE to finance the acquisition of non-financial assets is recorded by the GGS as an increase in the GGS's investment in the PNFC sector.

An exception to this 'default' treatment as an acquisition of equity occurs if there is no reasonable expectation of a sufficient rate of return in respect of the transfer. Were this circumstance to exist, under GFS, the transfer to TAHE is recorded as a capital transfer i.e. as an expense from transactions by the GGS. The pertinent question becomes whether

---

[52] ABS GFSM 2015, paragraph 3.15, IMF GFSM 2014, paragraph 3.10
[53] ABS GFSM 2015, paragraph 10.49, emphasis added
[54] ABS GFSM 2015, paragraph 10.49, 13.63

there is no reasonable expectation of a sufficient rate of return in relation to the annual funding to TAHE. If so, the 'rebuttable presumption' that the transfer is recorded as an acquisition of additional equity in TAHE would be rebutted, and the funding would be expensed.

Reasonable expectation of a sufficient rate of return

To assess whether there is no reasonable expectation of a sufficient rate of return on funding provided to TAHE, it is necessary to consider the application of the following statement in the GFS framework:

> *"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 includes a claim on the residual value of the corporation"*[55].

The ABS GFSM 2015 defines dividends and holding gains[56]. However, it provides more limited direction on the meaning of the balance of the above description of a realistic rate of return on funds.

The above extract regarding a realistic rate of return is the extent of guidance provided by the ABS GFSM 2015 to explain this concept[57]. Neither the ABS GFSM 2015 nor the IMF GFSM 2014 provide application guidance, worked examples or a basis for conclusions (such as those commonly seen in appendices to Australian Accounting Standards), nor do they provide any 'bright lines' or minimum benchmarks in relation to the concept of "sufficiency". As such, it is necessary to apply judgement when applying this concept of the GFS framework.

Application of judgement

In our experience, there is no typical fact pattern when assessing the treatment of transfers to public corporations to finance the acquisition of non-financial assets. Each instance must be evaluated on a case-by-case basis, having regard to the specific circumstances and by using judgement to apply the requirements of the GFS framework

Application of judgement when applying GFS requirements requires an assessment of the relevant facts, circumstances and broader context. A relative scarcity of transfers to public corporations means there is limited evidence around application of this aspect of the GFS framework by NSW and by other Australian jurisdictions. To the extent that there are transactions with analogous fact patterns, these can be useful in assisting with exercising judgement.

Judgement is applied to the various limbs of the GFS requirements. As previously outlined, 'realistic' return on an 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

---

[55] ABS GFSM 2015 paragraph 13.63, IMF GFSM 2014, paragraph A3.49
[56] ABS GFSM 2015, paragraph 6.130
[57] ABS GFSM 2015, paragraph 13.63, IMF GFSM 2014, paragraph A3.49

- a claim on the residual value of the corporation[58].

In order to assess whether the exception to the 'default' accounting treatment applies, the above criteria are specifically considered in turn. The following sections of this report consider the criteria in the context of annual funding to TAHE for the acquisition of heavy rail infrastructure and further explore other relevant considerations arising from the frameworks that relate to the accounting treatment of this annual funding transaction. .

6.2 What is included in GFS assessment of expectation of returns?

Having regard to the previously outlined requirements of the GFS framework, the following types of transactions constitute returns from TAHE to the GGS:

- dividends paid by TAHE to shareholders
- payments made by TAHE under the tax equivalent regimes
- a claim over the residual value of TAHE, were it to be wound up
- holding gains (both realised and unrealised).

The following sections consider each of the components of returns, including identification of factors relevant to exercising judgement in the context of the accounting treatment of annual funding to TAHE for the acquisition of heavy rail infrastructure.

Dividends from TAHE

The ABS GFSM 2015 clarifies that it considers dividends to consist of *"distributed earnings allocated to government or public sector units (as the owners of equity)"*[59]. TAHE is expected to remit dividends from profits to its shareholders. Such dividends are included in the GFS assessment of expectation of returns.[60]

Tax equivalent payments from TAHE

As set out above, in the context of GFS, tax equivalent payments are included in assessment of expectation of returns[61].

TAHE is currently subject to the TER, which applies a tax rate to accounting profit. Accordingly, to the extent that TAHE is profitable, it will be required to remit tax equivalent payments. Following the GFS requirements, these payments form part of the return that would be expected upon funding provided to TAHE for the acquisition of non-financial assets.

We note that financial distributions in the context of TPP 16-04 exclude tax equivalent payments[62]. The intention of TPP 16-04 is to subject government businesses to the discipline of making dividend and capital repayments[63]. This intention reflects the overall objective of the Commercial Policy Framework. Characterisation of payments under the

---

[58] ABS GFSM 2015, paragraph 13.63, IMF GFSM 2014, paragraph A3.49
[59] ABS GFSM 2015, paragraph 6.130
[60] ABS GFSM 2015, paragraph 13.63, IMF GFSM 2014, paragraph A3.49
[61] ABS GFSM 2015, paragraph 6.130
[62] TPP 16-04, page 2
[63] https://www.treasury.nsw.gov.au/information-public-entities/government-businesses/commercial-policy-framework

NSW specific policy framework designed to support financial discipline is not relevant to the treatment of the payments under GFS.

There are various examples in which the Commercial Policy Framework characterisation diverges from GFS. Another example would be a dividend paid by a SOC using proceeds from the sale of an asset or business. Such 'dividends' in a Commercial Policy Framework context are frequently treated as holding gains for GFS purposes. Accordingly, the GFS criteria prevails.

Holding gains

As previously outlined, holding gains are included in assessment of expectation of returns[64]. Holding gains may be realised or unrealised. In the context of TAHE, holding gains could include:

- Repatriations of proceeds from the sale of assets via a one off dividend. Whilst referred to as a dividend in the context of TAHE's financial reporting and the Commercial Policy Framework, such distributions are treated as holding gains for GFS purposes[65]. As a result, this type of 'dividend' is recorded as an other economic flow within the TSSA.
- Distributions of surplus cash via dividend or a return of capital. TAHE is expected to incur significant non-cash expenses in the form of depreciation, which means it will generate a degree of 'free cash flow' over and above its profit. Shareholders could seek repatriation of this cash via various mechanisms in accordance with the Commercial Policy Framework. Depending upon the circumstances, such repatriations could be classified as holding gains.

A movement in the net assets of TAHE that arises from an asset revaluation can also be classified as a holding gain or loss. Appendix 1 explores this aspect of holding gains in more detail.

At this stage, whilst there exists the potential for repatriation of 'surplus' cash, no firm expectations of holding gains have been established. Any future holding gains from TAHE would need be factored in subsequent GFS assessments of expectation of returns undertaken by NSW Government.

Impact of any TAHE asset revaluation on holding gains and GFS assessment of expectation of returns

Any asset revaluation increment or decrement that arises due to a change in the valuation technique that is appropriate for TAHE's assets (e.g. if it becomes appropriate for TAHE's assets to change from a CRC to DCF valuation technique, or vice versa) would:

- be considered an 'other volume change' under GFS
- would not meet the definition of a holding gain or loss under GFS
- would not be included in the assessment of returns to the GGS from TAHE.

[64] ABS GFSM 2015, paragraph 13.63
[65] ABS GFSM 2015, paragraph 11.3

For example, if TAHE changed the valuation technique for the majority of its assets from a CRC approach to a DCF approach for its 2020-21 period. the resulting write-down would be due to this change in valuation technique. As such, under GFS, this write-down constitutes an 'other volume change', meaning it does not result in a holding loss (and therefore is not included in a GFS assessment of expectation of returns).

Refer to Appendix 1 of this report for further details on the impacts of asset revaluations in the GFS context.

Claim on the residual value of the corporation

As previously outlined in the Accounting Framework section of this report, an expectation of a realistic return on funds also includes a claim on the residual value of the corporation.[66]

As a statutory SOC, TAHE's sole shareholder is the GGS, via the appointed shareholders. In the case of TAHE, the voting shareholders are the Treasurer and the Minister for Finance and Small Business[67] who hold equal shares and rights.[68]As the only 'shareholder' of TAHE, the GSS has a right to a share of the residual assets (i.e. 'net assets') of TAHE, were it to be wound up. This gives the NSW Government a clear expectation of one of the components included in the GFS assessment of expectation of returns from TAHE, irrespective of the future financial performance of TAHE.

We have considered the practices of other jurisdictions. Whilst not publicly stated, we understand that, in other jurisdictions, transfers to PNFC entities for the purposes of acquisition of non-current assets are recorded as acquisitions of additional equity on the basis that there is always an expectation of return to the GGS, in the form of the GGS' residual interest in the net assets of the entity. The effect of this position is that in those jurisdictions, even transfers to not-for-profit PNFC entities are recorded by the GGS as acquisitions of additional equity.

It is understood that the rationale behind such practices is that, as sole 'shareholder', the GGS will always be able to obtain a return from the residual interest in PNFC entities (which by virtue of their PNFC classification, are deemed to be market producers and therefore have income producing assets).

6.3 Expectation of returns

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 transfer to a public corporation in order for the transfer to be recorded as an acquisition of equity. Rather, both the ABS GFSM 2015 and IMF GFSM 2014 specify that the treatment depends on whether a realistic return can be expected on the investment or not, noting that the following are indicators of such a return:

---

[66] ABS GFSM 2015, paragraph 13.63
[67] https://www.treasury.nsw.gov.au/information-public-entities/government-businesses/state-owned-corporations
[68] NSW State Owned Corporations Act 1989, section 20H

- 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[69].

As previously set out, the residual claim criterion in respect of the NSW Government and its investment in TAHE is satisfied.

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 that there is an intention that the entity will make enough of a return to be able to pay dividends, or create holding gains. Thus, a key focus is 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.

Intention to generate returns

In considering the matter of 'intention', the following factors indicate that such an intention exists:

Establishment of appropriate legal and governance structure for generating returns

- The Government has articulated (via a second reading speech for amendment to legislation to establish TAHE) that:
  - 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[70].
- TAHE's objectives (enshrined in legislation) include 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[71].
- Having regard to the precedent set by other SOCs, establishment as a SOC indicates an expectation of for-profit status for TAHE. The TAHE Board has determined TAHE is for-profit for accounting purposes.
- As a SOC, the CPF 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. It follows that application of the CPF to TAHE indicates an intention to generate returns.

The factors outlined above demonstrate that TAHE's legal and governance structure is aligned with an intention to generate returns. The legal and governance structure also reflects the decisions and intentions of the Government. In other words, the Government has introduced legislation, established a legal and governance structure and applied

---

[69] ABS GFSM 2015, paragraph 13.63, IMF GFSM 2014, page134, box 6.3, page302, footnote 14, page 303, figure A3.2
[70] Second reading speech for Transport Administration Amendment, page 1
[71] *Transport Administration Act 1988*, Part 2 Division 2 section 10(1)

commercial disciplines, all of which enable generation of returns. It seems reasonable to conclude that Government's actions reflect its intentions.

Projected returns

Consistent with establishing TAHE with the appropriate structure to enable it to generate returns in the form of dividends for GFS purposes, current expectations are that TAHE will generate returns.

Based on modelling[72] that factors in the implementation of commercial access pricing, TAHE's 2020-21 revaluation, and TAHE management's commercial plan, it is anticipated that TAHE will record a profit in the 2021-22 financial year and will continue to record profits thereafter. Based on expectations of profitability, there is also an expectation that TAHE will remit distributions to shareholders in the form of dividends and tax equivalent payments.

TAHE's 2021-24 SCI (TAHE SCI) sets outs TAHE's financial and non-financial performance objectives. TAHE's SCI states that *"TAHE has established financial measures to guide our business through its strategic journey through FY22. These measures focus on building a strong foundation over the long-term to build a financial sustainable business."*[73]

TAHE's SCI specifically sets out financial key performance indicators (KPIs), which include what TAHE describes as "Returns to Government". TAHE's SCI states that its 'Returns to Government' include:

- 'Ordinary Dividends'
- 'Other returns to Government' – consisting of Government Guarantee Fees, land tax and income tax payable to Government.[74]

Within 'other returns', income tax payable will form part of the return for GFS purposes.

[FINAL SPECIFIC TARGET FINANCIAL KPIS TO BE INCLUDED ONCE SCI FINALLY ENDORSED – BELOW WORDING IS PLACEHOLDER BASED ON CONTENT IN PRELIMINARY SCI, TO DEMONSTRATE THAT POSITIVE RETURNS TO GOVT IS TARGET OF TAHE]

TAHE's SCI demonstrates that in each financial year of the SCI period (i.e. 2021-22, 2022-23 and 2023-24) its financial KPIs include specified targets for:

- positive 'Ordinary Dividends'
- positive 'Other returns to Government'.

---

72 'Modelling' refers to various activities undertaken by NSW Treasury and TAHE management, and includes the following outputs:

- "Treasury Budget Estimates – Returns.xlsx", emailed 24 June 2021
- "TAHE GFS returns audit evidence workbook_DRAFT.xlsx", emailed 24 June 2021
- "Treasury Budget Estimates – TAHE asset valuation.xlsx", emailed 24 June 2021
- "Statement of Corporate Intent 2021-24 – Transport Asset Holding Entity of NSW (Preliminary for Board Endorsement, 29 July 2021"

73 Statement of Corporate Intent 2021-24 – Transport Asset Holding Entity of NSW (Preliminary for Board Endorsement, 29 July 2021), Shareholder Agreement

74 Statement of Corporate Intent 2021-24 – Transport Asset Holding Entity of NSW (Preliminary for Board Endorsement, 29 July 2021), Financial Performance Indicators

Financial performance information in SCIs represents an agreed target. On the basis that the financial performance information is supported with underlying commercial arrangements, the SCI content demonstrates an expectation of returns for GFS purposes.

We note that TAHE is expected to have negative retained earnings and that the Commercial Policy Framework addresses such circumstances. TPP 16-04 TPP 16 04 states that shareholders may specify further business specific considerations which must be considered when determining the dividend.[75] In practice, this broadens the circumstances in which management decides to pay a dividend from a presumption that dividends are paid based on profits or retained earnings' balance. For example, it is possible to specify that surplus cash in a SOC is repatriated to shareholders via distributions, regardless of the retained earnings balance of the entity.

[FINAL SPECIFC WORDING IN RELATION TO BELOW TOPIC TO BE UPDATED ONCE FINAL SCI ENDORSED – BELOW IS BASED ON DRAFT WORDING WE HAVE SEEN FROM TSY COMMERCIAL ASSETS TEAM, BUT WE HAVE NOT SEEN INCORPORATED IN TO TAHE SCI DRAFT YET]

We note that TAHE's SCI includes the following statement:

"TAHE is a heavy rail entity earning significant access and license fees in respect of TAHE's assets through its commercial arrangements. TAHE's negative retained earnings position in FY22 is the result of a one-off accounting adjustment in relation to asset valuations, and this adjustment should not preclude TAHE from paying dividends. TAHE have consulted with Treasury and confirm that it will focus on maintaining cash flows, ensuring that it will be able to pay the dividends set out in this SCI."[76]

TAHE has been established with a legal and governance structure that enables and promotes generation of returns to Government. Further, TAHE has provided Government with evidence of projected returns. It is our view that the combination of these factors point to an inherent presumption of intent that would need to be rebutted. Accordingly, we now consider the matter of "sufficiency".

Implications of any future changes in intentions or expectations

It is possible that the intentions or expectations that existed in the past could change in the future. This point is not made to speculate about Government's plans; it is made simply to explore the relevant requirements of the financial and budgetary reporting framework.

If the NSW Government's intentions or expectations relating to TAHE were to change in the future, this does not mean past intentions or expectations were an error. It means there has been a change in intention or expectation. If intentions or expectations change, there may be a requirement to treat all or part of any future funding to TAHE as a capital transfer.

Such circumstances would not mean that prior annual funding amounts that were recorded as an acquisition of equity need to also be expensed, nor does it mean that prior years financial statements need to be restated. This outcome is due to the fact that when past

---

[75] TPP 16-04, page 3

[76] [76] Statement of Corporate Intent 2021-24 – Transport Asset Holding Entity of NSW (Preliminary for Board Endorsement, 29 July 2021), SECTION

annual funding amounts were recorded as equity, it was a matter of fact that the NSW Government had an intent and the expectation to obtain returns from TAHE.

AASB 108 explicitly states that hindsight should not be used in such circumstances:

> *"Hindsight should not be used when...correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period"*[77].

Given the requirements of AASB 108, a restatement of a prior year's acquisition of additional equity in TAHE would only be required if there was an error of fact. That is, where new evidence came to light that demonstrates that the fact was, that at the time of the capital transfer, there was no intention or expectation of generating a return on that funding.

Given the requirements of AASB 108 that prohibit the use of hindsight when making assumptions about management's intentions, a future change in intention or expectation would affect future accounting treatments in respect of future capital funding amounts and would not affect past accounting treatments.

6.4 'Sufficiency' of expected returns

As noted previously, neither ABS GFSM 2015 and IMF GFSM 2014 provides a "bright line" as to what constitutes "sufficient". 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 in its published accounting policies, 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.

A Department of Finance document *"Finance Advice Paper, Q&A – Equity Investments"* (DoF Paper) 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. <u>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.</u> 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"*[78].

---

[77] AASB 108, paragraph 53
[78] Department of Finance Advice Paper – Q&A – Equity Investments (emphasis added)

The Parliamentary Budget Office, Alternative Financing of Government Policies, Report No.01/2020 (PBO Report) produced by the Commonwealth 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"*[79].

In other words, the Commonwealth view is that as long as the investment in the entity will generate a return that beats inflation, the investment should be recorded as an acquisition of additional equity.

Having regard to the above factors and relevant requirements of the ABS GFSM and practices of the Commonwealth, in our view, the pertinent question in terms of 'sufficiency' of return on each annual capital funding amount provided to TAHE, is whether there is an expectation of additional incremental returns (which include dividends, tax equivalent payments, holding gains and residual claims) from TAHE in the future, as a result of the additional funding amount provided in that particular year.

6.5 Rate of expected returns

The expression of returns occurs as a rate, which infers that it is necessary to consider the return in the context of the capital transfer or funding provided.

> *"A realistic rate of return on funds is indicated by the intention to earn a <u>rate of return</u> that is sufficient to generate dividends or holding gains at a later date, and includes a claim on the residual value of the corporation".*[80]

As set out in section 5, the GFS treatment of amounts transferred by a government to a public corporation depends on expectation of returns. A pertinent question is therefore exactly which amounts provided to TAHE should be assessed in the context of an expectation of returns, and which amounts such be excluded from this assessment. In answering this question, it is useful to consider practices in other jurisdictions, as well as the GFS principles, requirements and relevant guidance.

The Commonwealth has published relevant material. Appendix D PBO Report states that:

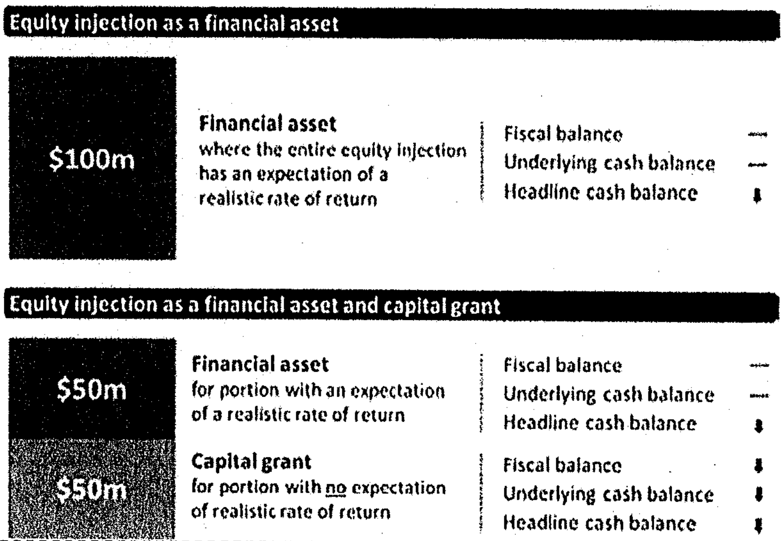
> *"According to the GFS, an equity injection in a corporation results in a financial asset on the balance sheet if 'a realistic return' is expected from the investment. Where the equity injection, or a portion of it, does not have an expectation of a realistic rate of return, the equity injection (or the relevant portion of it) is treated as a capital grant"*[81].

Appendix D of the PBO Report illustrates this concept diagrammatically, as follows:

---

[79] Parliamentary Budget Office, Alternative Financing of Government Policies, Report No.01/2020, Pg 3 Footnote 3
[80] ABS GFSM 2015 paragraph 13.63, IMF GFSM 2014, paragraph A3.49 emphasis added
[81] 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]



In addition, the DoF Paper describes this same approach to apportioning a capital injection between equity and grant, based on return expectations:

> *"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"*[82].

The ABS GFSM 2015 specifies that if a realistic return can be expected on the investment, an increase in financial assets in the form of equity is recorded[83]. 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)[84]. GFS makes clear via the decision tree (Diagram 13.3) that this is a test applied to the investment i.e. the equity contributed, and it is not necessary to consider returns on other amounts for which there was no expectation of return (i.e. those previously expensed).

Similarly, the Commonwealth, when articulating how they assess whether a funding injection should be recorded as equity, compare the expected returns with the current

---

[82] Department of Finance Advice Paper – Q&A – Equity Investments (emphasis added)
[83] ABS GFSM 2015, paragraph 13.63
[84] ABS GFSM 2015, paragraph 13.63-13.64, IMF GFSM 2014, paragraph A3.49

values of cumulative equity injections provided by the government.[85] Figure D1 (above) sets out in a diagram that amounts upon which no return is expected are treated as a capital grant. 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.

In the case of TAHE, it is noted that prior to 2015, funding injected for the acquisition of heavy rail infrastructure was expensed (not recorded as equity), as there was no expectation of a return.[86] In our view, and having regard to relevant GFS literature and relevant guidance from the Commonwealth above, the pre-2015 funding that was expensed by the GGS already should not be included in the amount upon which a return is expected by the GGS. This is because these funding amounts were already expensed by the GGS, and their inclusion within this amount would result in the GGS 'double-counting'.

Given the practice adopted by the Commonwealth, and having regard to TAHE circumstances, the following types of transactions would be included in the amount upon which a return is expected:

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

6.6 Timing of expected returns

The GFS framework requires management to consider whether there is an expectation of returns '<u>at a later date</u>'. This has implications for determining whether the funding amount to TAHE should be recorded as an acquisition of additional equity of expensed as a capital transfer.

The ABS GFSM 2015 does not prescribe a timeframe in which returns are expected. As noted in section 5, GFS publications reference returns being generated subsequent to the provision of funding, but do not clarify how much later. In the circumstances, judgement is required.

Timeframe over which returns are achieved

In assessing relevant timeframes, 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.

---

[85] https://www.finance.gov.au/publications/advice-paper/qa-equity-investments, p.2, Parliamentary Budget Office, Alternative Financing of Government Policies, Report No.01/2020, p.18, 3.1, Note, p19
[86] NSW Budget Statement 2015-16, Budget Paper No.1, Chapter 2, 2-1

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:

- NBN Co Limited (NBN) - a Commonwealth Government Business Enterprise (GBE). Since its establishment, NBN has received close to $30 billion in funding from the Commonwealth Government. This Commonwealth Government funding to NBN has been recorded by the Commonwealth Government GGS as an acquisition of equity in NBN.[87] [88] NBN has incurred losses since inception[89]. The following extract from NBN's financial statements for the year ended 30 June 2020 illustrates this circumstance.

Statement of changes in equity

	NBN Co Group			
	Accumulated losses $m	**Contributed equity $m**	**Other reserves $m**	**Total equity $m**
Balance at 30 June 2018	**(17,292)**	**29,500**	**4**	**12,212**
Loss for the year	(4,878)	-	-	(4,878)
Other comprehensive gain	-	-	3	3
Total comprehensive (loss)/gain for the year	**(4,878)**	**-**	**3**	**(4,875)**
Balance at 30 June 2019	**(22,170)**	**29,500**	**7**	**7,337**
Loss for the year	(5,239)	-	-	(5,239)
Other comprehensive gain	-	-	2	2
Total comprehensive (loss)/gain for the year	**(5,239)**	**-**	**2**	**(5,237)**
Balance at 30 June 2020	**(27,409)**	**29,500**	**9**	**2,100**

[87] https://www.finance.gov.au/government/commonwealth-investment-framework/commonwealth-investments-toolkit/equity; *"The Commonwealth provided $29.5 billion in equity in exchange for 29.5 billion ordinary shares (with a face value of $1.00 per share). The last equity drawdown was received by NBN Co in September 2017. NBN Co only has fully paid ordinary shares in issue, all of which are owned by the Commonwealth."*
[88] Commonwealth Consolidated Financial Statements for the year ended 30 June 2020, Page 104 , Note 5C Equity Investments
[89] NBN Co Limited Annual Report for the year ended 30 June 2020, Pg. 128

- Western Sydney Airport Co Ltd (WSA) – Commonwealth GBE. WSA received funding in 2019-20 from the Commonwealth Government, which has been treated as equity in 2019-20 despite WSA incurring losses from operating activities (i.e. accounting losses) in the same financial year[90]. The following extract from WSA's financial statements for the year ended 30 June 2020 illustrates this circumstance.

Statement of changes in equity

For the year ended 30 June 2020

	Accumulated Losses $000	Contributed Equity $000	Total Equity $000
Balance at 1 July 2019	(531,958)	594,037	62,079
Loss for the year	(363,452)	-	(363,452)
Other comprehensive loss	-	-	-
Total comprehensive loss	(363,452)	-	(363,452)
Transactions with owners of the company:			
Contributions of equity	-	505,128	505,128
Total transactions with owners	-	505,128	505,128
Balance at 30 June 2020	(895,410)	1,099,165	203,755

[90] WSA Co Ltd Annual Report for the year ended 30 June 2020

- Moorebank Intermodal Company (MIC) – a Commonwealth GBE. MIC receives funding from the Commonwealth Government, which has been recorded as equity, notwithstanding that MIC has incurred accounting losses since inception[91]. The following extract from MIC's financial statements for the year ended 30 June 2020

6.3. Consolidated statement of changes in equity for the year ended 30 June 2020

	Contributed equity (Note 18)	Accumulated losses	Total equity
	$'000	*$'000*	*$'000*
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	-	174,733
Balance at 30 June 2019	**380,733**	**(138,521)**	**242,212**
Balance at 1 July 2019	**380,733**	**(138,521)**	**242,212**
Loss for the year	-	(18,608)	(18,608)
Other comprehensive loss	-	-	-
Total comprehensive loss for the year	**-**	**(18,608)**	**(18,608)**
Transactions with owners, in their capacity as owners			
Contributions of equity (Note 18)	71,552	-	71,552
Balance at 30 June 2020	**452,285**	**(157,129)**	**295,156**

illustrates this circumstance.

[91] Moorebank Intermodal Company Annual Report for the year ended 30 June 2020, Pg. 38

- Australian Rail Track Corporation (ARTC) – a Commonwealth GBE. ARTC receives funding from the Commonwealth Government, which has been recorded as equity, despite making a loss from operating activities[92].The following extract of ARTC's financial statements for the year ended 30 June 2020 demonstrates this circumstance.

Consolidated statement of changes in equity
for the year ended 30 June 2020

Consolidated	Notes	Contributed Equity $'000	Property, plant and equipment revaluation reserve $'000	Hedging reserve - cash flow hedge - Interest rate swap $'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 2019		3,118,361	566,448	-	191,363	757,811	(562,260)	3,313,912
Total profit for the year as reported in the Financial Statements	8(c)	-	-	-	-	-	(860,317)	(860,317)
Re-measurement gains/(losses) on defined benefit plans - (net of tax)	8(c)	-	-	-	-	-	2,593	2,593
Cash flow hedge foreign exchange - (net of tax)	8(b)	-	-	(141)	-	(141)	-	(141)
Asset revaluation reserve adjustment - (net of tax)	8(b)	-	(31,988)	-	-	(31,988)	-	(31,988)
Total comprehensive income for the year		-	(31,988)	(141)	-	(32,129)	(857,724)	(889,853)
Dividends provided for or paid	8(b)	-	-	-	(23,325)	(23,325)	-	(23,325)
Asset disposal revaluation reserve adjustment	8(b)	-	(29,635)	-	-	(29,635)	29,635	-
Contributions of equity	8(a)	425,732	-	-	-	-	-	425,732
Balance at 30 June 2020		3,544,093	504,825	(141)	168,038	672,722	(1,390,349)	2,826,466

Our research indicates 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 NSW SOCs, we note that returns vary significantly across SOCs and over time.[93]

In our view, given the judgemental nature of the GFS framework on this aspect of the returns assessment, 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 where the assets' useful lives span decades.

In our view, entities with such assets in an initial transition phase could realistically take a significant number of years to generate a return, and the GGS expectation should be evaluated in this context, not in single years. This view is clearly consistent with that taken in other jurisdictions, where similar government-owned corporations, such as MIC and ARTC (who have a lack of profitability and returns in initial, early entity period years) still have capital injections from the government recorded as an acquisition of equity, on the basis that the government will realise returns at a later date.

[92] ARTC Financial Statements for the year ended 30 June 2020, Page 33[93] Historic information regarding dividends remitted by NSW SOCs was provided by management (NSW Treasury Commercial Assets team)
[93] Historic information regarding dividends remitted by NSW SOCs was provided by management (NSW Treasury Commercial Assets team)

Further implications of 'at a later date'

As previously noted, the GFS framework requires management to consider whether there is an expectation of returns at a later date.

In our view, the focus on an expectation of returns in the future, means that the existence of returns in the past, whilst potentially relevant to informing expectations, is not determinative to the current year's accounting treatment. This view is predicated on the basis that the ABS GFS Manual indicator is not whether there has been a return generated in the past.

Further, the past accounting treatment of transfers to the public corporation is also not determinative. The indicator is focused on whether there is an expectation of a future return at the time of the relevant capital transfer. The ABS GFS Manual indicator is not whether past capital transfers were expected to generate returns. Accordingly, expectations of returns in relation to prior period funding amounts are not relevant in considering the appropriate accounting treatment for a capital transfer in the current year.

The focus on future returns means that there is effectively an annual test. That is, when making any capital transfer to a public corporation, the consideration is whether there is an expectation of incremental returns as a result of the additional funding being provided.

7 Documentation

In addition to discussions with management and consideration of the background information in Section 3, we have referred to the various documentation and references in the preparation of our advice. 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. Documentation and references are listed here.

7.1 Documentation

We have referred to the following management workpapers and documentation:

- "TAHE GFS returns audit evidence workbook_DRAFT.xlsx', emailed 24 June 2021
- "Treasury Budget Estimates – Returns.xlsx", emailed 24 June 2021
- "Memo – 2020-21 HYBR – PNFC classification.docx
- "Memo – 2020-22 Budget – TAHE asset valuation.docx
- "Treasury Budget Estimates – TAHE asset valuation.xlsx, emailed 24 June 2021
- "Statement of Corporate Intent 2021-24 – Transport Asset Holding Entity of NSW (Preliminary for Board Endorsement, 29 July 2021)".

7.2 GFS pronouncements

We have referred to the following GFS pronouncements:

- 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).

7.3 Accounting pronouncements

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

- AASB 1049 *Whole of Government and General Government Sector Financial Reporting* (AASB 1049)
- AASB 116 *Property, Plant and Equipment* (AASB 116)
- AASB 13 *Fair Value Measurement* (AASB 13)
- Department of Finance, Finance Advice Paper, Q&A – Equity Investments, August 2018
- Parliamentary Budget Office, Alternative Financing of Government Policies, Report No.01/2020

- TPP 14-01 *Treasury Policy Paper Valuation of Physical Non-Current Assets at Fair Value* (TPP 14-01)

7.4 Policy framework documents

We have referred to the following policy documentation:

- Commercial Policy Framework Treasury Policy Papers for Government Business Available at: https://www.treasury.nsw.gov.au/information-public-entities/government-businesses/commercial-policy-framework
- TPP 16-04 *Treasury Policy Paper Financial Distribution Policy for Government Businesses* (TPP 16-04).

7.5 Legislation

We have referred to the following legislation:

- *Government Sector Finance Act 2018*
- *Protection of the Environment Administration Act 1991* (NSW)
- *State Owned Corporations Act 1989*
- *Transport Administration Act 1988.*

We have also referred to:

- Second reading speech and explanatory note to the Transport Legislation Amendment Bill 2011 (including second reading speech and explanatory note)
- Second reading speech to the Transport Administration Amendment Bill 2010.

7.6 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

7.7 Other relevant documents

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

- NSW Budget Statement 2015-16, Budget Paper No.1:

  https://www.treasury.nsw.gov.au/sites/default/files/pdf/2015-2016_Budget_Papers_BP1_Budget_Statement.pdf

Appendix 1 - Impact of TAHE asset revaluations

TAHE holds physical rail infrastructure assets. Movements in the fair value of TAHE's property, plant and equipment assets impact on TAHE's net assets and comprehensive income. Depending upon the circumstances, fair value movements can impact TAHE's profit or loss and/or other comprehensive income.

Revaluations of TAHE's assets impact on the carrying amount of the GGS's investment. TAHE has recorded a significant revaluation decrement as at 30 June 2021, which will impact on the GGS's carrying amount and be recorded as an other economic flow within the GGS statement of comprehensive income.

This appendix addresses the GFS treatment of the part of the movement in the carrying amount of the GGS investment in the PNFC sector that is attributable to the 30 June 2021 revaluation decrement.

Fair value accounting requirements in the NSW public sector

This section summarises relevant requirements applicable to the measurement of TAHE's property, plant and equipment assets.

TAHE applies AASB 116 Property, Plant and Equipment to its property, plant and equipment assets at 30 June 2021. Under AASB 116, TAHE is required to adopt the revaluation model[94]. The revaluation model requires that assets are measured at fair value, applying the requirements of AASB 13 *Fair Value Measurement* (AASB 13). TPP 14-01 provides guidance on how to measure the fair value of assets, taking into account the unique circumstances in the public sector.

For many public sector assets, there is no observable market to inform the fair value. Where a price for an identical asset is not observable, an entity measures fair value using a valuation technique. AASB 13 recognises three widely used valuation techniques[95] and TPP 14-01 requires their use:[96]

- market approach, which uses prices and other relevant information generated by market transactions involving identical or comparable assets
- income approach, which converts future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount (often referred to as DCF valuation)

---

[94] Mandates are contained in TC 20-08 Mandates of options and major policy decisions under Australian Accounting Standards (TC 20-08), which also references the requirements of TPP 14-01
[95] AASB 13.62
[96] TPP 14-01, Page 15

- cost approach, which reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost (CRC) valuation) [97].

AASB 13 requires that valuation techniques be applied consistently[98]. AASB 13 also acknowledges that a change in technique is appropriate when new information becomes available[99].

Revaluation increments or decrements arising from a change in valuation technique are accounted for prospectively as a change in estimate under AASB 108[100].

- Revaluation increments are recognised in other comprehensive income and in accumulated equity under the heading revaluation surplus except to the extent that the increment reverse a revaluation of the same asset previously recognised in profit and loss[101].
- Revaluation decrements are recognised in profit and loss except to the extent that the increment reverses a revaluation of the same asset previously recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset [102].

TAHE's 30 June 2021 asset revaluation

Prior to 30 June 2021, TAHE applied a cost approach to estimating the fair value of its assets. Once TAHE entered into new commercial access pricing arrangements with Sydney Trains and NSW Trains, TAHE had new information about future cash flows that enabled application of an income approach valuation technique.

At 30 June 2021, application of an income approach resulted in a revaluation decrement in respect of TAHE's property, plant and equipment assets. Some of this decrement was recognised in TAHE's pre-existing asset revaluation surplus and some was recognised in profit and loss.

Impact on the GGS arising from the revaluation decrement

Following the requirements set out in section 5.3, TAHE's 30 June 2021 revaluation decrement is recognised by the GGS as a reduction in the carrying value of its investment in the PNFC with a corresponding loss recorded within other economic flows. The question arises as to whether the loss is classified as a holding gain or as an other volume change. The following section addresses this question and concludes that the revaluation decrement arising from the 30 June 2021 re-measurement of TAHE's assets is recognised as an other volume change for GFS purposes.

---

[97] AASB 13, paragraph 65, AASB 13, Appendix A
[98] AASB 13, paragraph 65
[99] AASB 13, paragraph 65
[100] AASB 13, paragraph 66, AASB 108, paragraph 66
[101] AASB 116, paragraph 39
[102] AASB 116, paragraph 40

The implication of the revaluation decrement being an other volume change is that such economic flows are excluded from holding gains. Accordingly, the revaluation decrement is excluded from any consideration of expected returns from TAHE.

Asset revaluations – holding gain or loss, or other volume change?

In the context of asset revaluations, under GFS, the key question becomes whether the asset revaluation results from either:

- a change in monetary value (or equivalent) of the assets due to change in costs/prices (i.e. a holding gain/loss)[103]
- a change in use or purpose of an asset, or a reclassification of the asset (i.e. an 'other' volume change)[104].

The ABS GFSM defines holding gains / losses as *"changes in the current market 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 quantitively".*[105]

The ABS GFSM describes other volume changes as *"any change in the volume of an asset or liability that does not result from a transaction or a holding gain."*[106]

With the above definitions of the ABS GFSM in mind, the requirements of Australian Accounting Standards are relevant for determining to which of the above GFS categories the asset revaluation relates.

AASB 13 requires a change in valuation technique where another technique is more appropriate in the circumstances, and sufficient data is available to measure fair value which would maximise the use of relevant observable inputs and minimise the use of unobservable inputs.[107] As such, AASB 13 recognises that changes in the fair value measurement of assets can arise due to changes in the inputs into valuation techniques and recognises that re-measurements can occur due to the necessity to change valuation technique.

When there has been a change in how the asset is used or a change in its primary purpose, under AASB 13 this can result in another technique being more appropriate in the circumstances. Assuming sufficient data is available to measure fair value under the alternative technique, a re-measurement of the asset would occur due to the necessity to change in valuation technique.

For example, assets used in not-for-profit entities generally have a primary purpose to provide service potential and do not generate cashflows. It is generally not appropriate to use an income valuation technique in these circumstances, as there would not be sufficient data to measure the fair value of such assets using such an approach. A cost approach is often determined to be the most appropriate valuation technique, as this maximises the use

---

[103] IMF GFSM 2014, page134, box 6.3, IMF GFSM 2014, page 302, footnote 14, page 303, IMF GFSM 2014, figure A3.2
[104] AASB GFSM 2015, paragraph 11.19
[105] ABS GFSM 2015, paragraphs 11.3, emphasis added
[106] ABS GFSM 2015, paragraph 11.9, emphasis added
[107] AASB 13, Paragraph 61

of observable inputs (as information on the cost to replace the service potential of the asset can generally be obtained or calculated.)

In the for-profit context, the primary purpose of the asset is generation of income / profit, therefore a market or income approach is frequently used because it is possible to obtain sufficient data about cash inflows generated from selling or using the asset.

Thinking about these not-for-profit and for-profit contexts, AASB 13's valuation concepts and the requirements of the GFS framework are considered together in order to determine the GFS implications of a revaluation:

- Changes in inputs can arise due to changes in costs (in the case of CRC) or in prices (which affect cash flows in the case of DCF). As such, a re-measurement of an asset arising from a change in the costs or prices but using the same AASB 13 valuation technique is akin to a holding gain in GFS.[108] That is, re-measurement using the same technique but different inputs is a holding gain.
- Under GFS, a re-measurement of assets that occurs for reasons other than changes in costs/prices is not a holding gain. Accordingly, a re-measurement of assets that arises due to a change in AASB 13 valuation technique (where such a change was required to reflect a change to a more appropriate technique, for which there was sufficient data available) is not a holding gain. That is, re-measurement arising from a change in technique is not a holding gain.

Applying the analysis above, in TAHE's instance, a re-measurement that occurs as a result of a change from the CRC approach to the DCF approach is not a holding gain and is instead an other volume change. TAHE was previously a not-for-profit entity that held the assets primarily for service potential; TAHE was not expected to use the assets for commercial gain. Establishment as a for-profit SOC and implementation of commercial access agreements is evidence of a change in use and primary purpose of the assets. As such, a change in use or purpose of an asset will meet the definition of an other volume change[109].

As previously set out, under GFS, when there is a change in use or purpose of the asset, this is not a holding gain. Rather, this is termed a 'reclassification' of the asset. Reclassifications result in other volume changes:

> "*If the change in the use or purpose of an asset also means a change in its value, then a second entry in other changes in the volume of assets and liabilities is recorded for the change in value rather than a holding gain or loss. The change in value is not recorded as a holding gain because the value increase is due to a change in the use or purpose of the asset, and not due to a price change in the value of the asset held.*"[110]

The above analysis demonstrates how AASB 13 valuation concepts and requirements of the GFS framework intersect to conclude on the GFS treatment of a revaluation.

The ABS GFSM also notes that "*...other changes in the volume of assets and liabilities result from <u>events that change the quality and quantity of existing assets</u> or liabilities.*"[111]

---

[108] ABS GFSM 2015, paragraphs 8.27 and 11.3
[109] ABS GFSM 2015, paragraph 11.19
[110] ABS GFSM 2015, paragraph 11.19
[111] ABS GFSM 2015, paragraph 11.9, emphasis added

The rail infrastructure assets have not changed in quantity as at 30 June 2021. However, there has been a transition from RailCorp to TAHE the SOC, a move from not-for-profit to for-profit, and implementation of new commercial arrangements to reflect a shift in the purpose for which TAHE holds the assets.

In terms of the new context in which the assets are held, the 'quality' of the assets fundamentally changes when they are considered as having a primary purpose to generate profit instead of being held primarily for service potential. Under GFS, a re-measurement of assets that occurs for in response to a change in the quality of the asset is not a holding gain and is instead treated as an other volume change.

It can also be useful to consider whether the GFS treatment of other analogous circumstances accords with proposed treatment, in order to confirm consistency.

- When units are reclassified between sectors, the units' assets and liabilities are removed from one sector and added to another through other changes in the volume of assets and liabilities[112]. Units can be reclassified as a result of changes in recovery of production costs; there has been a significant change in TAHE's recovery of costs. It follows that TAHE's re-measurement of assets is analogous with such a reclassification and is therefore an other volume change.
- It is noted that were TAHE to be 'unwound' and its assets distributed to owners, this would also be treated as an other volume change and any subsequent re-measurement of assets to CRC would also be an other volume change.
- TAHE has been established as a result of legislative change; its administration has altered due to the specific legal and governance arrangements that apply to SOCs. These changes are the genesis of the new commercial access arrangements and subsequent re-measurement of assets. Such circumstances are contemplated in the ABS GFSM 2015.

  "When government units acquire equity in a public corporation or quasi-corporation as a result of legislation or an administrative change, this event will amount to a reclassification of the existing assets and liabilities that results in an addition of shares and other equity to the balance sheets of both entities through an other changes in the volume of assets entry."[113]

  TAHE's circumstances are somewhat analogous with the above situation, which requires treatment as an other volume change.

In the analogous scenarios discussed above, there has been some exogenous factor that resulted in a change in the carrying value of assets. The change in carrying value has not arisen due to changes in costs or prices. So too, TAHE's re-measurement has occurred due to the exogenous change in its establishment and legal and governance structure. Applying the GFS treatment by analogy, TAHE's re-measurement is recognised as an other volume change. This recognition outcome is consistent with the original conclusion resulting from the application of the GFS requirements to the AASB 13 valuation concepts.

---

[112] ABS GFSM 2015, paragraph 11.17
[113] ABS GFSM 2015, paragraph 11.20