

**Submission
No 1**

INQUIRY INTO TRANSPORT ASSET HOLDING ENTITY

Name: Mr Tony Harris

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Introduction

Following an agreement by all Australian jurisdictions, government financial statements are prepared according to Australian Accounting Standards (Generally Accepted Accounting Principles). These standards, developed initially for listed corporations, are used by government auditors to determine whether government accounts are to be qualified or unqualified. The standards are expressed as regulations made under the federal Corporations Act 2001. For this purpose, AASB10, relating to consolidated financial statements and AASB 1059, relating to service concessions, have relevance to TAHE.

GAAP have been crafted to meet the needs of the public sector and, as they apply to states, they reflect the System of National Accounts (Government Finance Statistics) developed by United Nation agencies to promote the preparation of comparable national financial statistics. The System of National Accounts has long been adopted by the Australian Bureau of Statistics.

There have been isolated attempts in Australia to present government accounts that do not conform to GAAP or GFS standards. To obtain federal taxation benefits and to skirt the conditions imposed by the Loan Council, NSW Government financial statements for several years in the 1990s incorrectly described the Sydney Harbour Tunnel as a privately owned asset. Although the Tunnel was legally owned by its developers, the state accounts were qualified by the state audit office. This deceit was corrected in the 2000s, with the concurrence of the Australian Taxation Office and the ABS, to reflect the essence of the financial relations between the government and the Tunnel developer.

A more blatant example is the Commonwealth's accounting of GST revenues and expenditures as state and territory transactions. This was done to hide the increase in these activities and the resulting increased share of GDP revenues and spending accounted for by the Commonwealth. This deviation was expressed in several annual Commonwealth financial statements, but it was not adopted by any other party, including the ATO and ABS. The misleading accounts were qualified by the Commonwealth auditor general and were rectified by a new government.

Background

Page 1–2 of NSW 2015-16 Budget Paper No. 1 sets out the government's decision to create TAHE, Transport Asset Holding Entity, which was eventually to hold all the government's public transport assets.

The Paper states

In accordance with Government Finance Statistics (GFS) classification, the Australian Bureau of Statistics has classified TAHE as a commercial Public Non-Financial Corporation (PNFC). This GFS framework applies to all State governments and the ABS independently determines in which sector a government entity belongs. Queensland and Victoria have similar entities.

TAHE will procure and sell assets consistent with Government requirements and lease those assets to the operators (both Government and non-Government) under negotiated leases and other contracts. As a result, public transport assets will, in time, be managed on a portfolio basis, generating greater efficiencies and synergies.

Until now, the Government has paid recurrent grants to Rail Corporation to deliver its capital program. From 1 July 2015, new funding for capital projects will be provided by equity injections, as TAHE will over time provide a commercial return. TAHE will use these funds to purchase services from TfNSW and this will result in the recognition of increased revenue in the General Government Sector (GGS) and a reduction in GGS capital expenditure. Table 1.1 provides a detailed reconciliation of the impact of this arrangement across the forward estimates.

This table showed that the resulting change in spending for 2015-16 to 2018-19 inclusive (the change in funding from grants to equity injections) was estimated to improve the budget results by a net \$3.662 billion.

Over the longer term, the delivery of new projects can also be directly contracted between TAHE and the private sector and TAHE will commence paying dividends to the Government. Projected revenues are expected to return close to pre-TAHE levels and expenses will reduce **as the costs will be contained in the PNFC sector** (emphasis added). This allows for greater transparency of procurement and project management costs.

As it happens, TAHE was incorporated on 1 July 2020 when the Rail Corporation NSW was renamed and converted into a statutory state-owned corporation. Notwithstanding this delay, the intervening budget results have benefited from the conversion of grants to equity injections for RailCorp's capital program. These budgets have also benefited because Treasury has not compensated Rail Corp for the use of its assets and has not had to bear the losses incurred by RailCorp.

The reduction in budget expenses (and thus the improvement in the budget result) for the five years from 2015-16 to 2019-20 by classifying RailCorp as a commercial non-financial public corporation was \$14,349 million comprised of \$5,829.4 million in operating losses and \$8,545.5 of equity injections for capital purposes. (Over the same period, RailCorp was granted \$324.7 million for capital purposes. The reasons for making grants versus equity injections are not publicly available.)

In none of those years did RailCorp make a profit, notwithstanding its "commercial" characterisations. In none of those years did NSW Treasury of Transport for NSW pay any fee to RailCorp for the use of RailCorp's assets to transport paying passengers. Given RailCorp's asset holdings approaching \$40 billion, a payment of around \$2 billion a year (or \$10 billion for the five years in question) for an access fee would not seem unreasonable. Such a fee would add to the General Government's operating expenses.

Rationale

The budget document quoted above claim that the creation of TAHE and its classification as a non-financial public corporation will result in greater synergies, efficiencies and transparency. These claims can be contested.

The separation of transport assets from transport operations involves significant co-ordination costs. Arguably, these costs are greater than when the required co-ordination occurs within the one organisation. There is already anecdotal indication

that the friction that results from separating asset management from asset use is causing increased costs. There is no evidence that these real costs are offset by real savings.

If the claimed advantages from separation were valid, they would also be valid notwithstanding whether TAHE was in the general government sector or was classed as a commercial non-financial public corporation.

The direct apparent benefits that accrue from establishing TAHE as a NFPC are those shown above: costs are moved from the budget (General Government) sector to the Public Non-Financial Corporation Sector. That alone is an insufficient reason to incur real additional net costs. But the resulting improvement in the budget result also increases the chances of retaining a AAA credit rating, which is the sole object of the state's Fiscal Responsibility Act 2012.

Analysis

As seen above, the classification of TAHE (and its predecessor NSW RailCorp) as commercial corporations allows payments to them from the budget to be classed as equity injections rather than grants. Unlike grants, equity injections do not form part of the operating expenses of the General Government Sector and thus have no direct impact on the budget result. And as suggested above, the classification of a state-owned corporation as a commercial non-financial corporation is now one made with the support of the ABS.

According to the ABS classification system, "non-market operators are included in ... General Government". Market operators respond to market forces. They make decisions in response to demand changes and expected costs of supply. They are exposed to market risks and have a goal of making a profit in the long run or at least covering capital and other costs.

These definitions accord with those used in the UN System of National Accounts. TAHE is controlled by the government and thus fits within public sector accounts. And if TAHE were a "market producer" it would not be in the general government sector. If, however, TAHE was a non-market producer it would be part of the general government sector.

To be a market producer, TAHE must have the capacity to adjust the supply of its services to cover its capital and other costs.

TAHE does not have the characteristics that should allow its classification as a commercial non-financial corporation. Firstly, it appears from government documents that TAHE does not have an independent ability to negotiate with non-governmental customers that would wish to use its rail assets. Secondly, it appears that TAHE does not have itself maintain the safety of its transport assets: these are maintained by Department of Transport agencies using TAHE funding. Thirdly, TAHE seemingly does not have independent capacity to restrict or expand its supply of rail transport assets. (For example, TAHE cannot independently open new or close existing rail stations based on expected passenger numbers.) Fourthly, TAHE's (and RailCorp's) economic

costs, especially depreciation and an economic return on its assets, are not met by the government. (This can be seen from RailCorp's annual reports.) Fifthly, TAHE has no say in the use of its assets: train operations are not determined by TAHE.

The ABS might assert that it can classify TAHE as a NFPC because there are similar entities in other states that have that classification. This "similarity criterion" does not exist in the UN System of National Accounts and it appears to suggest that if an earlier error has been made in classifications another, later error is justified.

There is the additional matter about whether TAHE's operations conform to GAAP. AASB 10 provides that TAHE should be within the General Government Sector (and thus should be reflected in that sector's Budget results) if TAHE does not effectively control its assets and operations.

Similarly, AASB 1059 which came into effect from 1 July 2020 requires an entity, in this case Transport for NSW, to disclose the assets it controls, regardless of the legal ownership of those assets. If NSW Treasury asserts that TAHE is acting as a principal, Treasury should explain how it made such a finding given the limitations of TAHE's control of regulated assets.

Conclusion

There is sense in the limitations imposed on TAHE by the government. Because rail passenger transport in Sydney is uneconomic, and is thus heavily subsidised by government, the government is right to control the extent of its contributions. Allowing TAHE to unilaterally determine operating or investing subsidies or to allow TAHE to use its monopoly powers would be fiscally imprudent. And it is also prudent that the government sector control train operations and the related safety issues. But the need for and extent of these impositions are such as to disqualify TAHE's classification as a commercial undertaking.

It is unsurprising that ABS might approve the classification of TAHE as a NFPC. It took Commonwealth authorities a decade to comprehend the complexities of the Sydney Harbour Tunnel financial arrangements. But if the ABS knowingly allows this classification, one could anticipate the government's establishing similar NFPCs to own other non-profitable assets such as public roads, hospitals and schools.

Tony Harris

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