Macquarie Generation

MACQUARIE GENERATION

ANNUAL REPORT

FOR THE YEAR ENDED 30 JUNE 2003

CONTENTS

Cover Image: Low pressure turbine blade, Liddell Power Station

LETTER TO SHAREHOLDERS

Hon Michael Egan MLC
Treasurer of New South Wales,
Minister for State Development,
Vice-President of the Executive Council

Hon John Della Bosca MLC
Special Minister of State,
Assistant Treasurer

Parliament of New South Wales
Macquarie Street
Sydney New South Wales 2000

Dear Shareholders

We have pleasure in submitting the Macquarie Generation Annual Report, including the Statement of Financial Performance, the Statement of Financial Position and the Statement of Cash Flows for the financial year ended 30 June 2003, as audited by the Auditor-General of New South Wales.

This Report is consistent with the requirement of Section 24A of the State Owned Corporations Act, 1989 and Section 10 of the Annual Reports (Statutory Bodies) Act, 1984 and is submitted to the Shareholders for presentation to the Parliament.

HE Rees
Chairman

GV Every-Burns
Chief Executive and Managing Director

October 2003

ABOUT MACQUARIE GENERATION

Macquarie Generation is a State Owned Corporation (SOC) formed in March 1996 in concert with deregulation of the New South Wales electricity sector. Macquarie Generation has as its core business the production, marketing and sales of electricity into the wholesale segment of the National Electricity Market.

The National Electricity Market provides the mechanism for electricity sales and marketing in New South Wales, Victoria, Queensland, South Australia and the Australian Capital Territory. Macquarie Generation owns and operates Bayswater and Liddell Power Stations, located in the Hunter Valley of New South Wales, adjacent to the New England Highway between the towns of Singleton and Muswellbrook. The Power Stations' combined generating capacity is 4,640 MW, which provided approximately 13.5% of the National Electricity Market demand for electricity in 2003.

Within the Power Stations' precinct, Macquarie Generation also owns and operates two 25 MW oil fired gas turbines and a 0.85 MW mini-hydro generator. Location of the Power Stations provides access to large quantities of coal from surrounding, mostly export-focused coal mines. Biomass, mostly in the form of sawmill waste, is approved for co-firing with coal at a maximum blend rate of 5%.

Macquarie Generation's corporate governance is vested in an independent Board of Directors, appointed by the Shareholders. An executive team lead by the Chief Executive and Managing Director is responsible for the Corporation's day-to-day business activities.

At 30 June 2003, Macquarie Generation employed a total of 610 people, with 560 located at Bayswater and Liddell Power Stations and 50 at a corporate office in Newcastle.

Mission Statement

Macquarie Generation seeks to become Australia's preferred provider of electrical energy and related products by adding value for its shareholders, customers and the community through the operation of a successful commercial business which supplies reliable and safe products at a competitive cost and in an environmentally sensitive manner.

Macquarie Generation Values:

- Strong customer relationships
- Highly reliable production and services
- People with meaningful and rewarding jobs
- Safe workplaces
- Environmentally responsible operations
- Good corporate citizenship

CHAIRMAN'S REVIEW

BEING A LOW COST GENERATOR IS BECOMING INCREASINGLY IMPORTANT

In 2003 the Corporation performed strongly in an operating environment where market prices and volumes were suppressed.

Costs of operation were the lowest since the Corporation was formed in 1996 and contributed to Net Profit before Tax of $100.7 million. This is down on last year's profit of $181.6 million, largely as a consequence of restructuring of the Statement of Financial Position. The Corporation repaid $400 million of Equity to the Shareholder by increasing its debt to $1.2 billion.

During the year we also refinanced $185 million of higher cost debt, and made total cash returns to the Shareholder of over $550 million for the year. Returns to the Shareholders since formation in 1996 are now more than $1.2 billion.

Our current debt to asset ratio of 41% is in line with good corporate practice.

The most pleasing aspect of the Corporation's performance was the continuing reduction in our overall cost of generating power plus the increase in efficiency of our existing assets. Being a low cost generator is becoming increasingly important in the deregulated market.

In March 2003 the ASX Corporate Governance Council released Principles of Good Corporate Governance and Best Practice Recommendations. In response, a thorough review of Macquarie Generation was undertaken involving external and internal auditors. I am pleased to report that nearly all the recommendations were in current practice or exceeded the best practice recommendations. Two variations from the recommendations—the need for membership of our Board Audit and Assurance Committee to be increased from two to three Non-Executive Directors and the publication of our Board and Management Committees Charters—have been adopted.

New South Wales continues to increase its power demand year by year.

To date the major interconnectors have assisted in making a plentiful, inexpensive supply available. Last year 14% of power used in New South Wales came from other regions.

Recent widespread blackouts in the USA and Italy have demonstrated that there is a requirement for robust interconnection and transmission. Progress has been made by Governments to improve the eastern Australian interconnectors, but much more has to be done to enhance the system and improve its transfer capacity while ensuring security of the power system. The current slow progress requires acceleration as demand moves closer to supply in all States except Queensland.

However, overdependence on interconnectors is equally dangerous as demonstrated by the recent blackout in Italy. There, 24% of power was supplied from other countries with a major shortfall in domestic capacity the stumbling block for system security.

New South Wales will soon require gas fired peaking capacity to deal with peak loads that are becoming more frequent and larger each year.

Inevitably a baseload station will be essential to give the State security of supply. With the current developments in electricity generation technology, a new baseload generator will be a highly efficient, low greenhouse intensity coal fired plant and, most importantly, it will need to be built within the next decade.

Another long term problem facing the industry is an ageing workforce of qualified tradespeople and engineers. As a Corporation we are beginning to address this situation through training and succession planning but the issue is a national problem and Macquarie Generation is unlikely to be able to resolve the looming skills shortage on its own. With our high staff retention rate, the diluting effect of newcomers alone will not address the problem. Without a concerted effort from the whole industry, we could be facing a severe shortage of technically qualified people within a decade.

In conclusion, my thanks for a satisfying result in 2003 go to all Macquarie Generation employees, Managers and Directors who have worked so well as a team to produce such a good financial result for the Corporation's owners and the people of New South Wales.

E. Rees.

HE Rees
Chairman

CHIEF EXECUTIVE'S REPORT

THE CORPORATION IS WORKING TO IMPROVE THE AVAILABILITY AND MAXIMISE THE CAPACITY OF ITS EXISTING POWER STATIONS

I am pleased to report that the Corporation completed another successful year of business operation while working to further consolidate its leading position in the National Electricity Market.

The strong commercial performance of the Corporation continued, evidenced by Net Profit before Tax of $100.7 million. This profit result exceeded our expectations and will produce a dividend to the Shareholders of $56 million.

At first glance, these results show a considerable reduction from last year's record result when the Corporation's profit was $181.6 million and its dividend $125 million. However, simple analysis of the 2003 result confirms the cumulative effects of capital restructuring, equity repayment, debt restructuring and market conditions.

The Corporation assessed that its past performance and future prospects in the National Electricity Market were sufficiently strong to warrant a review of its asset value. This was undertaken and formed the basis of a capital restructure in 2003. Consequently the Corporation raised debt and made an equity repayment to the Shareholders of $400 million. In combination with the dividend and a loan guarantee fee, this brought cash returns made to the Shareholders in the year to more than $550 million, which we believe is a commendable effort.

The cost of the increased debt and higher depreciation lifted financing charges $40 million above last year, and the fall in market prices as a result of very stiff competition from new Queensland generation reduced our market revenue by $45 million. But for those events, profit levels would have been close to the previous record.

Macquarie Generation's response to market pressure has been a long term, consistent drive to reduce controllable costs. It is notable that the Corporation's operating costs are at their lowest level since our formation in 1996. This has not been at the expense of performance. We remain confident that our levels of staffing and maintenance are appropriate, and that our fuel supplies are of suitable quality.

To further reduce long term costs in an environment of low interest rates, the Directors took a decision to refinance $185 million of higher cost debt. While accepting an upfront cost in 2003, the initiative will save $6.4 million per annum over a payback period of just over two years.

We are pleased with these commercial achievements but there is more to be done.

Electricity Market

2003 was never going to be easy with 1,700 MW of new generation scheduled to become available in Queensland at a time when the market clearly did not demand it. Our assessment that some of that generation was at lowest quartile costs allowed us to conclude that prices would fall in the market and that earnings would reduce consequently.

It is now history that the new Queensland plant suffered significant commissioning delays and that the forecast higher flows of electricity from Queensland into New South Wales did not eventuate in the first six months of the financial year. High reliability and availability of the Corporation's power stations enabled us to benefit from this window of opportunity and lifted our results above budget.

In February 2003 subdued demand for electricity and the availability of surplus generating capacity - exacerbated by new Queensland plant - contributed to a monthly average spot price in New South Wales of just $19.07/MWh – almost $10/MWh less than February 2002. Not surprisingly, a pattern of low prices has prevailed, making investment in new generation unattractive.

Our relationships with major customers continue to change and grow as the National Electricity Market matures. Retailers have also been affected by stiff competition, and regulatory uncertainty. We value the working relationships that have developed and the willingness to share insights that may encourage a more robust market in the future.

The Corporation continues to closely monitor and participate in the debate surrounding development of the National Electricity Market. The completion of the Parer Report and the creation of the Ministerial Council on Energy are important milestones to bring political and intellectual focus to the future shape of deregulated electricity supply.

Macquarie Generation believes that effective implementation of the Australian Energy Regulator, an Australian Energy Market Commission and an interconnection planning function will be of significant benefit to the electricity sector and the Australian economy.

Internal Relations

A new three-year Award was finalised late in 2002 after protracted negotiations involving management, employee representatives, peak unions and assistance from the Industrial Relations Commission.

Flowing from the negotiations, management and the peak unions agreed to complete a number of tasks prior to the next Award and have commenced a high-level consultation process in support of this aim.

Production Capacity

The Corporation notes the continuing growth in electricity demand in eastern Australia. There can be no doubt that new generation capacity will be required in the future, including peaking and base load capacity. Peak demand is growing at an average rate of 960 MW annually. Supply and demand will tighten within a few years and it is inevitable that gas and coal fired capacity will be required in addition to renewable resources.

In this regard, the Corporation's plans for a gas fired peaking or intermediate power station at Tomago are well advanced. We intend to evaluate the potential for private sector participation in the project when a start-up date is more clearly known.

In the meantime the Corporation is working to improve the availability and maximise the capacity of its existing power stations. We expect the fully maintained and progressively upgraded latent capacity of 500-1,000 MW at Liddell will return to the market in the near term at a lower cost than the construction of new plant.

The turbines upgrade at Liddell Power Station has commenced and in June 2003 the first of four retrofitted units was recommissioned with new LP turbines. Testing has confirmed increased output of the plant and increased thermal efficiency, expected to deliver carbon dioxide emission savings exceeding 100,000 tonnes per year and up to 50% better than originally anticipated.

The upgrade of the control systems at Liddell to digital technology was completed on a second unit and started on a third. At a cost of $74 million, the turbine and control projects are extending the life and utility of this important asset.

Safety and Environment

The Corporation maintains a strong focus on safety. In 2003 Bayswater and Liddell Power Stations achieved new internal records of 788 and 298 days respectively free of lost time injuries. Despite these very positive achievements the organisation suffered eight lost time injuries, which is a significant departure from the long term trend and from our goal of zero.

Each accident is thoroughly reviewed irrespective of whether lost time is involved and despite the unexpected nature of some accidents, we regard all as preventable. Safety remains an absolute priority.

The achievement of high environmental standards and the constant improvement of environmental outcomes are demonstrated particularly by projects such as the Liddell turbines upgrade and other initiatives under development. The Corporation's commitment to continuous improvement is reflected in its decision to seek accreditation of its Environmental Management Systems to ISO 14001 standard. The process is occurring within a tight timeframe and the necessary resources have been allocated to achieve it.

Fuel

Long term, low cost coal remains the most critical input into economically competitive electricity production.

Deliveries of coal to Macquarie Generation from the Mount Arthur mine commenced in 2003 after a three year development phase. This is an important milestone in the growth of new competitive fuel supplies to the power stations and followed the selection of Ingwe in 1998 as the miner in a process conducted jointly by Macquarie Generation and the Department of Mineral Resources. BHP Billiton successfully took the project forward after a series of acquisitions.

Further opportunities for long term coal supply were made available to the market during 2003 with a call for tenders for development of the Wilpinjong lease near Mudgee and a separate call for tenders for alternative supplies. The tenders have closed and are now the subject of evaluation.

Water

Amid widespread drought in New South Wales in 2003, the value of the Barnard River Scheme in supplementing the Corporation's normal water requirements was demonstrated. The first substantial water transfers in almost 20 years provided reassurance of the Corporation's ability to ride out a severe drought at the current level of electricity production.

Unfortunately, progressive limitations on the water licences for the power stations and the Hunter River Salinity Trading Scheme remain long term concerns. While adequate water is theoretically available to the Corporation for planned levels of production, it is most likely that significant capital expenditure will have to be made in the future to access water in times of very high flow. Likewise, a large additional water treatment plant for Lake Liddell is also in prospect to control and improve water salinity.

In this context the proposed National Water Sharing Policy and its implications are most important to the Corporation. The balance between the legitimate needs of the environment, other water users and electricity consumers are essential matters for consideration.

Industry and Community

A hesitant global economy has continued to cast a shadow over development proposals for the Macquarie Generation Industry Zone, but the opportunity has been taken to build stronger relationships with local communities.

An Industry Zone Open Day was well attended by neighbours, community and government representatives. This, and other initiatives, set the scene for a collaborative effort with Muswellbrook Shire Council to enhance public consultation through a new Committee with community oversight of existing and proposed industrial developments in the Industry Zone.

The Corporation was delighted to play a part in honouring Aberdeen resident Ms Tess O'Brien's tireless charity work by donating $20,000 to the Muswellbrook Carelink Service for their continuing support of cancer patients.

A further $10,000 was donated to the Singleton Cancer Appeal Committee, arising from fees collected for Bayswater Power Station's appearance in The Matrix Reloaded motion picture.

In conclusion, I would like to record my sincere thanks to everyone at Macquarie Generation for their continuing commitment to a healthy business and a healthy workplace.

GV Every-Burns
Chief Executive and Managing Director

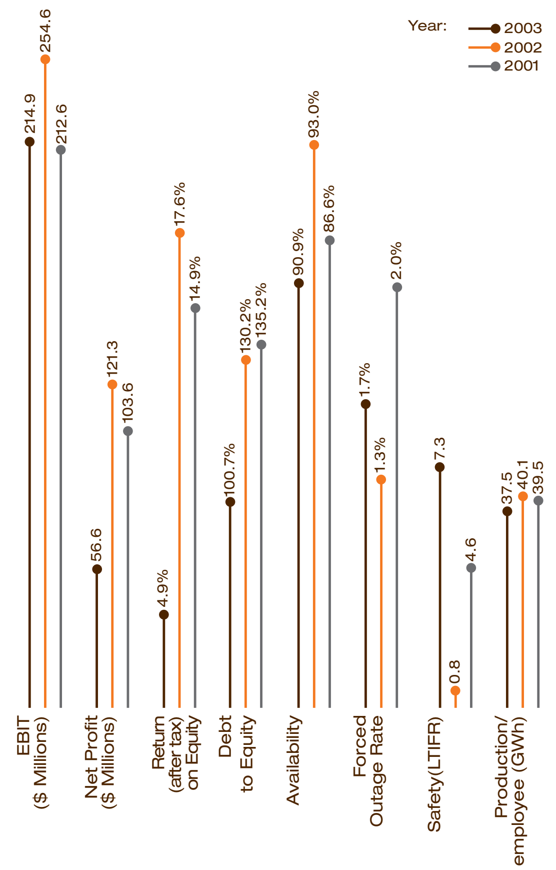
FINANCIAL PERFORMANCE

A SUMMARY OF MACQUARIE GENERATION'S FINANCIAL PERFORMANCE FROM 1 JULY 2002 TO 30 JUNE 2003

	2003	2002	% CHANGE
Statement of Financial Performance ($ millions)			
Revenue	757.1	813.6	-6.9
Other expenses from ordinary activities excluding depreciation	446.4	473.9	-5.8
Earnings before depreciation, interest and tax	310.7	339.7	-8.5
Depreciation expense	95.8	85.1	12.6
Earnings before interest and tax (EBIT)	214.9	254.6	-15.6
Net borrowing costs expense	114.2	73.0	56.4
Net profit before income tax expense	100.7	181.6	-44.5
Income tax expense	44.1	60.3	-26.8
NET PROFIT	56.6	121.3	-53.3
Statement of Cash Flows ($ millions)			
Cash flows from operating activities (excluding borrowing costs)	313.3	286.0	9.5
Capital expenditure	35.1	20.2	73.3
Dividends paid	125.0	100.0	25.0
Statement of Financial Position ($ millions)			
Total Assets	2,827.9	2,125.9	33.0
Total Debt	1,170.1	899.4	30.1
Equity	1,162.2	691.0	68.2
Dividend provided	56.0	125.0	-55.2
Financial Statistics			
EBIT to Revenue (%)	28.4	31.3	-9.3
Debt to Equity (%)	100.7	130.2	-22.6
Interest Cover (times)	1.9	3.5	-46.0
Return (after tax) on Equity (%)	4.9	17.6	-72.3
Operating Statistics			
EBIT per average employee ($ 000's)	352.3	415.9	-15.3
Safety (accidents per million hours worked)	7.3	0.8	812.5
Equivalent forced outage (%)	1.7	1.3	33.6
Availability (%)	90.90	93.03	-2.29
Production per employee (GWh)	37.5	40.1	-6.5

FINANCIAL HIGHLIGHTS

- Capital Restructure of the Corporation was finalised in July 2002 at the request of New South Wales Treasury resulting in:
  - revaluation of the infrastructure Property, Plant and Equipment in accordance with Accounting Standard AASB 1041 Revaluation of Non Current Assets resulting in an increase in the carrying value of assets by $870.9 million to $2.6 billion,
  - distribution to the Shareholders of $400 million, and,
  - increase in debt of $400 million in order to fund the distribution to the Shareholders.
- The increased valuation of the Corporation's assets resulted in an increase in depreciation expense which was partially offset by the extension of the useful lives of the Power Stations' assets from 40 to 50 years as disclosed in Note 3 (c) of the Financial Statements.
- Total revenue decreased by 6.9% to $757.1 million as a result of steady average sales prices and a 6% reduction in volume. The anticipated reduction in sales revenue was due directly to newly commissioned generation in Queensland and consequential increased flows of electricity over the fully operational Queensland to New South Wales Interconnector during the second half of the financial year.
- The Corporation continued to control costs resulting in a 3% reduction in Other Expenses from Ordinary Activities as per Note 3 to the Financial Statements including a 10% reduction in fuel expense offset by a 12.6% increase in depreciation expense due to the Capital Restructure.
- This resulted in a 15.6% decrease in earnings before interest and tax (EBIT) from $254.6 million to $214.9 million.
- Net Borrowing costs increased by 56.4% to $114.2 million due to the additional borrowings resulting from the Capital Restructure.
- Net profit before tax decreased by 44.5% to $100.7 million due mainly to the increase in depreciation expense and borrowing costs as a result of the Capital Restructure.
- Total equity increased by 68.2% or $471.2 million consisting of the asset revaluation increment of $870.9 million less the $400 million repayment to the Shareholders as per Note 18 to the Financial Statements.
- Total debt increased by 30% or $270.7 million consisting of the $400 million additional debt required for the Capital Restructure less repayments of $130 million resulting from the Corporation's on-going debt repayment strategy.
- As a result the debt to equity ratio decreased by 22.6% to 100.7%.
- Net profit after tax decreased by 53.3% to $56.6 million which exceeded expectations by 34.4%.
- Return on equity after tax decreased to 4.9% from 17.6% due to the reduction in net profit after tax as explained above and the increase in Equity as a result of the Capital Restructure.
- Dividend provided decreased from $125 million to $56 million, exceeding expectations.
- The Corporation maintained a high standard of plant performance including availability, incidences of forced outages and efficiency.
- The Corporation maintained a strong focus on safety. Bayswater and Liddell Power Stations each achieved new internal records of 788 and 298 days respectively free of lost time injuries.
- First of fours units were completed on the Liddell Low Pressure Turbine upgrade which is expected to save 100,000 tonnes of carbon dioxide in the next year.



PRODUCTION & ENVIRONMENT

Corporate Environment Policy

Macquarie Generation supplies electricity from the operation of its Bayswater and Liddell coal-fired Power Stations within the upper Hunter Valley of New South Wales.

Macquarie Generation accepts responsibility for environmental protection as an essential part of its business. Its objective is to comply with all applicable environmental laws and other requirements to which the organisation subscribes in a commercially-effective way which is consistent with community expectations. Macquarie Generation is committed to continual improvement of its environmental performance.

Macquarie Generation recognises that good environmental performance is the responsibility of all individuals within the organisation, and can be achieved by effective planning and management including establishment of objectives and targets, maintaining proper reporting systems and adequate training for all employees.

Macquarie Generation is committed to:

- developing and maintaining an appropriate Environmental Management System
- utilising operating practices which seek to prevent pollution and minimise environmental impacts in a commercially effective way by:
  - efficient use of energy and resources with a view to reducing consumption and minimising emissions or discharges to the environment;
  - waste management practices that include waste minimisation, recycling and approved waste handling and disposal; and
  - regular environmental assessment of the impact of existing operations
- implementing environmental incident response procedures for emergencies or other events which pose a risk to health, safety or the environment
- facilitating communication within the organisation as well as consultation with governments, contractors, industry groups and the public on matters relating to the environment
- periodically reviewing its Environmental Management System and progress towards achieving its environmental objectives and targets

Macquarie Generation will review this Policy on a biennial basis.

Environmental Performance

Regulatory Compliance

NSW EPA Licences:	3
Other NSW Government Licences:	3
Breaches notified:	1

(Liddell Ash Dam dust, July 2002)

Non-Coal Fuel Consumption

Biomass

Liddell	58,909 tonnes
Coal replaced by biomass	37,338 tonnes
Coal replaced since August 1999	149,814 tonnes (est.)
Electricity produced from biomass since August 1999	309,000 MWh (approx.)

Oils

Liddell (Supplementary Fuels Program)	21,049 tonnes
Liddell (boiler start-up)	8,907 tonnes
Bayswater (boiler start-up)	2,385 tonnes

Air Emissions[i]

Sulfur dioxide	5.4kg/MWh (Bayswater) 4.7kg/MWh (Liddell)
Oxides of Nitrogen (expressed as NO2)	2.5 kg/MWh (Bayswater) 2.4kg/MWh (Liddell)
Particulate matter	0.02kg/MWh (Bayswater) 0.17kg/MWh (Liddell)
Carbon Dioxide[ii]	923kg/MWh (Bayswater) 940kg/MWh (Liddell)

Water Management

Water diverted (Hunter River)	61,140 ML
Salt extracted	11,223 tonnes

Hunter River Salinity Trading Scheme

Salt discharged	Nil
Salinity Credits Days traded-in	Nil
Salinity Credits Days traded-out	Nil
Regional mine waters treated	Nil

Land Management

By-product sales:

Fly ash	60,561 tonnes[iii]
Bottom ash	5,154 tonnes[iv]
Lime	475 tonnes
Gypsum	2,067 tonnes
Cenospheres	1,966 m3
Eels (Plashett Reservoir)	1,041 kg

Power Stations' precinct hardwood plantation trials in association with State Forests (NSW) are continuing.

2003 Production

Bayswater

Energy Sent Out: 15,696 GWh

Availability: 91.94

Forced Outage Rate: 1.3

Station Trip Rate (per 1000 hrs): 0.15

Liddell

Energy Sent Out: 7,293 GWh

Availability: 89.35

Forced Outage Rate: 2.19

Station Trip Rate (per 1000 hrs): 1.84

Macquarie Generation is:

A foundation member of the Commonwealth Government's Greenhouse Challenge;

A partner in the Commonwealth Government's Greenhouse Gas Abatement Program;

A signatory to the Commonwealth Generator Efficiency Standards Program;

A signatory to the Electricity Supply Association of Australia's Code of Environmental Practice;

A member of the Hunter River Catchment Management Committee;

A member of the Coastal Valleys Water User's Customer Service Committee;

A member of the Upper Hunter Forests Steering Committee;

A member Clean Air Society of Australia and New Zealand (CASANZ);

A member Australian Wind Energy Association (AUSWEA);

A member of the Hunter Salinity Trading Scheme Operations Committee;

A foundation sponsor of the Upper Hunter River Rehabilitation Initiative.

[i] Annual average
[ii] Formulated from total fuel consumption minus biomass
[iii] Total classified and unclassified
[iv] Bayswater/Liddell total

FINANCIAL STATEMENTS

DIRECTORS' REPORT

The Board of Directors present their report together with the Financial Statements of the Corporation for the year ended 30 June 2003 and the auditors' report thereon:

Directors

The following persons were Directors of Macquarie Generation during the whole of the financial year and up to the date of this report:

- Evans Rees
- Grant Every-Burns
- Anna Buduls
- John Cahill
- Deborah Page
- James Watt
- The Hon. Robert Webster

Information on Directors

Evan Rees FIE Aust CPMetallurgy

Chairman and Non-Executive Director

Mr Rees was appointed Chairman of Macquarie Generation on 1 March 1996. Mr Rees was reappointed as Chairman on 1 March 2003 for a three year term ending on 28 February 2006.

Mr Rees worked for Australian National Industries (ANI), Australia's largest publicly listed engineering company for over 34 years. Mr Rees was an ANI Board member from 1986 when he was appointed Executive Director with the responsibility for manufacturing and steel distribution business. He was appointed ANI Managing Director in 1991 until retirement in 1996. Mr Rees is also Chairman of Bluestone Mortgages.

Grant Every-Burns BE(Hons) FAICD

Chief Executive and Managing Director

Mr Every-Burns was appointed as Chief Executive and Managing Director on 1 March 1996. Mr Every-Burns was reappointed as Chief Executive and Managing Director on 1 September 2002 for a three year term ending on 31 August 2005.

He was also Director and Vice President of the National Safety Council of Australia Limited from 1995 until early 2001. He is Chairman of the NEMMCO Participant Advisory Committee and Deputy Chairman of the National Generator Forum.

Mr Every-Burns has over 28 years of extensive engineering and managerial experience in running thermal power stations in New South Wales. His former roles include Manager of Bayswater and Eraring Power Stations, and Assistant General Manager of Pacific Power.

Anna Buduls BA MComm

Non-Executive Director

Ms Buduls was appointed Director of Macquarie Generation on 1 March 1996, is the Chairman of the Board Remuneration and Human Resources Committee and was appointed a member of the Board Audit and Assurance Committee on 25 July 2003. Ms Buduls was reappointed as a Director on 1 March 2002 for a two year term ending on 28 February 2004.

Ms Buduls has a financial background, including seven years at Macquarie Bank Limited. Ms Buduls is currently a Non-Executive Director of several listed and public sector entities, including Mirvac Group Limited and Freedom Furniture Limited.

John Cahill

Non-Executive Director

Mr Cahill was appointed Director of Macquarie Generation on 3 May 1996 and is a member of the Board Remuneration and Human Resources Committee. Mr Cahill was reappointed as a Director on 1 March 2003 for a year ending on 28 February 2004.

Mr Cahill is the Assistant General Secretary of the Public Service Association of New South Wales and a member of that organisation's Executive and Central Council, and Assistant State Secretary of the Community and Public Sector Union and a member of that Union's State Executive, State Council and National Council. He is also a Director of the Bowlers Club of New South Wales and a member of the Board Finance Committee; and a Director of the State Government Employees Credit Union and Chair of the Board Audit Committee.

Mr Cahill has 25 years industrial experience in the electricity generation industry.

DIRECTORS' REPORT

Deborah Page BEc FCA MAICD

Non-Executive Director

Mrs Page was appointed Director of Macquarie Generation on 1 March 2000 and is a member of the Board Audit and Assurance Committee. Mrs Page was reappointed as a Director on 1 March 2003 for a three year term ending on 28 February 2006.

Mrs Page, a chartered accountant, has held senior executive positions with the Commonwealth Bank, Allen, Allen & Hemsley, IBM and the Lend Lease Group and is a former KPMG partner. She is currently the Chair of the New South Wales Cancer Council and is a Director of Investa Properties Limited and the New South Wales Internal Audit Bureau.

James Watt FAICD BSc(For) BA MF

Non-Executive Director

Mr Watt was appointed Director of Macquarie Generation on 1 March 1996. He is the Chairman of the Board Audit and Assurance Committee and a member of the Board Remuneration and Human Resources Committee. Mr Watt was reappointed as a Director on 1 March 2003 for a three year term ending on 28 February 2006.

Robert Webster AFAIM

Non-Executive Director

Mr Webster was appointed Director of Macquarie Generation on 1 March 1996 and is a member of the Board Remuneration and Human Resources Committee. Mr Webster was reappointed as a Director on 1 March 2002 for a two year term ending on 28 February 2004.

Mr Webster is a Senior Client Partner of Korn/Ferry International and a former New South Wales Government Minister. He is Chairman of the National Science and Technology Centre, a Director of Australian Stock Exchange Settlement and Transfer Corporation Pty Ltd, Allianz Australia Limited, Brickworks Ltd and the Mirvac Group Limited.

Directors' Meetings

The number of Directors' meetings (including meetings of Committees of Directors) and the number of meetings attended by each of the Directors during the financial year ended 30 June 2003 were:

	BOARD MEETINGS		BOARD AUDIT AND ASSURANCE COMMITTEE MEETINGS		BOARD REMUNERATION AND HUMAN RESOURCES COMMITTEE MEETINGS	
	Held	Attended	Held	Attended	Held	Attended
Mr Evan Rees (4)	12	11	-	-	-	2
Mr Grant Every-Burns (1) (2)	12	12	-	6	-	5
Ms Anna Buduls (3)	12	12	-	2	5	5
Mr John Cahill	12	11	-	-	5	3
Mrs Deborah Page (5)	12	12	6	6	-	1
Mr James Watt	12	12	6	6	5	5
The Hon Robert Webster	12	11	-	-	5	5

(1) Although not a member of the Board Audit and Assurance Committee, Mr Every-Burns attended all meetings of the Committee by invitation.
(2) Although not a member of the Board Remuneration and Human Resources Committee, Mr Every-Burns attended all meetings of that Committee by invitation.
(3) Although not a member of the Board Audit and Assurance Committee, Ms Buduls attended two meetings held by invitation.
(4) Although not a member of the Board Remuneration and Human Resources Committee, Mr Evan Rees attended two meetings of that Committee by invitation.
(5) Although not a member of the Board Remuneration and Human Resources Committee, Mrs Deborah Page attended one meeting of that Committee by invitation

Principal Activities

The principal activities of the Corporation during the course of the financial year were:

- the operation and maintenance of coal fired thermal power stations for the purpose of generating and selling electricity into the wholesale energy market;
- the marketing and sale of electricity into the New South Wales region of the National Energy Market; and
- the management of market risk arising from participation in the New South Wales region of the National Energy Market.

There have been no significant changes in the nature of the activities of the Corporation during the year.

DIRECTORS' REPORT

Operating Results

The operating profit after tax of the Corporation for the financial year ended 30 June 2003 was $56.6 million.

Review of Operations

The operations of the Corporation during the financial year and the result of those operations are outlined in the attached Financial Statements.

Dividends

Dividends paid or proposed by the Corporation since the end of the previous financial year were:

- an interim dividend of $60.0 million in respect of the year ended 30 June 2002 was paid on 6 August 2002;
- a final dividend of $65.0 million in respect of the year ended 30 June 2002 was paid on 2 December 2002; and
- a dividend of $56.0 million in respect of the year ended 30 June 2003 has been provided for in the Financial Statements.

Capital Distribution

A review of the Capital Structure Policy of Macquarie Generation by New South Wales Treasury commenced during the 2000/2001 financial year. A repayment of equity of $240 million was made to the Shareholders during the 2000/2001 financial year. A further repayment of equity of $400 million was made to the Shareholders on 5 July 2002.

State of Affairs

There were no significant changes in the state of affairs of the Corporation during the financial year.

Likely Developments

In the opinion of the Directors, all appropriate information concerning likely developments in, and the likely results of, the operations of the Corporation is contained in the attached Financial Statements.

Further information as to the likely developments in the operations of the Corporation and the expected results of those operations in subsequent financial years has not been included in this report because the Directors believe, on reasonable grounds, that to include such information would be likely to result in unreasonable prejudice to the Corporation.

The Shareholders have announced that they are considering the sale of the Corporation's electricity trading capacity to the private sector. No firm details on this proposal are available at the time of this report.

Events Subsequent to Balance Date

There has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Corporation, to affect significantly the operations of the Corporation, the results of those operations, or the state of affairs of the Corporation, in subsequent financial years.

Environmental Performance Report

Protection of the Environment Operations Act 1997

Bayswater and Liddell Power Stations were licensed by the Environment Protection Authority (EPA) under the Protection of the Environment Operations Act 1997, which came into force on 1 July 1999.

Both stations are required to monitor atmospheric emissions of particulate matter, sulphur dioxide, nitrogen oxides and total fluoride emissions which must not exceed limits or concentrations specified in the licence. The Bayswater licence also regulates the volume, concentration and type of pollutants in aqueous discharges to Lake Liddell and Tinkers Creek, as well as the discharge from Lake Liddell to the Hunter River under the Hunter River Salinity Trading Scheme. It also permits the discharge of ash to the Ravensworth Ash Disposal site.

The licences also include requirements for reporting to the EPA of:

- Information obtained from monitoring;
- Exceedences of licensed discharge limits; and
- Events or occurrences which caused actual or potential environmental harm not otherwise permitted by the licence.

Macquarie Generation also holds a licence for the operation of its gas turbines at Liddell. This requires the reporting of incidences which cause or are likely to cause environmental harm.

Macquarie Generation complied fully with all relevant discharge limits, monitoring and reporting requirements. No limits for atmospheric emissions or aqueous discharges were exceeded. However, the Corporation was fined $1,500 by the Environmental Protection Authority for a dust problem within the site due to drought conditions.

Certificates of compliance have been completed for these licences.

DIRECTORS' REPORT

Water Management Act 2000

In December 2000 Macquarie Generation was issued with a Part 9 Water Management Licence in accordance with the Water Act 1912.

This licence enables the Corporation to obtain sufficient water for the operation of Bayswater and Liddell Power Stations in the long term, and combines all of the previously existing water licences and entitlements, including conditions of the Glennies Creek Dam Act (1979) and the Glennies Creek Agreement, into a single instrument.

As per the requirements of Part 9 of the Water Management Act 1912, the Licence was subject to a public review resulting in some modifications to the Licence.

The conversion of the Licence to the requirements of the Water Management Act 2000 has not taken place as of 30 June 2003. The Department of Land and Water Conservation is yet to advise of the Licence transfer process and its implications.

Waste Minimisation and Management Act 1995

Liddell Power Station is licensed to store coal tar substances under the Waste Minimisation and Management Act 1995. This material must be stored, contained and handled to prevent contamination of surface and ground waters and the generation of dust. The station has complied with the conditions of the licence.

Environmentally Hazardous Chemical Act 1985

An asbestos burial site is regulated by a Chemical Control Order issued by the EPA. The stations have complied with the order which regulates the management of the waste. There are no reporting requirements for the site.

Renewable Energy (Electricity) Act 2000

Macquarie Generation has a physical supply contract with Tomago Aluminium. Due to this contract Macquarie Generation has an obligation under the Renewable Energy (Electricity) Act 2000 to source power from renewable sources.

Waste Reduction and Purchasing Policy (WRAPP)

The Waste Reduction and Purchasing Policy requires all New South Wales State Owned Corporations to reduce waste and to increase purchases of operating supplies and materials that include recycled content from the following four areas:

- paper products (eg stationery),
- office equipment and consumables (eg toner cartridges),
- vegetation material (eg biomass), and
- construction and demolition material (eg concrete, fill or asphalt).

Macquarie Generation has implemented the Policy, including preparing a Waste Reduction and Purchasing Plan and reporting to Resource NSW. The items reported in the plan are a minor component of Macquarie Generation's operations.

More significant waste reduction activities include:

- Re-use of 65,715 tonnes of ash in cement manufacture, landscaping and road works;
- Re-use of approximately 2,542 tonnes of lime and gypsum by-products by the agricultural industry;
- Co-firing wood waste from licensed sawmills. Since the program trials in August 1999, over 313,000 tonnes of waste biomass has been utilised, and 309 GWh of greenhouse neutral electricity has been produced;
- Efficiency improvements at the Power Stations resulting in less coal burnt; and
- Use of recycled oil for boiler start-up at Bayswater and Liddell Power Stations.

Directors' Interests

The Corporation did not enter into any contracts during the financial year with entities in which Directors declared an interest.

No Director holds an interest in the share capital of the Corporation.

Directors' Benefits

No Director has declared the receipt of, or has declared an entitlement to receive, during or since the financial year, a benefit as a result of a contract made by the Corporation with a Director, an entity of which a Director is a member or an entity in which a Director has a substantial financial interest.

Indemnification of Directors and Officers

During the financial year Macquarie Generation paid a premium of $205,862, including GST, to insure the Directors and certain officers of the Corporation. The policy covers losses and expenses that may be incurred in defending civil or criminal proceedings that may be brought against the Directors and officers in their capacity as Directors and officers of the Corporation. At the date of this report no claims have been made against the policy.

DIRECTORS' REPORT

Rounding of Amounts

Amounts in the Financial Statements and Directors' Report have been rounded to the nearest thousand dollars unless otherwise indicated.

Signed in accordance with a resolution of the Directors.

HE Rees
Chairman

GV Every-Burns
Chief Executive and Managing Director

15 August 2003

STATEMENT OF FINANCIAL PERFORMANCE

FOR THE YEAR ENDED 30 JUNE 2003

	Notes	2003 $'000	2002 $'000
Revenue from Ordinary Activities	2	761,538	817,560
Borrowing costs expense	3	(118,565)	(77,040)
Other expenses from ordinary activities	3	(542,255)	(558,949)
Profit from ordinary activities before income tax expense		100,718	181,571
Income tax expense	4	(44,081)	(60,257)
NET PROFIT	18(d)	56,637	121,314
Net increase in asset revaluation reserve	18(c)	870,898	-
Adjustment resulting from change in accounting policy for employee benefits	18(d)	(406)	-
Total changes in equity other than those resulting from transactions with owners as owners		927,129	121,314

The above Statement of Financial Performance should be read in conjunction with the accompanying notes.

STATEMENT OF FINANCIAL POSITION

AS AT 30 JUNE 2003

	Notes	2003 $'000	2002 $'000
Current Assets			
Cash assets	6	62,461	136,993
Receivables	7	95,018	150,085
Inventories	8	98,921	83,152
Property, plant and equipment	9	487	-
Other	12	317	711
TOTAL CURRENT ASSETS		257,204	370,941
Non-Current Assets			
Receivables	7	149	270
Property, plant and equipment	9	2,561,540	1,746,402
Deferred tax assets	10	8,659	7,906
Intangible assets	11	339	188
Other	12	-	189
TOTAL NON-CURRENT ASSETS		2,570,687	1,754,955
TOTAL ASSETS		2,827,891	2,125,896
Current Liabilities			
Payables	13	116,672	125,793
Interest bearing liabilities	14	299,389	297,280
Provisions	16	74,742	136,741
Other	17	-	17,116
TOTAL CURRENT LIABILITIES		490,803	576,930
Non-Current Liabilities			
Interest bearing liabilities	14	870,700	602,165
Deferred tax liabilities	15	239,347	194,513
Provisions	16	28,887	25,263
Other	17	36,000	36,000
TOTAL NON-CURRENT LIABILITIES		1,174,934	857,941
TOTAL LIABILITIES		1,665,737	1,434,871
NET ASSETS		1,162,154	691,025
Equity			
Contributed equity	18(b)	281,078	681,078
Reserves	18(c)	870,898	-
Retained profits	18(d)	10,178	9,947
TOTAL EQUITY		1,162,154	691,025

The above Statement of Financial Position should be read in conjunction with the accompanying notes.

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 30 JUNE 2003

	Notes	2003 $'000	2002 $'000
Cash Flows from Operating Activities			
Cash received in the course of operations		897,284	817,901
Cash paid in the course of operations		(583,963)	(531,883)
Interest received		4,360	4,014
Borrowing costs		(103,037)	(73,538)
NET CASH INFLOWS FROM OPERATING ACTIVITIES	19	214,644	216,494
Cash Flows from Investing Activities			
Payments for property, plant and equipment		(34,900)	(20,042)
Payments for intangible assets		(167)	(192)
Proceeds from sale of property, plant and equipment		247	930
NET CASH (OUTFLOWS) FROM INVESTING ACTIVITIES		(34,820)	(19,304)
Cash Flows from Financing Activities			
Proceeds from borrowings		400,000	-
Repayment of borrowings		(129,356)	(39,686)
Dividend paid		(125,000)	(100,000)
Distribution to Shareholders	18(b)	(400,000)	-
NET CASH (OUTFLOWS) FROM FINANCING ACTIVITIES		(254,356)	(139,686)
NET (DECREASE) INCREASE IN CASH HELD		(74,532)	57,504
Cash at the beginning of the reporting period		136,993	79,489
CASH AT THE END OF THE REPORTING PERIOD	6	62,461	136,993

The above Statement of Cash Flows should be read in conjunction with the accompanying notes.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2003

Note 1—Summary of Significant Accounting Policies

This general purpose financial report has been prepared, as required by the State Owned Corporations Act, 1989, in accordance with the provisions of Part 3 of the Public Finance and Audit Act, 1983, Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board and Urgent Issues Group Consensus Views.

(a) Basis of Accounting

These Financial Statements have been prepared in accordance with the principles of accrual accounting and the historical cost convention, except for certain assets, which as noted, are at independent or Directors' valuation. The accounting policies adopted have been consistently applied except as otherwise noted.

(b) Income Tax

From 1 July 2001, Macquarie Generation became subject to the National Tax Equivalent Regime which reflects Federal Income Tax Acts.

Tax effect accounting procedures are followed whereby the income tax expense, calculated in accordance with the provisions of the National Tax Equivalent Regime, in the Statement of Financial Performance is matched with the accounting profit after allowing for permanent differences. Income tax on cumulative timing differences is set aside to the deferred income tax or the future income tax benefit accounts at the rates which are expected to apply when those timing differences reverse.

Future income tax benefits attributable to income tax losses are not carried forward as assets unless they are virtually certain of being realised. Recognised income tax losses are carried as a reduction in deferred income tax liabilities where it is expected that the benefit will be utilised in the same periods as the liability is incurred.

(c) Foreign Currency Translation

(i) Transactions

Transactions denominated in a foreign currency are converted to Australian dollars at the exchange rate at the date of the transaction. Foreign currency receivables and payables at balance date are translated at exchange rates current at balance date. Resulting exchange gains and losses are brought to account in determining the profit or loss for the year.

(ii) Specific Commitments

Hedging is undertaken in order to avoid or minimise possible adverse financial effects of movements in exchange rates. Gains or losses arising upon entry into a hedging transaction intended to hedge the purchase or sale of goods and services, together with subsequent exchange gains or losses resulting from those transactions are deferred in the Statement of Financial Position from the inception of the hedging transaction up to the date of the purchase or sale and included in the measurement of the purchase or sale. The net amounts receivable or payable under the hedging transaction are also recorded in the Statement of Financial Position. Any gains or losses arising on the hedging transaction after the recognition of the hedged purchase or sale are included in the Statement of Financial Performance.

When the anticipated purchase or sale transactions have been hedged, actual purchases or sales which occur during the designated hedged period are accounted for as having been hedged until the amounts of those transactions in the designated period are fully allocated against the hedged amounts.

If the hedged transaction is not expected to occur as originally designated, or if the hedge is no longer expected to be effective, any previously deferred gains or losses are recognised as revenue or expense immediately.

If the hedging transaction is terminated prior to its maturity date and the hedged transaction is still expected to occur as designated, deferral of any gains and losses which arose prior to termination continues and those gains and losses are included in the measurement of the hedged transaction.

In circumstances where a hedging transaction is terminated prior to maturity because the hedged transaction in no longer expected to occur as designated, any previously deferred gains and losses are recognised in the Statement of Financial Performance on the date of termination.

(d) Receivables and Revenue Recognition

Trade debtors are primarily attributable to electricity sales.

Electricity sales are recognised when metered as delivered. Electricity sales revenue comprises National Electricity Market settlements at spot market price and also payments due to the Corporation by counterparties in respect of electricity hedging contracts. Electricity option fee income is recognised when the income is earned which is upon entering a contract.

Note 1—Summary of Significant Accounting Policies (continued)

(d) Receivables and Revenue Recognition (continued)
Secured sundry debtors represent loans advanced to employees to assist in the purchase of housing in the Hunter region. These are secured by mortgages over the subject properties. The carrying amount of the debt excludes any unearned income. Interest revenue is brought to account over the term of each contract.

Bad debts are written off in the period in which they are identified.

(e) Inventories
Stores and materials, coal, biomass and oil stocks are stated at the lower of cost and net realisable value. Cost is determined using the weighted average cost method, which is updated upon the receipt of new items and is separately determined for each location.

(f) Recoverable Amount of Non-Current Assets
The recoverable amount of a non-current asset is the net amount expected to be recovered through the net cash inflows arising from its continued use and subsequent disposal, discounted to present values using the Corporation's weighted average cost of capital which was 11% for the 2002/2003 year.

Where the carrying amount of a non-current asset is greater than its recoverable amount the asset is revalued to its recoverable amount. Where net cash inflows are derived from a group of assets working together, recoverable amount is determined on the basis of the relevant group of assets. Any decrement in carrying amount is recognised as an expense in the net profit or loss in the reporting period in which the recoverable amount write down occurs.

(g) Property, Plant and Equipment
Property, plant and equipment are valued in accordance with New South Wales Treasury Accounting Policy for Valuation of Physical Non-Current Assets and are valued at fair value.

Property, plant and equipment is brought to account at cost or at independent or Directors' valuation, less, where applicable, any accumulated depreciation.

Costs arising from the installation, start-up and development of assets acquired or constructed are included in the carrying value of those assets.

Revaluation increments are credited directly to the asset revaluation reserve, except that, to the extent that an increment reverses a revaluation decrement in respect of that class of asset previously recognised as an expense in net profit or loss, the increment is recognised immediately in revenue in net profit or loss.

Revaluation decrements are recognised immediately as expenses in net profit or loss, except that, to the extent that a credit balance exists in the asset revaluation reserve in respect of the same class of assets, they are debited directly to the asset revaluation reserve.

Depreciation is calculated on a straight line basis to write off the net cost or revalued amount of each item of property, plant and equipment, other than freehold land, over its expected useful life to the Corporation.

Major spares purchased specifically for the infrastructure plant are capitalised and depreciated on the same basis as the plant to which they relate.

The estimated useful lives of Power Station assets were reassessed as at 1 July 2002 and as a result increased from 40 years to 50 years based on current engineering and environmental assessments.

Estimates of useful lives are made on a regular basis for all assets and these are:

Power Stations	50 years
Other Buildings	35 years
Other Plant and Equipment	2.5–10 years

Provision is not made for potential capital gains tax arising from the disposal of property, plant and equipment unless there is an intention to sell the assets concerned.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2003

Note 1—Summary of Significant Accounting Policies (continued)

(h) Sale of Non-Current Assets
Proceeds from the sale of property, plant and equipment are included in revenue. The depreciated value of such assets is included in expenditure.

(i) Leased Assets
Macquarie Generation leases a large proportion of its mobile plant under fully maintained operating leases. Operating lease payments are charged to the Statement of Financial Performance in the periods in which they are incurred, as this represents the pattern of benefits derived from the leased assets.

(j) Intangible Assets—Water Entitlements
Costs incurred in the purchase of water entitlements are deferred and amortised on a straight line basis over the period of their expected benefits which is 15 years.

(k) Trade and Other Creditors
These amounts represent liabilities for goods and services provided to the Corporation prior to the end of the financial year and which are unpaid at that date. These amounts include payments due to counterparties in respect of electricity hedge contract sales.

(l) Interest Bearing Liabilities
Borrowings are carried at their principal amounts, representing proceeds received on issue, net of amortisation. Discount or premium on borrowings is amortised over the terms of the borrowings and is included in the Statement of Financial Performance as a financing charge. Interest is recognised as an expense in the period to which it relates and is accrued as part of other creditors.

(m) Derivative Instruments
(i) Financial
New South Wales Treasury Corporation has been engaged to manage the treasury risk of Macquarie Generation in accordance with both approved Board policies and the Treasury Management Guidelines issued by New South Wales Treasury. To achieve this, New South Wales Treasury Corporation enters into derivative financial instruments, as disclosed in Note 23(b), on Macquarie Generation's behalf. Derivative financial instruments are not recognised in the Financial Statements on inception.

The accounting for forward foreign exchange contracts is in accordance with Note 1(c)(ii).

(ii) Commodity
Macquarie Generation is a participant in the wholesale electricity market. The Corporation forward sells electricity production using commodity based contracts which are settled other than by physical delivery in accordance with normal market practice. The Corporation employs a range of electricity hedging instruments to manage market risk, as disclosed in Note 23(b). Derivative financial instruments are not recognised in the Financial Statements on inception.

(n) Maintenance and Repairs
Plant of the Corporation is required to be overhauled on a regular basis. This is managed as part of an ongoing major cyclical maintenance program. The costs of this maintenance are charged as expenses as incurred, except where they relate to the replacement of a component of an asset, in which case the costs are capitalised and depreciated over the asset's remaining useful life in accordance with Note 1(g). Other routine operating maintenance, repairs and minor renewal costs are also charged as expenses as incurred.

(o) Employee Benefits
(i) Wages, Salaries and Annual Leave
Liabilities for wages, salaries and annual leave are recognised and are measured as the amount unpaid at balance date, at the remuneration rates expected to be paid when these obligations are settled in respect of employees' services up to that date.

(ii) Long Service Leave
A liability for long service leave is recognised, and is measured as the present value of expected future payments to be made in respect of services provided by employees up to balance date. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using interest rates on national government guaranteed securities with terms to maturity that match, as far as possible, the estimated future cash outflows.

Note 1—Summary of Significant Accounting Policies (continued)

(o) Employee Benefits (continued)

(iii) Superannuation
A liability or asset in respect of defined benefit superannuation is recognised, and is measured as the difference between the present value of employees' accrued benefits at balance date and the net market value of the schemes' assets at that date. The present value of accrued benefits is based on expected future payments which arise from membership of the schemes to balance date.

Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using interest rates on national government guaranteed securities with terms to maturity that match, as far as possible, the estimated future cash outflows. The amount included in the Statement of Financial Performance in respect of superannuation represents the contributions made by the Corporation to the superannuation schemes, adjusted by the movement in the superannuation asset or liability.

(iv) Employee benefit on-costs
Employee benefit on-costs, including payroll tax, are recognised and included in employee benefit liabilities and costs when the employee benefits to which they relate are recognised as liabilities.

(p) Provision for Insurance

The provision is represented by the amounts of reported claims, which have not been settled at balance date.

(q) Dividends

Provision is made for the amount of any dividend determined by the Directors on or before the end of the financial year but not distributed at balance date and is in accordance with New South Wales Treasury Dividend Policy.

(r) Mine Rehabilitation

The Corporation owns land, which includes mine sites that have attached to them a statutory obligation to rehabilitate that land, under the terms of a license issued by the Department of Mineral Resources. The future rehabilitation costs are expected to be incurred from the present until the 2021/2022 year and have been estimated by specialist internal technical staff. The balance of the provision represents the net present value of the estimated future cash flows required to complete the rehabilitation process, discounted by the Corporation's weighted average cost of capital.

(s) Segment Reporting

The Corporation operates predominantly in one business segment, that being the generation of electricity, and within one geographical segment, Australia.

(t) Rounding of Amounts

Amounts shown in these Financial Statements are rounded to the nearest thousand dollars when presented in tabular form. However, amounts quoted within text are stated as whole dollars.

(u) Comparative Figures

Where necessary, comparative information has been reclassified to enhance comparability in respect of changes in presentation adopted in the current year.

The unfunded superannuation liability has been reclassified from Note 17 Other Liabilities to Note 16 Provisions.

As disclosed in Note 4(c) the Corporation elected to change from a usage to a purchases basis for the taxation deduction of coal expenditure in accordance with Income Tax Ruling IT 333. Therefore the comparatives for aggregate income tax expense in Note 4(a), specifically the tax losses recognised and deferred income tax provision balances, have been revised to reflect this basis.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2003

	2003	2002
	$'000	$'000
Note 2—Revenue		
Revenue from Operating Activities		
Sales revenue	755,741	811,585
Miscellaneous sources	1,175	952
	756,916	812,537
Revenue from Outside the Operating Activities		
Net foreign exchange gains	15	79
Interest revenue	4,360	4,014
Sale of property, plant and equipment	247	930
	4,622	5,023
REVENUE FROM ORDINARY ACTIVITIES	761,538	817,560
Note 3—Operating Profit		
(a) Net Gains and Expenses		
Profit from ordinary activities before income tax expense includes the following specific net gains and expenses:		
Net Gains		
Net gain on disposal of		
Buildings	-	337
Writeback of insurance provision	-	8,975
Expenses		
Borrowing costs		
Interest and related finance charges	118,565	77,040
Depreciation of		
Buildings	15,637	7,337
Plant and equipment	80,121	77,812
Total Depreciation	95,758	85,149
Amortisation—water entitlements	16	4
Bad and doubtful debts		
Sundry debtors	1	1
Trade debtors	-	849
Total Bad and Doubtful Debts	1	850
Net loss on disposal of property, plant and equipment	85	180
Other provisions		
Employee entitlements	9,382	7,856
Redundancy	215	140
Total Other Provisions	9,597	7,996
Superannuation contributions to defined benefit funds	13,061	15,773
Superannuation contributions to accumulation funds	1,176	1,080
Total Superannuation Expense	14,237	16,853
Net loss on foreign currency transactions	-	-

	2003	2002
	$'000	$'000
Note 3—Operating Profit (continued)		
Expenses (continued)		
Operating lease rentals	1,989	1,914
Directors' remuneration	432	426
Auditors' remuneration		
Audit of the Financial Statements	132	128
Consultants' fees	2,065	2,941
(b) Expenses from ordinary activities, excluding borrowing costs expense, included in the Statement of Financial Performance by function:		
Electricity generation operational expenditure	542,255	558,949

(c) Revision of accounting estimates

Depreciation expense for the 2002/2003 year has increased as a result of the increase in valuation of the Corporation's assets following the revaluation process in July 2002. This increase has been partially offset by the revision and resulting extension of the useful lives of the Power Stations in July 2002.

The estimated useful lives of the Power Stations' property, plant and equipment were reviewed in line with current engineering and environmental assessments. As a result of the review, the useful lives were increased from 40 years to 50 years. The effect on depreciation expense for current and future years as a result of the increase in the useful lives was to decrease depreciation expense by $23.4 million per annum for Bayswater Power Station and $35.8 million per annum for Liddell Power Station. The decrease will take effect until the end of the useful life of the respective Power Station.

Note 4—Income Tax

(a) Income tax on operating profit differs from the prima facie tax on that profit as follows:

	2003	2002
Prima facie income tax on the operating profit at 30%	30,215	54,471
Tax effect of permanent differences:		
Non-assessable revenue	-	(101)
Non deductible depreciation on revaluation of non current assets	11,555	-
Non deductible superannuation contributions	2,553	4,732
Non deductible asset revaluation decrement	-	151
Non deductible entertaining expenses	13	23
Non deductible consultants' fees	5	253
Non deductible legal expenses	18	716
Non deductible sundry items	(18)	(12)
	14,126	5,762
Income tax adjusted for permanent differences	44,341	60,233
(Over)/under provision in previous year	(260)	24
INCOME TAX EXPENSE	44,081	60,257
Aggregate income tax expense comprises:		
Tax profit (losses) recognised	(3,915)	11,042
Deferred income tax provision	48,749	47,258
Future income tax benefits	(753)	1,957
	44,081	60,257

(b) Future income tax benefits attributable to tax losses have been recognised as a reduction to the provision for deferred income tax and are disclosed in Note 15. Future income tax benefits disclosed in Note 10 are attributable to timing differences and do not include tax losses.

(c) The Corporation elected to change from a usage to a purchases basis for the deduction of coal expenditure in accordance with Income Tax Ruling IT 333 from the financial year ending 30 June 2002. The comparative and current year tax balances reflect this basis.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2003

	2003	2002
	$'000	$'000

Note 5—Dividend

In accordance with the share dividends scheme determined by the voting shareholders, and as required by the Energy Services Corporation Act, 1995, the Board has provided for a dividend payment of $56,000,000 (2002–$125,000,000). This will be paid during the course of the 2003/2004 year and is represented by the balance of the provision at 30 June 2003 as disclosed in Note 16.

Note 6—Cash Assets

	2003	2002
Cash at bank and on hand	3	3
Deposits at call	62,458	136,990
	62,461	136,993

The above figures agree to cash at the end of the period as shown in the Statement of Cash Flows.

Deposits at Call

The deposits are bearing floating interest rates which at balance date averaged 4.8% (2002–4.8%).

Note 7—Receivables

	2003	2002
Current		
Trade debtors	94,717	150,431
Less: Provision for doubtful debts	849	849
	93,868	149,582
Sundry debtors—secured*	89	114
Sundry debtors—unsecured	1,061	389
	95,018	150,085
Non-Current		
Sundry debtors—secured*	149	270

*Secured by mortgages over the subject properties.

Note 8—Inventories

	2003	2002
Coal stocks (at cost)	52,142	37,892
Stores and materials (at cost)	45,225	43,651
Oil stocks (at cost)	1,554	1,609
	98,921	83,152

Note 9—Property, Plant and Equipment

	2003	2002
Current		
Buildings		
Other buildings:		
At independent valuation 2002	400	-
Less: Accumulated depreciation	13	-
	387	-
Land		
Non Infrastructure:		
At independent valuation 2002	100	-
TOTAL DEPRECIATED VALUE OF CURRENT LAND AND BUILDINGS	487	-

	2003	2002
	$'000	$'000
Note 9—Property, Plant and Equipment (continued)		
Non-current		
Buildings		
Power Stations:		
At Directors' valuation 2003	460,800	-
At cost	-	169,256
Less: Accumulated depreciation	15,543	45,316
	445,257	123,940
Other buildings:		
At independent valuation 2002	2,000	2,400
Less: Accumulated depreciation	81	-
	1,919	2,400
TOTAL NON-CURRENT BUILDINGS	447,176	126,340
Land		
Infrastructure:		
At Directors' valuation 2003	10,700	-
At cost	-	3,281
Non infrastructure:		
At independent valuation 2002	800	900
TOTAL NON-CURRENT LAND	11,500	4,181
Plant and equipment		
Power Stations:		
At Directors' valuation 2003	2,103,165	-
At cost	57,576	2,054,384
Less: Accumulated depreciation	76,451	456,157
	2,084,290	1,598,227
Other plant and equipment:		
At Directors' valuation 2003	20,433	-
At cost	1,765	35,905
Less: Accumulated depreciation	3,624	18,251
	18,574	17,654
TOTAL NON-CURRENT PLANT AND EQUIPMENT	2,102,864	1,615,881
TOTAL DEPRECIATED VALUE OF NON-CURRENT PROPERTY, PLANT AND EQUIPMENT	2,561,540	1,746,402

Valuation of Non Infrastructure Land and Buildings:

The valuation of non infrastructure land and buildings is based on the capitalisation of the estimated rental value of the property in the open market if applicable or the land value plus depreciated replacement value of improvements. The 2002 revaluation was carried out by members of the Australian Property Institute on behalf of International Valuation Consultants as at 31 January 2002.

Directors' Valuation 2003:

The Directors' valuation of infrastructure land, buildings, plant and equipment, associated with the Power Stations, is based on fair value. As the assets belong to a cash generating operation and the sum of the depreciated replacement costs exceeded the discounted cash flow valuation of the operations, the Directors have determined that the discounted cash flow valuation equates to fair value. This is in accordance with the requirements of AASB 1041 Revaluation of Non Current Assets. The asset values were apportioned on the basis of the depreciated replacement costs as determined by the independent valuers.

The Directors' valuation of other plant and equipment, not associated with the infrastructure of the Power Stations, is based on fair value equating to the written down value of the assets at 30 June 2002 prior to the revaluation.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2003

	2003	2002
	$'000	$'000
Note 9—Property, Plant and Equipment (continued)		

Reconciliations

Reconciliations of the carrying amount of each class of current and non-current property, plant and equipment at the beginning and end of the current and previous financial year are set out below.

	2003	2002
Land—Infrastructure		
Carrying amount at start of year	3,281	3,281
Revaluation increments	7,419	-
Additions	-	-
Disposals	-	-
Depreciation expense	-	-
Carrying amount at end of year	10,700	3,281
Land—Non Infrastructure		
Carrying amount at start of year	900	1,016
Revaluation decrements	-	116
Additions	-	-
Disposals	-	-
Depreciation expense	-	-
Carrying amount at end of year	900	900
Buildings—Power Stations		
Carrying amount at start of year	123,940	130,678
Revaluation increments	336,860	-
Additions	-	462
Disposals	-	-
Depreciation expense	15,543	7,200
Carrying amount at end of year	445,257	123,940
Buildings—Other		
Carrying amount at start of year	2,400	2,889
Additions	-	36
Revaluation decrements	-	388
Depreciation expense	94	137
Carrying amount at end of year	2,306	2,400
Plant and Equipment—Power Stations		
Carrying amount at start of year	1,598,227	1,656,262
Revaluation increments	523,462	-
Additions	39,052	15,211
Disposals	-	-
Depreciation expense	76,451	73,246
Carrying amount at end of year	2,084,290	1,598,227
Plant and Equipment—Other		
Carrying amount at start of year	17,654	19,177
Revaluation increments	3,157	-
Additions	1,765	3,816
Disposals	332	773
Depreciation expense	3,670	4,566
Carrying amount at end of year	18,574	17,654

	2003	2002
	$'000	$'000
Note 9—Property, Plant and Equipment (continued)		
Total		
Carrying amount at start of year	1,746,402	1,813,303
Revaluation increments	870,898	-
Additions	40,817	19,525
Disposals	332	773
Revaluation decrements	-	504
Depreciation expense	95,758	85,149
Carrying amount at end of year	2,562,027	1,746,402
Note 10—Deferred Tax Assets		
Non-Current		
Future income tax benefit	8,659	7,906
Note 11—Intangible Assets		
Non-Current		
Water entitlements	359	192
Less: Accumulated amortisation	20	4
	339	188
Note 12—Other Non-Current Assets		
Current		
Prepayments	317	711
Non-Current		
Development costs carried forward	-	189
Note 13—Payables		
Current (Unsecured)		
Accounts Payable	101,381	113,570
Accrued Interest	15,291	12,223
	116,672	125,793
Note 14—Interest Bearing Liabilities		
Current (Unsecured)		
Borrowings	299,389	297,280
Non-Current (Unsecured)		
Borrowings	870,700	602,165

Borrowings are comprised of fixed rate debt of $1,077,589,006 (2002–$869,445,322) bearing interest rates of between 4.7% and 6.9% and the remainder bearing floating interest rates of between 4.7% and 4.9%. These rates are exclusive of the Government Guarantee Fee and New South Wales Treasury Corporation administration fees.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2003

	2003	2002
	$'000	$'000
Note 14—Interest Bearing Liabilities (continued)		
Maturity Analysis		
The following table summarises the maturity pattern of Macquarie Generation's borrowings.		
Up to one year	299,389	297,280
Over one and up to five years	505,726	346,365
Over five years	364,974	255,800
Total	1,170,089	899,445
Financing Arrangements		
Facilities Available		
Bank overdraft	2,000	2,000
New South Wales Treasury Corporation loans	1,650,000	1,250,000
New South Wales Treasury Corporation Come And Go facility	390,000	390,000
Total Available	2,042,000	1,642,000
Facilities Utilised		
Bank overdraft	-	-
New South Wales Treasury Corporation loans	1,170,089	899,445
New South Wales Treasury Corporation Come And Go facility	-	-
Total Utilised	1,170,089	899,445

Macquarie Generation, with the exception of overdraft facilities, is required to undertake all new borrowings through the New South Wales Treasury Corporation.

Note 15—Deferred Tax Liabilities

	2003	2002
Non-Current		
Provision for deferred income tax	239,347	194,513

Deferred Income Tax

The provision for deferred income tax has been reduced by $43,823,203 (2002–$39,907,976) in respect of future income tax benefits attributable to tax losses. (See Also Note 4(b))

Note 16—Provisions

	2003	2002
Current		
Insurance	529	875
Dividend	56,000	125,000
Employee benefits	6,253	7,237
Mine rehabilitation	370	250
Unfunded employee superannuation	11,590	3,379
	74,742	136,741
Non-Current		
Employee benefits	21,247	17,245
Mine rehabilitation	7,640	8,018
	28,887	25,263

Movements in Provisions

Movements in each class of provision during the financial year, other than employee benefits and unfunded superannuation liability, are set out opposite.

	2003	2002
	$'000	$'000

Note 16—Provisions (continued)

	Insurance	Dividend	Mine Rehabilitation	Total
	$'000	$'000	$'000	$'000
Current				
Carrying amount at the start of the year	875	125,000	250	126,125
Additional provisions recognised	290	56,000	378	56,668
Payments/other sacrifices of economic benefits	(636)	(125,000)	(258)	(125,894)
Carrying amount at the end of the year	529	56,000	370	56,899
Non-Current				
Carrying amount at the start of the year	-	-	8,018	8,018
Additional provisions recognised	-	-	-	-
Payments/other sacrifices of economic benefits	-	-	(378)	(378)
Carrying amount at the end of the year	-	-	7,640	7,640

Note 17—Other Liabilities

	2003	2002
Current		
Amounts received in advance	-	76
Coal contract termination payment	-	17,040
	-	17,116
Non-Current		
Security deposit	36,000	36,000
	36,000	36,000

Security Deposit

The security deposit was provided under the terms of a long term electricity supply contract. The deposit is non-interest bearing and is repayable upon any breach of the contract by Macquarie Generation or upon completion of the contract in 2017.

Coal Contract Termination Payment

The coal contract termination payment represents an amount payable to a supplier releasing them from their obligations under a long term coal contract. The contract was terminated as part of the settlement of a dispute. Payments under the terms of the settlement were completed in July 2002.

Note 18—Equity

(a) Share Capital	No. of Shares	No. of Shares
Ordinary shares, fully paid	2	2

In accordance with the State Owned Corporations Act, 1989, the two voting shareholders, the Honourable M.R. Egan MLC, Treasurer and the Honourable J.J. Della Bosca MLC, Special Minister of State hold one share each valued at $1.00 per share.

(b) Contributed Capital	2003	2002
Opening balance	681,078	681,078
Distribution to Shareholders	(400,000)	-
CLOSING BALANCE	281,078	681,078

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2003

	2003	2002
	$'000	$'000

Note 18—Equity (continued)

Repayment of Equity to New South Wales Treasury

As a consequence of the finalisation of New South Wales Treasury's review of Macquarie Generation's Capital Structure a repayment of equity of $400 million was made in July 2002.

	2003	2002
(c) Reserves		
Asset Revaluation Reserve		
Balance 1 July 2002	-	-
Increment on revaluation of infrastructure land, buildings, property, plant and equipment	870,898	-
Balance 30 June 2003	870,898	-
(d) Retained Profits		
Retained profits at the beginning of the financial year	9,947	13,633
Adjustment resulting from change in accounting policy required to comply with AASB 1028 Employee Benefits	(406)	-
Net profit	56,637	121,314
Dividends provided for	(56,000)	(125,000)
RETAINED PROFITS AT THE END OF THE FINANCIAL YEAR	10,178	9,947

Note 19—Cash Flow Information

Cash includes cash on hand and deposits at call which are readily convertible to cash on hand and are subject to an insignificant risk of changes in value.

	2003	2002
Reconciliation of Net Cash Flows from Operating Activities to Operating Profit after Income Tax		
Operating profit after income tax	56,637	121,314
Depreciation and amortisation	95,774	85,153
Revaluation decrements	-	504
Increase (decrease) in net borrowings accruals	15,528	3,502
Net loss (gain) on sale of non-current assets	85	(157)
Tax profit (losses) recognised	(3,915)	22,409
Increase in net deferred taxes payable	47,996	37,849
Changes in assets and liabilities		
Decrease (increase) in trade and other debtors	55,190	(70,423)
Decrease (increase) in inventories	(15,769)	(14,351)
Decrease (increase) in other operating assets	283	12,771
Increase (decrease) in trade and other creditors, employee entitlements and other provisions	(37,165)	17,923
NET CASH FLOWS FROM OPERATING ACTIVITIES	214,644	216,494

Note 20—Capital Expenditure Commitments

	2003	2002
Commitments for the acquisition of assets contracted for at the reporting date but not recognised as liabilities, payable:		
Within one year	36,133	33,054
Later than one year but not later than five years	18,007	49,804
	54,140	82,858

Note 21—Lease Commitments

	2003	2002
Commitments in relation to leases contracted for at the reporting date but not recognised as liabilities, payable:		
Within one year	2,938	976
Later than one year but not later than five years	12,198	-
	15,136	976

	2003	2002
	$'000	$'000

Note 22—Events Occurring After Balance Date

There have been no events occurring after balance date, and prior to completion of this financial report, that have significantly or may significantly affect the operations of the Corporation, the results of those operations or the state of affairs of the Corporation in subsequent financial years.

Note 23—Financial Instruments

(a) Recognised Financial Instruments
Macquarie Generation has recognised certain financial instruments in the accounts. These financial instruments have been disclosed in Notes 6,7,13,14 and 17.

(b) Unrecognised Financial Instruments
Interest Rate Exposure
The Corporation manages interest rate risk with the assistance of interest rate swaps, interest rate futures and options. These products are also used to assist in the management of Macquarie Generation's financial assets, with positions being marked to market and a gain or loss recognised in the accounts. All derivatives are managed through New South Wales Treasury Corporation in accordance with Board policies including total value and credit risk and can only be used for hedging purposes.

(i) Interest Rate Swap Contracts
The Corporation's borrowings at 30 June 2003 include securities that bear an average variable interest rate of 4.9%. It is the policy to protect the borrowings from exposure to increasing interest rates. Accordingly New South Wales Treasury Corporation has entered into interest rate swap contracts on Macquarie Generation's behalf under which the Corporation is obliged to receive and pay interest at variable rates and fixed rates. The contracts are settled on a net basis each 90 days and the net amount receivable or payable at the reporting date is included in other debtors or other creditors. Asset and liability swaps in place at 30 June 2003 have fixed interest rates ranging between 5.3% and 6.3% and variable rates that range from 4.7% to 4.8%.

At 30 June 2003, the notional principal amounts and periods of expiry of the interest rate swap asset and liability contracts are as follows:

	2003	2002
	$'000	$'000
1–2 years	18,400	-
2–3 years	46,000	18,400
3–4 years	11,600	-
4–5 years	-	11,600
2–3 years *	-	(18,400)
4–5 years *	-	(11,600)
	76,000	-

* The negative amounts represent asset interest rate swap contracts

(ii) Interest Rate Futures
All gains or losses incurred in the use of interest rate futures are included in the Statement of Financial Performance as part of the Corporation's borrowing costs for the year.

The futures position at the end of the year is as follows:

	Delivery Month	Number Contracts Sold	Number Contracts bought	Total Nominal Value	Total Nominal Value
				2003	2002
				$'000	$'000
90 Day Bill Futures	-	-	-	-	15,000
3 Year Bond Futures *	Sep-03	-	191	(19,100)	1,000
10 Year Bond Futures	Sep-03	90	-	9,000	-
		90	191	(10,100)	16,000

* The negative amounts represent bought futures positions

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2003

Note 23—Financial Instruments (continued)

(b) Unrecognised Financial Instruments (continued)

Foreign Currency Exposure

In the normal course of business the Corporation enters foreign currency contracts for the supply of parts and equipment. Macquarie Generation policy requires exposures exceeding A$250,000 to be fully hedged through the use of forward foreign exchange contracts. Gains and losses are brought to account on a basis consistent with the underlying asset or liability.

At balance date the details of the outstanding contracts are:

	2003	2002	2003	2002
	Australian Dollars		Average Exchange Rate	
	$'000	$'000		
Buy United States Dollars				
Maturity				
0–6 months	1,855	1,827	0.668	0.565
1–2 years	976	958	0.668	0.565
2–3 years	-	926	0.668	0.565
Buy Swiss Francs				
Maturity				
0–6 months	188	377	0.902	0.842
6–12 months	562	424	0.902	0.842
1–2 years	561	426	0.902	0.842
2–3 years	556	-	0.902	-

As these contracts are hedging anticipated future purchases, any unrealised gains and losses on the contracts, together with the cost of the contracts, are deferred and will be recognised in the measurement of the underlying transaction provided the underlying transaction is still expected to occur as originally designated. Amounts receivable and payable on open contracts are included in other debtors and other creditors respectively. As at 30 June 2003 the Corporation's foreign exchange position gave rise to an unrealised loss of $556,471 (2002–$232,070) which has been deferred.

Electricity Hedging Contracts

The Corporation manages exposure to fluctuations in wholesale electricity market prices through the use of various types of hedging contracts in accordance with Board approved policy.

The terms and face values of the Corporation's outstanding electricity hedging contracts at the reporting date are detailed in the following table:

	2003	2002
	Face Values	
	$'000	$'000
Less than 1 year	446,000	370,000
1 to 5 years	462,000	481,000
5 to 10 years	96,000	152,000
	1,004,000	1,003,000

The weighted average fixed price of electricity hedging contracts is $36.01/MWh (2002–$36.05/MWh).

The unrecognised gain in respect of electricity hedging contracts at 30 June 2003 was $27,000,000 (2002–$36,000,000 gain).

The gain is determined using readily available independent market price estimates as provided by the Australian Financial Markets Association, using conventional market valuation techniques and is quoted in net present value terms discounted by the Corporation's weighted average cost of capital.

The details disclosed above on electricity hedging contracts represent outstanding electricity swap contracts entered into by the Corporation.

In addition, the Corporation has entered into electricity options, caps and collars which have not been valued as at 30 June 2003 as a reliable and generally accepted valuation methodology is not currently available and the value is not considered material.

(c) Interest Rate Risk Exposure

Interest rate risk is the risk that the financial instrument will fluctuate due to changes in market interest rates. The Corporation's exposure to interest rate risks and the weighted average interest rate for each class of financial assets and financial liabilities, both recognised and unrecognised at balance date are listed over page.

Note 23—Financial Instruments (continued)

(c) Interest Rate Risk Exposure (continued)

	FLOATING INTEREST RATE	FIXED INTEREST RATE MATURING IN: 1 YEAR OR LESS	1 TO 5 YEARS	OVER 5 YEARS	NON-INTEREST BEARING	TOTAL
	$'000	$'000	$'000	$'000	$'000	$'000
2003 Financial Assets						
Cash	62,458	-	-	-	3	62,461
Receivables	238	-	-	-	94,929	95,167
Interest rate swaps *	-	-	-	-	-	-
Interest rate futures **	(19,100)	19,100	-	-	-	-
	43,596	19,100	-	-	94,932	157,628
Weighted average interest rate	5.0%	4.4%	-	-		
Financial Liabilities						
Trade creditors	-	-	-	-	101,381	101,381
Accrued interest	-	-	-	-	15,291	15,291
Borrowings	92,500	299,444	413,226	364,919	-	1,170,089
Security deposit	-	-	-	-	36,000	36,000
Interest rate swaps *	(76,000)	76,000	-	-	-	-
Interest rate futures **	(9,000)	9,000	-	-	-	-
	7,500	384,444	413,226	364,919	152,672	1,322,761
Weighted average interest rate	4.8%	5.3%	6.0%	5.9%		
NET FINANCIAL ASSETS (LIABILITIES)	36,096	(365,344)	(413,226)	(364,919)	(57,740)	(1,165,133)

	FLOATING INTEREST RATE	FIXED INTEREST RATE MATURING IN: 1 YEAR OR LESS	1 TO 5 YEARS	OVER 5 YEARS	NON-INTEREST BEARING	TOTAL
	$'000	$'000	$'000	$'000	$'000	$'000
2002 Financial Assets						
Cash	136,990	-	-	-	3	136,993
Receivables	384	-	-	-	149,971	150,355
Interest rate swaps *	(30,000)	-	30,000	-	-	-
	107,374	-	30,000	-	149,974	287,348
Weighted average interest rate	6.0%	-	5.7%	-		
Financial Liabilities						
Trade creditors	-	-	-	-	113,570	113,570
Accrued interest	-	-	-	-	12,223	12,223
Borrowings	30,000	287,280	326,365	255,800	-	899,445
Security deposit	-	-	-	-	36,000	36,000
Coal contract termination payment	-	-	-	-	17,040	17,040
Interest rate swaps *	(30,000)	-	30,000	-	-	-
Interest rate futures **	(16,000)	15,000	1,000	-	-	-
	(16,000)	302,280	357,365	255,800	178,833	1,078,278
Weighted average interest rate	-	6.3%	6.5%	6.6%		
NET FINANCIAL ASSETS (LIABILITIES)	123,374	(302,280)	(327,365)	(255,800)	(28,859)	(790,930)

* Notional principal amounts ** Notional principal amounts—negative liability amounts indicate sold futures

(d) Credit Risk Exposure

Recognised

Credit risk is the risk of financial loss arising from another party to a contract or financial position failing to discharge a financial obligation thereunder. Macquarie Generation's exposure to credit risk is represented by the carrying amounts of financial assets, net of any provision for doubtful debts on the Statement of Financial Position. The recognised financial assets of the Corporation include amounts received by Government owned agencies (77%), secured debtors (18%) and other debtors (5%).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2003

Note 23—Financial Instruments (continued)

(d) Credit Risk Exposure (continued)

Unrecognised

The Corporation is exposed to credit related losses in the event of non-performance by counterparties to derivative instruments.

i) Electricity Hedging Contracts:

The Corporation manages its credit risk exposure to electricity hedging contracts by applying a Board approved policy under which the exposure limit applicable to each respective counterparty is determined with reference to an acceptable public credit rating assigned by an approved credit rating agency.

In the absence of an acceptable public rating, the Corporation requires a bank guarantee or other acceptable security exercisable in the state of New South Wales.

The Corporation calculates credit risk in accordance with Australian Prudential Regulation Authority guidelines and the amount calculated at balance date under this method was $117,590,000 (2002–$121,742,000).

ii) Forward foreign exchange contracts, interest rate swaps and interest rate futures:

Credit exposures are represented by the net fair value position of the contracts, as disclosed.

(e) Net Fair Value of Financial Assets and Liabilities

Bases for Determining Net Fair Values

Recognised

The net fair value of cash and cash equivalents and non-interest bearing financial assets and financial liabilities is represented by their carrying value, except in regard to a non-interest bearing security deposit and coal contract termination payment where net fair values are disclosed in the table below.

The net fair value of other monetary financial assets and liabilities including the security deposit and coal contract termination payment is based on the market prices where markets exist or by discounting the expected future cash flows by the current interest rates for assets and liabilities with similar risk profiles.

Unrecognised

The net fair value of unrecognised financial assets or liabilities is represented by the amounts receivable or payable at the reporting date based on appropriate interest rates, exchange rates or wholesale electricity spot prices at that date.

The recognised and unrecognised financial assets and financial liabilities of the Corporation are recorded at net fair value except as disclosed in the following table.

	2003		2002	
	Carrying Amount $'000	Net Fair Value $'000	Carrying Amount $'000	Net Fair Value $'000
Recognised Financial Instruments				
Financial Assets				
Loans to employees	238	218	384	336
TOTAL	238	218	384	336
Financial Liabilities				
Borrowings and accrued interest	1,185,380	1,221,331	911,668	926,659
Security deposit	36,000	12,475	36,000	11,453
Coal contract termination payment	-	-	17,040	17,040
TOTAL	1,221,380	1,233,806	964,708	955,152
Unrecognised Financial Instruments				
Financial Liabilities				
Electricity hedging contracts	-	27,000	-	36,000
Interest rate futures	-	22	-	-
TOTAL	-	27,022	-	36,000
Financial Liabilities				
Forward foreign exchange contracts	-	556	-	232
Interest rate swaps	-	1,733	-	353
Interest rate futures	-	-	-	192
TOTAL	-	2,289	-	777

Although loans to employees are carried at an amount above net fair value, the Directors have not caused those assets to be written down as it is intended to retain those assets to maturity.

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Note 24—Superannuation

Macquarie Generation contributes to defined benefit and accumulation superannuation funds on behalf of all employees and Directors.

(a) Defined Benefit Superannuation Funds

Macquarie Generation contributes to three defined benefit superannuation schemes: the State Superannuation Scheme (SSS), State Authorities Superannuation Scheme (SASS) and the State Authorities Non-Contributory Superannuation Scheme (SANCS). Employees contribute to the schemes at various percentages of their wages and salaries. Macquarie Generation contributes to the schemes at rates as advised by Pillar Administration.

Contributions to the schemes are expensed when paid or payable and reduce the superannuation liability. These payments are held in Investment Reserve Accounts by Pillar Administration. The Investment Reserve Accounts are invested by Pillar Administration and the resultant investment income or deficit adds to or subtracts from the balance of these accounts.

At balance date any net unfunded superannuation liability is recognised as a liability in the Statement of Financial Position. Similarly the amount of any net overfunded position is brought to account as revenue and recognised as an asset in the Statement of Financial Position in the form of prepaid superannuation contributions. The net unfunded superannuation liability included in the Statement of Financial Position as at 30 June are composed of:

	SASS (i)	SANCS (ii)	SSS (iii)	TOTAL
	$'000	$'000	$'000	$'000
	2003	2003	2003	2003
Gross liability assessed by actuaries as at 30 June 2003	22,750	8,543	62,565	93,858
Investment reserve	18,592	7,041	56,635	82,268
(Unfunded superannuation liability)	(4,158)	(1,502)	(5,930)	(11,590)
	2002	2002	2002	2002
Gross liability assessed by actuaries as at 30 June 2002	19,701	7,928	56,517	84,146
Investment reserve	17,578	6,672	56,816	81,066
(Unfunded superannuation liability)/prepaid contributions	(2,123)	(1,256)	299	(3,080)

(i) SASS—State Authorities Superannuation Scheme

(ii) SANCS—State Authorities Non-Contributory Superannuation Scheme

(iii) SSS—State Superannuation Scheme

Triennial actuarial reviews of the above schemes are carried out by the Scheme's Actuary. The last review was conducted as at 30 June 2000. On an annual basis the Scheme's Actuary will review the key actuarial assumptions employed in the last triennial review and determine the financial position of each fund as at 30 June. The Corporation has been advised that the triennial actuarial review as at 30 June 2003 will be carried out during the forthcoming financial year.

The actuarial assumptions used in determining the financial positions of each of the schemes shown above are as follows:

	2003/04	2004/05	2005/06 and thereafter
	% p.a.	% p.a.	% p.a.
Investment return	7.0	7.0	7.0
Salary growth rate	4.0	4.0	4.0
Consumer price index	2.5	2.5	2.5

(b) Accumulation Superannuation Funds

Macquarie Generation also contributes to various accumulation superannuation funds on behalf of employees and Directors at the statutory rate of salaries and wages or Directors' fees as determined by the Superannuation Guarantee (Administration) Act 1992 which was 9% (2002–8%).

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2003

Note 25—Directors' Interests

No Director has declared the receipt of, or has declared an entitlement to receive, or become entitled to receive, during or since the financial year, a benefit as a result of a contract between Macquarie Generation and a Director, an entity of which a Director is a member or an entity in which a Director has a substantial financial interest.

Note 26—Remuneration of Directors

	2003	2002
	$	$
Income paid or payable, or otherwise made available, to Directors in connection with the management of the affairs of the entity	858,292	854,597

The numbers of Directors whose total income from the entity was within the specified bands are as follows:

$	No.	No.
50,000–59,999	-	1
60,000–69,999	4	4
70,000–79,999	1	-
100,000–109,999	1	1
420,000–429,999	1	1

Details of the nature and amount of each element of the remuneration of each Non-Executive Director of Macquarie Generation are set out in the following tables.

Name	Travel Allowance $	Directors' Base Fees $	Committee Fees $	Superannuation Expense $	Total $
	2003	2003	2003	2003	2003
Evan Rees (Chairman)	941	96,434	-	8,573	105,948
Anna Buduls	580	54,565	5,000	5,361	65,506
John Cahill	949	54,565	-	4,911	60,425
Deborah Page	820	54,565	10,000	5,777	71,162
James Watt	580	54,565	7,000	5,541	67,686
The Hon. Robert Webster	396	54,565	1,667	5,061	61,689
Total Directors' fees	4,266	369,259	23,667	35,224	432,416

Name	Travel Allowance $	Directors' Base Fees $	Committee Fees $	Superannuation Expense $	Total $
	2002	2002	2002	2002	2002
Evan Rees (Chairman)	1,289	95,418	-	7,634	104,341
Anna Buduls	738	53,490	6,250	4,779	65,257
John Cahill	738	53,490	-	4,279	58,507
Deborah Page	999	53,490	6,250	4,779	65,518
James Watt	738	53,490	8,750	4,979	67,957
The Hon. Robert Webster	396	53,490	6,250	4,779	64,915
Total Directors' fees	4,898	362,868	27,500	31,229	426,495

Note 27—Remuneration of Executives

	2003	2002
	$	$
Total remuneration received, or due and receivable, from the entity by Executive Officers (including Directors) whose income is $100,000 or more	2,777,999	2,697,916

The numbers of Executive Officers (including Directors) whose remuneration from the entity was within the specified bands are as follows:

$	No.	No.
100,000–109,999	-	1
110,000–119,999	1	1
120,000–129,999	2	3
130,000–139,999	1	-
140,000–149,999	2	1
150,000–159,999	-	1
160,000–169,999	1	-
190,000–199,999	1	1
210,000–219,999	-	1
220,000–229,999	1	1
230,000–239,999	2	2
240,000–249,999	1	-
260,000–269,999	1	1
420,000–429,999	1	1

For the purposes of this note, Executive Officers are defined as being those senior management employees who take part in the management of the affairs of the entity, are employed under a performance based employment contract and whose total remuneration package including benefits and incentive payments received from the entitity during this financial year exceeded $100,000.

The number of Executive Officers with remuneration (excluding incentive payments) equal to or exceeding the equivalent of Senior Executive Service (SES) Level 1 ($117,000 for the year ending 30 June 2003) at the end of the reporting period was 13 (2002–13).The number of executive officer positions equal to or exceeding SES Level 1 filled by women in the current year was 1 (2002–1).

In relation to the Chief Executive and Managing Director and Managers reporting directly to him, the following specific remuneration and incentive payments were made during the financial year. The 2003 incentive payments were earned during the 2002/2003 year and will be paid during the 2003/2004 year. Likewise the 2002 incentive payments were earned during the 2001/2002 year and paid during the 2002/2003 financial year.

	2003	2003	2002	2002
	$ Remuneration Package	$ Incentive Payment	$ Remuneration Package	$ Incentive Payment
Position				
Chief Executive and Managing Director	331,244	110,500	313,101	95,000
Chief Financial Officer and Company Secretary	204,697	53,300	190,975	43,090
Manager Marketing and Trading	213,078	59,780	204,822	49,200
Manager Bayswater Power Station	189,479	47,500	181,684	50,050
Manager Liddell Power Station	189,617	45,600	181,665	41,860
Manager Fuel and Environment	181,131	45,375	173,667	46,980
General Manager Human Resources	162,122	-	158,699	29,415

Macquarie Generation has in place an executive and staff incentive program. In the case of executive contract staff, incentives are aligned to measurable commercial targets that increase profit and shareholder value outcomes. An additional payment of $150,000 was made in the year to the Manager Marketing and Trading in fulfilment of a condition of contract. The incentive payments are subject to the recommendation of the Remuneration and Human Resources Committee for approval by the Board. Disclosure of the specific targets would entail the disclosure of commercially sensitive information.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2003

Note 28—Exemptions

The Financial Statements have been prepared in accordance with the requirements of Part 3 of the Public Finance and Audit Act 1983 and the Public Finance and Audit Regulation 2000, except that the following exemptions have been granted by the Treasurer to allow disclosure for the electricity industry on a basis broadly consistent with the Corporations Act 2001:

(1) Exemption from preparing manufacturing, trading and profit and loss statements;
(2) Exemption from reporting amounts set aside for renewal or replacement of fixed assets;
(3) Exemption from reporting amounts set aside to any provision for known commitments;
(4) Exemption from reporting amounts appropriated for repayment of loans, advances, debentures and deposits;
(5) Exemption from reporting material items of income and expenditure on a program or activity basis in respect of commercially sensitive information; and
(6) Exemption from reporting the excess of non-current asset value over the replacement cost.

END OF AUDITED FINANCIAL STATEMENTS

DIRECTORS' DECLARATION

Pursuant to Section 41C of the Public Finance and Audit Act, 1983, we state that in the opinion of the Directors of Macquarie Generation:

a) the accompanying Financial Statements and Notes comprise a general purpose financial report which has been prepared in accordance with applicable Australian Accounting Standards, the State Owned Corporations Act, 1989, the Public Finance and Audit Act, 1983, the Public Finance and Audit Regulation, 2000 and mandatory professional reporting requirements and give a true and fair view of the Corporation's financial position as at 30 June 2003 and its performance for the year ended on that date;

b) at the date of this statement, there are reasonable grounds to believe that the Corporation will be able to pay its debts as and when they become due and payable;

c) we are not aware of any circumstances at the date of this declaration that would render any particulars included in the financial report to be misleading or inaccurate.

This declaration is made in accordance with a resolution of the Directors.

HE Rees
Chairman

GV Every-Burns
Chief Executive and Managing Director

15 August 2003

INDEPENDENT AUDIT REPORT

AUDITOR-GENERAL
NEW SOUTH WALES

GPO BOX 12
SYDNEY NSW 2001

INDEPENDENT AUDIT REPORT

MACQUARIE GENERATION

To Members of the New South Wales Parliament

Audit Opinion

In my opinion, the financial report of Macquarie Generation:

(a) presents fairly the Corporation's financial position as at 30 June 2003 and its financial performance and cash flows for the year ended on that date, in accordance with applicable Accounting Standards and other mandatory professional reporting requirements in Australia, and

(b) complies with section 41B of the *Public Finance and Audit Act 1983* (the Act).

The opinion should be read in conjunction with the rest of this report.

The Board's Role

The financial report is the responsibility of the members of the Board of Macquarie Generation. It consists of the statement of financial position, the statement of financial performance, the statement of cash flows and the accompanying notes.

The Auditor's Role and the Audit Scope

As required by the Act, I carried out an independent audit to enable me to express an opinion on the financial report. My audit provides *reasonable assurance* to Members of the New South Wales Parliament that the financial report is free of *material* misstatement.

My audit accorded with Australian Auditing and Assurance Standards and statutory requirements, and I:

- evaluated the accounting policies and significant accounting estimates used by the Board in preparing the financial report, and
- examined a sample of the evidence that supports the amounts and other disclosures in the financial report.

An audit does not guarantee that every amount and disclosure in the financial report is error free. The terms 'reasonable assurance' and 'material' recognise that an audit does not examine all evidence and transactions. However, the audit procedures used should identify errors or omissions significant enough to adversely affect decisions made by users of the financial report or indicate that Board members had failed in their reporting obligations.

My opinion does not provide assurance:

- about the future viability of the Corporation
- that it has carried out its activities effectively, efficiently and economically, or
- about the effectiveness of its internal controls.

Audit Independence

The Audit Office complies with all applicable independence requirements of Australian professional ethical pronouncements. The Act further promotes independence by:

- providing that only Parliament, and not the executive government, can remove an Auditor-General, and
- mandating the Auditor-General as auditor of public sector agencies but precluding the provision of non-audit services, thus ensuring the Auditor-General and the Audit Office are not compromised in their role by the possibility of losing clients or income.

R Sendt

R J Sendt
Auditor-General

SYDNEY
15 August 2003

CORPORATE GOVERNANCE STATEMENT 2003

Charter and Legislation

Macquarie Generation is a statutory State Owned Corporation, in accordance with the State Owned Corporations Act 1989. It was constituted on 1 March 1996 under the Energy Services Corporations Act 1995 as an electricity generator.

Section 8 of the State Owned Corporations Act 1989 sets out the principal objectives of State Owned Corporations while the Energy Services Corporations Act 1995, Part 2 Section 5 sets out the principal objectives of electricity generators.

Corporate Governance Framework

The Board of Directors and management of Macquarie Generation are committed to achieving and demonstrating the highest standards of corporate governance.

In June 2003 the Audit and Assurance Committee considered a report from Management that assessed Macquarie Generation's governance framework against the governance principles released by the ASX Corporate Governance Council in March 2003 and against best practice guidelines provided by the Audit Office of New South Wales.

The Corporation's governance framework was largely consistent with the recommendations and exceeded them in some areas.

The relationship between the Board and Management is important to the Corporation's long term success. Day-to-day management of the Corporation's affairs and the implementation of the corporate strategy and policy initiatives are formally delegated by the Board to the Managing Director and senior executives as set out in the Corporation's delegations policy. These delegations are reviewed on an annual basis.

The Directors are responsible to the Shareholders for the performance of the Corporation in both the short and the longer term. Their focus is to enhance the interests of Shareholders and other key stakeholders and to ensure the Corporation is efficiently managed.

A description of the Corporation's main corporate governance practices is set out below. All these practices, unless otherwise stated, were in place for the entire year.

The Board of Directors

The Board operates in accordance with the governing legislation and the Corporation's Memorandum and Articles of Association. The Board has undertaken to develop a formal charter for its role and responsibilities during 2003/2004.

Board Composition

The Board comprises six Non-Executive Directors and one Executive Director. Non-Executive Directors bring a fresh perspective to the Board's consideration of strategic, risk and performance matters and are best placed to exercise independent judgement and review and constructively challenge the performance of Management.

In recognition of the importance of independent views and the Board's role in supervising the activities of management the Chairman is an independent Non-Executive Director.

The Chairman is nominated by the Shareholders and meets regularly with the Managing Director.

The Corporation has a mix of Directors on the Board from different backgrounds with complementary skills and experience.

The Board undertakes periodic assessments of the performance of the Board in order to ensure maximum contribution to the strategic management and governance of the Corporation.

Responsibilities

The responsibilities of the Board include:

- Contributing to the development of and approving the corporate strategy.
- Reviewing and approving business plans, the annual budget and financial plans including available resources and major capital expenditure initiatives.
- Overseeing and monitoring:
  - organisational performance and the achievement of the Corporation's strategic goals and objectives,
  - compliance with the Corporation's Code of Conduct, and
  - progress of major capital expenditures and other significant corporate projects.
- Monitoring financial performance including approval of the annual and half-year financial reports and liaison with the Corporation's internal and external auditors via the Audit and Assurance Committee.
- Appointment, performance assessment and, if necessary, removal of the Managing Director allowing for consultation with the Shareholders.
- Ratifying the appointment, removal and performance assessment of the members of the senior management team.
- Reviewing and approving the remuneration and performance incentive arrangements for the senior executive team.

CORPORATE GOVERNANCE STATEMENT 2003

Responsibilities (continued)

- Ensuring there are effective management processes in place and approving major corporate initiatives.
- Enhancing and protecting the reputation of the Corporation.
- Ensuring the significant risks facing the Corporation, including those associated with its legal compliance obligations have been identified and appropriate and adequate control, monitoring, accountability and reporting mechanisms are in place.
- Reporting to Shareholders on the operation of the Corporation.

Board Members

Details of the members of the Board, their experience, expertise, qualifications, term of office and independent status are set out in the Directors' Report under the heading 'Information on Directors'. There are six Non-Executive, independent Directors and one Executive Director at the date of signing the Directors' Report.

The Directors in office were considered and nominated by the Shareholder based on the skills and experience they could bring to Board deliberations on current and emerging issues. The Shareholder sets the term of office of each Director and consults with the Chairman on director appointments.

In addition the Shareholder and the Board seeks to ensure that:

- at any point in time, its membership represents an appropriate balance between Directors with experience and knowledge of the Corporation and Directors with an external or fresh perspective, and
- the size of the Board is conducive to effective discussion and efficient decision making.

Chairman and Chief Executive

The Chairman is responsible for leading the Board, ensuring that Board activities are organised and efficiently conducted and for ensuring Directors are properly briefed for meetings. The Chief Executive and Managing Director is responsible for implementing the Corporation's strategies and policies.

Commitment

The Board held ten board meetings and two corporate strategy sessions during the year. Four of those meetings were held at operational sites of the Corporation.

The number of meetings of the Corporation's Board of Directors and of each Board Committee held during the year ended 30 June 2003, and the number of meetings attended by each Director is disclosed on page 3 of the Directors' Report.

It is the Corporation's practice to allow its Managing Director to accept appointments outside the Corporation with the prior written approval of the Board. No appointments of this nature were accepted during the year ended 30 June 2003.

During the year ended 30 June 2003 the Chief Executive and Managing Director held the positions of Chairman of the NEMMCO Participant Advisory Committee and Deputy Chairman of the National Generators Forum.

Conflict of Interests

The Corporation did not enter into any contracts during the financial year with entities in which Directors declared a conflict of interest.

Directors and Board Committees have the right, in connection with their duties and responsibilities, to seek reasonable independent professional advice at the Corporation's expense.

Corporate Reporting

The Chief Executive and Managing Director and Chief Financial Officer and Company Secretary have made the following certifications to the Board:

- that the Corporation's financial reports are complete and present a true and fair view, in all material respects, of the financial condition and operational results of the Corporation,
- that the above statement is founded on a sound system of internal control and risk management which implements the policies adopted by the Board and that the Corporation's risk management and internal control is operating efficiently and effectively in all material respects, and
- there have been no incidents of significant environmental risk during the year.

The Chief Executive and Managing Director and the Chief Financial Officer and Company Secretary have provided similar certifications to the Board since 1997.

Board Committees

The Board has established Committees to assist in the execution of its duties and to allow detailed consideration of complex issues. Current Committees of the Board are the Audit and Assurance, and Remuneration and Human Resources Committees. Each is comprised entirely of Non-Executive Directors. The Committee structure and membership is reviewed on an annual basis.

Board Committees (continued)

The Board also forms other Committees on a needs basis to address specific issues. In the past a Legal Affairs Committee and a Strategic Issues Management Committee have operated.

Each of the Committees has its own written Charter setting out its role and responsibilities, composition, structure, membership requirements and the manner in which the Committee is to operate. The Charters for the Committees will be available on the Corporation's website.

All matters determined by Committees are submitted to the full Board as recommendations for Board decision and minutes of Committee meetings are made available to all members of the Board for information.

Remuneration and Human Resources Committee

The Remuneration and Human Resources Committee consists of the following Non-Executive Directors:
Anna Buduls (Chairman)
John Cahill
James Watt
The Hon. Robert Webster

The Remuneration and Human Resources Committee advises the Board on remuneration policies and practices generally, and makes specific recommendations on remuneration packages and other terms of employment for the Managing Director and other senior executives. Committee members receive regular input from an external remuneration expert on recent developments on remuneration and related matters.

Executive remuneration and other terms of employment are reviewed annually by the Committee having regard to personal and corporate performance, contribution to long term growth, relevant comparative information and independent expert advice. As well as a base salary, remuneration packages include superannuation, retirement and termination entitlements, performance-related bonuses and fringe benefits.

Further information on Directors' and Executives' Remuneration is set out in Notes 26 and 27 to the Financial Statements.

The Committee has oversight responsibility for management succession planning, including the implementation of appropriate executive development programs and ensuring adequate arrangements are in place, so that appropriate candidates are recruited for later promotion to senior positions.

Audit and Assurance Committee

The Audit and Assurance Committee consists of the following Non-Executive Directors:

James Watt (Chairman)
Anna Buduls
Deborah Page

The Audit and Assurance Committee has appropriate financial expertise and all members have a working knowledge of the industry in which the Corporation operates.

The main responsibilities of the Committee are to review and assess financial reports, monitor the performance of the Corporation's internal control systems, ensure that internal and external audit plans address areas of high operational and financial risk, oversee the effective operation of the risk management framework, recommend the appointment, remuneration and monitor the performance of the Corporation's auditors and review and monitor related party transactions.

In fulfilling its responsibilities, the Audit and Assurance Committee receives regular reports from Management and the internal and external auditors and requires the Chief Executive and Managing Director and Chief Financial Officer and Company Secretary to state in writing to the Board that the Corporation's financial reports present a true and fair view, in all material respects, of the Corporation's financial condition, operational results and are in accordance with relevant accounting standards.

The Audit and Assurance Committee has authority, within the scope of its responsibilities, to seek any information it requires from any employee or external party.

External Auditors

The Audit Office of New South Wales is appointed by New South Wales Parliament as the external auditors. The Audit Office of New South Wales complies with all professional independence requirements. Fees paid to the external auditors are provided at Note 3 to the Financial Statements.

CORPORATE GOVERNANCE STATEMENT 2003

Risk Assessment, Internal Control and Management Reporting

The Board is responsible for ensuring there are adequate policies in relation to risk oversight and management, and internal control systems. In summary, the Corporation's policies are designed to ensure strategic, operational, legal, environmental, reputation and financial risks are identified, assessed, addressed and monitored to enable achievement of the Corporation's business objectives.

Considerable importance is placed on maintaining a strong control environment. There is an organisational structure with clearly drawn lines of accountability and delegation of authority. Adherence to the Code of Conduct is required at all times and the Board actively promotes a culture of quality and integrity.

The Board receives monthly reports from Management on compliance with Risk Management Policies and material financial and operational risks that may impede meeting business objectives.

Detailed control procedures cover management accounting, financial reporting, project appraisal, environment, health and safety, IT security, compliance and other risk management issues.

The Chief Financial Officer and Company Secretary consolidates the business unit reports from each member of the Executive for the annual corporate strategy process, which includes sessions attended by the Board and senior management. The strategy planning sessions are held over several days and review the Corporation's strategic direction and business plan in detail, and include specific focus on the identification of the key business, operational and financial risks which could prevent the Corporation from achieving its objectives.

In addition the Board requires that each major proposal submitted to the Board for decision be accompanied by a comprehensive risk assessment and evaluation, and where required, Management's proposed mitigation strategies. Following implementation and operation, Management is required to complete post implementation evaluations on major projects and to report outcomes to the Board.

The Board monitors the operational and financial performance of the Corporation against budget and other key performance measures through monthly management reports received from each member of the Executive.

Executive Committees

The management of business risk is conducted through Management Committees covering the following areas:

- Executive
- Energy Trading
- Environment
- Safety
- International Accounting Standards Implementation
- Budget Review
- Information Technology

All of the Committees have formal Charters setting out responsibility and authority.

Code of Conduct

The Corporation has developed a formal Code of Conduct, which has been fully endorsed by the Board and applies to all Directors and employees. The Code covers fairness and equity, confidentiality, the use of corporate resources, acceptance of gifts and benefits, conflicts of interests, corrupt conduct and accountability.

The Code is regularly reviewed and updated as necessary to ensure it reflects the highest standards of behaviour and professionalism and the practices necessary to maintain confidence in the Corporation's integrity.

Continuous Disclosure and Shareholder Communication

Management is responsible for ensuring compliance with the continuous disclosure requirements to the Shareholders and overseeing and coordinating information disclosure to the Shareholders' representatives, the Treasury of New South Wales.

The Shareholders and officers of New South Wales Treasury receive a copy of the Corporation's yearly and half yearly reports which are lodged in Parliament on or near 30 November and 28 February each year respectively.

STATUTORY INFORMATION

Senior Management Team

Title	Name and Qualification	Executive Committee Representation (1)
Chief Executive and Managing Director	Mr Grant Every-Burns BE(Hons),FAICD	1,2,4,5,6
Chief Financial Officer and Company Secretary (7)	Mr David Ipkendanz BEc DipEd FCPA	1,3,4,6
Manager Bayswater (7)	Mr John Neely BSc(Eng)	1,2,3,5,6
Manager Liddell (7)	Mr John Marcheff BE	1,2,3,5,6
General Manager Human Resources (7) (8)	Ms Lee Edmonds-Ward JP BA(Pol. Sci., Soc.) MBA SRN(G), MAHRI, FACOHN	1,5
Manager Marketing and Trading (7)	Mr Russell Skelton BE	1,3,4
Manager Fuel and Environment (7)	Mr Steve Ireland BE BLegS	1,2

Notes:
(1) Reflects membership of Executive Committee
(2) Executive Environment Committee
(3) Executive Information Technology Governance Committee
(4) Executive Trading Committee
(5) Executive Safety Committee
(6) Executive Budget Review Committee
(7) Direct report to the Chief Executive
(8) Resigned July 2003

Annual Report Costs

Macquarie Generation's Annual Report fulfils dual roles as a marketing tool and vehicle for the disclosure of statutory information. The total external costs (including consultants and printing costs) incurred in the production of the annual report was $30,653 (inclusive of GST). The annual report is available on the Corporation's website at www.macgen.com.au.

Chief and Senior Executive Officers

Macquarie Generation has not been included as a Declared Authority under Schedule 3 of the Public Sector Management Act 1988. Accordingly, Macquarie Generation senior managers are not members of the Government's Senior Executive Service (SES) and terms and conditions of their employment are set out in the Macquarie Generation Contract of Employment as disclosed in Note 27 to the Financial Statements.

Controlled Entities

Macquarie Generation has no controlled entities of the kind referred to in Section 39 (1A) of the Public Finance and Audit Act 1983.

Statement of Corporate Intent

The State Owned Corporations Act, 1989 requires Macquarie Generation to identify and set out reasons for departures from the Performance Targets contained in the Statement of Corporate Intent.

The major departures from the Statement of Corporate Intent (SOCI) are reported in the following table.

	2002/2003 Actual ($m)	2002/2003 SOCI Target ($m)
Tax Expense	44.1	18.1
Dividend Payable	56.6	42.1

STATUTORY INFORMATION

Macquarie Generation's performance was above target due primarily to higher than anticipated spot prices in the National Electricity Market in the first half of the financial year due to the commissioning delays of new generation in Queensland and consequential reduced flows over the fully operational Queensland to New South Wales interconnector.

Equal Employment Opportunity (EEO)

As at 30 June 2003, Macquarie Generation's workforce comprised 608 employees (excluding casuals) including trainees and apprentices in the following categories by percentage of the total staff numbers:

Trends in the Representation of EEO Groups

EEO Group:	Government target	2003	2002	2001	2000
Women	50%	11%	11%	11%	12%
People identifying as Aboriginal or Torres Strait Islander	2%	1.2%	1%	0.5%	0.5%
People whose first language as a child was not English	20%	4%	4%	4%	4%
People with a disability	12%	10%	10%	11%	12%
People with a disability requiring adjustment in the workplace	7%	3.2%	3.2%	3.4%	3.6%

Trends in the Distribution of EEO Groups (Note 1)

EEO Group:	Benchmark or target	2003	2002	2001	2000
Women	100	89	83	82	79
People identifying as Aboriginal or Torres Strait Islander	100	N/a	N/a	N/a	N/a
People whose first language as a child was not English	100	110	108	108	113
People with a disability	100	96	94	93	88
People with a disability requiring adjustment in the workplace	100	N/a	N/a	94	90

Note:
1. A distribution index of 100 indicates that the centre of distribution of the EEO group across salary level is equivalent to that of other staff. Values less than 100 mean that the EEO group tends to be more concentrated at lower salary levels than is the case for the other staff. The more pronounced this tendency is, the lower the index will be. The Distribution Index is automatically calculated by the software provided by the Office of the Director of Equal Opportunity in Public Employment (ODEOPE).

Achievements during 2002/2003 and key strategies proposed for 2003/2004

Key activities promoting workforce equity and diversity during the 2002/2003 financial year and planned for the 2003/2004 financial year included the following:

- Reviewing and improving flexible work options to meet employees' family needs, including child and elder care responsibilities;
- Continuing financial support to two community-based child care centres;
- Financial and other support to community based play groups and day care centres;
- Workplace awareness programs promoting equity and diversity;
- Reviewing policies and procedures to ensure equity and diversity practices are incorporated as appropriate;
- Surveying employees through exit interviews and climate surveys;
- Promoting and continuing to participate in traineeship programs, targeting EEO groups;
- Participating in work experience programs for people with a disability; and
- Improving EEO Data Collection to achieve a 100% response rate.

STATUTORY INFORMATION

Ethnic Affairs Priorities Statement

During the reporting period, an Ethnic Affairs Priorities Statement (EAPS) has been prepared, in accordance with the requirements of the Community Relations Commission and Principles of Multiculturalism Act 2000.

As an electricity generator and wholesaler, the Corporation does not provide direct services to the community. The Power Stations are remote from local communities, with the nearest township of Muswellbrook, some 28 km away. In dealings with providers of goods and services, some major contracts are made with international suppliers. In such circumstances, the suppliers arrange to have Australian-based representatives involved in contract negotiations between the parties. Nevertheless, Macquarie Generation ensures cultural differences are considered in such processes.

Essentially, as dictated by the nature of the Corporation's operations, geographical location and workforce profile, the strategies included in the EAPS support the key strategies and indicators contained in the Corporation's Equity and Diversity Program Management Plan 2000–2003. Key indicators applicable to EAPS are ensuring that merit based recruitment practices are maintained, that flexible working arrangements and/or provision of facilities are available to accommodate the needs of employees in regard to cultural or religious difference; and ensuring that written material produced by the Corporation is free of discriminatory references or language.

Freedom of Information

No requests for release of information under the NSW Freedom of Information Act were received by Macquarie Generation during the reporting period.

Funds Granted to Non-Government Community Organisations

Macquarie Generation donations and sponsorships during the reporting year to Hunter region community organisations totalled $171,411.

Overseas Visits

Name	Title	Country	Purpose
D. Ipkendanz	Chief Financial Officer and Company Secretary	United Kingdom	Presentations and meetings with insurance underwriters
J. Neely	Manager Bayswater Power Station	Europe, South Africa, United States	Water desalination projects
E. Burton	Water Plant Professional Officer Bayswater Power Station	Europe, South Africa, United States	Water desalination projects
S. Ireland	Manager Fuel and Environment	United Kingdom, Europe, United States	New energy technology and fuel sources.
J. Marcheff	Manager Liddell Power Station	Japan	Liddell Power Station Low Pressure Turbine Upgrade
C. Duck	Turbine Engineer Liddell Power Station	Japan	Liddell Power Station Low Pressure Turbine Upgrade
J. Sullivan	Environmental Engineer Liddell Power Station	Japan	Liddell Power Station Low Pressure Turbine Upgrade
G. Ryan	Project Manager Information Technology	South Africa	SAP IT migration consultancy

Promotion

A variety of communication vehicles were produced to inform stakeholders of corporate activities during the reporting year as follows:

- Annual Report 2002;
- Awareness advertising, Rural Press Ltd (Upper Hunter TV Guide);
- Television awareness campaign, Tomago project;
- Media releases, radio and TV interviews;
- Internet website updates: www.macgen.com.au;
- Community Billboard, Radio 2NM; and
- Casual newspaper and magazine advertising.

STATUTORY INFORMATION

Consultants' Fees

Consultants equal to or more than $30,000

Consultant	$ Cost	Nature
Finance, accounting and tax		
New South Wales Treasury Corporation	55,582	Treasury Management
Information technology		
Graham Barclay	31,105	ISO Software Consultancy
Pragmat Solutions	72,741	Records Management Project
Environmental		
Hunwick Consultants	140,863	General Environmental Consultancy
Marston and Marston	694,492	Wilpinjong and Anvil Hill Coal Exploration Advice
Marston International	146,663	Wilpinjong Mine Assessment Project
Pacific Power International	31,563	Environmental Services Advice
Symbiosis Solutions	40,200	Recycling Projects Advice
Marketing and Trading		
Frontier Economics	41,251	Intra Region Constraints Advice
Frontier Economics	54,542	Review of Rebidding Data
Frontier Economics	89,604	Value Interruptability Advice
Garrad Hassan Pacific	30,864	Industrial Zone Development Costs
Symbiosis Solutions	87,802	Fly Ash Market Consultancy
Engineering		
Alstom Power	33,245	Gassifier Advice for Liddell
ERM Mitchell McCotter	188,455	Waste Management Site for Ravensworth Void
Total consultancies equal to or more than $30,000	**1,738,972**	

Consultancies less than $30,000

During the financial year 62 other consultancies were engaged in the following areas:

Area	$ Cost
Finance, accounting and tax	101,137
Information technology	12,652
Legal	13,229
Environmental	37,799
Market Trading	66,414
Engineering	14,895
Human Resources	51,440
Training	28,823
Total consultancies less than $30,000	**326,389**
Total consultancies per Note 3(a) to the Financial Statements	**2,065,361**

NOTES

NOTES

CONTACT DETAILS

MACQUARIE GENERATION CORPORATE OFFICE
34 GRIFFITHS ROAD
LAMBTON NSW 2299

POSTAL ADDRESS
PO BOX 3416
HAMILTON DC NSW 2303
AUSTRALIA

TELEPHONE
61 2 4968 7499

FACSIMILE
61 2 4968 7489
61 2 4968 7433

BUSINESS HOURS
8AM–5PM MONDAY TO FRIDAY

BAYSWATER POWER STATION
LIDDELL POWER STATION
NEW ENGLAND HIGHWAY,
MUSWELLBROOK NSW 2333

POSTAL ADDRESS
PRIVATE MAIL BAG 2
MUSWELLBROOK NSW 2333
AUSTRALIA

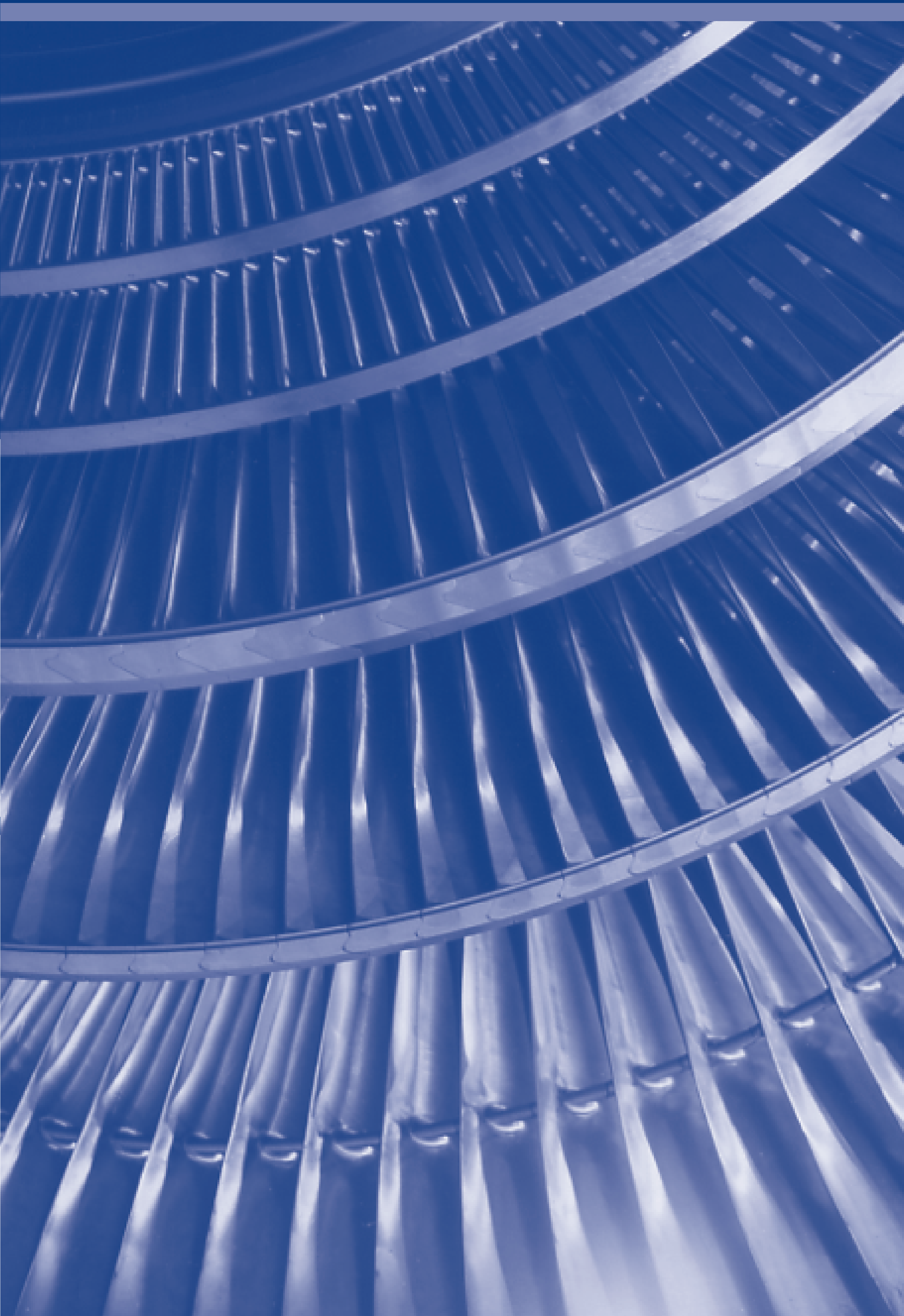
TELEPHONE
61 2 6542 0711

BUSINESS HOURS ADMINISTRATION
8AM–4PM MONDAY TO FRIDAY

SECURITY AND OPERATIONS
24 HOURS 7 DAYS

WEB SITE ADDRESS
WWW.MACGEN.COM.AU

FOR THE PURPOSES OF THIS REPORT, THE YEAR 2003 REFERS TO THE FISCAL YEAR 1 JULY 2002 TO 30 JUNE 2003.



Macquarie Generation