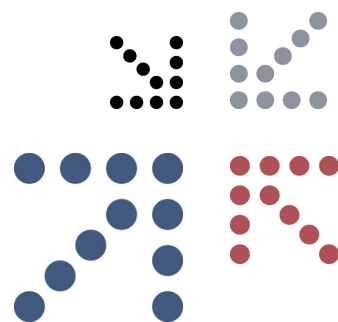


Governance Arrangements Infrastructure Investment by Regulated Service Providers



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1. Executive Summary

The Queensland Competition Authority (QCA) is currently undertaking to identify the general pricing principles which should underpin the treatment of infrastructure investments made in response to extraordinary circumstances eg. drought, across all regulated industries. The purpose of this paper is to provide background material to the QCA, for “Chapter 4 – Governance Arrangements” in particular, of the Issues Paper.

To achieve this the paper surveys the various governance arrangements which apply to infrastructure investments. In particular, it details the externally imposed obligations on regulated entities that relate to risk management, financial hurdle rates and quality assurance.

The paper firstly reviews the governance arrangements by entity type and by industry. It then considers generic risk management issues before reviewing relevant requirements of accounting and audit standards, investment hurdle rates and other infrastructure development requirements.

The paper provides an overview of many entity and industry specific and general issues relating to infrastructure development. For further information on a particular issue please refer to the sources provided.

2. Introduction

2.1 Background

The Queensland Competition Authority (QCA) has been directed to identify the general pricing principles which should underpin the treatment of infrastructure investments made in response to extraordinary circumstances across all regulated industries.

Following the release of the QCA Issues Paper “General Pricing Principles for Infrastructure Investments made in response to Extraordinary Circumstances” the QCA briefed BDO Kendalls to provide comment on and review of specific governance arrangements as outlined in “Chapter 4 – Governance Arrangements” of the Issues Paper.

In particular, the brief was to provide advice on the key obligations (including any necessary approvals) on regulated service providers in relation to infrastructure investment and in relation to risk management (including financial hurdle rates and quality assurance). This advice was to focus on:

- Obligations that were externally imposed on regulated service providers, and which may arise from legislative provisions, accounting standards, auditing requirements, government policies or private sector arrangements such as industry codes; and
- Regulated service providers encompassing government owned and non-government owned entities:
 - Declared local government monopoly businesses;
 - Regulated electricity distributors;
 - Regulated gas distributors;
 - Declared coal handling services of the Dalrymple Bay Coal terminal;
 - Declared coal-carrying networks; and
 - Declared government monopoly water providers.

The scope of the brief excluded arrangements related to risk and pricing between service providers and their customers.

2.2 Methodology

BDO Kendalls held a series of meeting with stakeholders from each of the regulated industries. Further research was undertaken on the governance issues that were raised during these meetings.

3. Acknowledgements

We acknowledge the contribution of officers of the following entities to the preparation of this paper:

- ❑ Brisbane Water, Brisbane City Council
- ❑ CS Energy Ltd
- ❑ Energex Ltd
- ❑ Envestra Ltd
- ❑ Gladstone Area Water Board
- ❑ NQ Water
- ❑ Office of Government Owned Corporations (OGOC), Queensland Treasury
- ❑ Prime Infrastructure Ltd
- ❑ Ports Corporation Queensland
- ❑ Queensland Rail Coal
- ❑ Queensland Rail Network Access
- ❑ SEQ Water Company
- ❑ SunWater

4. Governance by Entity Type

4.1 Corporations

Infrastructure development for a corporation is subject to director's duties as prescribed by the Corporations Act 2001. A corporation can incur expenditure on infrastructure development provided it is in the best interests of the corporation to do so and the company remains solvent throughout. Listed companies have the additional requirement of reporting against governance arrangements under Australian Stock Exchange Listing Rule 4.10.

Corporations Act 2001

The *Corporations Act 2001* regulates the framework within which companies exist, operate and report. It is not prescriptive as to the way in which a company seeks to generate a profit and consequently does not dictate processes or hurdles that must be met before investments can be entered into. The Corporations Act does however specify several principles that directors and other officers must be influenced by in making infrastructure investments - whether in extraordinary or usual circumstances. A director must:

- ❑ Use Care and Diligence – A director must employ the levels of care and diligence that a reasonable person would use in that position: s. 180(1).
- ❑ Use Good Faith – A director must exercise their powers and discharge their duties in good faith; in the best interests of the corporation; and for a proper purpose: s. 181.
- ❑ No Improper Use – A director must not improperly use their position and/or information gained by virtue of their position to either gain an advantage for themselves or someone else; or cause detriment to the corporation: ss. 181 & 182.

Insolvent trading

The most specific directors' duty relates to the duty to prevent insolvent trading: s. 599G. The requirement is both subjective and objective in that a director is in breach of the section if they fail to prevent the company from incurring a debt and:

- ❑ they were aware; or
- ❑ a reasonable person in a like position would have been aware;

that there were reasonable grounds for suspecting that the company is either insolvent or would become insolvent by entering into the transaction.

The insolvency restriction goes further than ensuring that a proposed project is likely to be successful in the long run-by requiring that the company will at all times have access to adequate cashflows to fund the project on a day-to-day basis.

Directors must also include a director's declaration in the Annual Financial Report as to whether, in their opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable: s.295 (4)(c).

Listed Corporations

Under ASX Listing Rule 4.10, a listed company must include information in its annual report about the main corporate governance practices that it had in place during the reporting period¹. The attachment to the guidance note on this rule (Guidance Note 9) provides an indicative list of corporate governance matters that an entity may take into account when developing its corporate governance practices disclosure.

Since the release of Guidance Note 9, the ASX Corporate Governance Council has released "Principles of Good Corporate Governance and Best Practice Recommendations."² While these principles are not mandatory, a listed company is required to disclose the extent to which it has complied. Under the corporate governance principles a company should:

1. Lay solid foundations for management and oversight;
2. Structure the board to add value;
3. Promote ethical and responsible decision-making;
4. Safeguard integrity in financial reporting;
5. Make timely and balanced disclosure;
6. Respect the rights of shareholders;
7. Recognise and manage risk;
8. Encourage enhanced performance;
9. Remunerate fairly and responsibly; and
10. Recognise the legitimate interests of stakeholders.

The recognition and management of risk is identified as a matter for discussion in both the guidance note and the Corporate Governance Principles. For further information on risk management and establishing appropriate procedures, refer to AS/NZS 4360 – *Risk Management* published by Standards Australia (www.standards.com.au).

¹ <http://www.asx.com.au/ListingRules/guidance/corpgov.pdf> Last visited 29 October 2003

² <http://www.shareholder.com/shared/dynamicdoc/ASX/364/ASXRecommendations.pdf> Last visited 29 October 2003

4.2 Government Owned Corporations

Infrastructure development for a Government Owned Corporation (GOC) is subject to the constraints of the Statement of Corporate Intent and the requirements of the Investment Guidelines for Government Owned Corporations. Company GOCs must also meet the requirements of a corporation as discussed in the section on Corporations.

Types of Government Owned Corporations

The *Government Owned Corporations Act 1993* (section 7) provides for two types of GOC:

- ❑ A statutory GOC that is established as a body corporate under an Act and is not registered under the *Corporations Act 2001*. The *Corporations Act 2001* does not apply to a statutory GOC.
- ❑ A company GOC that is incorporated or registered under the *Corporations Act 2001*. The *Corporations Act 2001* applies to the extent that it is not inconsistent with the *Government Owned Corporations Act 1993*.

Principles of Government Owned Corporations

The four principles of corporatisation in the *Government Owned Corporations Act 1993* (Section 19) are:

- Principle 1 – Clarity of objectives
- Principle 2 – Management autonomy and authority
- Principle 3 – Strict accountability for performance
- Principle 4 – Competitive neutrality

In terms of responsibilities for infrastructure investment decision-making, the key elements are:

Clarity of objectives

- ❑ Each GOC will have clear, non-conflicting objectives; and
- ❑ Each GOC will be set specific financial and non-financial performance targets for its commercial activities.

Management autonomy and authority

- ❑ The board will be required to use its best endeavours to ensure that the GOC meets its performance targets;
- ❑ The board will be given the autonomy and authority to make commercial decisions within areas of responsibility defined by the corporatisation framework; and
- ❑ Ministerial reserve powers will be required to be exercised in an open way.

Strict accountability for performance

- ❑ The GOC's board will be accountable to the shareholding Ministers for the GOC's performance;
- ❑ The GOC's statement of corporate intent will form the basis for accountability;
- ❑ Performance will be monitored by the Government against performance targets specified in the statement of corporate intent; and
- ❑ Government monitoring of the GOC is intended to compensate for the absence of the wide range of monitoring to which listed corporations are subject to, for example, the sharemarket and Commonwealth regulatory agencies.

Competitive neutrality

- ❑ In order to ensure, wherever possible, that each GOC competes on equal terms with other entities carrying on business, any special advantages or disadvantages of the GOC because of its public ownership or its market power will be removed, minimised or made apparent.

Responsibilities of the Board

For both statutory and company GOCs, the role of the board includes the following matters (Section 92 for a Statutory GOCs and Section 95 for a Company GOC)—

- (a) Being responsible for the GOC's commercial policy and management;
- (b) Ensuring that, as far as possible, the GOC achieves, and acts in accordance with, its statement of corporate intent and carries out the objectives outlined in its statement of corporate intent;
- (c) Being accountable to the GOC's shareholders for its performance as required by this Act and other laws applying to the GOC; and
- (d) Ensuring that the GOC otherwise performs its functions in a proper, effective and efficient way.

Governance and Risk Management

The Queensland Audit Office (QAO) in its Report to Parliament No.2 of 2002-03 reported on governance and risk management practices in Local Governments and in Government Owned Corporations. This report followed earlier QAO reviews of governance in the budget sector.

In its report the QAO noted that the GOCs reviewed had systems in place to facilitate the identification, analysis, assessment, treatment, monitoring and review of risks. QAO also noted that risk management has been incorporated as part of the corporations' strategic and business planning processes. However, it is not clear whether these reviews assessed the supply risks facing infrastructure service providers.

Amongst the QAO recommendations was one that GOCs should ensure that "risk management is undertaken as part of normal business practice and not as a separate task at set times".

Finding

In our discussions with regulated service entities, risk management was seen as a critical element of the investment evaluation process and was an integral element of the management practices within the organisation.

Statement of Corporate Intent

The Statement of Corporate Intent is an agreement between the board of a GOC and its shareholding Ministers.

The Statement of Corporate Intent must be consistent with the GOC's corporate plan (Section 113) and must specify the GOC's financial and non-financial performance targets for the relevant financial year (Section 114). The GOC Act also requires that the Statement of Corporate Intent must include matters outlined in Section 122 (Community service obligations) and Section 171 (Employment and industrial relations plan).

The Statement of Corporate Intent may include (Section 115 (1)):

- (b) An outline of the nature of scope of the activities proposed to be undertaken by the GOC during the relevant financial year;
- (d) The GOC's capital structure and dividend policies;
- (e) An outline of the major infrastructure investments proposed to be undertaken by the GOC during the relevant financial year;
- (g) An outline of the policies adopted by the GOC to minimise and manage any risks of investments and borrowings that may adversely affect its financial stability;
- (h) An outline of the GOC's policies and procedures relating to the acquisition and disposal of major assets; and
- (i) The GOC's accounting policies that apply to the preparation of its accounts.

Investment Guidelines for Government Owned Corporations

The Office of Government Owned Corporations in 2003 released "Investment Guidelines for Government Owned Corporations"³. The objectives of the investment guidelines are to:

- Clearly set out the expectations, priorities and risk concerns of shareholding Ministers, without compromising the responsibility and accountability of board directors;
- Ensure GOCs put in place commercial investments and hold boards accountable for their investment decisions;
- Replicate, as far as possible, private sector market disciplines in order to control the Government's risk exposure from the investment activities of GOCs'; and

³ http://www.ogoc.qld.gov.au/Documents/Investment_Guidelines.pdf. Last visited 20 November 2003

- Provide confidence to industry that market type disciplines are being applied to GOCs.

The guidelines achieve these objectives by espousing 10 investment principles:

1. GOC investments are subject to shareholding Minister notification and approval requirements;
2. The decision-making process used by a GOC in developing a significant investment proposal will be reviewed by shareholding Ministers.
3. Significant investment proposals will be assessed and approved by shareholding Ministers based upon the commercial merit of the proposal and the ability of the investment to contributed to the long-term strategic objectives of he entity;
4. QTC will conduct a credit review of each GOC on an annual basis and in cases of new funding applications that would have credit rating implications;
5. The State does not guarantee any obligation arising from the investment activities of a GOC, entities controlled by a GOC, or entities in which the GOC has an investment stake;
6. A GOC should ensure risk sharing arrangements are commensurate with their own financial contribution to a joint venture relationship established by third parties;
7. Investments undertaken at the direction of Government will be dealt with and financially supported via commercially based Community Service Obligation arrangements;
8. Investments are restricted to a GOC's core business activities;
9. Interstate and overseas investments will continue to be strictly limited and assessed on a case by case basis, with shareholding Ministers' approval being required for all such investments regardless of the value of the investment. Investments will need to be proved to be commercially sound, of strategic advantage to the corporation and consistent with its core operations within Queensland, to be considered; and
10. Post approval monitoring will apply for significant investment projects and will form the basis of determining future GOC investment approval thresholds.

Applicable Legislation

The following table⁴ summarises the legislative requirements that apply to the two types of GOC:

Legislation	Statutory GOC	Company GOC
<u>Corporations Act 2001</u>	Does not apply	Applies
<u>Public Service Act 1996</u>	Does not apply	Does not apply
<u>Public Sector Ethics Act 1994</u>	Does not apply	Does not apply
<u>Equal Opportunity in Public Employment Act 1992</u>	Applies	Applies
<u>Freedom of Information Act 1992</u>	Does not apply to "excluded" commercial activities and "prescribed" Community Service Obligations.	Does not apply to "excluded" commercial activities and "prescribed" Community Service Obligations (Golden

⁴ http://www.ogoc.qld.gov.au/goc_legislation.htm. Last visited 24 October 2003

Legislation	Statutory GOC	Company GOC
		Casket, though, has no specific exemption).
<u>Judicial Review Act 1991</u>	Does not apply to "excluded" commercial activities and "prescribed" Community Service Obligations (SunWater, though, has no specific exemption).	Does not apply to "excluded" commercial activities and "prescribed" Community Service Obligations (Golden Casket, though, has no specific exemption).
<u>Criminal Justice Act 1989</u>	Applies	Does not apply
<u>Financial Administration and Audit Act 1977</u> <u>Financial Management Standard 1997</u> (subordinate legislation)	Limited application	Does not apply

4.3 Category 1 Water Authorities

Infrastructure development by a Category 1 Water Authority is subject to ministerial approval via the performance plan which must contain details about proposed infrastructure and major asset investment, borrowings and the management of borrowing and investment risks.

Established under the *Water Act 2000*, Category 1 Water Authorities are required to operate on a commercial basis and in a competitive environment. The *Water Act 2000* outlines the commercialisation principles and their elements that a water authority must adhere to.

The key objectives of a Category 1 Water Authority are to be—

- (a) Commercially successful in carrying out its activities; and
- (b) Efficient and effective in providing goods and delivering its services, including things done as community service obligations.

Role of the Board

The main statutory functions of the water authorities' board are to:

- ❑ Conserve, store and supply untreated and treated water in bulk to local authorities and major consumers within the operational area.
- ❑ Conserve, store and supply, with the approval of the Minister, untreated water in bulk to electricity generating authorities whether within the operational area or otherwise.
- ❑ Take measures to protect the quantity and quality of present and future supplies of water.
- ❑ Investigate and plan future head works, treatment works and trunk mains.
- ❑ Construct, operate and maintain, and where necessary, improve and extend head works, treatment plants and trunk mains.
- ❑ Administer and manage property under its control.
- ❑ Provide, operate, protect and maintain recreational facilities.

Reporting Requirements

The commercial success, efficiency and effectiveness of a Category 1 Water Authority are to be measured against its financial and non-financial performance targets stated in its performance plan.

The performance plan is, *inter alia*, required to contain:

- ❑ The authority's proposed infrastructure investments;
- ❑ The authority's capital structure;
- ❑ An outline of borrowings made, or proposed to be made, by the authority;
- ❑ An outline of the policies adopted by the authority to minimise and manage any risk of investments and borrowings that may adversely affect its financial stability; and
- ❑ An outline of the authority's asset management plan, including its policies and procedures relating to the acquisition and disposal of major assets.

The performance plan is subject to ministerial approval. Due to the requirement to list infrastructure investments, those investments are also subject to ministerial approval.

Applicable Legislation

In summary, an infrastructure investment undertaken by a Category 1 Water Authority would be subject to:

- ❑ The Water Act 2000;
- ❑ Commercial Project (if large enough to affect the commercial viability of the Water Authority);
- ❑ Ministerial approval of the performance plan; and
- ❑ Requirements of the Financial Administration and Audit Act and the Financial Management Standard.

4.4 Local Government

Commercialised Significant Business Activities

In relation to infrastructure development, commercialised significant business activities within local governments are subject to the same investment requirements as local governments themselves.

Driven from the Implementation Agreement of 11 April 1995 related to implementation of National Competition Policy and Related Reforms to Local Governments, the *Local Government Act 1993* establishes a process to assess a range of significant business activities and to establish commercialised business units.

Local Governments which establish a commercialised business unit are required to:

- (a) include within their corporate plan an outline of its objectives and the nature and scope of the activities proposed to be carried out by the business unit. (*Local Government Act 1993* Section 579);
- (b) produce an annual performance plan for each commercialised business unit (*Local Government Act 1993* Section 580);
- (c) ensure that an annual statement on the operations of each commercial business unit for the preceding year is provided to the local government. That annual statement of operations must contain:
 - a. information to enable an informed assessment to be made of the unit's operations, including a comparison of the unit's performance with its annual performance plan;
 - b. particulars of any amendment made to its annual performance plan for the financial year;
 - c. particulars of any directions to the unit; and
 - d. particulars of the impact that any changes to its annual performance plan may have had on the unit's financial position, operating surpluses and deficits and prospects.

Financial Reporting Requirements of Commercialised Business Units

The legislation does not require Commercialised Business Units to produce general purpose financial reports in accordance with accounting standards. Financial information on the performance and financial position of commercialised business units is required to be reported as a note to the financial statements of the Local Government as a separate program. However, in a number of cases, Local Governments prepare reports on the financial performance and financial position of their commercialised business units in accordance with the requirements of accounting standards and these are presented in a separate report on the businesses.

Joint Boards

A joint board established under the Local Government Act 1993, as in the case of the Townsville-Thuringowa Water Supply Joint Board, is an independent local authority. In relation to infrastructure development, a joint board is subject to the same planning and reporting requirements as a Local Authority.

Established under the *Local Government Act 1993*, joint boards have the general powers of a company to the extent that the joint board is a body corporate, has a common seal and may sue and be sued in its corporate name.

The jurisdiction and powers of the joint board include:

- (a) Obtaining, conserving and storing treated, or untreated, water in bulk in the operational area;
- (b) Treating water in bulk in the operational area;
- (c) Supplying treated, or untreated, water in bulk to—

- (i) Townsville and Thuringowa City Councils; and
- (ii) Consumers in the operational area;
- (d) Selling to its consumers treated, or untreated, water in bulk on conditions the joint board considers appropriate;
- (e) Investigating and planning for headworks, treatments works and trunk mains the joint board considers appropriate to meet the present and bulk water requirements of its consumers;
- (f) Doing all things the joint board considers appropriate to ensure and maintain the quality and quantity of present and future supplies of water in the operational area; and
- (g) Constructing, operating and communications, officers, stores and depots, houses and other accommodation the joint board considers appropriate to carry out its jurisdiction

Applicable Legislation

Acts that apply to a joint board include:

- ❑ the Local Government Act 1993
- ❑ as a constructing authority, the Acquisition of Land Act 1967;
- ❑ as a public sector entity, the Financial Administration and Audit Act 1977; and
- ❑ as a statutory body, the Statutory Bodies Financial Arrangements Act 1982.
- ❑ as a Local Authority, the Water Act 2000

Local Government Owned Corporations

Infrastructure development proposals must be outlined in the statement of corporate intent, against which the board of a Local Government Owned Corporation will be held accountable.

The board of a Local Government Owned Corporation (LGOC) must provide a performance report on which it is held accountable against its statement of corporate intent. Consequently, any proposed infrastructure developments and progress on any commenced infrastructure developments must be reported on.

Objectives of Corporatisation

Under Section 586 of the *Local Government Act 1993*, the objectives of corporatisation are to improve overall economic performance, and the ability of local governments to carry out their responsibilities for the good rule and government of their areas, by—

- (a) establishing efficient and effective corporatised corporations; and
- (b) establishing a framework for accountability of corporatised corporations.

Role of the Board

The role of an LGOC's board includes the following—

- (a) Responsibility for the corporation's commercial policy and management;
- (b) Ensuring, as far as possible, the corporation achieves, and acts in accordance with, its statement of corporate intent and, its corporatisation charter;

- (c) Accounting to the corporation's shareholder for its performance; and
- (d) Ensuring the corporation performs its functions in a proper, effective and efficient way.

One of the key principles of corporatisation (Section 590) is the principle of strict accountability for performance, whereby:

- (a) the board is held accountable to the shareholder for the corporation's performance; and
- (b) the corporation's statement of corporate intent forms the basis for this accountability.

The directors of an LGOC also have a duty to prevent insolvent trading (Section 694).

Reporting Requirements

Before 1 May of each year, the board of an LGOC must prepare and submit to its shareholder for agreement, a draft corporate plan for at least 3 years starting on 1 July of that year.

LGOC's must also prepare a statement of corporate intent which must be consistent with the corporate plan. Matters to be included in the statement of corporate intent are outlined in Section 668 of the *Local Government Act 1993* and include:

- (a) An outline of the corporation's objectives and functions;
- (b) An outline of the nature and scope of the activities proposed to be carried on by the corporation in the relevant financial year;
- (c) An outline of the corporation's main undertakings;
- (d) The corporation's capital structure and dividend policies;
- (e) An outline of the major infrastructure investments proposed to be carried out;
- (f) An outline of the outstanding and proposed borrowings by the corporation;
- (g) An outline of the policies adopted by the corporation to minimise and manage any risk of investments and borrowings that may adversely affect its financial stability; and
- (h) An outline of the corporation's policies and procedures relating to the acquisition and disposal of major assets.

Applicable Legislation

A LGOC is subject to:

- *the Financial Administration and Audit Act 1977* – for these external audit provisions which apply to Local Governments; and
- *the Statutory Bodies Financial Arrangements Act 1982*.

4.5 Public-Private Partnerships

The creation of public-private partnerships for the provision of public infrastructure development is subject to the approval of Cabinet on the recommendation of the Cabinet Budget Review Committee.

Private sector involvement in the provision of public infrastructure is encouraged by the Queensland Government where it can be shown that the state will achieve better value for money, compared with the option of delivering the project and/or service entirely at the public sector's cost and risk.

The 'Value for money framework'⁵ relating to public-private partnerships indicates the Queensland Government's likely position on relevant risks and how risks may be addressed in contractual relationships.

The policy applies to public infrastructure projects where the expected capital value will exceed \$30M or the Net Present Value (NPV) will exceed \$50M during the term of the contract.

The policy is intended to ensure that the whole-of-life costs and risks of delivering infrastructure are analysed, and that the opportunity for private sector innovation is properly explored.

The following principles⁶ underpin the Queensland Government's approach in developing contractual relationships with the private sector:

- ❑ Performance measures should be established to ensure that the quality of services delivered meets the needs of the community and that the project outcomes are transparent;
- ❑ Projects should focus on the output specification (the end result) rather than the input specification (the means of delivery);
- ❑ Projects to be delivered under the policy framework must have Government approval, prior to the formal involvement of the private sector;
- ❑ The allocation of risk and the commercial framework of the contractual relationship model should be capable of delivering the best value for money outcome for Queensland;
- ❑ Private sector participation is to be subject to a competitive tendering process, consistent with the principles of the Government's State Purchasing Policy;
- ❑ The principles of transparency and accountability for process and outcomes must be observed, with full recognition of the requirement to protect private sector intellectual capital and commercial confidentiality where appropriate;
- ❑ The conduct of the private sector should always be such that confidence in the probity regime is implemented and maintained at all times;
- ❑ Where possible, standardised approaches should be used to minimise transaction cost and time; and
- ❑ Where appropriate, incentives for all parties should be considered to encourage a high level of performance.

⁵ http://www.sd.qld.gov.au/dsdweb/docs-bin/v2/major_proj/ppp_policy.pdf Last visited 28 October 2003

⁶ Ibid 6

Governance Private Public Partnership Proposals

As stated above, projects must have Government approval, prior to the formal involvement of the private sector. Approvals may be gained from the following parties:

- ***Cabinet*** – which oversees the implementation of project initiatives;
- ***Cabinet Budget Review Committee*** – which is responsible for the review of each proposal in consideration of the project’s conformity to Government policy; and
- ***Portfolio Minister*** – who is responsible for each project initiative under the policy.

5. Governance by Industry

5.1 Water Infrastructure Services

Regulatory Framework

The regulatory framework governing water service providers is principally aimed at ensuring the maintenance of reliable water services, safeguarding the interests of customers and protecting the safety of the community generally. Under the *Water Act 2000*, all rights to the use, flow and control of all water in Queensland are vested in the state. The Act requires the preparation of:

- ❑ **Water Resource Plans** which outline the government's goals for a catchment's social, economic and environmental needs; and
- ❑ **Resource Operations Plan** which outline how the environmental and consumptive objectives specified in the Water Resources Plan are met. This plan also addresses the management of water that may become available for future use.

Water licences and permits issued under the *Water Act 2000* for the taking of water and interfering with the flow of water must be in accordance with any approved Water Resource Plan or Resource Operations Plan.

The responsibility of water providers in relation to the supply of water is governed by the *Water Act 2000*, the Water Regulation and the individual Water Service Provider's licence. These responsibilities include:

- ❑ ***Responsibility to maintain service quality standards.*** Quality standards include factors such as levels of interruptions to supply and parameters in relation to pressure and flow. Water service providers are required to develop customer service standards and have a current asset management plan to support their service quality standards.
- ❑ ***Responsibility for dam safety.***
- ❑ ***Responsibility for flood mitigation.*** A water service provider's licence details its responsibility to undertake flood mitigation activities.
- ❑ ***Responsibility to report on certain activities.*** Performance monitoring reporting to the regulator.
- ❑ ***Responsibility to reduce water distribution system losses (where possible).*** A water service licence includes a water use efficiency component and makes it the water service provider's responsibility to put in place procedures to minimise distribution system losses.
- ❑ ***Responsibility to comply with relevant technical standards and codes.***

In return for complying with guidelines the *Water Act 2000* grants water service providers indemnity for acts that are not under their control i.e. downstream flooding.

Service Provider Obligations

The *Water Act 2000* provides a regulatory framework for the provision of water and sewerage services including the establishment of water service provider obligations:

- ❑ Strategic Asset Management Plans; and
- ❑ Customer Service Standard.

However, the regulator may exempt a small service provider from these requirements if the cost of complying would outweigh the benefits. None of the entities that we interviewed were small service providers.

Strategic Asset Management Plans

To ensure continuity of supply of each of the service provider's registered services, the *Water Act 2000* requires a service provider to prepare a strategic asset management plan and to manage by it.

In particular, a service provider must:

- ❑ Prepare a Strategic Asset Management Plan;
- ❑ Have the plan certified by a registered professional engineer as being appropriate for the service provider's infrastructure and registered services;
- ❑ Have the plan approved by the regulator;
- ❑ Comply with the approved strategic asset management plan when supplying services to its customers;
- ❑ Arrange for regular audits about the service provider's strategic asset management plan and compliance with the plan; and
- ❑ Provide an annual performance report (see Annual Reports below)

A service provider's strategic asset management plan must state the following:

- (a) The registered services to which the plan applies;
- (b) The infrastructure for the provision of registered services;
- (c) Standards for appropriate levels of service, including customer service, and performance indicators for the service; and
- (d) An operation, maintenance and renewals strategy that demonstrates how each standard will be achieved.

The annual performance report must:

- (i) Measure the service provider's performance for the financial year against the strategic asset management plan;
- (ii) Document the actions taken by the service provider to implement the plan including the application of funds to support implementation of the plan;
- (iii) State the outcome of any review of the plan and how the service provider addressed the matters raised in the review; and
- (iv) Contain a summary of finding of and any recommendations stated in an audit report given to the regulator in the financial year to which the report relates.

Customer Service Standards

In addition to the Strategic Asset Management Plan, a service provider must prepare and comply with a Customer Service Standard. The service provider must also annually review the Customer Service Standard and prepare an annual performance report.

Customer Service Standards are for the protection of customers who do not have a contract with the service provider. A non-contracted customer who considers that the service standard is significantly deficient or has not been complied with can complain to the service provider. If the complaint is not resolved, then the complainant can refer the matter to the regulator.

It should be noted that for customers for whom Customer Service Standards are subject to a contract these standards are enforceable via contract law including Common Law and the *Trade Practices Act 1974*.

A service provider's Customer Service Standards must state the following matters:

- (a) The level of service to be provided by the service provider;
- (b) The process for service connections, billing, metering, accounting, customer consultation, complaints and dispute resolution; and
- (c) Any other matter stated in guidelines that are issued by the regulator.

The annual performance report must:

- (i) Measure the service provider's performance for the financial year against the customer service standard; and
- (ii) State the outcome of any review to the standard and how the service provider has addressed matters raised in the review.

National Standards

The goal of the Australian National Committee on Large Dams (ANCOLD) is to encourage improvement in the planning, design, construction and operation of large dams in Australia, and to ensure that dam owners have access to world's best practice through the skills of Australian professionals. ANCOLD achieves this through the publication of national standard guidelines and by holding conferences. These standards cover a range of topics including guidelines on the design, construction and operation and environmental management of dams.

5.2 Electricity Distribution Services

Electricity Industry

Entities in the Queensland electricity industry must meet the licensing requirements of the Office of Energy. This Office is responsible for:

- monitoring and improving the operating performance of the electricity and gas industries;

- ❑ providing an efficient regulatory and licensing regime for the electricity and gas industries; and
- ❑ providing a complaints and dispute resolution service between energy customers and suppliers.

Transmission and Distribution Systems

The electricity transmission and distribution systems in Queensland are regulated entities that operate under the legislative requirements of:

- ❑ the Electricity Act 1994;
- ❑ the Electricity Regulation 1994;
- ❑ the Electricity - National Scheme (Queensland) Act 1997;
- ❑ the National Electricity Code; and
- ❑ Electricity Safety Act 2002.

These requirements are subject to monitoring by the Office of Energy. The Queensland Competition Authority has a price-determining role pursuant to the *Electricity - National Scheme (Queensland) Act 1997*.

National Grid

The National Electricity Code “the code” outlines the supervising, administering and enforcing roles of the National Electricity Code Administrator (NECA). NECA's role includes monitoring and reporting on compliance with the Code and reviewing the adequacy of the code.

Amongst other things the code outlines (see extracts below):

- ❑ National market objectives;
- ❑ Market Pricing Principles; and
- ❑ Principles for network pricing.

Electricity Other

Other industry specific factors include the *Electricity Safety Act 2002*, which is directed at eliminating the human cost of death, injury and property destruction that electricity can cause. To achieve this, the *Act* outlines the safety requirements for parties in the electricity industry, including regulated electricity distributors (s.26). The *Act* imposes a criminal offence with a maximum penalty of 3 years or 2,000 penalty units (s. 27) if a breach causes multiple deaths. There are owner penalties for lesser breaches.

The Electricity Supply Association of Australia Limited (ESAA) is the industry body for the electricity industry. It provides the electricity industry representation with government, regulatory bodies, and the media and, as such, does not apply governance obligations.

National Electricity Market Objectives

- b. The objectives of the national electricity *market* are as follows:
1. the *market* should be competitive;
 2. customers should be able to choose which supplier (including generators and retailers) they will trade with;
 3. any person wishing to do so should be able to gain access to the *interconnected transmission and distribution network*;
 4. a person wishing to enter the *market* should not be treated more favourably or less favourably than if that person were already participating in the *market*;
 5. a particular energy source or technology should not be treated more favourably or less favourably than another energy source or technology; and
 6. the provisions regulating trading of electricity in the *market* should not treat intrastate trading more favourably or less favourably than interstate trading of electricity.

Electricity Market Pricing Principles

The electricity code outlines the markets pricing principles in clause 6.1.1

- b. The key principles underlying the *transmission* and *distribution* pricing provisions in this clause intended to:
1. promote competition in the provision of *network services* wherever practicable;
 2. facilitate a commercial environment which is transparent and stable, and which does not discriminate between users of *network services*; and
 3. regulate the non-competitive market for *network services* in a way which seeks the same outcomes as those achieved in competitive markets.

The core objectives intended to be achieved by the application of the *transmission* and *distribution* pricing provisions are:

1. efficiency in the use, operation, and maintenance of, and investment in, the *network*, and in the location of *generation* and demand;
2. upstream and downstream competition;
3. price stability; and
4. equity.

Schedule 6.7 sets out the principles for network pricing, as follows:

1. Cost reflective pricing
2. Non-discriminatory pricing of network services
3. Compatibility with market trading arrangements
4. Network prices for economically efficient investment
5. Network interconnectors being managed to reduce the barriers to a national market
6. published and transparent network prices
7. transition arrangements required by governments.

Investment Processes

Under the code, a *Network Owner's* required rate of return on equity is estimated using the Capital Asset Pricing Model (CAPM)

5.3 Queensland Rail – Network Access

Obligations on Queensland Rail relative to investments in regulated service infrastructure are derived from a range of sources including the *Transport Infrastructure Act 1994*, the *Transport Planning and Coordination Act 1994* and the *Government Owned Corporations Act 1993*.

The *Transport Infrastructure Act 1994* has as one of its objectives the establishment of a regime that:

- (i) contributes to overall transport effectiveness and efficiency; and
- (ii) contributes to lower transport costs by allowing the maximum flexibility in rail transport operations, consistent with achieving safety objectives; and
- (iii) provides a high level of accountability; and
- (iv) allows railway managers and operators to make decisions on a commercial basis; and
- (v) provides a framework under which Queensland Rail may operate as required by the *Government Owned Corporations Act 1993*.

The *Transport Infrastructure Act 1994* requires the development of transport infrastructure strategies for approval of the Minister. The strategies are to include specific objectives sought to be achieved, proposals for provision of transport infrastructure, investment criteria for deciding priorities for government supported transport infrastructure between and within different transport modes, and options for financing the priorities. A strategy must also take account of agreements or arrangements between the State and the Commonwealth about the funding of transport infrastructure.

Following the development of the strategies, there is a requirement for the development of a rail implementation program for the relevant year and for one or more later years.

In preparing its corporate plan or a statement of corporate intent, Queensland Rail is required to take into account the transport infrastructure strategies. Queensland Rail may, however, spend amounts on transport infrastructure other than rail transport infrastructure if the spending would contribute to effectiveness and efficiency.

For Network Access, there are a range of obligations when considering any investment, including:

- ❑ **Track Build standards** – Infrastructure design (rating of track depending upon the life of the mine and risk level assessed). An Australian standard provides guidance on technical standards.
- ❑ **Safety** – Railway safety management standards are covered in AS4292 and include standards of relevance for Network Access of Queensland Rail for

track, civil and electrical infrastructure, signalling and telecommunications systems and equipment, operational systems and interface with other infrastructure.

- ❑ **Land acquisition** – Native title issues, cultural heritage, any existing leases or easements, environmental requirements.
- ❑ **Purchasing** – ensuring that efficient purchasing policies and practices are adopted, noting that in some areas of the market there is not extensive competition for supply of some elements of below rail infrastructure.
- ❑ **Commercial risks** – Will normally be addressed in contractual arrangements such as ‘take or pay’ contracts for new or upgraded track or, in some cases, with ‘track build’ costs being met by a mining company.
- ❑ **Other Risk issues** – assessment of risks associated with water/flooding, earthquake and malicious damage/terrorism.

5.4 Gas Distribution Services

The *Gas Supply Act 2003* commenced on 1 July 2003 and is based largely on the Council of Australian Governments’ gas and competition agreements.

The *Gas Supply Act 2003* institutes a new gas business-licensing regime within Queensland. This means that a company distributing gas (i.e. transporting it through a pipeline system) will require a distribution authority. The Act addresses customer protection in a number of ways. First and foremost, it retains price control due to the fact that the overwhelming majority of gas customers use a relatively small amount of gas. Because customers cannot choose between retailers, the Queensland Government retains the right to control the price of gas supply. Nonetheless, the Act requires the Minister to consider the interests of both industry and customers when setting prices.

In considering further investment in distribution, the Gas companies operating in Queensland will consider the question of expected return, given the price control arrangements. This will include considerations of alternative investments in gas distribution in other parts of Australia.

Other factors specifically related to the gas industry are the Gas Code and a range of technical standards, including standards for construction of gas pipelines.

6. Risk Mitigation

6.1 Risk Management

The ASX Corporate Governance Council's issued "Principles of Good Corporate Governance and Best Practice Recommendations"⁷ include as Principle 7 the recognition and management of risk for the establishment of a sound system of risk oversight and management and internal control.

The Principles state that this risk oversight system should be designed to:

- Identify, assess, monitor and manage risk; and
- Inform investors of material changes to the company's risk profile.

This structure is noted as being able to enhance the environment for identifying and capitalising on opportunities to create value. The above principles are for application by listed entities, although they also are persuasive in terms of best practice for unlisted entities.

Australian and New Zealand Standard AS 4360:1999 on Risk Management provides a framework for identifying, assessing, monitoring and managing risk.

The Queensland Auditor-General in undertaking reviews of Corporate Governance practices in Queensland (including for Government Owned Corporations and Local Governments) includes risk management in the areas subject to review. The Queensland Audit Office highlighted the following example in relation to a co-ordinated risk management system for local government —

Better Practice Example – Coordinated Risk Management System

The main elements of the local government's risk management system were as follows –

- risk management methodology utilised was based on the Australian/New Zealand Standard on Risk Management (AS/NZ 4360) including the provision of guidance on the application of the Standard (particularly in relation to risk assessment);
- development of appropriate definitions of risks to be managed by the local government with linkages to desired corporate outcomes including adequate coverage of risks relevant to the local government;
- responsibility for the ongoing development and review of risk management policy, standards and monitoring and reporting of risk management activities had been clearly assigned to individuals and/or divisions;
- establishment of a specific committee for oversight of the local government's risk management activities;
- ongoing analysis, review and update of risk registers and Business Continuity Plans/counter disaster plans including the regular testing of these plans;
- guidance, information and training provided to employees to ensure staff awareness and corporate consistency in relation to managing risk;
- various ISO accreditations associated with risk management systems; and
- risk management policy was accessible on the local government's intranet and had electronic linkages to other relevant areas, including guidance on risk management.

⁷ <http://www.shareholder.com/shared/dynamicdoc/ASX/364/ASXRecommendations.pdf> Last visited 29 October 2003

6.2 Insurance

Terrorism Insurance

The *Terrorism Insurance Act 2003* which commenced on 1 July 2003, overcomes the gap in available insurance for businesses caused by market failure following the events of 11 September 2001. In general, the cover applies to commercial property insurance and business interruption insurance on contracts in relation to loss or damage to property.

The effect of the insurance is to nullify any provisions which would exclude liability for terrorism to the extent that they are eligible terrorism losses for the purposes of the legislation. The insurance cover becomes operational via a Ministerial declaration that a terrorist incident has occurred.

6.3 Natural Disaster Relief Arrangements

The following notes on Natural Disaster Relief Arrangements (NDRA) have been primarily taken from the Commonwealth Department of Transport and Regional Services (DOTARS)⁸ and the Queensland Government's State Counter Disaster Organisation⁹. For more information, these sources should be consulted.

NDRA in relation to Regulated Service Providers

NDRA act as a safety net for those affected by disasters and provide a cost sharing formula between the Queensland and Commonwealth Governments.

NDRA apply where damage was caused by an *eligible natural disaster event* and where state expenditure on *eligible measures* will exceed the \$200,000 *threshold*. Further discussion on eligible natural disaster events, eligible measures and the threshold is contained below.

The relief measures are not compensation based and assistance is targeted at those in the community who are unable to provide for their own recovery. A principle objective of NDRA is to ensure that disaster relief assistance does not operate as a disincentive to effectively plan, mitigate and allocate sufficient resources for disasters or to discourage individuals or businesses taking out appropriate insurance to protect their assets and income.

NDRA excludes all the entities that we interviewed, with the exception of Queensland Rail. However, in some circumstances, exceptions may operate to include these commercial undertakings in particular, where there is:

- Significant damage to the undertakings of smaller Local Governments (where the undertakings are funded with significant public contributions); and/or

⁸ <http://www.dotars.gov.au/ndr/arrangements.htm> Last visited 14 November 2003

⁹ <http://www.disaster.qld.gov.au/default.asp> Last visited 14 November 2003

- ❑ Ineligible damaged works and the level of expenditure required to undertake the repair is beyond an Authority's financial capacity.

To exercise these discretions, the government will look to the financial effects on the Authority concerned and not to the 'exceptional' nature of the physical event that caused the damage. To be considered as 'exceptional', the Authority concerned would need to show that restoration costs were beyond its financial/borrowing capacity.

As stated above, the NDRA assistance is not provided as compensation for damage/losses sustained or as a disincentive to self-help by way of commercial insurance and/or other appropriate strategies or disaster mitigation. Therefore, the extent to which the above discretions would be exercised in the face of poor infrastructure management is uncertain. Poor infrastructure management would include:

- ❑ practices that fail to mitigate the risk of damage from natural disasters, particularly the failure to implement a risk mitigation strategy; and
- ❑ poor planning, particularly in the design and construction of infrastructure developments.

Purely commercial activities, activities and infrastructure that are not deemed to be a public asset or would not unduly disrupt the ongoing activities of a community, for example, infrastructure built for a particular corporate client would probably have a more remote chance of having this inclusionary discretion applied.

Due to these uncertainties, the availability of natural disaster relief arrangements cannot be relied upon in the development and pricing of infrastructure projects.

Eligible Natural Disaster Event

An **eligible natural disaster event** includes any one of, or combination of, the natural phenomena, Bushfire, Cyclone, Earthquake, Flood, Storm, Storm Surge and also Landslide. It does not include disasters where poor environmental planning, commercial development, personal intervention or accidents are significant contributing factors to the event. Social, environmental and technological disasters are also ineligible.

Eligible Measures

Eligible Measures include:

- b. **restoration or replacement of an essential public asset** by a State to the extent necessary to restore that asset to the equivalent of its pre-disaster standard.

Where an **essential public asset** (2.3) is an asset of an **eligible public undertaking** that, in the judgement of the State concerned, is an integral and necessary part of the State's infrastructure where the loss of the asset would unduly disrupt the ongoing activities of a community; such assets would be restored or replaced as a matter of urgency.

An **eligible public undertaking** (2.4) includes a state railway and means a public undertaking which provides community, social or economic services outside the normal market mechanism. These services are either free of charge or at a nominal charge well below the costs of production. Other undertakings may be agreed between a State and the Commonwealth in the light of special circumstances.

An **ineligible public undertaking** includes (2.5):

- b. a public trading undertaking which is primarily engaged in the production of goods and services for sale in the market with the intention of recovering all or a significant proportion of its operating costs.

Examples include: electricity and gas supply, operations of ports and waterways; sewerage services and water supply.

Threshold

The threshold amount for activation of Commonwealth/State funding is \$200,000; i.e. expenditure by the state on eligible relief measures must exceed \$200,000. For isolated disaster events that do not reach the \$200,000 threshold, State Disaster Relief arrangements apply to relief measures relating to community response and assistance to individuals.

Local governments are considered for assistance once the cost of eligible works exceeds their 'trigger-point' amount. The trigger point for larger councils is 1% of general rates and for smaller councils, \$103,000.

A lower trigger point of \$50,000 is available for smaller councils which have completed a disaster risk assessment based on the Australian and New Zealand Risk Management Standard AS/NZS 4360:1999. A pre-requisite for Commonwealth funding is the existence of disaster mitigation strategies or a commitment to develop and implement such a strategy.

Should natural disaster damage occur to the assets of Local Government/s and, either projected State expenditure does not exceed \$200,000 or the damaged works are ineligible for NDRA funding, then the funded assistance will only be considered in cases where the level of expenditure is beyond the Authority's financial capacity.

6.4 Counter Terrorism

The Queensland Government has established the Security Planning and Coordination (SPC) unit in the Department of the Premier and Cabinet and the Counter Terrorism Coordination Unit (CTCU) in the Queensland Police Service. Those units have been established to provide leadership and coordination across all levels of government and the private sector to implement a consistent approach to ensuring the security and the continued operation of Queensland's critical infrastructure.

“Critical infrastructure” is defined as infrastructure which, if destroyed, degraded or rendered unavailable for an extended period, will significantly impact on social or economic well being or affect national security or defence. The Queensland Government has issued a document “Securing Queensland’s Critical Infrastructure; Guidelines for owners/operators”.

The Guidelines have identified critical infrastructure in the following industries:

- ❑ Banking and finance;
- ❑ Electrical power systems;
- ❑ Emergency services (police, fire and ambulance);
- ❑ Food supply;
- ❑ Gas, oil and fuel;
- ❑ Government services;
- ❑ Health services;
- ❑ Information and communications;
- ❑ Transport (air, road, water and rail); and
- ❑ Water supply systems.

They indicate that critical infrastructure owners/operators (both private and public sector) have a vital role in preventing, responding to and recovering from potential terrorist activity.

The guidelines further state that owners/operators will best understand their business, its vulnerabilities and how to protect it, and, as outlined in the national principles for critical infrastructure protection, they have responsibility to:

- ❑ Provide adequate security of their assets (including having a security plan aligned to the current terrorism alert level);
- ❑ Actively undertake the planning process in accordance with Risk Management Standard, AS/NZS 4360:1999 (including risk vulnerability assessment, security planning, emergency response planning and business continuity planning, within a counter-terrorism context);
- ❑ Conduct a review of the risk management plan on an annual basis;
- ❑ Participate in any exercises to test plans conducted by government authorities; and
- ❑ Report any incidents or suspicious activity to State or Territory police.

As indicated in the Guidelines “(the) risk management process should include completing or reviewing a vulnerability assessment; a security plan; and emergency response plan that can be used during any emergency situation, including a suspected, threatened or known terrorist activity; and a business continuity management plan, to ensure an organisation could continue to operate after a significant disruption. Many businesses will already have these plans in place, but they should be revised, or implemented if they don’t currently exist, to reflect a counter-terrorism context. All plans should be reviewed annually.”

The guidelines go on to indicate that it is good corporate governance for critical infrastructure owners/operators to review risk management and recovery arrangements in relation to the new security environment, and that many owners/operators have already completed this process.

Maritime Transport Security

The Australian Government has been working with State and Territory governments and industry to improve the security of Australia's transport system and reduce the likelihood of transport being a target or used as a vehicle for terrorism.

One aspect of the framework is the *Maritime Transport Security Bill 2003* which was introduced into Federal Parliament on 18 September 2003. This bill establishes a regulatory framework that safeguards for maritime transport against unlawful interference and covers ships, ports and port facilities.

In particular, the bill seeks to establish preventive security requirements for maritime activities, requiring persons involved in these activities to meet certain obligations - with one particular obligation being to develop and comply with a maritime security plan. These plans provide a framework for evaluating risks to ships and ports and put procedures in place to react to changes in security threats.

7. Other Considerations

7.1 Accounting and Audit Standard Requirements

Accounting Standards

One of the common features of the governance framework for regulated service entities is that Australian Accounting Standards generally apply as follows:

Type of Organisation	Accounting Standards Framework
Joint Local Government (NQ Water)	General Purpose Financial Reports prepared in accordance with Australian Accounting Standards, with the <i>Local Government Act 1993</i> and the Local Government Finance Standard 1994.
Statutory Body (e.g. Gladstone Area Water Board which is a Statutory Body established under the Water Act 2000 and from 1 October 2000 commenced operations as a Category 1 Commercialised Water Authority)	General Purpose Financial Reports prepared in accordance with the <i>Financial Administration and Audit Act 1977</i> and the disclosure requirements of the Financial Management Standard 1997 – Accounting policies adopted conform to applicable Australian Accounting Standards, Urgent Issues Group Consensus Views and the relevant principles of the Statement of Accounting Concepts.
Local Government Owned Corporations (Wide Bay Water)	General Purpose Financial Reports prepared in accordance with Australian Accounting Standards, with the <i>Local Government Act 1993</i> and the Local Government Finance Standard 1994, <i>Financial Administration and Audit Act 1977</i> and the disclosure requirements of the Financial Management Standard 1997.
Fully commercialised business unit of a Local Government (e.g. Brisbane Water)	These business units form part of the overall General Purpose Financial Reports which are prepared by Local Governments in accordance with the Local Government Act 1993 and the Local Government Finance Standard 1994 and which are in line with Australian Accounting Standards in particular accounting standard AAS27 on Financial Reporting for Local Governments. Special Purpose Financial Reports are voluntarily prepared by some Local Government business units setting out the financial performance and financial position of the business unit.
Statutory Government Owned Corporation. (e.g. SunWater)	General Purpose Financial Reports prepared in accordance with the <i>Financial Administration and Audit Act 1977</i> and the disclosure requirements of the Financial Management Standard 1997 – Accounting policies adopted conform to applicable Australian Accounting Standards, Urgent Issues Group Consensus Views and the relevant principles of the Statement of Accounting Concepts.
Company Government Owned Corporation. (e.g. Energex)	General Purpose Financial Reports prepared in accordance Australian Accounting Standards, Urgent Issues Group Consensus Views, other authoritative pronouncements of the Australian Accounting Standards Board, the <i>Corporations Act 2001</i> and the provisions of the <i>Government Owned Corporations Act 1993</i> .
Company operating under the Corporations Act (unlisted) (SEQ Water)	General Purpose Financial Reports prepared in accordance with the <i>Corporations Act 2001</i> , Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting

Type of Organisation	Accounting Standards Framework
	Standards Board and consensus views of the Urgent Issues Group.
Company operating under the Corporations Law (listed) (Envestra and Prime Infrastructure)	General Purpose Financial Reports prepared in accordance with the <i>Corporations Act 2001</i> , Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board and consensus views of the Urgent Issues Group.

Apart from any commercialised business units of Local Governments which are not reporting entities, all entities which are regulated service providers are obliged to prepare General Purpose Financial Reports and thereby adopt accounting standards.

General Purpose Financial Reports will be impacted in the near future by the moves to International Financial Reporting Standards, with the commitment for reporting entities in Australia to move to those standards by 2005.

Findings

There is no current legal obligation for commercialised business units of Local Governments to provide General Purpose Financial Reports, although those which are reporting entities would be required to do so by accounting concept statements and standards.

Audit Requirements

All Government organisations (including entities controlled by a State Government owned entity) are required to be audited by the Queensland Audit Office unless exempted. Section 73 of the *Financial Administration and Audit Act 1977* indicates that unless exempted by regulation, the Auditor-General must audit all public sector entities. Public sector entities are defined in Schedule 3 of the Act as meaning:

- (a) a department; or
- (b) a local government; or
- (c) a statutory body; or
- (d) an entity that is controlled by 1, or more than 1, department, local government or statutory body or by a combination of departments, local governments and statutory bodies.

This includes all Statutory Bodies, all Local Government entities including Joint Local Governments such as NQ Water, all Government Owned Corporations whether Statutory or Company GOCs, and a company controlled by State/Local Governments such as South East Queensland Water Company.

Private sector organisations such as Envestra and Prime Infrastructure have appointed auditors from the private sector.

Findings

From our interviews the impact of auditing requirements on the investment decision-making process is not significant. There is some impact on public sector controlled

entities from the work undertaken by the Queensland Audit Office on corporate governance and risk management.

7.2 Asset Accounting Requirements

Local Governments - Register of non-current assets

All local government entities are required to keep a register of non-current assets.

All local government entities must determine a threshold level of no more than \$5,000 below which the value of a non-current asset must be treated as an expense. That threshold may differ for different assets and the amount or amounts must be recorded in the local government's accounting manual and disclosed by way of note in its annual financial statements.

Non-current assets must be valued using the fair value basis although a local government may value a non-current asset by using the cost basis if the asset has—

- (a) a useful life from new of not more than 10 years; or
- (b) a carrying value of not more than \$50 000 or, if a lesser amount is decided by the local government, the lesser amount.

Public Sector Entities (other than Local Governments)

All statutory bodies under the *Financial Administration and Audit Act 1977* are required to value assets in accordance with guidelines issued under the Financial Management Standard titled 'Non-Current Asset Accounting Guidelines for the Queensland Public Sector'.

A statutory body must comprehensively revalue material assets at least once every 5 years, and otherwise revalue the assets at least annually between comprehensive revaluations.

Recording assets includes—

- (a) accurately calculating depreciation based on the asset's useful life to the agency; and
- (b) maintaining an adequate audit trail; and
- (c) identifying and recording transactions for assets; and
- (d) obtaining information about assets to allow the timely provision of relevant and reliable information for the agency's managers and its external reports.

Accounting Standard AASB1041

The primary accounting standard which applies to the valuation of assets is AASB 1041 “Revaluation of Non-Current Assets”. AASB1041 was issued in July 2001 and applies for financial years ending on or after 30 September 2001.

The accounting standard applies to the following entities by the following means:

Entity	Authority	Effect
Public Sector Entities including statutory bodies and government owned corporations.	AASB1041 prescribed under Financial Management Standard in Schedule 3. However, the Non-Current Asset Accounting Guidelines for the Queensland Public Sector (issued under the Financial Management Standard 1997) prescribe the use of fair value for all land, buildings, infrastructure and heritage and cultural assets.	Fair value only
Local Governments including Joint Local Government (NQ Water)	AASB1041 prescribes the Financial Management Standard (Schedule 3). However, section 36 of the Local Government Finance Standard requires Local Governments to use fair value. This removes the option of selecting between fair value and historic cost as allowed under the accounting standard.	Fair value only
Company Government Owned Corporations	AASB1041 prescribed under Corporations Act 2001	Historic cost or fair value
Other Corporations Act Entities	AASB1041 prescribed under Corporations Act 2001	Historic cost or fair value

The main difference in accounting for infrastructure assets between the public sector entities (other than Company GOCs) and companies is that apart from some low value items, public sector entities are required to use fair value, whereas those operating under the *Corporations Act 2001* (including Company GOCs) are able to make a choice between historic cost or fair value. The accounting standard however places restrictions on moving between fair value and cost.

It is worth noting that a Local Government Bulletin issued 21 May 2002 (ref 07/02) indicates that, prior to the adoption of AASB 1041, local governments used the deprival method to value non-current assets above the threshold. That Bulletin noted that for the time being the AASB accepts the view that, in the public sector, deprival value is an appropriate surrogate for fair value.

7.3 Investment Hurdle Rates

Private Sector Companies

The overriding issue for private sector companies (Prime Infrastructure and Envestra) is whether the proposed investment will deliver a rate of return which is likely to be acceptable to its shareholders. An important group of stakeholders in this regard are Stock Market analysts whose analyses can be crucial to the future standing of a company within the market.

One of the risks identified by Prime Infrastructure in considering whether to invest in an expansion of a declared regulated service is the regulatory risk associated with being subject to prices oversight.

Government Owned Corporations

GOCs are required to have an independent credit rating assessment. This assessment is an important element of the credit review which may be required for Shareholding Ministers as part of the process for obtaining project approval.

GOCs therefore need to be mindful of the expected return on investment to deliver the overall entity rate of return for shareholding Ministers. This influences the hurdle rate for investments. As individual project risk also needs to be considered, and this may mean that a higher hurdle rate is required for certain projects than the overall entity rate.

Independent Credit Rating Agency Assessment

The independent credit rating required under the Code of Practice for Government Owned Corporations' Financial Arrangements (June 2002) has to be reviewed once every three years. These ratings are required to determine any competitive neutrality fee payable by the GOC.

Queensland Treasury Corporation's Credit Unit undertake the annual credit review on behalf of Queensland Treasury. That review focuses on a GOC's ability to sustain existing and planned levels of debt.

A credit review at the option of shareholding Ministers may also be required to be undertaken by Queensland Treasury Corporation as a pre-requisite for obtaining project approval for investment proposals; especially significant investments. It is expected that Queensland Treasury Corporation would be provided with copies of the draft Statement of Corporate Intent, Corporate Plans and any business cases in support of the significant investment.

Local Government

We did not identify any prescribed requirements related to hurdle rates for investments for Local Government Commercialised Business Units. However, a Local Government Bulletin of June 2001 (Ref 06/01) titled Update on National Competition Policy Issues includes a section on Rate of Return which suggests that:

“for larger businesses, councils should determine the rate of return on assets using Weighted Average Cost of Capital and the Capital Asset Pricing Models. Based on this methodology, the QCA has assessed available information and identified indicative asset betas and related post tax nominal premiums to be added to the prevailing risk free rate for major business activities (that is, to the ten year bond rate). This may be utilised by councils as benchmarks for assessing the rate at which a comparable private sector entity carrying on the activity would be able to obtain capital in the market, having regard to the appropriate split between debt and equity.

Business Activity	Asset Betas	Post Tax Nominal Premium to Ten Year Bond Rate (per cent)
Water and Sewerage	0.35 to 0.45	2.1 to 2.7
Refuse Management	0.39 to 0.49	2.3 to 2.9
Plant and Equipment Hire	0.40 to 0.51	2.4 to 3.0
Road Construction and Maintenance	0.42 to 0.52	2.5 to 3.1
Cultural / Recreation / Leisure	0.45 to 0.55	2.7 to 3.3

When applying these rates of return, councils will need to include interest, taxes and the value of dividend imputation tax credits to the cash flow for each business activity. When selecting a point estimate, councils should be cognisant that larger businesses and those with high stability of cash flows will be expected to lie towards the lower end of the range and smaller businesses and those with unstable or seasonal cash flows will be expected to lie towards the top of the range.

Councils may instead wish to undertake their own analysis to estimate appropriate alternative capital structures and / or rates of return on capital.”

Whilst these guidelines are designed to help determine the rate of return for the organization they have an influence in terms of the minimum investment rate to be earned on individual infrastructure investments.

7.4 Other Requirements

Acquisition of Land

Most entities that we interviewed were listed as a constructing authority under the *Acquisitions of Land Act 1967*. These entities have the power to take land for purposes as listed in the schedule to the act. These purposes include:

- ❑ Dams or weirs or other works for the conservation or reticulation of water,
- ❑ Flood gates and flood warnings, flood prevention or flood mitigation,
- ❑ Works which the constructing authority is authorised by any Act or resolution of Parliament to construct or erect or for the purposes of any Act;
- ❑ Any purpose declared under a regulation to be a purpose for which land may be taken under and subject to this Act.

The process for the acquisition of land includes the issue of a notice in writing specifying the particular purpose for which the land to be taken is required; and stating the description of the land to be taken. Compensation is to be agreed between the parties, however if agreement cannot be gained the Land Court will determine the compensation.

The other entities that are not listed as a constructing authority, namely SunWater and the private sector entities, have the ability to negotiate the acquisition of land or, for projects of regional or state significance, the state can compulsorily acquire land on their behalf.

Purchasing Requirements

State Purchasing Policy

The State Purchasing Policy¹⁰ applies to government departments and those GOCs who have been notified of the policy under section 123 of the *Government Owned Corporations Act 1993*. The policy objectives are:

- ❑ to advance Government priorities;
- ❑ to achieve value for money; and
- ❑ to ensure probity and accountability for outcomes.

Value for money assessment must include consideration of:

- ❑ contribution to the advancement of Government priorities;
- ❑ non-cost factors such as fitness for purpose, quality, service and support; and
- ❑ cost related factors including whole-of-life costs and transaction costs associated with acquisition, use, holding, maintenance and disposal.

¹⁰ <http://www.qgm.qld.gov.au/policy2000/Policy2000.pdf> Last visited 29 October 2003

Probity and accountability requirements are set out in legislation including:

- *Financial and Administration and Audit Act 1977;*
- *Financial Management Standard 1997;* and
- *Public Sector Ethics Act 1994.*

Purchasing for Local Government Entities

Under the *Local Government Act 1993*, section 481, a local government must have regard to the following purchasing principles—

- (a) Open and effective competition;
- (b) Value for money;
- (c) Enhancement of capabilities of local business and industry;
- (d) Environmental protection; and
- (e) Ethical behaviour and fair dealing.