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# Sydney Water Corporation

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## AUDIT OPINION

The audit of the consolidated financial report of Sydney Water Corporation and its controlled entities for the year ended 30 June 2006 resulted in a qualified Independent Audit Report. The qualification related to assets and liabilities of the Build-Own-Operate (BOO) schemes not being recognised in Sydney Water's balance sheet.

The audit report for 2004-05 was similarly qualified.

## KEY ISSUES

### Field Resources Management Project

Sydney Water is implementing a new system to manage the scheduling and reporting of maintenance works. Sydney Water's Internal Audit unit recently issued its draft findings to Sydney Water management. Comments were due back by late October. The main finding in the draft report was that governance over the project has not been effective.

The new system will replace the paper based system and ageing mobile radio dispatch system. The deliverables of this project are outlined in the table below.

Deliverable	Original	Revised
Project cost	\$9.3 million (Nov 2004)	Approx \$20.5 million (Sept 2006)
Completion date	March 2007	March 2008

Source: Sydney Water

The project cost and completion date only relate to stage one of the project. Stage two, which involves delivery of the geographic information system and document management functionality, will only proceed subject to approval of a subsequent business case. The original cost for stage two was \$2.3 million.

Sydney Water Board papers and other project reports indicate that the project was proceeding to plan until March 2006. After that date, problems were encountered with:

- the project's scope and complexity
- the costs and complexities associated with security
- the extent of testing procedures, and
- the integration of the new system with Sydney Water's existing systems.

To address these concerns, Sydney Water engaged a consultant in July 2006 to review the project, and to develop a robust plan and monitor delivery of the plan. The consultant's 'health check' of the project was completed in August 2006. The Board of Sydney Water accepted the consultant's recommendations at its September meeting, and the project team is in the process of implementing them, including:

- replacing staff on the project
- supplementing the existing project team with greater capability and expertise, and
- improving the quality of management processes.

Sydney Water reassessed the business case supporting the project and concluded that continuing with the project was the best outcome for the organisation. Amongst other benefits, the new system is expected to deliver business efficiencies and improve Sydney Water's response times to breaks and leaks in the water network. Once implemented, Sydney Water believes the new system should reduce its operating expenditure by \$4.4 million per annum. Sydney Water will implement stage one of the new system and may implement stage two, depending on the business case.

The project was approved in November 2004, and Sydney Water had spent \$5.4 million as at 31 August 2006.

Internal Sydney Water reports and documents state that the causes of the increase in costs are not the same as those associated with the Customer Information Billing System (see below) in 2002.

### **Customer Information Billing System (CIBS)**

Sydney Water commenced litigation in the Supreme Court against PricewaterhouseCoopers (PwC) in 2003, in respect of its implementation of the failed CIBS system. The litigation claim seeks damages against PwC under several heads of claim, including contract law and negligence. The claim also seeks legal costs and interest on the damages. The discovery phase of the litigation is complete and the parties are preparing their evidence. No hearing date has been set. The parties attended a mediation session in May 2006 that was unsuccessful.

We understand that Sydney Water has incurred significant legal and related costs associated with this litigation.

We reported our key findings and recommendations following the termination of the CIBS project in Volume One of the Auditor-General's 2003 Report to Parliament.

### **Ability to Replace System Assets in the Future - Repeat Issue**

We have reported over the last four years our concern about Sydney Water's ability to fund the replacement of its system assets given the age and condition of the system and relevant regulatory pricing structures. At 30 June 2006, Sydney Water estimates that it would cost \$21.7 billion to replace its assets (\$19.8 billion at 30 June 2005). In comparison, the recoverable amount of the assets at 30 June 2006, being the estimate of the discounted future net cash inflows the assets are expected to generate over their remaining life, was only \$10.0 billion (\$10.7 billion).

Consistent with Australian Accounting Standards requirements, Sydney Water uses its weighted average cost of capital to discount the cash inflows generated by the assets. However, this is significantly higher than the actual return Sydney Water has made on its assets. This highlights that the current regulatory framework, amongst other factors, presents a problem for Sydney Water in being able to achieve a commercial rate of return on its water and wastewater services as they currently exist.

While the 2005-2009 Independent Pricing and Regulatory Tribunal's (IPART) price determination granted real price increases to Sydney Water, it has not bridged the gap between the recoverable amount of the system assets and the cost of replacing them using the modern engineering equivalent replacement cost methodology. The current drought, combined with demand management initiatives, has reduced the impact on revenue of real price increases.

From an accounting perspective, if this situation continues, Sydney Water will have to write down the value of new system assets as they are completed. This is because the cost of new assets will be greater than the cash inflows they will generate over their life. This write down will be recognised against Sydney Water's asset revaluation reserve, which at 30 June 2006 was \$1.8 billion. If the reserve reduces to zero then any further write down of assets will be treated as an expense. This will reduce profits and affect Sydney Water's ability to pay dividends to its shareholders, as well as key financial indicators.

IPART regulates Sydney Water's prices. In response to the above concerns, IPART points out that Sydney Water's replacement cost asset valuation of \$21.7 billion includes assets paid for by developers, supplied free of charge by developers and funded by government grants. IPART makes no provision for the replacement of such assets in determining Sydney Water's water and sewerage service charges until such time as they are due to be replaced, with the cost paid for by Sydney Water. IPART considers that to do otherwise would have the effect of Sydney Water being funded twice for the same assets. There are discrete developer charges determined separately by Sydney Water in accordance with a methodology determined by IPART.

Once an asset is replaced at Sydney Water's expense, IPART increases prices to enable Sydney Water to recover the cost of the new asset over its expected service life. IPART considers that the prices it determines provide for a rate of return equivalent to Sydney Water's weighted average cost of capital on the regulatory asset base, as calculated by IPART and excluding developer funded and gifted assets.

IPART has also indicated that it undertakes an annual audit of Sydney Water's compliance with the system performance standards and asset management provisions contained in Sydney Water's operating licence. The outcomes of this audit are tabled in Parliament and are considered by IPART in determining Sydney Water's prices.

Pricing determinations take a range of factors into account. We believe that the gap between Sydney Water's 'replacement' asset values and their cash generating capability is significant and needs further analysis by key stakeholders.

#### **Dividends**

The increase in the dividend payable by Sydney Water is greater than the increase in net cash flows generated from normal operating activities. The dividend payable at 30 June 2006, increased by \$73.0 million to \$193 million.

The net cash flows generated from normal operating activities in 2005-06 increased by \$26.7 million to \$287 million.

Based on net cash flows from normal operating activities and the dividend payable, only \$93.5 million (\$140 million) of cash was available for reinvesting into the business. This indicates that Sydney Water will need to increase external loans to fund capital works.

Given the way demand management for water is impacting Sydney Water's cash flows and revenues, maintaining or increasing the dividend in the future could become problematic. We understand that Sydney Water is anticipating paying a dividend of \$140 million for 2006-07.

#### **Desalination Plant**

In February 2006, a revision of the Metropolitan Water Plan by the NSW Government resulted in the construction of a desalination plant being deferred. However, the Plan noted that if Sydney's water storage levels drop to 30 per cent or below, Sydney Water would build a desalination plant immediately. Sydney Water is designing a blueprint for the plant in case it needs to construct it in the future, and expects to complete the blueprint design by the end of 2006.

At 30 June 2006, Sydney Water had spent \$70.7 million on planning and designing the blueprint and acquiring parcels of land. It expects that the final cost of this work will be \$110 million. IPART had allowed \$94.0 million for this work in its price determination.

A large component of the costs incurred relates to acquiring land at Kurnell. Sydney Water compulsorily acquired two parcels of land. It paid \$24.3 million to compensate the owner of one of the land parcels. The owner of the other property, and other affected parties, are appealing the compensation amount in the Land and Environment Court. A hearing is yet to take place. Sydney Water has initially recognised the Valuer-General's determined compensation sum of \$13.1 million for this property, as part of the cost of the project. The final amount for land acquisition will only be known after finalisation of the court action.

In the original business case prepared in November 2005, Sydney Water estimated a desalination plant producing 125 megalitres of water per day would cost approximately \$1.3 billion to build and \$36.3 million each year to operate. Based on current water consumption levels, a desalination plant of this size is estimated to supply about nine per cent of Sydney's drinking water.

If the desalination plant is built, Sydney Water expects that IPART will revise the current pricing structure to ensure a commercial rate of return.

Because the NSW Government decided to terminate the original proposal to build a desalination plant, Sydney Water made ex-gratia payments of \$5.0 million to the two consortia involved in the proposal. Sydney Water engaged an independent firm to verify the validity of claims made by the consortia before making the payments.

### Security Upgrade Program

In Volume 4 of the 2005 Auditor-General's Report to Parliament, we reported that Sydney Water was taking corrective action to address several security weaknesses at all Sydney Water sites. Since then, Sydney Water believes that it has rectified the weaknesses. The final cost to complete the security upgrade program was \$14.5 million. Sydney Water estimates that maintaining this system will, on average, cost \$5.0 million per annum.

Sydney Water commissioned a post implementation review of the program, which concluded that it achieved its objective of establishing basic and robust security. However, the original timeframe and budget were exceeded, due to several factors including unclear stakeholder expectations; unrealistic time frame; poor upfront project initiation and planning; and commissioning of sites by staff with insufficient security experience.

Sydney Water will implement several recommendations from the review to avoid similar issues in the future.

## PERFORMANCE ISSUES

### IPART Operational Audit

IPART reported the results of its 2004-05 operational audit of Sydney Water in February 2006. The audit assessed Sydney Water's performance against the standards in its operating licence.

The audit found that Sydney Water managed its resources to achieve predominantly high to full compliance with its operating licence requirements. The results of the audit are summarised in the table below.

Year ended 30 June	2005 %	2004 %	2003 %
Full compliance	71	65	67
High compliance	19	21	22
Partial compliance	6	7	5
Low compliance	1	1	--
Non compliance	--	--	--
Insufficient information	3	5	7

Source: Sydney Water

Sydney Water's performance in 2004-05 in the area of full compliance was better than the previous year. Full compliance means that Sydney Water met all the requirements of a particular standard, whilst high compliance means most requirements were met with some minor technical failures or breaches.

The audit found that Sydney Water had supplied excellent quality drinking water through a comprehensive water quality management system during the year. However, IPART noted that it would not have met its 2004-05 water conservation and demand management targets in the absence of mandatory water restrictions. IPART also believes that Sydney Water is unlikely to meet the 2010-11 targets unless it takes further action. As a result of the audit, the Minister imposed no penalties on Sydney Water. He outlined two specific areas for its attention, namely in relation to the extent of water recycling, and leakage reduction.

### Water Services Association of Australia Benchmarking

The Water Services Association of Australia (WSAA) has in the past reported on the performance of the Australian urban water industry. WSAA compared performance on customers, service performance, infrastructure, and economic and financial performance across Australian water retailers and wholesalers. The National Water Commission will now perform this reporting under the National Water Initiative.

The table below shows Sydney Water's performance over the past four years on some of the key indicators.

Year ended 30 June	2006	2005	2004	2003
Volume of water consumed (kl) per residential property	203.0	211.0	224.0	255.0
Operating cost per property for water supply services (\$)	218.0	230.1*	221.2*	250.6*
Total cost per property for water supply services (\$)	303.0	398.7*	386.4*	473.6*
Water quality complaints per 1,000 properties	0.8	1.1*	1.4*	2.0*
Water interruption frequency per 1,000 properties - Unplanned	196.4	233.8*	260.4*	274.9*
Average duration of an unplanned water supply interruption (hrs)	1.9	1.7*	1.7*	2.3*
Water main breaks and leaks per 100 km	34.5	37.8*	38.0*	50.7*
Wastewater reticulation main breaks and chokes per 1,000 properties	12.3	11.7	10.4	11.9
Water recycled (%)	3.5	2.8	3.2	2.6
Water leakage (Infrastructure Leakage Index)	1.6	1.8	2.1	2.9

Source: Figures for 2003 to 2005 from WSAA report for 2004-05. 2005-06 figures from Sydney Water (unaudited).

\*These numbers are not directly comparable to the 2005-06 figures because of a change in definition. Provided for information only.

The volume of water consumed continues to decrease as a result of water restrictions and Sydney Water's demand management strategies. The increase in wastewater breaks and chokes is a result of the dry weather during the year. Sydney Water has advised us that 75 per cent of chokes are caused by tree roots. To address this, Sydney Water will focus on inspecting pipes to determine the program of works.

Sydney Water's water leakage improved in 2005-06. Further information on this is provided under the heading 'Water Loss' below. The International Water Association believes an infrastructure leakage index between 1.0 and 2.9 indicates that an entity is making a substantial effort to manage and maintain its infrastructure, and to ensure all detected leaks and bursts are promptly repaired.

Total and operating costs per property for water supply services have reduced between 2003 and 2005, as has the incidence of water quality complaints and water interruption frequency.

## Civil Maintenance

In 2005, Sydney Water took part in a benchmarking exercise utilising 2004-05 data that reviewed fifteen civil maintenance activities. Nineteen water authorities in Australia took part in the exercise. The findings included:

- Sydney Water's water and waste water service level is below the average due to a lack of customer complaint data, and a high degree of repeat work and interruption times
- Sydney Water's water and waste water cost performance was near average, and
- Sydney Water's waste water operations appear to be more cost effective than its water operations.

Sydney Water has implemented a number of the recommendations from the benchmarking exercise and it is reviewing further initiatives to improve services and cost efficiency, such as additional benchmarking.

## Maintenance Activities

The table below highlights that Sydney Water completed almost all of its planned maintenance for 2005-06. The results are consistent with the previous year.

Year ended 30 June	2006	2005
Total planned maintenance completed for network and treatment assets (%)	97.0	96.0
Total planned maintenance completed for critical assets (%)	99.5	100.0
Budgeted maintenance expenditure (\$m)	157.0	147.2
Actual maintenance expenditure (\$m)	153.0	146.3
Backlog maintenance (number of jobs)	6,963	7,876
Backlog maintenance (\$m)	9.0	10.5

Source: Sydney Water

During 2005-06, Sydney Water completed 212,529 maintenance jobs (203,001 in 2004-05). Backlog maintenance has remained steady over the last two years. Whilst Sydney Water believes this is an acceptable amount of backlog insofar as it allows efficient scheduling and continuation of workflow, it nevertheless plans to significantly reduce the extent of backlog maintenance by 30 June 2007. Backlog maintenance is lower priority maintenance work that Sydney Water had planned to address by a certain date, but which was not achieved. Sydney Water monitors backlog maintenance to ensure critical work is not delayed.

At present, most of Sydney Water's planned maintenance activities are time based. Sydney Water is gradually moving to condition based and run to fail maintenance programs because these methods are more cost efficient.

## Water Loss

The table below summarises water loss within the water distribution system. Water is lost because of leaks in buried water mains. The volume of water loss decreased substantially in 2005-06, because of the inspecting of 18,000 kilometres of water mains during the year and the repairing of leaks found.

Year ended 30 June	2006	2005
Volume of water loss (megalitres)	44,906	52,873
Water loss compared to water supplied (%)	8.5	10.0

Source: Sydney Water

Sydney Water believes it will meet its operating licence requirement of reducing water loss to no more than 38,325 megalitres per year by 30 June 2009. It considers it can achieve this by inspecting 18,000 kilometres of water mains each year, and by renewing water mains and improving pressure management. Sydney Water will invest \$300 million into these initiatives, and others, over the next three years.

The target of 38,325 megalitres was assessed as being the economic level of leakage, which is the point at which costs associated with leakage reduction equals the benefits derived from water savings. Reducing water loss beyond this point would cost more than producing the lost water from another source.

### Savings from water restrictions

Sydney Water estimates that water restrictions have saved 105,288 megalitres of water in 2005-06 (100,557 megalitres in 2004-05). This represents 20 per cent (18.9 per cent) of total water supplied by Sydney Catchment Authority to Sydney Water in each year. The data supplied by Sydney Water suggests that Level 3 restrictions, which commenced on 1 June 2005, have resulted in a higher level of water savings than achieved under Level 2 restrictions.

### Wastewater services

Sydney Water operates its 30 sewerage treatment plants (STPs) and 659 sewer pumping stations in accordance with strict licence conditions set by the Department of Environment and Conservation (DEC). The table below highlights Sydney Water's compliance with those licence conditions.

Year ended 30 June	2006	2005
Total number of Penalty Infringement Notices issued by DEC (relating to prior year non-compliances)	3	2
Total number of license non-compliances	408	380

Source: Sydney Water

Of the 408 licence non-compliances in 2005-06, 59 per cent (60 per cent in 2004-05) relate to uncontrolled dry weather overflows, which are usually caused by tree root chokes, mechanical and electrical failures and power outages at pumping stations. Sydney Water has commenced a number of initiatives to reduce dry and wet weather overflows, including implementing an optimal choke management strategy and amplifying and upgrading a number of pumping stations and STPs.

Sydney Water reported its 2005-06 non compliances to DEC in August 2006. DEC has yet to review the non-compliances to determine if any result in a licence breach. Of the 380 non-compliances reported in 2004-05, DEC determined that 3 breached the licence conditions.

Under its 2005-10 operating licence, Sydney Water must ensure that no more than 25,000 properties are affected by an uncontrolled dry weather overflow each year. Sydney Water advises that it met this target in 2005-06, with only 22,572 properties affected.

### Financial Performance Information

We extracted the following information from Sydney Water's consolidated financial reports, for the years ended 30 June 2006 and 30 June 2005. The information is based on Australian Equivalents to International Financial Reporting Standards (AEIFRS). Sydney Water's current ratio (a measure of its liquidity) has remained steady at 0.3. A current ratio of 1.0 is, in most instances, considered appropriate. However, Sydney Water can manage its cash flows with a lower liquidity ratio because its revenues and expenditures are highly predictable, and because it can quickly source funds from a facility with NSW Treasury Corporation, as well as approved borrowing facilities and a bank overdraft.

Year ended 30 June	2006 \$m	2005 \$m
Profit before tax	<u>461.7</u>	<u>160.2</u>
Dividend payable	193.0	120.0
Income tax payable	<u>54.9</u>	<u>41.1</u>
<b>Total government contributions</b>	<b><u>247.9</u></b>	<b><u>161.1</u></b>
Dividend + tax/profit before tax (%)	53.7	100.1
Capital expenditure	520.2	426.0
Total borrowings	2,875.5	2,639.2
Total assets	10,818.8	11,573.7
Total liabilities	4,335.1	4,345.8
Current ratio	0.3	0.3

Sydney Water's operating profit for 2005-06 was significantly higher than the prior year because of a favourable movement in the defined benefit superannuation liability. Excluding the movement in this liability, Sydney Water's operating profit before tax would have been \$271 million (\$246 million for 2004-05). This means the tax and dividend payable, as a percentage of profit before tax, increased from an adjusted 65.2 per cent to 91.6 per cent for 2005-06.

The following table compares Sydney Water to the Australian water industry and other Government Trading Enterprises (GTEs).

Year ended 30 June	Sydney Water		All States	
	2005	2004	Water 2005	All GTEs 2005
<b>Performance Measure</b>				
Return on assets (%)	3.5	3.6	5.7	4.3
Return on equity (%)	2.5	2.8	3.5	2.9
Debt to equity (%)	31.6	30.1	23.0	32.5
Cost recovery (%)	143.0	148.6	156.8	122.8

Source: The Productivity Commission's Financial Performance of Government Trading Enterprises 2000-01 to 2004-05

Sydney Water's return on assets, return on equity and cost recovery decreased in 2004-05, and continues to be below the average for the water industry. Because of differences in the market environment and the valuation of assets, it is difficult to make a direct comparison between Sydney Water and the water industry and all GTEs. For example, the water entities that value infrastructure assets at historic cost will report a higher rate of return on assets than those applying fair value, such as Sydney Water.

## CONTROL ISSUES

We identified some opportunities for improvement in internal controls/procedures. These were minor, and we reported them to management.

## COMPLIANCE ISSUES

We examined whether Sydney Water complied with:

- best practice requirements in NSW Premier's Department Circular 2003-02 'Electronic Information Security - Business Continuity Planning', and whether there was a general business continuity plan and how regularly this was reviewed, and
- best practice requirements in NSW Treasury Circular 04/07 'Procurement Policy Reform' which was issued in conjunction with the Policy and Guidelines Paper TPP04-1 on NSW Government Procurement Policy.

Sydney Water complied with these requirements; however we identified opportunities for improvement, including the need to:

- improve training and awareness programs in business continuity planning, and
- build on its comprehensive asset class contingency plans to develop separate stand-alone critical infrastructure contingency plans for critical assets. Sydney Water has contingency plans in place for its infrastructure assets that have demonstrated their effectiveness when incidents have occurred. It is now developing specific infrastructure contingency plans for critical assets. Sydney Water intends to finalise these plans by February 2007.

## OTHER ISSUES

### Occupational Health and Safety (OH&S)

The Internal Audit unit finished a review of Sydney Water's health and safety program early in 2006. It concluded that Sydney Water had not implemented the health and safety management system consistently, exposing it to unacceptable occupational health and safety risks. This was mainly caused by a lack of understanding of management responsibilities for OH&S. Sydney Water has developed an action plan to address the recommendations over the next 12 months.

In addition to the internal audit review, WorkCover completed its triennial OH&S audit of Sydney Water. It identified 28 corrective action requests. One of the corrective actions is to formally document the OH&S risk management program. Sydney Water has developed a Safety Improvement Plan to improve its compliance with legislative requirements and best practice.

While Sydney Water's management of OH&S needs improving, the level of injury in Sydney Water has gradually reduced over time. Sydney Water measures workplace injury through the Lost Time Injury Frequency Rate (LTIFR), which measures the number of lost time injuries per million hours worked. The LTIFR at 30 June 2006 was 8.2 (14.8 at 30 June 2005).

### Review of Major Capital Projects

Sydney Water's capital expenditure in 2005-06 was \$520 million (\$426 million in 2004-05). This was 12 per cent below the SCI target of \$592 million. Sydney Water advised that this was mainly due to:

- deferral of \$32.0 million for the desalination project
- \$17.0 million in efficiency savings, and
- \$23.0 million due to scope changes, deferrals, delivery and approval delays.

Sydney Water has advised that the under-spending will not result in any material increase in risk to business outcomes or asset performance.

In its 2005 price determination, IPART suggested Sydney Water should achieve a capital efficiency target of 3.5 per cent in 2005-06. Sydney Water advised that it has achieved capital efficiencies of 3.1 per cent.

The original and current cost estimates and service delivery dates for all capital projects with an original cost above \$50.0 million are listed in the table below. Sydney Water considers that cost variances principally relate to escalation in costs for projects that were approved some time ago, and increases in the scope of works. Delayed regulatory approvals and construction related delays are also cited as factors. Sydney Water considers the overall risk profile of its capital program to be low.

Project	Original Cost Estimate (and year) \$m	Current Cost Estimate \$m	Original Service Delivery Date	Current Service Delivery Date
Malabar System Risk Reduction - Stages 1-3	53.0 (1998)	143.0	Mid 2007	Mid 2007
Illawarra Wastewater Strategy	104.0 (1997)	223.9	Mid 2005	Late 2006
South Western Sydney Sewerage Scheme	201.0 (2001)	180.0	Late 2007	Late 2008
North Head Sewerage Treatment Plant	106.0 (2003)	151.6	Mid 2009	Late 2009
Blue Mountains Sewerage Scheme Stage Two	51.2 (1998)	156.0	Late 2006	Mid 2009
Liverpool Sewerage Treatment Plant (STP) Upgrade - Stage 4a	76.0 (2001)	116.0	Mid 2005	Late 2005
Bondi STP	95.0 (2000)	91.8	Early 2007	Late 2006

To understand the causes of unfavourable variations, Sydney Water engaged an independent firm to review its current cost estimating processes. Some of the findings from the review included:

- There is no standard approach to developing or updating project estimates, which can lead to outdated or inadequate estimates for some projects
- Sydney Water inconsistently applies risk based cost estimating techniques on large or complex projects, and
- Cost escalation has generally not been factored into Sydney Water's initial project estimates, which significantly contributes to increased costs for projects that have been delayed in the planning phase.

Sydney Water has commenced implementing the review's recommendations.

## Recycling

As outlined in the Government's 2006 Metropolitan Water Plan, Sydney Water plans to increase the volume of recycling to 70 billion litres a year in 2015. This would equate to over 13 per cent of the current water consumption by Sydney Water customers. In 2005-06, Sydney Water recycled over 15 billion litres of wastewater collected, or 3.5 per cent (2.8 per cent in 2004-05). At present, Sydney Water ranks amongst the lowest recyclers on a percentage basis when compared to other water retailers in Australia.

The largest recycling initiative is the Western Sydney Recycled Water project, which Sydney Water estimates will save up to 27 billion litres of water by 2015. Sydney Water has received expressions of interest for the first stage of this project and it will issue a request for tender in November 2006. The first stage of the project relates to replacing water releases from Warragamba Dam with recycled water. Sydney Water believes this will save 18 billion litres of water, and will be commissioned by mid 2009.

In September 2006, Sydney Water commissioned its largest industrial water recycling scheme. Instead of using drinking water in its steel making business, BlueScope Steel will use recycled water. This will save over 7 billion litres of drinking water per year, which is about 18 per cent of Illawarra's water usage in 2005-06.

## Sale of Property at Miranda

After extensive negotiations with a preferred tenderer, Sydney Water terminated the negotiations in January 2006 because the tenderer could not meet the conditions of a 2003 Ministerial Direction. The Direction required Sydney Water to sell the property to a not-for-profit aged care organisation, which would develop the site for three tier aged care accommodation and affordable housing.

In February 2006, a new Ministerial Direction was issued under section 20N(1) of the *State Owned Corporations Act 1989* (SOC Act), requiring Sydney Water to sell the land for a similar purpose, but now open to any interested party. Under the new Direction, Sydney Water must approve the development of the site to ensure it meets the specified conditions.

Sydney Water has advised us that it has exchanged contracts for the sale of the Miranda site, and settlement will occur in late October 2006. Sydney Water has recently agreed the first interim reimbursement for costs in complying with the Direction, with the Treasurer. It anticipates submitting a final claim to the Treasurer later this year.

## Walter Construction Group (Walter) Collapse

Walter was placed in voluntary administration at the beginning of 2005. As a result, Sydney Water incurred an additional \$11.8 million on projects partly delivered by Walter. By calling upon bank guarantees provided by Walter, Sydney Water has recovered \$9.7 million of the additional costs incurred. It is confident of recovering the remaining amount of \$2.1 million.

Following the Walter collapse, Sydney Water now mitigates its exposure to financial losses by conducting an annual review of contractor viability for all major projects.

## FINANCIAL INFORMATION

### Abridged Consolidated Income Statement

Year ended 30 June	2006 \$'000	2005 \$'000
Service charges	676,093	635,309
Usage charges	589,106	549,666
Other	275,345	240,033
<b>TOTAL REVENUE</b>	<b>1,540,544</b>	<b>1,425,008</b>
Employee related expenses*	82,295	369,510
Bulk water	137,382	120,299
Water treatment	97,387	95,187
Maintenance and operational services	145,488	130,840
Borrowing	171,564	153,697
Depreciation and amortisation	170,356	181,882
Other	274,332	213,369
<b>TOTAL EXPENSES*</b>	<b>1,078,804</b>	<b>1,264,784</b>
<b>PROFIT BEFORE TAX*</b>	<b>461,740</b>	<b>160,224</b>
Tax	196,155	51,089
<b>PROFIT AFTER TAX</b>	<b>265,585</b>	<b>109,135</b>

\* includes a net superannuation gain of \$191 million (2005: net expense of \$85.6 million)

The increase in service and usage charges was mainly due to a price increase in October 2005. Other revenue increased because Sydney Water received more developer contributions, and received \$17.0 million from the Water Savings Fund to pay for demand management initiatives.

The decrease in employee related expenses was largely due to the movement in the actuarially assessed defined benefit superannuation liability. The liability reduced by \$191 million in 2005-06, compared to an increase of \$85.6 million in the previous year.

The increase in bulk water charges was due to a price increase in October 2005. More maintenance work, such as the inspection of 18,000 kilometres of pipes during the year, led to the increase in maintenance and operational expenses.

Other expenses increased mainly due to asset write downs; losses on disposal of assets; and Sydney Water's \$32.5 million contribution to the Water Savings Fund.

### Abridged Consolidated Balance Sheet

At 30 June	2006 \$'000	2005 \$'000
<b>TOTAL CURRENT ASSETS</b>	<u>222,161</u>	<u>178,749</u>
Investments and other financial assets	7,122	7,069
Property, plant and equipment	10,528,243	11,328,038
Intangibles	<u>61,322</u>	<u>59,846</u>
<b>TOTAL NON-CURRENT ASSETS</b>	<u>10,596,687</u>	<u>11,394,953</u>
<b>TOTAL ASSETS</b>	<u>10,818,848</u>	<u>11,573,702</u>
<b>TOTAL CURRENT LIABILITIES</b>	<u>672,101</u>	<u>538,966</u>
<b>TOTAL NON-CURRENT LIABILITIES</b>	<u>3,663,006</u>	<u>3,806,787</u>
<b>TOTAL LIABILITIES</b>	<u>4,335,107</u>	<u>4,345,753</u>
<b>NET ASSETS</b>	<u>6,483,741</u>	<u>7,227,949</u>

The increase in current assets was mainly due to an increase in the amount receivable from customers for service and usage charges, and an increase in assets held for sale.

The decrease in property, plant and equipment was due to the lower recoverable amount for those assets, as previously noted in this report.

The increase in total current liabilities was largely due to an increase in accruals and dividend payable.

### SYDNEY WATER'S SUBSIDIARIES

Sydney Water's subsidiaries during the year were Australian Water Technologies Pty Ltd (AWT), AWT International (Thailand) Limited and AWT Philippines, Inc.

AWT Philippines, Inc did not prepare a financial report for 2005-06. It was given an exemption by the Treasurer because it did not trade during the year and was in the process of being liquidated. The audits of the remaining subsidiaries for the year ended 30 June 2006 resulted in unqualified Independent Audit Reports.

The contribution to the Sydney Water Group result was:

Year ended 30 June	2006		2005	
	Sydney Water %	Subsidiaries %	Sydney Water %	Subsidiaries %
Total revenues*	99.9	0.1	99.2	0.8
Profit before tax*	100.0	--	99.1	0.9
Total assets	100.0	--	100.0	--
Total liabilities	100.0	--	100.0	--

\*Excluding intra group dividends

The subsidiaries' contribution to the overall results of the Sydney Water Group reduced this year because Sydney Water is gradually winding down their activities.

### SYDNEY WATER ACTIVITIES

Sydney Water is a statutory State owned corporation established under the *Sydney Water Act 1994*. It provides sustainable water services to the communities it services, and has as its principal objectives the protection of public health, protection of the environment, and to be a successful business.

For further information on Sydney Water, refer to [www.sydneywater.com.au](http://www.sydneywater.com.au).