Sydney Water Corporation

AUDIT OPINION

The audit of Sydney Water Corporation's financial report for the year ended 30 June 2007 resulted in a qualified Independent Auditor's 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 2005-06 was similarly qualified.

The audits of the financial reports of Australian Water Technologies Pty Ltd and its controlled entity for the year ended 30 June 2007 resulted in unqualified Independent Auditor's Reports.

Unless otherwise stated, the following commentary relates to the consolidated entity.

KEY ISSUES

Desalination Plant and the Price of Water

Sydney Water will need to achieve price increases to fund its future cost of debt.

The future cost of debt will increase as the desalination plant, with an approved cost of $1.8 billion, will be fully debt funded. The debt will alter Sydney Water's debt profile significantly over the next few years.

Refer also to our comment below on Sydney Water's ability to fund the replacement of its existing system assets given the age and condition of the system and relevant regulatory pricing structures.

The desalination plant's approved budget includes contingencies of $128 million (about 12 per cent of the total project cost) and provision of $64.0 million to cover expenses such as the acquisition of easements, settlement of land valuation dispute and compensation for disruption and damages to businesses and residences. The provision also covers time and safety incentives. The contractors can earn up to $20.0 million if they achieve Sydney Water's safety targets and complete the work three months ahead of the scheduled completion dates.

Contracts were signed in June and July 2007 to construct the water delivery infrastructure and desalination plant respectively. The contracts commit the parties to delivering the infrastructure within 26 months of the contract date. The party responsible for constructing the plant will also operate it for a 20 year period.

The deliverables of this project are outlined in the table below.

Deliverable	Original (November 2005)*	Approved (July 2007)#
Desalination plant cost ($b)	Not available	***1.0***
Water delivery infrastructure cost ($b)	Not available	***0.6***
Total project cost ($b)	1.3	***1.8***
Completion date	na	***December 2009***

Source: Sydney Water.
* Based on a 125 megalitre per day desalination plant.
\# Based on a 250 megalitre per day desalination plant.
na not applicable.

The latest internal status report prepared by Sydney Water suggests there are no significant environmental, technical or time issues related to the plant and its contracted cost of $1.0 billion. This estimated cost of the water delivery pipeline outlined in the table above was $570 million in July 2007. Sydney Water is still working through the agreed final cost for this part of the project with its alliance partners. Geotechnical investigations are continuing and the final cost estimate for the pipeline works is expected to be available in November 2007.

Work has commenced on constructing the desalination plant. It will be capable of producing 250 megalitres of water per day. Once operational, it will have the capacity to provide over 15 per cent of Sydney's current water consumption. At 30 June 2007, Sydney Water had spent $109 million on the project ($70.7 million at 30 June 2006).

When operational, Sydney Water estimates it will cost between $9.0 million and $55.0 million per annum to operate the plant depending on the volume of water produced. At full capacity the cost is $55.0 million per annum while it will cost an estimated $9.0 million per annum to have the plant on minimal utilisation.

Sydney Water estimates it will need 400,000 megawatt hours of electricity per year to operate the desalination plant at full capacity. Sydney Water has recently sought Request for Proposals from the market place to supply 100 per cent renewable energy. Electricity will be the largest component of the operating cost. Based on $76.00 per megawatt hour, Sydney Water estimates electricity will be 35 to 46 per cent of the total operating costs.

Sydney Water advises the NSW Government has not decided on the operating rules for the plant, other than it will operate at full capacity for the first two years. Until the operating rules are determined, the impact this will have on Sydney Water's existing arrangements with the operators of the four largest water filtration plants is unknown. Currently, most of Sydney's drinking water is processed by the Prospect water filtration treatment plant. The arrangement with this operator does not expire until 2022.

The supply of water from the desalination plant is unlikely to have a financial impact on the Sydney Catchment Authority (SCA). Sydney Water currently sources all of its water from SCA. Sydney Water advises that it expects to favour SCA bulk water over desalinated water when the SCA supply is adequate.

In June 2007, a wholly controlled entity, Sydney Desalination Plant Pty Ltd, was created. This entity will own the desalination plant, the intake and outlet pipes. The water pipeline delivery infrastructure will be owned directly by Sydney Water.

Ability to Replace System Assets in the Future – Repeat Issue

The gap between Sydney Water's 'replacement' asset values and their value based on cash generating capability is significant.

At 30 June 2007, Sydney Water estimates it would cost $22.3 billion ($21.7 billion) to replace its assets as they currently exist at today's prices. In comparison, the recoverable amount of the assets at 30 June 2007, being the estimate of the discounted future net cash inflows the assets are expected to generate over their remaining life, was $11.2 billion ($10.0 billion).

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 the replacement value on its water and wastewater services as they currently exist.

In its recent submission to the Independent Pricing and Regulatory Tribunal (IPART), Sydney Water has sought increased water prices to improve its financial viability and to bridge the gap between the replacement cost of its existing infrastructure assets and their recoverable amount. Sydney Water has requested IPART grant it a seven per cent real rate of return on its regulated asset base, and that it reconsider the assumption all new assets have a 100 year life. Sydney Water believes its assets have a significantly lower actual life. Sydney Water estimates the weighted average life of water and wastewater assets will be 83 and 75 years respectively from 30 June 2008.

IPART considers 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.

IPART points out Sydney Water's replacement cost asset valuation of $22.3 billion includes assets paid for and supplied free of charge by developers, as well as those 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 they are due to be replaced at Sydney Water's cost. IPART believes to do otherwise would effectively mean Sydney Water is 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.

IPART will consider Sydney Water's arguments, including those relating to its weighted average cost of capital and average asset lives as part of its assessment of Sydney Water's pricing proposals. IPART is expected to release its report and determination of future water, sewerage and stormwater prices for Sydney Water in June 2008.

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. The results of the operating licence are summarised below under the heading 'IPART Operational Audit'.

Dividends

Sydney Water's ability to pay future dividends is dependent on profits being available for distribution and access to loan funds.

Sydney Water provided $140 million ($193 million) for dividends in 2006-07. Dividend targets have been established for the next five years.

Field Resources Management (FRM) Project

In Volume Four of the 2006 Auditor-General's Report to Parliament we reported that Sydney Water encountered problems with its FRM project. The FRM project will replace the paper based system and ageing mobile radio dispatch system used in scheduling and reporting maintenance works. The problems included complexities with the project scope, security, testing and integration. The deliverables of this project are outlined in the table below.

Deliverable	Original (November 2004)	Revised (September 2006)	Forecast (September 2007)
Project cost ($m)	9.3	20.5	18.8
Completion date	March 2007	March 2008	May 2008

Source: Sydney Water.

While the completion date has been delayed, the forecast project cost is almost nine per cent lower than the revised cost approved by the Sydney Water Board in September 2006. The project cost and completion date only relate to stage one of the project. Sydney Water is preparing a business case for of the next stage project. The original budget for stage two was $2.3 million.

Internal reporting to the Sydney Water Board and an independent health check conducted in June 2007 suggests the project is proceeding in line with the current project plan. None of the concerns raised in the July 2006 health check, such as improving management processes and capability and expertise, were evident in the recent heath check.

In September 2006, 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 will reduce its operating expenditure by $4.4 million per annum. At 30 June 2007, Sydney Water had spent $9.9 million on the project.

Customer Information Billing System (CIBS)

Sydney Water commenced litigation in the Supreme Court against PricewaterhouseCoopers (PwC) in 2003. Sydney Water is seeking damages against PwC for the failed CIBS project. Sydney Water has incurred significant legal and related costs associated with this litigation. The matter has now been set for hearing in May 2008.

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

PERFORMANCE INFORMATION

IPART Operational Audit

IPART reported the results of its 2005-06 operational audit of Sydney Water in May 2007. The audit assessed Sydney Water's performance against the standards in its operating licence.

The audit found 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	2002 %	2003 %	2004 %	2005 %	2006 %
Full compliance	69	67	65	71	***86***
High compliance	14	22	21	19	***12***
Partial compliance	11	5	7	6	***2***
Low compliance	3	--	1	1	**--**
Noncompliance	1	--	--	--	**--**
Insufficient information	2	7	5	3	**--**

Source: Sydney Water.

Sydney Water's performance in 2006 was better than in previous years. In particular, Sydney Water achieved full compliance in water conservation and demand management, which was a significant improvement. IPART believes Sydney Water is on target to reduce water consumption to 329 litres per capita per day by 2011. Part of the reason for achieving full compliance in water conservation and demand management was IPART's decision to include savings attributable from water restrictions.

The audit concluded Sydney Water achieved partial compliance in responding to water main breaks and installing flow meters in the water supply system. Further information on response times can be found below under the heading 'Response Times'.

Full compliance means 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.

Water Conservation

As mentioned above, Sydney Water must meet the water conservation target of 329 litres per capita per day by 30 June 2011. Water consumption for 2006-07 and 2005-06 are detailed in the table below.

Year ended 30 June	Actual		Target
	2006	2007	2011
Target water consumption per capita per day (litres)	na	***na***	329
Actual water consumption per capita per day (litres)	341	***328***	na

Source: Sydney Water.
na: not applicable.

The reduced actual water consumption in 2006-07 is just below the 30 June 2011 target as result of a number of initiatives including reducing leaks, recycling and demand management programs.

The IPART operational audit concluded Sydney Water's demand management strategy is in line with world's best practice. Most of Sydney Water's demand management programs are achieving or exceeding planned water savings. However, actual savings from tiered pricing and the Building Sustainability Index (BASIX) were less than expected.

Response Times

The table below shows the percentage of calls to Sydney Water relating to water main breaks and leaks responded to within the target time. The response times and targets form part of Sydney Water's operating license.

Year ended 30 June	Actual		Target
	2006 %	2007 %	2007 %
Priority 6 (stop water loss within 2 hours)	72.3	***86.9***	***70***
Priority 6 (stop water loss within 3 hours)	84.4	***94.2***	***90***
Priority 5 (stop water loss within 3 hours)	57.8	***71.0***	***65***
Priority 5 (stop water loss within 6 hours)	80.1	***92.6***	***85***
Priority 4 (stop water loss by the end of next working day)	67.3	***79.6***	***50***
Priority 4 (stop water loss within 5 days)	90.9	***96.0***	***100***

Source: Sydney Water.

The table shows that Sydney Water has improved its response time in 2006-07, meeting all the targets except for one. Reasons for the improvements include: improved resource management during periods of high workloads; delaying non essential planned works; increased overtime; and re-starting the clock when the priority assigned to a break or leak is upgraded.

A priority 6 is defined as a high flow of water causing an immediate danger to people, property or the environment. Typically this involves water gushing or spurting from the ground and results in a major water loss. A leak is classified as priority 5 when it is running at a rate greater than the full flow of a garden tap, while a priority 4 leak exists when the water loss is less than the full flow of a garden tap.

For 2006-07, if the break or leak was re-prioritised, the clock was reset. The 2005-06 results were not updated to reflect this new approach.

National Performance Report

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

Year ended 30 June	2004	2005	2006	2007
Volume of water consumed (kilolitres) per residential property	224.0	211.0	205.0	***199.0***
Water quality complaints per 1,000 properties	1.4*	1.1*	0.8	***0.8***
Water interruption frequency per 1,000 properties – Unplanned	260.4*	233.8*	196.4	***183.8***
Water main breaks and leaks per 100 km	37.5	37.3	41.9	***34.5***
Sewer main breaks and chokes per 100 km	81.5	92.3	87.1	***90.1***
Water recycled (%)	3.2	2.8	3.5	***4.3***
Water leakage (Infrastructure Leakage Index) (%)	2.1	1.8	1.5	***1.5***

Source: Figures for 2004 to 2006 from National Performance Report 2005-06. The 2006-07 figures provided by Sydney Water.
* These numbers are not directly comparable 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 sewer main breaks and chokes is a result of the dry weather during the year.

Sydney Water's water leakage has remained constant at 1.5 in 2006 and 2007. 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.

Water Loss

The table below summarises water loss within the water distribution system. Water is lost because of leaks in water mains.

Year ended 30 June	2006	2007
Volume of water loss (megalitres)	42,602	***44,261***
Water loss compared to water supplied (%)	8.5	***8.5***
Costs incurred to reduce water loss ($m)	68.9	***91.6***

Source: Sydney Water.

Sydney Water must reduce water loss to no more than 38,325 megalitres per year by 30 June 2009. It is currently reviewing its leakage program and has identified new initiatives that increase the likelihood of achieving the operating licence requirement.

In 2006-07, Sydney Water inspected 18,080 kilometres of pipeline (18,011 kilometres) and believes this annual inspection program is the main reason for the significant decrease in water loss since 2002-03. However, it also believes the full benefits of this program have been realised and the annual inspection of pipelines will only maintain or slightly reduce current water losses.

Sydney Water plans to spend a further $205 million on leak reduction activities over the next two years. Leak reduction activities include the annual inspection program, renewal of water mains and improving pressure management.

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

Recycling

The table below shows the volume of water recycled by Sydney Water over the last three years.

Year ended 30 June	2005	2006	2007
Volume of recycled water (billion litres)	13.0	15.0	***22.0***
Recycled water as a percentage of total effluent discharged (%)	2.8	3.5	***4.3***

Source: Sydney Water .

While Sydney Water increases the level of recycled water, it ranks amongst the lowest recyclers on a percentage basis when compared to other water retailers in Australia.

According to Sydney Water a direct comparison between water retailers is problematic. The overwhelming majority of water recycling projects in Sydney have been implemented to save drinking water in the dams. Other States have achieved higher volumes of recycling where there are opportunities to recycle for agricultural and irrigation purposes. While these are important uses of recycled water, they do not, in the majority of cases, save on the draw of the stored drinking water supply.

However, the NSW Government plans to increase the volume of recycling to 70 billion litres a year in 2015 and to 100 billion litres by 2032. Sydney Water believes water recycling in Sydney will exceed the 70 billion litre target by 2015.

Sydney Water is committed to several projects to meet the 2015 target, including the Western Sydney Recycled Water project, which it estimates will result in the recycling of up to 27.0 billion litres of water by 2015. A contract for the first stage of this project was recently awarded and involves replacing water releases from Warragamba Dam into the Hawkesbury-Nepean River with treated effluent from Sydney Water's sewerage system. Sydney Water believes this will save up to 18 billion litres of water, and will be commissioned by mid 2009.

Sydney Water believes creating a recycled water grid which will service existing urban and growth areas will help achieve the 100 billion litre target. The Liverpool to Ashfield pipeline will be a key component of the recycled water grid and will have the capacity to transport 47 billion litres of treated effluent per year. Sydney Water estimates demand would exist for 29 billion litres per year.

Sydney Water plans to invest more than $650 million on recycling projects over the next five years.

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 Climate Change (DECC). The table below highlights Sydney Water's compliance with those licence conditions.

Year ended 30 June	2005	2006	2007
Total number of Penalty Infringement Notices issued by DECC (usually relating to prior year Noncompliances)	2	3	***2***
Total number of licence Noncompliances	380	408	***243***

Source: Sydney Water.

Of the 243 licence Noncompliances in 2006-07, 48 per cent (59 per cent) 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 advises the reduction in overflows is mainly a result of improved response times to incidents and a program of inspecting and rehabilitating key assets susceptible to overflow.

Sydney Water has reported its 2006-07 Noncompliances to DECC. DECC has yet to review all Noncompliances to determine if any result in a licence breach. Of the 408 Noncompliances reported in 2005-06, DECC determined that only one breached the licence conditions, resulting in a penalty infringement notice. The other penalty infringement notice reported in the table above relates to an incident that occurred in September 2006. Sydney Water was fined $1,500 for each breach.

Under its operating licence, Sydney Water must ensure no more than 25,000 properties are affected by an uncontrolled dry weather overflow each year. Sydney Water advises it met this target in 2006-07, with 24,924 properties affected (22,572) and attributes the increase to extended dry weather conditions.

Maintenance Activities

The table below shows Sydney Water completed all its planned maintenance for 2006-07. The results are consistent with the previous year.

Year ended 30 June	2006	2007
Total planned maintenance completed for network and treatment assets (%)	97.0	***95.0***
Total planned maintenance completed for critical assets (%)	99.5	***100.0***
Budgeted maintenance expenditure ($m)	157.0	***178.3***
Actual maintenance expenditure ($m)	153.0	***175.4***
Backlog maintenance (number of jobs)	6,963	***6,347***
Backlog maintenance ($m)	9.0	***9.5***

Source: Sydney Water.

During 2005-06, Sydney Water completed 210,188 maintenance jobs (212,529). Backlog maintenance has gradually decreased over the last two years. Sydney Water believes this is an acceptable amount of backlog insofar as it allows efficient scheduling and continuation of workflow. Backlog maintenance is lower priority maintenance work Sydney Water had planned to address by a certain date, but did not achieved. While no formal plan is in place to reduce backlog maintenance by a certain date and/or by a certain percentage, Sydney Water does monitor backlog maintenance each month 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 for some less critical assets because these methods are more cost efficient. Under the 'run to fail' maintenance program, Sydney Water waits until its assets break down before carrying out maintenance.

Financial Performance Information

Sydney Water's current ratio (a measure of its financial liquidity) is relatively steady at 0.36 (0.33). A current ratio of one 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	2007 $m
Profit before tax before superannuation actuarial gains	256.6	***359.9***
Dividend payable	193.0	***140.0***
Income tax payable	54.8	***89.7***
Total government contributions	247.8	***229.7***
Dividend + tax/profit before tax and superannuation actuarial gains (%)	96.6	***63.8***
Net profit margin before superannuation actuarial gains (%)	16.7	***21.4***
Current ratio	0.33	***0.36***

Source: Sydney Water.

Price increases, as determined by IPART, and an increase in developer contributions were the main reasons for a favourable improvement in the net profit margin before superannuation actuarial gains.

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	2006	Water 2006	All GTEs 2006
Return on assets (%)	2.7	***5.7***	***5.5***	***4.9***
Return on equity (%)	1.5	***3.9***	***4.2***	***4.6***
Debt to equity (%)	36.5	***44.3***	***28.6***	***48.5***
Cost recovery (%)	128.0	***167.7***	***163.5***	***120.8***

Source: The Productivity Commission's Financial Performance of Government Trading Enterprises 2004-05 to 2006-07.

Sydney Water's return on assets and equity, and cost recovery, improved considerably in 2005-06 and were generally consistent with the averages for the water industry across Australia. The increases were largely due to a favourable movement in defined benefit superannuation liabilities. The reduction in superannuation liabilities resulted in non cash revenue of $112 million ($205 million) being recognised in the income statement.

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 may report a higher rate of return on assets than those applying fair value, such as Sydney Water.

OTHER INFORMATION

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

Review of Major Capital Projects

Sydney Water's capital expenditure in 2006-07 was $648 million ($520 million). This was five per cent above the Statement of Corporate Intent target of $609 million. Sydney Water advised that this was mainly due to some projects running ahead of schedule, such as the South Western Sydney Sewerage Scheme project.

In its 2005 price determination, IPART suggested Sydney Water should achieve efficiency savings of six per cent in delivering its capital works program in 2006-07 (3.5 per cent). Sydney Water advised that it achieved capital efficiencies of two per cent (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. Most projects are consistent with the original cost estimate. The delays in service delivery are mainly due to scope changes and delays in obtaining regulatory approvals.

Project	Original Cost Estimate (and year) $'m	Current Cost Estimate $'m	Original Service Delivery Date	Current Service Delivery Date
Completed during 2006-07:				
Illawarra Waste Water Strategy	104 (1997)	212	Mid 2005	--
Malabar System Risk Reduction – Stages 1-3	53 (1998)	129	Mid 2007	--
In progress at 30 June 2007:				
Desalination Project	1,950 (2007)	1,833	Late 2009	Early 2010
Replacement Flows	265 (2006)	230	Late 2009	Early 2010
South Western Sydney Sewerage Scheme	201 (2001)	181	Late 2007	Mid 2008
North Head Sewerage Treatment Plant	106 (2003)	152	Mid 2009	Late 2009
Rouse Hill Sewage Treatment Plant and Recycled Water Plant	78 (2006)	78	Late 2008	Early 2009
Hoxton Park Recycled Water	65 (2006)	65	Mid 2009	Late 2009
Brooklyn and Dangar Island Sewerage Scheme	56 (2006)	56	Mid 2008	Mid 2008
Blue Mountains Sewerage Scheme Stage Two	51 (1998)	156	Late 2006	Early 2009

The significant increase in cost of the North Head Sewerage Treatment Plant project is due to a re-evaluation of the design development, cost escalation and tender prices. The significant increase in the cost of the Blue Mountains Sewerage Scheme Stage Two was caused by a change in how sewage discharge should be treated.

Sydney Water considers the overall risk profile of its capital program, other than the desalination delivery pipeline, to be low. The desalination delivery pipeline is rated as medium risk as the construction passes through difficult soil risk conditions.

Property disposals

In accordance with a Ministerial Direction issued in February 2006, Sydney Water sold its Miranda property for $11.0 million. Under the Ministerial Direction and covenants placed on the sale, the successful purchaser is required to develop the site for three tier aged care accommodation and affordable housing.

As a result of complying with the Ministerial Direction, Sydney Water incurred significant costs and had to forego a higher sale price. Accordingly, NSW Treasury reimbursed Sydney Water $8.9 million.

Sydney Water disposed of a further ten properties in 2006-07 for $63.4 million (11 properties for $10.7 million). Over the next three years, Sydney Water plans to dispose of 32 properties worth approximately $179 million. This includes Sydney Water's current head office site which will become surplus once it moves to its new Parramatta office in 2009.

Carbon Neutrality Program and Renewable Energy

Sydney Water has decided to become carbon neutral by 2020. Sydney Water plans to achieve this milestone by predominantly using carbon credits it has already earned, future carbon credits it will earn through demand management programs and generation of green energy, and acquiring carbon credits from the external market. Other strategies to achieve a carbon neutral status include reducing energy use and generating renewable energy.

Sydney Water's first milestone is a 60 per cent reduction in carbon emissions by 30 June 2012. It can achieve this target by retiring existing and future carbon credits.

Sydney Water estimates the financial impact of achieving carbon neutrality status by 2020 is in excess of $70.0 million. Most of this relates to revenue foregone as a result of retiring carbon credits.

Sydney Water has approved the construction of seven renewable energy generation projects. These projects include biogas cogeneration and hydroelectric. These projects will cost $39.0 million to construct and will generate about 51 gigawatt hours of renewable energy. The net present value of this investment is approximately $7.2 million.

Occupational Health and Safety (OH&S)

In Volume Four of the 2006 Auditor-General's Report to Parliament, we reported that an internal audit review found Sydney Water had not implemented the health and safety management system consistently, exposing it to unacceptable occupational health and safety risks. Sydney Water is appropriately addressing its occupational health and safety risks.

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 2007 was 6.5 (8.2).

FINANCIAL INFORMATION

Abridged Consolidated Income Statement

Year ended 30 June	Consolidated		Parent	
	2007 $'000	2006 $'000	2007 $'000	2006 $'000
Service charges	***704,992***	676,093	***704,992***	676,093
Usage charges	***651,178***	589,106	***651,178***	589,106
Superannuation actuarial gains	***112,412***	205,457	***112,412***	112,412
Other	***336,034***	275,345	***335,396***	274,479
TOTAL REVENUE	***1,804,616***	1,745,588	***1,803,978***	1,745,135
Employee related expenses	***291,268***	287,737	***291,261***	287,733
Bulk water	***151,015***	137,382	***151,015***	137,382
Water treatment	***98,730***	97,387	***98,730***	97,387
Maintenance and operational services	***167,161***	145,067	***167,142***	145,129
Borrowing	***179,830***	171,564	***179,830***	171,564
Depreciation and amortisation	***163,967***	170,356	***163,967***	170,356
Other	***280,374***	274,009	***280,322***	273,856
TOTAL EXPENSES	***1,332,345***	1,283,502	***1,332,267***	1,283,447
PROFIT BEFORE INCOME TAX	***472,271***	462,086	***471,711***	461,688
Income tax expense	***120,440***	196,155	***136,120***	196,012
PROFIT AFTER INCOME TAX	***351,831***	265,931	***335,591***	256,676

The increase in service and usage charges is consistent with the increase in prices as set by IPART. Other revenue increased because Sydney Water received more developer contributions.

The increase in bulk water charges is consistent with the increase in price as set by IPART. An increase in maintenance activity led to the increase in maintenance and operational services expenses. The increase in borrowing expenses is explained by Sydney Water's increasing debt portfolio.

Abridged Consolidated Balance Sheet

At 30 June	Consolidated		Parent	
	2007 $'000	2006 $'000	2007 $'000	2006 $'000
Current assets	***254,175***	222,161	***253,040***	221,194
Non-current assets	***12,041,637***	10,596,687	***12,043,668***	10,594,597
TOTAL ASSETS	***12,295,812***	10,818,848	***12,296,708***	10,819,791
Current liabilities	***710,046***	672,101	***717,629***	679,265
Non-current liabilities	***4,345,757***	3,663,006	***4,345,767***	3,663,030
TOTAL LIABILITIES	***5,055,803***	4,335,107	***5,063,396***	4,342,295
NET ASSETS	***7,240,009***	6,483,741	***7,233,312***	6,477,496

Current assets increased mainly due to customers owing larger amounts and higher values of assets held for sale.

Property, plant and equipment were higher than 2006 due to an increase in the recoverable amount for those assets, as previously noted in this report.

Investments and other financial assets include the $87.5 million surplus in one of the defined benefit superannuation schemes. At 30 June 2006, the three defined benefit superannuation schemes had a combined deficit of $59.0 million.

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

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.

CONTROLLED ENTITIES

The following controlled entities have not been reported separately on as they are not considered material by their size or the nature of their operations to the consolidated entity.

Entity Name
Australian Water Technologies Pty Ltd
AWT International (Thailand) Limited
Sydney Desalination Plant Pty Limited