Mount Isa Line — Q&A

2016–17 Below Rail Financial Statements

1. What are the Below Rail Financial Statements?

Queensland Rail owns and operates a 6,500-kilometre rail network, including the commuter lines in south east Queensland, the West Moreton system, and the Mount Isa and North Coast lines. It also operates the state's suburban and long-distance passenger train services.

Every year Queensland Rail prepares an Annual Report and Financial Statements, which shows the overall financial performance of Queensland Rail.

The Below Rail Financial Statements are a subset of Queensland Rail's Financial Statements. They allocate assets, costs, revenues and investments related only to Queensland Rail's below-rail services.[1] The Below Rail Financial Statements excludes passenger stations and associated facilities as they are not required to enable the operation of freight train services.

Starting in 2016–17, the Queensland Competition Authority (QCA) has required that Queensland Rail prepare separate Below Rail Financial Statements for the Mount Isa Line, North Coast Line and Metropolitan system, as well as for the West Moreton system (which Queensland Rail has been reporting separately on since 2010).

2. What are the Below Rail Financial Statements used for?

The Below Rail Financial Statements are intended to provide access seekers and access holders with information about the revenues and costs of providing the declared rail infrastructure services.

However, because the Below Rail Financial Statements are based on the accounting performance of the business, the information in the Below Rail Financial Statements is not used by the QCA for setting prices.

3. Does the QCA use information in the Below Rail Financial Statements to set prices?

No. Where the QCA sets a reference tariff — such as on the West Moreton system — it uses a 'building block' methodology to estimate what the efficient costs of providing the service would be. This includes estimating efficient operating and maintenance costs, as well as estimating the value of the regulated asset base (RAB) (see question 5) and depreciation profile.

There are significant differences between the way the QCA estimates the individual building blocks and the accounting treatment in the Below Rail Financial Statements, even if the concepts are the same (see Table 1).

As an example, Queensland Rail treats ballast undercutting as maintenance — which is reflected in Queensland Rail's Below Rail Financial Statements as an expense. The QCA treats ballast undercutting as capital expenditure and includes this in the RAB.

4. Queensland Rail's Below Rail Financial Statements shows a 10% return on assets (ROA) in 2016–17. Does that mean Queensland Rail is monopoly pricing?[2]

No. It is not correct to compare the 10% ROA in the Below Rail Financial Statements for the Mount Isa Line with a regulated return that would be set by the QCA.

[1] Clause 5.3.1 of the *Queensland Rail Access Undertaking* (AU1) The QCA requires Queensland Rail to prepare separate Below Rail Financial Statements to show the costs of providing below-rail infrastructure services.

[2] Monopoly pricing is considered to be a return that is earned above the return that a regulator would apply to a regulated asset. The QCA decided that the benchmark rate of return for the West Moreton assets for the AU1 period was 5.73%.

Table 1: Differences between economic building blocks and Below Rail Financial Statements

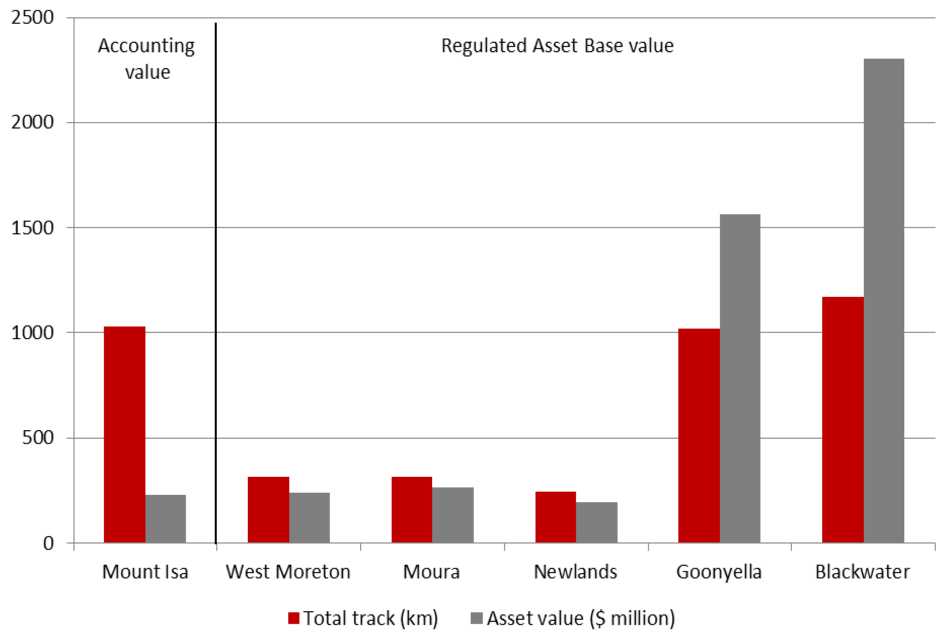
	Economic Building Blocks	Below Rail Financial Statements
Operating expenditure	Estimate of the efficient cost of providing the service. The regulator may consider a range of methods to estimate these costs including historical actual costs, benchmarking or other approach.	Actual operating costs in any year, based on a cost allocation process approved by the QCA and reconciled back to the Queensland Rail Financial Statements.
Maintenance expenditure	Estimate of efficient maintenance costs of providing a service, based on the forecast use of the infrastructure. The regulator may apply a different definition to maintenance costs than those used for accounting purposes eg. ballast undercutting and in some instances rail renewal may be treated as capital expenditure rather than maintenance.	Actual annual maintenance costs, with treatment consistent with the Australian Accounting Standards (AAS).
Asset valuation	Regulated asset base (see question 4)	Accounting valuation (see question 4)
Depreciation	Depreciates the value of the RAB over the useful life of the asset. The useful life of assets is approved by the regulator. It may include estimate of useful life, matching asset to mine life etc.	Depreciation of accounting value of assets consistent with the AAS.

The perception of a high return on the Mount Isa Line assets arises because a comparison is being made to the accounting value of the Mount Isa Line assets — $250.069 million as at 30 June 2017— not a RAB value. The QCA has not assessed what the RAB value would be for the Mount Isa Line.

However, as shown in Figure 1, the accounting value for the Mount Isa Line is lower than the RAB values for the West Moreton system and for Aurizon's Moura system — even though the track length is more than three times longer.

The Mount Isa Line has a similar track length to Aurizon's Goonyella system, and while there are differences in the track standard, the RAB value for the Goonyella system is almost seven times higher than the Mount Isa Line's accounting valuation.

Figure 1: Asset values and track lengths — different valuation approaches as at 30 June 2017



Source: Queensland Rail Below Rail Financial Statements, West Moreton MAR, Aurizon UT5 Submission, system information packs

To make a like-for-like comparison between the return on the Mount Isa Line and the return from assets regulated by the QCA would require the Mount Isa assets to be valued in the same way. The modified Depreciated Optimised Replacement Cost (DORC) valuation for the Mount Isa Line (the methodology the QCA applied to the West Moreton RAB) was estimated at $1.343 billion as at 1 October 2016.

5. Why are there differences between the accounting and RAB value of assets?

As part of the process for setting prices —which includes earning a return on assets—regulators estimate the value of the RAB so that a regulated business can recover the value of efficient capital invested in assets, plus the agreed value of the existing assets.

The accounting value of assets is not used by regulators as the basis for setting prices. The purpose of an accounting valuation is to assist owners understand the financial performance of a business — based on the accounting standards, and will either be based on historic cost or fair value.

Table 2: Differences between economic building blocks and Below Rail Financial Statements

	Regulatory Asset Valuation	Accounting Valuation
Purpose	Used as an input to the 'building block model' to set prices (ie. estimating depreciation and the 'return on capital' blocks). Regulators use the RAB to ensure that regulated business can recover the value of efficient capital invested in assets.	Assists investors to understand the financial performance of a business – based on the accounting standards. Statutory accounts reflect a common set of financial metrics that are applied equally across all industries and for comparison about the value of a business.
Methodology	Estimate of the 'unrecovered cost of prudent capital investment'. In practice the RAB can be determined using a range of methodologies: • Depreciated actual (historic) cost • Depreciated optimised replacement cost (DORC) • Line in the sand (which may be the net present value of future cash flows depending on a series of assumptions made by the regulator) • Other as determined by regulator.	Under the Australian Accounting Standards assets are either valued at cost (depreciated historic cost) or 'fair' market value. Queensland Rail's assets on the Mount Isa Line are valued at 'fair' market value and subject to an impairment test annually. Assets may be impaired if their book value is higher than the net present value of future cash flows (linked to price and volume).
Audience	Customers/regulator/business	Shareholders/business
Revaluation	No – the initial RAB should be a 'set and forget'. The only changes are made via the 'roll-forward' method – opening RAB plus inflation, minus depreciation plus new capex equals closing RAB.	Yes – the AAS allow a business to change its asset valuation methodology. Assets valued a fair value are routinely reviewed – with assets devalued and increased in value as market circumstances change.
Inclusion of assets in asset base	RAB is updated as assets are commissioned, which may occur a number of years after the asset was constructed, if the project takes a number of years.	Accounting assets valuation updated by annual capital expenditure – which may include assets under construction and yet to be commissioned.
Exclusions	Yes – contributed assets (ie. assets funded by customers/government that are not to earn a return).	No – all business assets are included in the statutory accounts, regardless of the source of funding.

6. What does the Queensland Rail Access Undertaking 1 (AU1) say about how access charges on the Mount Isa Line should be set?

AU1 requires Queensland Rail to set its access charges so that its expected access revenue

- at least covers the floor costs of providing the services and
- does not exceed the ceiling revenue.

Floor costs are considered to be the operating, maintenance and capital renewal costs of providing the service. Ceiling revenue includes earning a commercial return on the assets used to provide the service, plus the depreciation of the asset.

7. How does the Queensland Rail set prices on the Mount Isa Line?

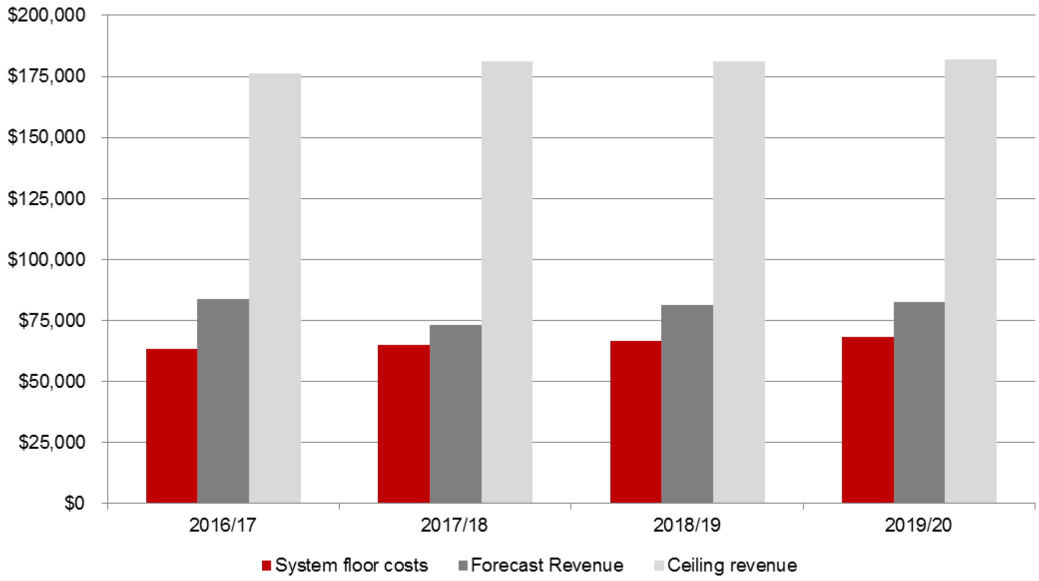
Queensland Rail sets its access charges on the Mount Isa Line so that it at least covers the operating, maintenance and capital renewal costs of providing service (floor revenue), taking into account the forecast volumes on the system.

Queensland Rail does not receive government subsidies for the provision of infrastructure access services on the Mount Isa Line, so if it is not able to cover these costs, the service is not financially sustainable. Access revenue is important to support the maintenance and asset renewal on the Mount Isa, so that rail remains a reliable link in the North West Minerals Province export supply chain.

Further, as the rail transport is in direct competition with road transport for a number of the commodities hauled on the Mount Isa Line, particularly intermodal freight, Queensland Rail sets its access charges to ensure that efficient above and below rail transport costs remain competitive with road transport.

Based on current volumes and prices on the Mount Isa Line, Queensland Rail's access charges recover less than half of the ceiling revenue and only marginally above the floor costs (Figure 2).

Figure 2: Estimated system floor costs, access revenue and ceiling revenue — Mount Isa Line 2016–17 to 2019–20 ($'000)



Source: Queensland Rail