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Beyond commercial in confidence: accounting for power privatisation in Victoria

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Abstract

Purpose – The purpose of this paper is to examine whether the use of commercial-in-confidence arrangements within the public sector allows the deliberate manipulation of accounting figures to generate support for the privatisation agenda.

Design/methodology/approach – A case study is presented of an Australian power entity, United Energy, where the privatisation was subject to commercial-in-confidence restrictions and differing opinions as to the accuracy of the entity's financial accounts during the privatisation process. It examines many of the key "commercial-in-confidence" documents, which are now available through parliamentary and official document sources, together with pre- and post-privatisation financial statements.

Findings – The accounting figures were shaped to support a privatisation agenda and this was obscured by the commercial-in-confidence provision. Some attempts were made to use accounting arrangements to reduce federal taxes but this failed. A substantial element of the reported sale price represented internal transfers between the state-owned entity and the government with the actual price paid by the purchaser being substantially lower than the reported price. The price paid was based on the financial statements which were openly challenged by the Auditor-General. The paper strongly supports the contention that manipulation of accounting figures occurs under commercial-in-confidence privatisations.

Research limitations/implications – This was limited to one example at one time. Further work is needed on other settings.

Practical implications – The paper challenges the success claimed for the privatisation process and for the social benefits of privatisation by tender.

Originality/value – There was little evidence of a substantial improvement in financial performance following privatisation or that the pre-privatisation performance was substantially boosted to support the privatisation agenda. It did show that the accounting served political ends.

Keywords Privatization, Public sector organizations, Electricity, Auditing, Australia

Paper type Case study

Introduction

This paper explores whether the use of commercial-in-confidence arrangements within the public sector allows the deliberate manipulation of accounting figures to generate

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support for a privatisation agenda. The focus of the paper is on the privatisation of the state electricity retailer, United Energy, in Victoria, Australia. Barton (2006) highlights the dangers of the increasing use of commercial-in-confidence clauses in public sector accountability and outsourcing contracts. He claims that the use of commercial-in-confidence clauses in outsourcing activities undermines public sector accountability. The work of Barton is extended here to consider the case of the restructure and privatisation of the Victorian State power industry, specifically the sale of the power distribution entity, United Energy. On the surface this was a textbook example of the privatisation of a state industry (Newbery, 1999, p. 255). The financial arrangements and contractual details of the sale were subject to commercial-in-confidence provisions and the project can only be evaluated through the subsequent access to contract details and parliamentary documents. The tender-style privatisation approach means that there is a possibility that aspects of existing public sector accountability were obscured by commercial-in-confidence arrangements, while ongoing practices and structures of private sector commercial transparency and governance are also not in place. According to Craig and Amernic (2004, 2006) this provides the opportunity for accounting rules to be manipulated (or even broken) to make the pre-privatisation financial performance look poor and the post-privatisation performance look better. Therefore the process of privatisation provides the potential for abuse in the absence of adequate public accountability.

Within Australia privatisation occurred at both a federal and state level. Federal privatisations involved major public enterprises such as the national airline (Qantas), the Commonwealth Bank and telecommunications (Telstra). Many of the States privatised public business enterprises and all or part of utilities such as power, and water (Funnell, 2001). However, internationally the reforms of the Victorian State public sector and the associated privatisation process are seen as one of the most radical (Eckersley and Zifcak, 2001) and Victoria was described by privatisation advocates as a text-book example of the privatisation of state power assets (Newbery, 1999, p. 255).

Victoria is one of eight Australian states and territories; each state's parliament is sovereign with the power to issue legislation while the territories' parliaments have the power to produce legislation, but it must be approved by the federal parliament in Canberra before it becomes law. Powers are reserved to the state parliaments with the federal parliament only having the powers specifically delegated to it by the states. This is a result of the federal parliament coming into being as part of the union of the pre-existent states.

In 1992 Jeff Kennett, the leader of the Victorian Liberal Party, was elected as the Victorian State's new premier[1] replacing a Labour government beset by allegations of financial mismanagement. English (2002, p. 52) noted that Kennett set about reforming the public sector by introducing the concepts of NPM and economic neo-liberalism. The changes implemented by Kennett were justified as a means of improving the financial situation of the State (Alford and O'Neill, 1994, pp. 6-7). Alford and O'Neill claimed that Kennett viewed reducing the size of government as the best way to reduce the State's debt and it was accomplished by the transfer of a number of government services to the private sector, through either privatisation or contracting out.

One such service was provided by the State Electricity Commission of Victoria (SECV). It had supplied electricity to consumers in Victoria from the 1920s (Alford and

O'Neill, p. 1). As part of the pre-sale restructuring, the SECV was split into a number of sub-entities, one of which was known as United Energy. Many of the aspects of the sale of United Energy were deemed to be commercial-in-confidence and at the time the contract was signed the documents were not available for scrutiny and review. The use of commercial-in-confidence and the subsequent release of documents provides an opportunity to explore the claims of researchers such as Craig and Amernic (2004, 2006) that accounting figures may be manipulated to make the privatisation appear more financially beneficial.

The next section introduces the process of the privatisation of state-owned network utilities and the literature that focuses on the role of accounting and accountants in the privatisation of public assets. A case study research method is adopted, which explores the provisions of the commercial-in-confidence sale document, the pre and post privatisation financial statements and the post-privatisation performance of United Energy. This provides the framework to illuminate the place of accounting in the privatisation arrangements.

Accounting and the privatisation process

Economists have argued that network utilities such as power represent a natural monopoly where the costs of infrastructure offer a virtually insurmountable barrier to competition (e.g. Newbery, 1999, p. 27). One solution to this monopoly problem was the state ownership and control of these assets. However, it was argued that as part of the process of privatisation, these assets could be restructured with generation, distribution networks and the supply or sale of electricity being transformed into separate and stand-alone entities and regulation being installed to ensure effective competitive behaviour in the newly created "power markets". Bacon and Besant-Jones (2002) in their review of the privatisation and liberalisation of the electric power industry in developing countries argue that privatisation involved the following six steps:

(1) Obliging electric enterprises to operate according to commercial principles.

(2) Introduction of competition in order to improve sector performance.

(3) Restructuring or unbundling the electric supply chain to enable the introduction of competition. Breaking up the incumbent power utility into multiple generators and distributors of power that trade with each other in a competitive wholesale power market.

(4) Privatisation of the unbundled electricity generators and distributors under dispersed ownership.

(5) Development of economic regulation of the power market.

(6) Focusing the government's role on policy formation and executing and divesting their role as operator and investor.

In New Zealand the Crown's commercial activities were restructured as state-owned business enterprises (SOEs) prior to privatisation, were required to charge full cost for their services and to compete with the market (commercial neutrality) (Scott *et al.*, 1990). The architects of these reforms suggested that the changes were made in order to achieve the "greatest technical and allocative neutrality [...] even when the competition might make the SOEs less profitable" (Scott *et al.*, 1990, p. 146).

The growth of accounting within these public sector organisations can be seen as a response to this growing commercial and competitive environment. Carlin (2005) also argued that the introduction of accrual accounting in the public sector was the first stage of the privatisation process as the information that was needed to initiate privatisation (the value of assets, liabilities and profitability) could be most efficiently collected under an accrual accounting regime.

Ogden (1995) studied the privatisation of the UK water industry and argued that financial performance became the primary objective with the restructure of public sector institutions along the lines of commercial enterprises. Ogden (1995) maintained that the shift from social criteria to economic results supplanted the culture of the water industry that focused on engineering and operational demands and led to the introduction of more accounting control and a greater emphasis on costs. This conclusion was consistent with the work by Guthrie (1993), who suggested that the accounting, auditing and accountability regimes were both implicated and strengthened in the reform process. Based on their study of NPM reform in Australia, Hoque and Moll (2001, p. 322) claimed that accounting came to play an increasingly important role in the reformed public sector, driven by national competition policy. However, Hoque and Moll (2001) contend that the growth of accounting was not just a technical phenomenon, but was the result of institutional, political and economic inter-organisational forces. Lapsley (1999) also linked the accounting practices with political agendas in suggesting that accounting gave effect to politically determined notions of efficiency, cost effectiveness, value for money and financial accountability. Newberry and Jacobs (2008) extend this line of argument with the claim that accounting was used to serve political ends in the context of the New Zealand reform process.

However, accounting is not just a tool of politics, but also provides possibilities for resistance. Shaoul (1997) illustrated that accounting can provide both a justification for and the means to challenge the rationales of privatisation by providing an assessment of the post-privatisation performance of privatised entities. Yet the utility privatisation process within the UK was politicised and in practice resistance was rare. Shaoul (1997) argued that the privatisation of the UK water industry resulted in generous dividends to shareholders and remuneration to top management with no improvement in service quality and little evidence of the stated goals of efficiency and cost reduction. Walker (1993) came to a similar conclusion in the Australian setting. He argued that the financial performance of public water authorities was better than that achieved by the private sector, although incompatible accounting had been used to argue otherwise.

Craig and Amernic (2004, 2006) argue that accounting was used as a rhetorical device both prior to and during privatisation to support, promote and legitimatise the privatisation process of Canadian National Rail (CNR). Craig and Amernic (2004) studied the chief executive communications within the monthly employee magazine that focused on financial matters. They argued that these communications illustrated how concepts of efficiency, rate of return and cost cutting, became the CNR's primary concern. Craig and Amernic (2004) also suggested that CNR employed accounting techniques that gave the impression the entity was performing poorly in order to prepare the entity's "balance sheet" for privatisation. Their argument was that the "poor" performance of the state-owned entity provided the justification for privatisation. Craig and Amernic (2006) continued the same story. They argued that actions were taken and accounting policies were selected to reduce the profitability of CNR prior to the privatisation process that would have the roll-on effect of increasing profitability once CNR was privatised through their initial public offering (IPO). The Craig and Amernic (2006) study was based on a close reading of the prospectus issued by CNR to support the IPO of their shares. Public offering of shares was a popular form of privatisation in Canada and in the UK. However, in Australia and New Zealand, perhaps due to the smaller capacity of the share market and certainly the premium associated with control, it was also common to privatise through tender and to sell all (or strategic parts) of the organisation to a single purchaser.

This process of tender and sale is more interesting than the public offering process because of the significantly increased possibility of manipulation associated with the commercial-in-confidence structures that often accompanied these agreements given that it is in the interest of government and the purchaser to represent the privatisation as a success (Barton, 2006). The first research question addressed in this paper is to identify whether accounting played a particular role in constructing the financial arrangements associated with the privatisation process.

Craig and Amernic (2006) not only argue that there was manipulation, but also argue that this reduced the profitability and financial position of the state-owned enterprise and increased the profitability of the entity once the privatisation has been completed. This is based on a rhetorical argument and they do not demonstrate that it has actually occurred. In contrast and based on the electricity privatisation in Victoria Quiggin (2004, p. 113) argued in the lead-up to privatisation both governments and managers of government businesses were likely be particularly concerned about profitability, leading to structural changes and the use of accounting devices to "smooth out fluctuations in reported earnings" (Quiggin, 2004, p. 113) i.e. that pre-privatisation profit will be maximised and post-privatisation profit reduced. So although Craig and Amernic (2004, 2006) and Quiggin (2004) suggest that accounting manipulations will be used to alter the figures, they disagree about the direction of this manipulation. Therefore the second research question involves an extension of the first will and attempt to explore the direction of any bias or manipulation observed.

It is only by studying a detailed case of the actual accounting practices associated with privatisation that this issue can be resolved. The normal barrier to this analysis is the contractual arrangements and "commercial in confidence" structure.

Methods

This paper presents a historical case study of the privatisation of United Energy. Case studies are the principal research method adopted by earlier researchers in this area such as Ogden (1995), Shaoul (1997) and Craig and Amernic (2004, 2006). Yin (2003) argued that case studies can be used to challenge and to extend earlier case study work and the theoretical models and observations derived from those cases. Therefore the case study approach is an appropriate way to address the central research question of whether accounting was used to manipulate the pre-privatisation profitability, with the objective of increasing the post privatisation profitability of United Energy.

The United Energy case was selected because the documented contractual arrangements associated with the privatisation of United Energy allow a serious *ex-post* investigation of the accounting policies and procedures associated with the process that have simply not been possible in the earlier cases described in the literature. Although the United Energy contract was covered by "commercial in confidence" provisions the subsequent availability of original documents makes it possible to conduct a critical case study of the actual accounting practices and contractual arrangements.

A number of secondary sources were used; including the report on the reform of Australia's electricity edited by Hodge *et al.* (2004) and the monograph by Alford and O'Neill (1994). However, while these provide much of the background on the Victorian public sector reforms and the reforms of the Victorian power industry there is little secondary analysis of the nature or use of accounting and what does exist was compiled at a time before the relevant parliamentary and contractual documents became publicly available. The primary sources for the accounting were the privatisation contract documents, parliamentary debates, and the reports of the Victorian Auditor-General, and their use is a recognised research approach in the public sector context (Funnell, 1998). These sources are supplemented by other government legislation and reports, newspaper reports and commentaries.

The method of data analysis applied in this case was historical textual analysis in the narrative tradition (Czarniawska, 1997). Drawing on qualitative methods experts such as Denzin (1989) and Seale (1999) "validity" and "credibility" of talk or text is understood to depend upon its closeness to the phenomena or event being studied. In this study the original contractual documents have been utilised where possible and were regarded as a highly credible source. The documents from the parliamentary debates, the reports of the Victorian Auditor-General and subsequent published United Energy financial statements were also used. There are also regarded as having a high level of credibility and validity[2]. In this sense a defensible or credible narrative is produced based on the existing texts while recognising that any account or record only presents one of a number of perspectives. Original written source documents were not always available given the focus of the study on commercial-in-confidence arrangements, and therefore other available resources such as newspaper reports and secondary documents are used. Although some interviewees were used as informants, the confidential and legal nature of these issues meant that published sources were preferable for quotations and were possible sources were triangulated against other evidence or documents.

Reforming the Victorian public sector

In the 1980s the Cain[3] Labour Government sought to redefine the public sector in Victoria through the introduction of the concepts of managerialism. The transformation also entailed the corporatisation of a number of government departments (Alford & O'Neill, p. 3). Leading up to the 1992 election, there was a perception that Victoria was in the midst of a financial crisis. An independent inquiry known as the Nicholls Report was commissioned by the government to ascertain the extent of the financial difficulties. The report confirmed "that the State has a significant and growing debt problem, particularly within the budget sector of government where revenues have not been sufficient to cover the government's operating expenses for the last three years" (*Independent Review of Victoria's Public Sector Finances*, 1992, cited in Alford and O'Neill, 1994, p. 7). The State's financial situation became a key election issue and the Victorian Liberal Party argued that reducing the size of government was the best way to alleviate the financial deficit. This entailed shifting services to the private sector through either contracting out or privatisation (Alford and O'Neill, 1994, p. 2). Alford and O'Nell suggested that the incumbent Labour Party and many community organisations noted that privatisation was a threat to the institutions, the programs and the values that they wished to preserve.

In 1992, Jeff Kennett, the leader of the Victorian Liberal Party, was elected as the State Premier of Victoria and he set about making a number of changes with the stated aim of eliminating the current account deficit (Alford and O'Neill, 1994, p. 8). These changes included increasing tax revenue, making cuts in expenditure, outsourcing the provision of services and selling a number of the State's assets (Alford and O'Neill, 1994, p. 8). The size of the public service was substantially reduced and cuts of $618 million were made to health, welfare and education (Alford and O'Neill, 1994, p. 9). Alford and O'Neill (1994, p. 22) suggest that Kennett:

> Redefined the relationship between the government and public sector employees, restructured the machinery of government, rejigged the boundaries between the public service, the public sector and the private sector, and recast many of the explicit rules and implicit values of public sector employment.

The Victorian government introduced a number of key pieces of legislation at the commencement of their first term, including the *Employee Relations Act 1992* and the *Public Sector Management Act* 1992. The *Employee Relations Act* reduced the power of the unions by banning compulsory unionism, removing other practices and arrangements that supported the unions and making some strikes and pickets illegal (Alford and O'Neill, 1994, pp. 23-4). The *Public Sector Management Act* resulted in a reduction in the number of government departments from 22 to 13, the introduction of contract employment and greater transparency of employment costs (Alford and O'Neill, 1994, pp. 25-6). These measures resulted in the replacement of public sector employment practices with private sector management practices and values.

The second stage was the foundation for the government's privatisation program, which was established with the passing of the *State Owned Enterprises Act 1992*. Treasurer Alan Stockdale stated that the Act would "provide an umbrella framework for the reorganisation of specified businesses conducted by the State in accordance with a modern corporatisation model, while still retaining accountability to Government" (*Victorian Parliamentary Documents*, 1992, p. 634). The bill drew criticism from the opposition because it exempted the sale of statutory authorities and state-owned enterprises from the *Freedom of Information Act* and from the State's Ombudsman jurisdiction (Alford and O'Neill, 1994, pp. 25-6). It also opened the possibility of "commercial in confidence" restrictions on the privatisation process and documents. Once the *State Owned Enterprises Act 1992* was passed, the government proceeded with the privatisation of a number of different state assets with the electricity industry earmarked to play a prominent role. In October 1993, the Government began the restructuring of Victoria's electricity industry.

Electricity industry reform

The public sector has been responsible for the electricity industry within the state of Victoria since Sir John Monash founded the State Electricity Commission of Victoria

(SECV) in the 1920s (Alford and O'Neill, 1994, p. 1). The SECV supplied electricity to the consumers by way of a vertically integrated monopoly involving the generation, transmission and distribution of electricity via a single entity (Rann, 1998). By 1990, the public perception promoted by the newspapers was that the SECV had become cumbersome (Moran, 2002, p. 2). This was consistent with the view that liberalist reforms were needed to increase efficiency levels within the public sector.

The push to reform and restructure the SECV followed the pathway for the restructure and regulation of network utilities recommended by Newbery (1999). At the Federal level of government there was an explicit move towards the privatisation of state-owned utilities and this was reflected in the review of the SECV by the Industry Commission and the Hilmer Inquiry into the possible establishment of a national competition policy (Rann, 1998). It is the same competition policy that Hoque and Moll (2001) claimed drove the reforms in the Australian State of Queensland. The Industry Commission's review specifically recommended privatisation and competition to increase efficiency of the SECV (Moran, 2002, p. 2). The Hilmer Inquiry was more general but produced similar recommendations for the structural reform of public monopolies, the application of competitive neutrality to public sector businesses, a process for reviewing anti-competitive legislation and third party access to services provided by essential infrastructure (Rann, 1998). Table I presents the timeline for the reform of the SECV and the associated Victorian power industry.

The Kennett Government embraced the Federal initiatives for competition (Alford and O'Neill, 1994, p. 105). In October of 1993 the State Treasurer announced the break-up of the SECV into separate operating entities and the creation of Generation Victoria (generation), National Electricity (transmission) and Electricity Services Victoria (distribution) (Rann, 1998). The Electricity Supply Industry (ESI) Reform Unit was also established and was headed by Dr. Peter Troughton, the architect of

August 1993	Electricity Supply Industry (ESI) Reform Unit was established and was headed by Dr Peter Troughton. Commissioned a series of reports on the Victorian power industry
October 1993	Government announced the break-up of the SECV into separate operating entities and the creation of Generation Victoria (generation), National Electricity (transmission) and Electricity Services Victoria (distribution)
July 1994	Large industrial companies could choose their power retailer
October 1994	National Electricity (the transmission entity) was split up into the Victorian Power Exchange and PowerNet Victoria. The Victorian Power Exchange was responsible for linking all the electricity industry businesses and PowerNet became the owner of the high voltage transmission grid, as well as being responsible for its maintenance
October 1994	Electricity Services Victoria was separated into five different distribution entities: Citipower, Solaris Power, United Energy, Eastern Energy, and Powercor
December 1994	Government flagged its intention to privatise the five distribution entities between August and December 1995
January 1995	Generation Victoria was divided into five independent and commercially oriented generating companies
January 2002	Full retail competition

Table I.
Victorian power industry reform timeline

telecommunications and electricity privatisation in New Zealand (Alford and O'Neill, 1994, p. 106). The goal of the Reform Unit was to promote competition as a means of increasing efficiency, enhancing customer choice and reducing debt (Office of State Owned Enterprises, 1993, cited in Alford and O'Neill, 1994, p. 106). The *Electricity Industry Act 1993* was passed through the Victorian Parliament to pave the way for the change.

In October 1994, National Electricity (the recently established transmission entity) was split up into the Victorian Power Exchange and PowerNet Victoria. The Victorian Power Exchange was responsible for linking all the electricity industry businesses and PowerNet became the owner of the high voltage transmission grid, as well as being responsible for its maintenance (Rann, 1998). Within the same month, Electricity Services Victoria was separated into five different distribution entities, Citipower, Solaris Power, United Energy, Eastern Energy and Powercor (Rann, 1998). In January 1995 Generation Victoria was also divided into five independent and commercially oriented generating businesses (VAGO, 1996). The basic premise of the restructure was to create competition at the generation, transmission and distribution levels of the Victorian power industry (Rann, 1998), which was consistent with the privatisation model advocated by Newbery (1999). The intention was also to establish a number of entities that would be attractive to potential private sector purchasers.

In December 1994, the Government flagged its intention to privatise the five distribution entities and between August and December 1995, the sale of the distribution entities to the private sector was completed (VAGO, 1996). The sale of the State's electricity assets between 1993 and 1999 raised a reported total of $21.4 billion (Moran, 2002), far exceeding expectations. This included the sale of the distribution, generation and transmission assets. The Auditor-General calculated that in 1997/1998 an annual saving of $760 million was expected from the privatisation of the electricity industry, increasing annually thereafter (Moran, 2002). These savings would be generated through a reduction in State debt and the associated interest payments. The State's credit rating was also raised to AAA, helping to reduce the cost of borrowing in future periods (Moran, 2002). The Victorian electricity industry was eventually opened to full competition in January 2002 (Moran, 2002).

Even before the privatisation of United Energy there were major accounting issues relating to the valuation of assets and the resulting depreciation for the purposes of tax. It was proposed that assets would be re-valued as part of the sale and therefore for the privatised entity the tax depreciation would be higher and the resulting tax expenses would be lower than if depreciation was based on historical pre-privatisation values. Corporations tax is collected at a federal rather than at a state level and state-owned entities such as United Energy were not subject to federal tax although some state required a "notional equivalent" to be paid to the state. In July 1995 this scheme was challenged as the Federal Treasurer (Mr Willis) ruled that assets would be depreciated on the basis of their pre-sale value over the economic life of the asset rather than a higher value based on the sale price of the business with an accelerated depreciation rate (Davidson, 1995). This was the first, although unsuccessful example of an accounting policy being used in the privatisation process. The impact of this particular policy had it been allowed would have been to reduce the taxable income of United Energy and the federal tax liability for the privatised entity without directly affecting the cash flows. Quiggin (2004) was right than Craig and Amernic's (2004, 2006) because the asset valuation change was intended (unsuccessfully) to depress post-privatisation profit. If the tax depreciation change were allowed the lower post privatisation profits would have been a product of a change in accounting policy rather than the result of lower post-privatisation efficiency.

Strong opposition to the privatisation of the state energy assets in Victoria came from the public and from a number of major civil society groups. In 1995 the Consumer Law Centre produced a paper entitled "Six reasons why Victorian consumers may be disadvantaged by the privatisation of public utilities" and the People Together Project (a group supported by the Victorian Council of Social Services and nine church organisations) ran an Independent Public Inquiry into the Privatisation of the Electricity Industry (Ward and Hodge, 2004, p. 44). The Uniting Church circulated reports detailing the effects of privatisation on the poor and the topic became a part of the Church's weekly sermons (Blake and Green, 1995). Additionally, the "Brotherhood of St Laurence"[4] stated that privatisation would result in reduced living standards for the poor and disadvantaged as well as a less generous service for customers with payment problems (Siemon, 1995, p. 2). In response, the Kennett government suggested that the claims made by the Uniting Church and the Brotherhood of St Laurence were a politically motivated left-wing challenge to his reform agenda (Blake and Green, 1995). Kennett then commissioned a $1.3 million publicity campaign to support his case for privatisation (Ward and Hodge, 2004, p. 44).

While the Kennett government had personal and political incentives to promote the success of the power privatisations, there were larger stakes as the Victorian privatisations were the test case for Australia:

> Without a doubt, the Kennett government industry restructuring and privatisation program is shaping up as a test case for the entire Australian electricity industry. If it delivers the goods – cheaper power for consumers and industry and less political heat for the State government – then Kennett will have earned a place in the history books (Ries, 1995).

United Energy

United Energy was the first of the electricity entities to be sold and it was also the most significant; being described as the "jewel in the crown" (Davidson, 1995) of the five distribution entities. United was sold on the basis of a *sale by tender* to the Power Partnership consortium on 7 September 1995 for a reported $1.8 billion. The consortium consisted of the AMP society (40.9 per cent), the New South Wales State Authorities Superannuation Board (9.2 per cent) and the United States-based Utilicorp (49.9 per cent), who assumed majority control (VAGO, 1996). United Energy's distribution network covered the south-eastern suburbs of Melbourne, Victoria's capital and distributed power to over 520,000 customer sites, the majority of whom were residential customers (VAGO). In 1998, United Energy floated 42 per cent of the capital ($390 million) on the Australian Stock Exchange (*Business Review Weekly*, 1998). By May 2003, Utilicorp (now called Aquila) had quit the Australian market and sold its remaining 34 per cent stake in the Power Partnership to AMP and Alinta for $1.32 billion (Myer, 2003). Table II shows the timeline for the privatisation of United Energy.

In August 1995 it looked like the initial privatisation of United Energy would be derailed as two of the four bidders withdrew from the process. The offer from the

Table II.
United Energy privatisation timeline

December 1994	Government flagged its intention to privatise the five distribution entities between August and December 1995, starting with United Energy
August 1995	Two of the four bidders withdrew from the privatisation process. The offer from Utilicorp rescued the process and was $400 million above market expectations
7 September 1995	United sold to the Power Partnership consortium for reported $1.825 billion (split into a $1.55 billion capital payment and $275 million franchise fees to be paid over five years)
1998	United was partially floated on the Australian Stock Exchange
May 2003	Utilicorp (now called Aquila) quit the Australian market and sold its share in the Power Partnership to AMP and Alinta for $1.32 billion

US-based Utilicorp in conjunction with their local partners rescued the sale process (Pheasant, 1995) with an unexpectedly high offer price of $1.8 billion ($400 million above market expectations). This was split into two parts, a $1.55 billion capital payment and $275 million franchise fees to be paid over five years. The franchise fees arrangement was structured to constitute an expense and therefore to reduce profit and to be tax deductible for the purposes of federal income tax.

Bidders for United Energy hoped that the ATO (Australian Tax Office) would allow them to claim the franchise fees as an expense for tax purposes which would reduce the tax payable on future earnings. However, on the 4 August 1995, just hours before the bid was due, the ATO stated that the franchise fees were unlikely to be tax deductible (Myer, 1995). United Energy unsuccessfully appealed this decision. The issue of asset valuation and depreciation was the first and the franchise fees were the second attempt to use accounting policy to construct the financial arrangements. Both attempts were motivated by the desire to avoid the payment of federal income tax rather than a decrease in economic performance or "earnings management" as suggested by Quiggin (2004).

Given the Kennett government dominance of both the upper and the lower house of the Victorian Parliament and because the sale agreement and contractual documents were deemed to be commercial-in-confidence there was little scope for political opposition to the reform changes. However, the commercial-in-confidence sale contract and associated documents were released as parliamentary documents (www.contracts.vic.gov.au/major/united_energy.htm) following a subsequent change of the Victorian government. In addition further documents were released under a Freedom of Information request.

The commercial-in-confidence sale contract

The arrangement for sale of United Energy was made up of three different contracts. The first was for the sale of the assets of United Energy between United Energy Ltd and the "Power Partnership" (Utilicorp United Inc., the State Authorities Superannuation Board and the Australian Mutual Provident Society), the second an asset purchase agreement in which the Power Partnership resold the assets back to United Energy Ltd and the third a share sale agreement between the SECV, the State of Victoria and the Power Partnership. The three contracts were all signed as at 3 August

1995. All of these contracts were commercial-in-confidence and were not released to the public or to the parliament. Attached as "Annexure A" to the share sale agreement was the financial statements for the six months ending 31 December 1994, together with an audit opinion from KPMG stating that the accounts present fairly the company's state of affairs as at 31 December 1994. In addition "Annexure C" contained a draft balance sheet as at 30 June 1995 which appears to be the basis for many of the "estimated" contingent financial calculations associated with the contractual purchase price. A subsequent document signed on 6 September 1995 redefined and clarified many of the key financial elements associated with the purchase price, shifting the amounts from an estimated to an actual total. The sequence of events or transactions steps taken within the sales and purchase agreements was presented as the "recitals" or pre-completion matters at the beginning of the share sales agreement. These are presented in Figure 1 (and also in Table III) together with the impact of the adjustments to the contingent elements of the price reflected in the 6 September 1995 document.

Figure 1 and Table III show the three different entities which were part of the contractual agreement, the Victorian Government (VG), United Energy (UE) – the entity being sold and the Power Partnership (PP) who was the purchaser. Transaction (1) was a book entry where United Energy and the Victorian government convert an existing loan of $4 million into shares. This was necessary in order to have shares to sell as part of the subsequent sale transaction. Transaction (2) placed a value on United Energy's "licence" to distribute and sell electricity and (3) issued that value as preference shares to the Victoria Government. These shares were untimely sold to the

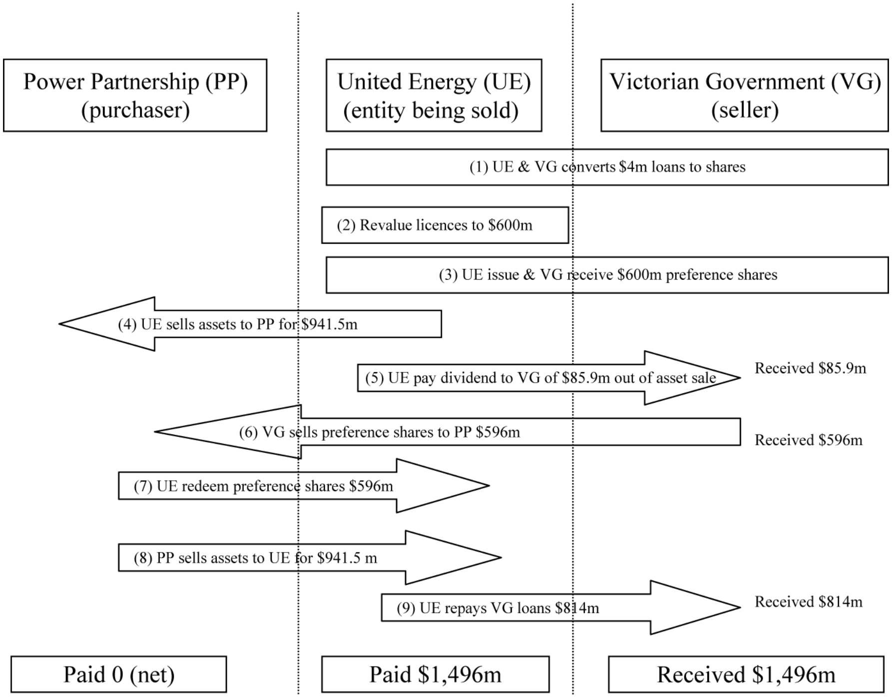

Figure 1.
Pre "share-sale" transactions and events

Table III.
Pre-sales sales transactions and events

	Transactions (million)	Power partnership (PP) Buyer shares Buyer asset sales Seller asset purchase	United Energy (UE) Seller asset sales Buyer asset purchase	Victorian Government (Vic Gov) Share seller
	Adjust financing arrangements so loans can be drawn on by both the company and the buyer			
1	Capitalise $4 million SECV loan into shares		$4 mil converted from loan to shares	SECV loan converted to $4 million shares
2	United Energy revalue licences to $600 mil		Revaluation $600 million	
3	Out of licence revaluation United Energy will issue redeemable preference shares to the seller		Company issue shares $600 million	Receive shares $600 million
	Draw down loan facilities	Access loan facilities		
4	Asset buyer (PP) buys excluded assets	− 950.5 adjusted to − 941.5	950.5 adjusted to 941.5	
5	United Energy declare and pay dividend to Vic Gov from profit on sale of assets and profits for the year		− 85.9	85.9
6	Seller sell shares to the buyer (preference shares)	− 600 adjusted to − $596.41		600 adjusted to $596.41
7	United Energy redeem preference shares	− 600 adjusted to − $596.41	600 adjusted to $596.41	
8	United Energy purchase excluded assets back from power partnership	950.5 adjusted to 941.5	− 950.5 adjusted to − 941.5	
	Buyer repay and company draw-down loan facility and buyer subscribe UEL debenture			
9	Company repay SECV and TCV loans[a]		− 765 adjusted to − 814.184	765 adusted to 814.184
	Net amount	0	− $1,496.49	$1,496.49

Note: [a] TCV loan $470.8 million SECV loan $343.360 million

Power Partnership (6) for $596 million and then redeemed back by United Energy with a net result of $596 million being transferred from United Energy to the Victorian Government with no cost to the Purchaser (Power Partnership). The asset sale and buy-back represented by transaction (4) and (8) was a simple transfer between United Energy and the Power Partnership and then back. The net effect of this would be to inflate the asset values as with the consequent impact on depreciation and federal tax described earlier in the paper. The two remaining real flows were (5) the payment of a $85.9m dividend from United Energy to the Victorian Government and (9) the repayment of $814 million debt that United Energy owed the Victorian Government (referred to as the SECV – State Electricity Corporation of Victoria and TCV – Treasury Corporation of Victoria). The net effect of these transactions was the transfer of $1,496 million from the state-owned enterprise (United Energy) to the Victorian Government. In effect this was a payment from one pocket to another.

The price for the $4 million shares of United Energy (transaction (1) Figure 1) was specified under the share sale agreement and was dependent upon the values contained in a 30 June 1995 balance sheet. This balance sheet was to be prepared by the company (United Energy) under the direction of the buyer (clause 8.1) which was the Power Partnership rather than by the seller (the Victorian State) and therefore this provided the opportunity for the buyer to directly influence the final actual price they would pay.

Under the contractual arrangements the seller (Victorian State) was required to procure a reviewer to undertake a review of the balance sheet and the contract indicated that this reviewer was KPMG. Within their review KPMG was required to set out any adjustments needed to make the balance sheet comply with accounting standards, calculate the purchase price and report that the adjusted balance sheet has been drawn up in accordance with accounting standards. Accounting standards were specifically defined under clause 1.3 and contained exclusions from the requirements to show a true and fair view of the financial position of the company as at 30 June 1995.

The results of the KPMG review were reflected in the modifications signed on 6 September 1995. That document reports an estimate sale price of $643m which less the $596 million paid for the redeemable preference shares would result in a payment of just $47 million by the Power Partnership to purchase United Energy. However, both the original August 1995 and the modified September 1995 agreement showed that the price of $47 million would be increased or decreased by the amount that the net assets deviated from $343.4 million (this matched the net asset balance in the unaudited draft 30 June 1995 balance sheet attached as annexure C in the sale documents). The audited and published financial statements for the year ending 30 June 1995 showed net liabilities of $36.4 million. This would imply that the Power Partnership was paid $332.8 million[5] to take the asset United Energy. This seems too incredible to believe but alternatives require the author to speculate that the financial statements used as the basis of the purchase calculation were different from those that were published. If the two major loans were treated differently the payment price would change. The State Electricity Corporation of Victoria (SECV) loan of $343 million was specifically defined as a current liability under the clause 1.3 "accounting standards" (despite any impact on true and fair) however the Treasury Corporation of Victoria (TCV) loan of $470.8 million could have been presented as a term liability rather than as a current liability. This would have the effect of changing the published net liabilities from $36.4 million into net assets of $434.4 million which would result in a net payment of $138 million[6] from the Power Partnership. We regard this as the most plausible estimate of the actual price paid.

From this it becomes clear that the majority ($1,496 million) of the sale price of $1.55 billion reported by the Kennett government was not paid by the purchaser but was paid by the state-owned entity United Energy. The central and important point is that the payment of $1,496 million was an internal transfer between a state government and a state-owned entity representing a repayment of debt and that the most plausible net price actually paid by the purchaser was only $138 million. It is clear that $138 million is considerable less that $1.55 billion. So in reporting that they had received $1.55 billion (plus franchise fees) the Kennett government was telling the truth. However, complex contracts and the commercial in confidence provisions obscured the very large internal transfer component.

The full reported sale price for United Energy was $1.8 billion which included the sale price of $1.55 billion and franchise fees of $275 million. However it was not inevitable that the state government would receive the $275 million franchise fees. Clause 4.6 of the sale agreement indicated that there was a liability on the seller to repay $85 million of the $275 million franchise fees to the buyer if they did not have a tax ruling stating that the fees were deductible for the purpose of federal corporation tax within three years. The tax ruling when it did come was not favourable. Therefore the net amount of franchise fee paid by the purchaser was $190 million ($275 million-$85 million) which combined with the plausible price of $138m results in an estimated net total payment of $328 million to buy United Energy rather than $1.8 billion.

The other important factor in determining the purchase price was the 30 June 1995 financial statements because the actual price paid by the Power Partnership was dependent on the net asset balance in the 30 June 1995. Although United Energy was still a state-owned entity the contract indicated that the accountants were prepared under the direction of the purchaser (Power Partnership) rather than the seller (Victorian State). Clearly there was the potential that this would allow the purchaser (Power Partnership) to influence the accounts in a way that reduced the amount they had to pay. Was there any evidence of such influence? Under the sale agreement (clause 8.5) there was an ongoing obligation to make the financial accounts for the year ended 30 June 1995 available to the Victorian Auditor-General although it was also explicitly stated that any such audit or report shall have no impact on the sale. Therefore the work of the Victorian Auditor-General provides a means to evaluate the influence of the purchaser on the 30 June 1995 financial statements.

The 30 June 1995 audit

The financial statements for the pre-privatised United Energy for the year ending 30 June 1995 were prepared by the subsequent purchaser (Power Partnership) and tabled in the Victorian Parliament on 14 May 1996. They showed a reported $26 million loss. The loss became a contested issue, with the privatised United Energy and the incumbent Victorian Government claiming the loss as legitimate and the Auditor-General and the Victorian Opposition questioning the accounting practices that produced such a figure.

The 30 June 1995 audit would normally be conducted by the Victorian Auditor-General as recognised under the sale agreement due to United Energy for the year 30 June 1995 still being a state-owned entity. The company (and State Treasurer) suggested that a chartered accounting firm (Arthur Andersen) assume the role of auditor under the corporations act, requesting the Auditor-General's resignation (VAGO, 1996). However the Auditor-General, refused to step-down and claimed that he had a mandate to perform the audit under the Audit Act as the 30 June 1995 accounts were prepared for a state-owned entity. The Auditor-General stated that (VAGO, 1996, ref. 3.8.124):

> The company was advised that the audit of its financial statements for the period ended 30 June 1995 had not been finalised and that a number of issues mainly relating to provisions recorded in the statement needed to be resolved. Furthermore, United Energy was advised that under the circumstances, until the audit report was issued on the 30 June 1995 financial statements, I would not resign as the auditor of the company to ensure that such action did not prejudice in any way my ability to finalise the audit of the company.

The Auditor-General claimed the financial statements overstated the provisions of United Energy by $70.9 million without a valid basis and had this amount not been provided for, the company would have reported an operating profit of $44.9 million, rather than a $26 million loss (VAGO, 1996). The following extract from the Auditor-General's report explains the reason for the issue of a qualified opinion (VAGO, 1996):

> As disclosed in notes 5 and 13 to the financial statements, United Energy Limited has included an extraordinary item in the profit and loss account and as part of provisions in the balance sheet an amount of $23 million in respect of income tax on revenue which will be earned subsequent to 30 June 1995. Accounting Standard AASB 1020 Accounting for Income Tax (Tax Effect Accounting) defines income tax expense as "the amount of income tax which would be payable on the pre-tax accounting profit adjusted for permanent differences". As the related revenue had not been earned as at 30 June 1995, it should not have been taken into account in determining the income tax expense and therefore, in my opinion this accounting treatment is a departure from AASB 1020.
>
> United Energy Limited has also included as part of provisions in the balance sheet certain items totalling $47.9 million which, in my opinion, should not have been raised. Of this amount $29.7 million, which relates to provisions for losses on obligations to Tariff H customers, debt refinancing and uninsured claims should not have been recognised as no present obligation existed at balance date. The remaining $18.2 million relates to the incorrect measurement of provision for losses on co-generation agreements, voluntary departure packages and regulatory compliance costs, resulting in the overstatement of these provisions by that amount (VAGO, 1996, ref. 3.8.106).

The Auditor-General argued that the $23 million tax expense was a tax on income that had not yet been earned and therefore was not allowable under AASB1020. This was included in the 30 June 1995 profit and loss account as an extraordinary item relating to the double taxation of unbilled revenue, which United Energy believed would be subject to both the State Equivalent Tax and Federal Income Tax. The question of the income tax provision was the same issue that the purchase contract had indicated did not have to comply with the "true and fair" requirement. However, the notes to the financial statements detail that "unbilled revenue and the related State Equivalent Tax during the period 1 July 1995 to 6 September 1995 will be accounted during this period as normal operating income and related income tax and have not been adjusted for in the accounts at 30 June 1995" (United Energy, 1995, p. 13). This implies that the revenue related to the tax expense would not be brought to account until the following year. AASB 1020 *Accounting for Income Tax (Tax Effect Accounting)* (AASB, 1995, p. 3.313) required entities to report only the income tax expense attributable to the transactions included in the profit and loss account for a financial period, irrespective of whether the income tax is currently payable, has already been paid, or will become payable in the future. This would indicate that the tax payable should not be recorded as a tax expense as it was based on revenue that is yet to be earned and not included in the profit and loss account. It appears that United Energy's treatment of the tax expense as an extraordinary item directly contradicted the requirements of AASB 1020, the very point made by the Auditor-General. This had the effect of reducing the pre-privatisation profit and rendering profit in subsequent years tax-free.

United Energy provided for a future abnormal loss on Tariff H customers, debt refinancing and uninsured losses of $47.9 million. Tariff H customers are historically, large commercial and industrial customers. Due to the requirements of the *Electricity Act 1993* United Energy was obliged to supply electricity to certain Tariff H customers at rates lower than other tariffs, resulting in future financial losses (United Energy, 1995, p. 13). At the time of the preparation and issuance of the United Energy financial statements there was no Australian Accounting Standard in effect that dealt with accounting provisions. However, in the absence of a specific accounting standard, such items are accounted for against the criteria contained in the Australian Conceptual Framework, specifically Statement of Accounting Concept 4 *Definition and Recognition of the Elements of Financial Statement* (AASB, 1995, p. 2.45). SAC 4 defines a liability as:

> [. . .] future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events.

Further guidance is offered in SAC 4 on the nature of a liability where it is stated that:

> [. . .] the existence of a liability depends on the present obligation being such that the legal, social, political or economic consequences of failing to honour the obligation leave the entity little, if any, discretion to avoid the future sacrifice of economic benefits to another entity (AASB, 1995, p. 2.64).

In examining this transaction, the Auditor-General was of the opinion that United Energy did not have a present obligation as there was contestability in the market for Tariff H customers and therefore it could not be demonstrated that United Energy would be required to actually supply electricity at the Tariff H rate to any of its customers. The Auditor-General argued that this was an anticipation of future losses and not permitted under the accounting standards.

According to the Auditor-General there were a further $18.2 million of provisions for losses on co-generational agreements, voluntary departure packages and regulatory compliance costs which were overstated and inconsistent with accounting standards and guidelines. These collective provisions and adjustments clearly had the effect of reducing the pre-privatisation profit. The provisions and adjustments that the Auditor General criticised were in the financial statements prepared by the purchasers but were not in the draft 30 June 1995 balance sheet in Annexure C of the sale contract; suggesting that they were inserted under the influence of the purchasers. The management of United Energy maintained that the difference in opinion over these provisions related to purely technical matters and stated that:

> [. . . the accounts] had not been dressed up for sale. These are purely accounting book entries not cash entries. It's just the way of accounting; we would argue we are taking a more commercial view. He (the auditor-general) is falling back on accounting principles and technicalities (Robinson, 1996, p. 2).

The establishment of these controversial provisions and adjustments had the effect of reducing the performance of the pre-privatisation entity and increasing the performance of the post-privatisation entity. This would support the Craig and Amernic (2004, 2006) assertion that there would be a financial big-bath in the pre-privatisation period rather than the Quiggin (2004) claim that state-owned performance would be inflated in relation to post-privatisation performance.

Given the structure of the sale agreement these provisions would have impacted the net assets balance and would have resulted in an actual sale price being less than they would otherwise have been. The effect of these contested provisions would have to reduce the "actual" share price to be paid by the purchasers by $70.9 million and it would have decreased the estimated net purchase price $398.9 million to $328 million.

Appointing Arthur Andersen

Arthur Andersen was appointed 13 November 1995 and issued a clear audit opinion allowing the inclusion of the contested provisions and a reported loss of $26 million, in direct contrast to the qualified opinion from the Auditor-General (VAGO, 1996). When the financial statements of United Energy for the year ended 30 June 1995 were tabled in Parliament they were not accompanied by the Auditor-General's report but were accompanied by the Arthur Andersen report, which stated that the financial statements were:

> [P]resented fairly in accordance with Australian Accounting Standards and other mandatory professional reporting requirements [Urgent Issues Group Consensus Views] and statutory requirements so as to present a view of the company which is consistent with our understanding of its financial position, the results of its operations and its cash flows (United Energy, 1995).

In accepting the audit Arthur Andersen were obliged under the then ethical pronouncements of both of the Australian accounting bodies – the CPA (Professional Statement F.3) and the Australian Institute of Chartered Accountants (Professional Appointments) (*Accounting and Auditing Handbook 1995*, 1995) – to communicate with the Auditor-General as the existing auditor to determine whether there were reasons why the appointment should not be accepted. If this was done then the staff within Arthur Andersen would have known that the Auditor-General believed the accounts misrepresented United Energy's financial position and the existence of a qualified audit report. Against that the Arthur Andersen accountant who audited United Energy's accounts was quoted in a newspaper saying that he had not seen the Auditor-Generals criticisms (Robinson, 1996). Most members of parliament were unaware of the Auditor-General's report as it was not released with the United Energy financial statements (*Victorian Parliamentary Documents*, 1997). The Opposition's energy and resources spokesman stated that "(a)n attempt had been made to keep the critical part of the Auditor-General's report away from public scrutiny" (*Victorian Parliamentary Documents*, 1997). United Energy's annual report was the only one of the five distribution entities whose financial statements were introduced to parliament after the state election, even though United was the first to be sold (Davidson, 1996a, p. 1) and was tabled in parliament eleven months after the reporting period ended (Skulley, 1996, p. 9).

Arthur Andersen had acted on behalf of the purchaser, the Power Partnership Consortium, during the sale of United Energy (Yule, 2002, p. 239) and was openly criticised in the press when appointed to the audit due to the perceived conflict of interest. Davidson (1996b, p. 4) stated that:

> Ethically, Arthur Andersen could not act as adviser to the purchaser of the business during the sale process when their duty is to minimise the cost of the sale to their client and then become the external auditor for the same period when the purpose is to provide a true value of the business for the people in whose name the business is to be sold.

Davidson described the appointment of Andersen as "corporate cowboys appointing tame auditors who share the views of management". The United Energy financial statements showed that for this period Arthur Andersen was paid $155,000 audit fees and $848,000 for "other services" (Yule, 2002, p. 239; United Energy, 1995, note 20). The appointment of Andersen in this setting would seem to be contrary to the contemporary ASCPA/ICAA ethical code requirement for professional independence, which stated that (*Accounting and Auditing Handbook 1995*, 1995, pp. 1102 and 1171):

> In each professional assignment undertaken, a member in public practice must be and be seen to be free of any interest which is incompatible with objectivity... In determining whether a member in public practice is or is not seen to be free of any interest which is incompatible with objectivity, the criterion should be whether a reasonable person, having knowledge of the relevant facts, could conclude that the member has placed himself or herself in a position where his or her objectivity would or could be impaired.

Post-privatisation performance

Arguably Craig and Amernic (2004, 2006) imply that the big-bath effect prior to privatisation opens the opportunity for exceptional financial performance subsequent to privatisation while Quiggin (2004) suggested that accounting manipulations prior to privatisation make the post-privatisation performance appear devalued when compared to the pre-privatisation entity. In the case of United Energy there is some evidence to support the Craig and Amernic's contention that the accounting figures were manipulated to make the pre-privatisation performance look worse but this is not clear cut. Therefore there are questions as to the financial performance improvements following privatisation.

Much of the initial financial performance information was difficult to access as it was not until the company was listed on the stock exchange that financial information was released. However, Table IV shows the financial performance of United Energy following privatisation was generally positive. United Energy reported a profit of $21 million in 1996, $15 million in 1998 and $95 million in 1999. They made a loss of $42 million in 1997 but this coincided with the final legal decision that the franchise fee element of the purchase price was not a deductible expense. Therefore this would have also been accompanied by a capital payment from the Victorian State to United Energy of $85 million. While the post privatisation performance of United Energy was good it was not exceptional.

Date	Profit (loss)	Issues or events
21 December 1994 (six months)	21.3 million	Prepared under state ownership
30 June 1995	Company privatised (reported price A$1.8 billion estimate actual paid $328 million)	
30 June 1995	(22.6) million	Under state ownership but prepared by the new "purchaser" management. Contested (70.9 million) provisions
30 June 1996	21 million	Information not released in 1997. Released as part of the listing prospectus
30 June 1997	(42) million	Released as part of the listing prospectus. Claimed that the loss was due to being unable to deduct franchise fees for tax
May 1998	Company listed (total A$2.1 billion)	
30 June 1998	15 million	(51) million abnormal items associated with interest rate swap costs (49) and buildings devaluation (2)
30 June 1999	95 million	

Table IV. United Energy profit/loss

In 1998 United Energy made a fully subscribed public issue of $350 million of capital, which represented 41.6 per cent of the shares and brought the total listed value of capital to $2.1 billion. Co-incident with the shares listing in 1998 the New South Wales State Authorities Superannuation Board sold their 9.23 per cent holdings in United Energy to Utilicorp for an undisclosed sum which would have briefly brought Utilicorp's holding to 59.13 per cent before this was averaged down to 34.5 per cent as a result to the public listing (*Your Money Weekly*, 1998). Utilicorp/Alinta sold their remaining 34.5 per cent shareholding to the other partners (now just AMP) for $1.32 billion in May 2003.

Because the sale value of the NSW Super Board's holdings was not disclosed and the issues associated with the asset sale agreement it is impossible to be precise about the capital gains made by Utilicorp. However it is possible to give an estimate. At the reported sale price of $1.8 billion (not paid by the purchasers) Utilicorp would have made a very modest total return of 25 per cent or around 3.5 per cent per year. However, if they paid our estimated net sale price of $328m they would have made a return of 302 per cent over the ownership period and 43 per cent per year. This scale of capital return is astonishing. While this pattern of ordinary financial performance and high capital gains does not directly match Craig and Amernic's (2004, 2006) prediction it generally supports their argument. The three important drivers in this case were:

(1) the use of accounting policy to avoid federal income tax;

(2) the construction of a sales arrangement that allowed the government to report an outstanding sale price; and

(3) the consequential astonishing capital gains made by the purchaser.

Conclusion

The paper begins by highlighting the concerns that commercial-in-confidence provisions undermine public sector accountability. This is a particular problem in the context of privatisation, as a number of researchers have argued that accounting can be used for rhetorical purposes to justify a political agenda.

Craig and Amernic (2004, 2006) claim that accounting figures and policies were manipulated in the context of Canadian rail privatisation to make the state-owned rail entity appear inefficient and wasteful and the privatised for-profit rail entity appear efficient and successful. However, Craig and Amernic (2004, 2006) provide few specifics on the actual accounting practices used. Yet Quiggin (2004) provides the opposite argument to Craig and Amernic (2004, 2006), that the accounting manipulation favours the state-owned entity and is to the detriment of the financial performance of the privatised entity. Again there is a lack of specific evidence.

This paper addresses the debate about privatisation and accounting manipulation by exploring the key documents in the case of the tender-based privatisation of United Energy. Many of the documents, and much of the information which was initially considered commercial-in-confidence, are now available through parliamentary questioning, documents tabled in parliament and freedom of information access.

From the beginning of the privatisation process it was clear that particular accounting policies were being used that had the effect of reducing the levels of federal tax payable. One example of this was the case made by the state that assets should be depreciated on the basis of sale price rather than on historic cost. If this were accepted it would have increased depreciation, driven down profits and reduced tax payable. Another example in the case of United Energy was the structure of part of the purchase price as franchise fees that were also intended to be deductible for the purposes of federal tax. However, the ATO was not prepared to accept either arrangement.

It seems probable that the state and national political pressure for the privatisation of power in Victoria to be seen as a resounding success, may have led to commercial-in-confidence purchase arrangements that were far from transparent. Given that the purchasing company was granted the power to prepare the closing financial statements for the pre-privatised United Energy entity and that the actual purchase price was dependent upon the value of key figures within the financial statements, this raises issues of concern. This is heightened when one recognises that the accounts prepared and presented by the purchaser were criticised by the Auditor-General for not being consistent with accounting standards and that the Auditor-General was subsequently removed as the auditor of a state entity and replaced by the audit firm who were also the principal financial advisor to the purchasing entity. The inclusion of the provisions disputed by the Victorian Auditor General resulted in the purchaser paying $70.9 million less for the sale.

The rules governing the preparation of these statements also redefined "accounting standards" to allow exceptions to the obligation to show a true and fair picture. Upon review of the commercial-in-confidence documents it became clear that there was a distinct difference between the reported total price and the amount that was actually paid for the purchase of the asset. The actual sale price was further obscured by asset sale and buyback arrangements and complex conditional claw-back calculations based on the 30 June 1995 financial statements. It seems that the majority of what the Victorian government received ($1,496 million) was an internal transfer from the state-owned entity to repay the debt. Based on the published financial statements it appeared that the purchaser was actually paid $328 million to take the asset. Our most plausible estimate of the actual price paid by the purchasing entity was $138 million which with the net balance of franchise fees ($190 million) came to a total of $328 million. Over the period of ownership Utilicorp achieved a return of over 43 per cent per year, most of which were capital gains.

When the actual price paid by the purchaser is combined with the net internal transfer between the state-owned entity and the Victorian government it is clear that the reported sales receipts were technically true. They did receive a total of $1.8 billion as part of the sale. However, it is clear from the documents that the purchasers did not pay anywhere near that amount. That the use of commercial-in-confidence provisions obscured this distinction to be exploited is a cause for serious concern. The United Energy case illustrates that the concerns about the use of commercial-in-confidence arrangements in the sale of public assets are well placed and raises important questions about the composition of the reported sale figures for many of the other tender-based privatisation agreements. It is possible that these could also involve a substantial element of the reported sale price being paid by the government to itself rather than actually being paid by the purchasing entity.

Politically the government of the day also did well out of the privatisation process and the reported sale price of $1.8 billion was an important element of that. One Australian newspaper, (*The Australian*, 1997), suggested that Victoria was now "in the black" and that the legacy of state mismanagement, the drain on government spending and debt had been eliminated by the privatisation process and that Victoria was now focused on its "core business". The underperforming state-owned business enterprises had been radically transformed into highly profitable enterprises which lead to a significant improvement in the state's reported financial performance. However, the basis for this claim of performance was the particularly good reported prices that Kennett secured for United Energy and the other Victorian State energy assets. If the actual price paid for these assets was dramatically lower than reported then much of the political and historical credit is contestable; particularly if exceptional profits were made by the purchasers on public listing and sale.

Davidson (1996c) argued that the government was trying to make the sale of United Energy look better than it was as a sale price of $1.8 billion appeared to be significantly better if the entity being sold recorded a loss of $26 million, rather than a profit of $44.9 million. The questionable profit figure also makes it easy for management to turn the entity's performance around in following years. This observation would seem to directly challenge the claim from the United Energy management that the accounts had not been "dressed-up for sale", it supports Craig and Amernic's (2004, 2006) arguments.

It could be argued that with the removal of the Victorian Auditor-General as the auditor of the 30 June 1995 financial statements public accountability was undermined. However, he did continue with the audit and reported his observations. However, the removal of the Victorian Auditor-General from this audit was not principally associated with the issue of "commercial in confidence" but rather a clear attack on the independence and authority of the Auditor-General. There is evidence that the removal of the Auditor-General as the auditor of United Energy was a direct response to the threat of a qualified audit opinion as it was not until three months after the sale and after the commencement of the audit that the Auditor-General was replaced as United Energy's auditor (VAGO, 1996). In this context the commercial-in-confidence arrangements allowed the substantial difference between the reported "estimated" sale price of $1.8 billion paid to the state and the actual sale price paid by the purchasers to go unchallenged.

The accounting profession, in the form of Arthur Anderson, did not acquit itself well in this story. However, the criticism could be more widely applied. It was clear that the entire privatisation structure was conceived and arranged with joint assistance from accountants and lawyers. Figure 1 and Table III show how this resulted on an emphasis of form over substance, particularly where that form was likely to result in a reduction of federal income tax. It is deeply concerning that in the absence of public and commercial transparency associated with the privatisation process that Arthur Andersen, as a major accounting firm, did not challenge the accounting information or even significantly reflect on the reported public perceptions of conflict of interest which came with them taking over from the Auditor-General on the 1995 United Energy audit. The relevant audit partner of Arthur Andersen publicly stated that he was unaware of the Auditor-General's work which would appear to be a breach of professional auditing standards. Therefore the context of privatisation by tender poses a serious concern under commercial-in-confidence arrangements as there is no counter-balancing market visibility if both parties to the agreement are happy and the Auditor-General is restricted. There is no possibility of public accountability, market consequences or legal action in the interest of the public. The contested provisions challenged by the Auditor-General but allowed by Arthur Anderson resulted in the purchasers paying $70.9 million less for United Energy than they would have otherwise paid. In short the behaviour of Arthur Anderson as an accounting firm in the privatisation of United Energy is consistent with their alleged behaviour in the Enron case.

In conclusion Victoria was following a textbook privatisation strategy, a process which has been commented on by the privatisation advocates and experts. It seems clear that the privatisation of United Energy presented the opportunity for a number of politically and financially motivated adjustments of the accounting information. It is also clear that there are major questions about the financial performance of United Energy. Based on the sales contract and the published 1995 financial statements there is evidence that there was an effort to report an inflated sale price. There were also efforts to reduce future federal tax liabilities and to present the financial performance of the privatised entity in a positive light when compared to the state-owned entity. Given these issue there must be questions about the validity of claims made by Quiggin (2004) of the substantial decrease in financial and operational performance following privatisation.

The limitation of these findings is that they only apply to the privatisation of United Energy undertaken in Victoria during the early 1990s. While this was a single case, there are arguably broader implications for the use of accounting in the public sector that arise. It would appear that there was a political willingness in this case to use accounting figures for political ends with little awareness of this by the public or the profession because of the commercial-in-confidence arrangements. Therefore commercial-in-confidence arrangements can be abused for political ends. The danger of the loss of public accountability structures associated with parliamentary review and Auditor-General oversight is clear in this context.

We would reiterate the point made by Craig and Amernic (2006) that there is a strong need for a dispassionate, objective and wide-ranging analysis of any privatisation. This case shows that commercial-in-confidence arrangements present at the time of privatisation suggest that many of these projects lacked the scrutiny that they should have received and that the financial, economic and public interest impact of these changes can only be addressed now that many of the documents relating to the privatisation process are becoming accessible. We show that key elements to the basis for claims of "winners" (or even losers) such as the prices achieved for the privatisations and the company profits before and after privatisation may vary from the figures that were generally reported.

Notes

1. The Premier is the state level equivalent of a prime minister.
2. The semi-legal nature and the strong emphasis on accurate recordings, transcription and verification associated with Hansard within parliaments makes parliamentary records one of the most credible and reliable sources possible.
3. John Cain was leader of the Labor party in Victoria and Premier of Victoria from 1982-1990.
4. This is an Anglican male religious order formed in Australia in the 1930s with a focus on social justice and the needs of the poor. Their mission is "working for an Australia free of poverty" www.bsl.org.au
5. $47 - 343.4 + 36.4 = (\$332.8)$
6. $470.8 + (36.4) - 343.4 + 47 = \$138$ million

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