

**Investigation of  
Competitive Neutrality Complaints against  
the State Valuation Office**

**INDEPENDENT PRICING AND REGULATORY TRIBUNAL  
OF NEW SOUTH WALES**



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## **1 INTRODUCTION**

In New South Wales, legislation and government policy requires that government agencies involved in significant business activities in contestable markets comply with competitive neutrality principles, to ensure they do not enjoy a net advantage over their competitors simply as a result of their public sector ownership.

In 2003, three private valuation firms – Quotable Value Australia, Crown Valuation Services, and Matheson Stephen – complained that the State Valuation Office (SVO) had failed to comply with these principles in tendering for specific contracts to provide land valuation services for the NSW Valuer General and a Victorian Council.

The SVO's attempts to resolve these competitive neutrality complaints directly with the complainants failed, and the Independent Pricing and Regulatory Tribunal of New South Wales (the Tribunal) was asked to investigate the complaints under delegation from the State Contracts Control Board.<sup>1</sup>

The Tribunal has completed the investigation. It found that the methodology the SVO used to price each of the tenders that were the subject of the complaints is consistent with NSW competitive neutrality principles. However, in applying this methodology for two of these tenders – those for the City of Whitehorse and Sydney City – it underestimated the resources it would require to fulfil the contracts. Due to a lack of information, the Tribunal made no finding on whether this underestimation was done deliberately in breach of competitive neutrality principles.

This report explains the Tribunal investigation and findings in detail:

- Chapter 1 outlines the background to the investigation, including the nature of the complaints against the SVO, and the events that led to the Tribunal being asked to conduct the investigation
- Chapter 2 describes the Tribunal's investigation process
- Chapter 3 sets out its assessment and findings of fact
- Chapter 4 summarises its overall findings and recommendations.

Please note that since the complaints were lodged, the SVO has been renamed the Property Valuation Service.<sup>2</sup> However, for ease of reference, 'the SVO' has been used throughout this report to refer to both the former SVO and the current Property Valuation Service.

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<sup>1</sup> The complaints were referred to the Tribunal to avoid potential conflicts of interest, as the State Contracts Control Board was involved in awarding some of the contracts in question.

<sup>2</sup> As of 30 June 2003.

## 2 BACKGROUND TO THE INVESTIGATION

When the competitive neutrality complaints against it were lodged, the SVO operated as a commercial business unit within the NSW Department of Commerce. It comprised a head office in Sydney and regional offices across the State, and provided property valuation services to a variety of clients both within and outside NSW.

Since then, the Department of Commerce has been reorganised. As part of this reorganisation, the SVO's name has been changed to the Property Valuation Service. Its regional activities are now coordinated through the regional branches of the Office of Government Business (which is also within the Department of Commerce). In addition, the Department of Commerce has introduced new business rules that focus the operation of the SVO to within NSW, and then only for government clients.

This chapter outlines the activities of the SVO that are relevant to the competitive neutrality complaints, describes the nature of these complaints, and sets out the steps taken to resolve the complaints prior to the Tribunal being asked to conduct its investigation.

### 2.1 SVO activities

The SVO competes with private sector firms to provide land valuation services for the NSW Valuer General and other clients. For example, each year the Valuer General calls for tenders for the provision of land valuation services in a number of NSW Local Government areas. It then awards 'mass valuation' contracts to the successful tenderers. These contracts are for a period of three or four years, depending on the location of the contract area.

The SVO currently holds 24 out of 36 mass valuation contracts in NSW including contracts for the Canterbury/Bankstown, North Harbour, Penrith, Upper North Sydney, Warringah, South Coast, Queanbeyan, Griffith, Taree and Deniliquin areas.<sup>3</sup> These contracts represent its main source of revenue. In 2002/03, they generated almost \$6 million of the SVO's total annual revenue of \$11.7 million.

### 2.2 Nature of the complaints

Three private valuation firms, Quotable Value Australia (Quotable), Crown Valuation Services (Crown), and Matheson Stephen (Matheson) made complaints against the SVO in relation to its tenders for mass valuation contracts. These firms had tendered for contracts for the following local government areas:

- Canterbury/Bankstown
- North Harbour
- Upper North Sydney
- Warringah
- Sydney City<sup>4</sup>

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<sup>3</sup> Source <http://www.lpi.nsw.gov.au/facts/valuationcontracts.html>

<sup>4</sup> The Sydney City tender was awarded to SVO, however, following the competitive neutrality complaint, the previous contract was extended for one year. The contract was subsequently re-tendered and awarded to a private sector tenderer.



- City of Whitehorse (Victoria).

Each tender was for a three-year contract from May 2003, except the City of Whitehorse contract, which was for a two-year period from January 2003. In each case, the contract was awarded to the SVO.

Quotable, Crown and Matheson each alleged that the SVO failed to comply with NSW competitive neutrality principles in pricing its tender bids for these contracts. The key concern raised by the complainants and addressed in this investigation is that the SVO may have priced its bids significantly below the level required to recover its costs and therefore may have breached NSW competitive neutrality principles.

Specifically, Quotable's complaint related to the SVO's 2003 tender for the Sydney City mass valuation contract. It alleged that the SVO's tender bid failed to comply with competitive neutrality principles. It noted that the quoted price in the SVO's 2003 tender was lower than that in its 1999/2000 tender, despite the fact that there had been significant increases in its staff salary levels and a 2 per cent increase in its employer superannuation contributions. It suggested that these facts indicate that the SVO did not use full cost pricing in its 2003 tender and engaged in predatory pricing practices.

Crown's complaint related to the specific tenders it lost to the SVO and to the SVO's pricing practices in general. It alleged that the low level of the prices included in the SVO's 2003 tenders indicate that these prices were 'anti competitive predatory prices' and that it was engaging in 'loss leader' pricing practices, and therefore was in breach of competitive neutrality principles. Crown implied that the SVO had not made real allowances for operating costs such as Professional Indemnity Insurance and return on capital.

Matheson's complaint related to a tender for land valuation services for the City of Whitehorse, Victoria. It alleged that the SVO won the contract for these services based on quoted prices that were significantly below known benchmarks, and suggested that this raises doubts about whether the prices were set to fully recover costs. At the time of its complaint, Matheson was the incumbent contractor for the City of Whitehorse. Based on its experience, it was concerned that the SVO's pricing did not reflect the full transport and accommodation costs it would incur in providing the services, or the cost of engaging additional Victorian-based personnel.

Quotable and Crown also made complaints related to the administration of the tender process, which the Tribunal considered to be outside the scope of its investigation. These additional concerns were:

- that the requirement that the SVO price its services in a competitively neutral manner was not adequately assessed by the relevant tender evaluation committees or adequately demonstrated by the selected tenderer
- that there was a lack of independence and probity in tender processes as the Department of Commerce was involved both as the tender bidder and the tender assessor
- that the tender assessor gave the SVO an opportunity to rectify a deficiency in its tender bid, thus conferring an unfair advantage on the SVO during the tender process.

The State Contracts Control Board and NSW Supply have reviewed these matters and were satisfied that the tender process was not flawed.

### **2.3 Events prior to the Tribunal conducting its investigation**

The NSW Government's policy for handling competitive neutrality complaints requires a two-stage resolution process. In line with the requirements for the first stage of this process, the SVO liaised directly with Quotable, Crown and Matheson when it received the complaints, to try to resolve the competitive neutrality issues. These attempts failed.

As part of the second stage of the process, the Minister for Commerce assessed the complaints against the grounds for referral as required by section 146 of the *Public Sector Employment and Management Act 2002* (PSEM Act). The Minister was satisfied that:

- the complaints related to public trading activities of the SVO
- the complainants could demonstrate that they compete in a market with the SVO and were hindered from doing so by the matters complained of
- the competitors were materially affected by the matters complained of
- the complaints were made by the competitors or their authorised representatives
- the complaints had been raised with the agency and the complainants had reasonable grounds for not being satisfied with the response to the complaint.

The Minister then referred the complaints to the Tribunal for investigation under delegation from the State Contracts Control Board.

### 3 THE TRIBUNAL'S INVESTIGATION PROCESS

In conducting this investigation, the Tribunal followed the requirements of Part 7.3 of the PSEM Act regarding the investigation of competitive neutrality complaints and reporting of findings.

It notified the complainants, the SVO, the Premier, the Treasurer and the Minister for Commerce that it was conducting the investigation. It provided the complainants with the opportunity to provide additional information, and requested submissions from the SVO and the Treasurer. It then considered the information and submissions it received, and undertook its own assessment of the SVO's compliance with competitive neutrality principles for each of the tenders associated with the complaints.

The criteria the Tribunal used for this assessment are set out in Chapter 4. The Tribunal established these criteria based on the definition of competitive neutrality principles in Section 145 of the PSEM Act. These principles comprise the competition principles referred to in the *Competition Principles Agreement*<sup>5</sup> and the NSW Government policies developed for the purpose of complying with or giving effect to these principles.

These policies include:

- NSW Treasury's *Policy Statement on the Application of Competitive Neutrality*, January 2002, which outlines the NSW Government's competitive neutrality initiatives; costing and pricing guidelines for NSW Government businesses; and the competitive neutrality complaints mechanism
- NSW Treasury's *Guidelines for Pricing of User Charges*, June 2001, which provides guidance to agencies on how to price goods and services sold into contestable markets in a competitively neutral way, and covers:
  - who the competitive neutrality guidelines apply to
  - the costs that should be included in competitively neutral pricing, that is, taxes and charges, and commercial rates of return
  - the use of full cost attribution and avoidable cost.

Finally, the Tribunal made this report publicly available on its website and sent a copy of the report to the relevant parties.

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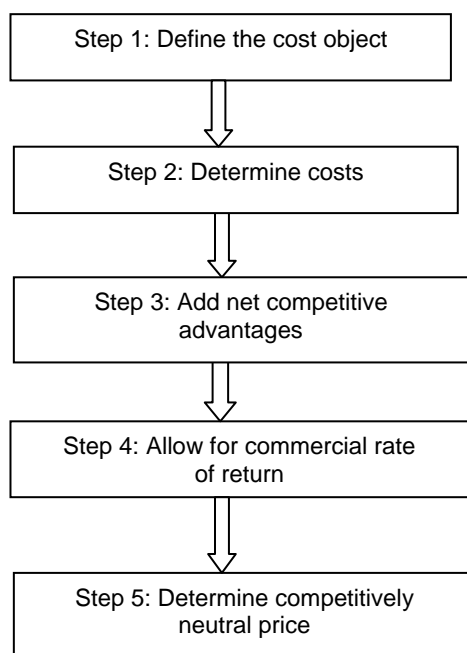
<sup>5</sup> NSW Treasury, *Policy Statement on the Application of Competitive Neutrality*, January 2002, Appendix A.

## 4 TRIBUNAL'S ASSESSMENT AND FINDINGS OF FACT

The *Guidelines for Pricing of User Charges*<sup>6</sup> state that competitively neutral pricing involves:

- identifying the costs derived from the accounting system
- adjusting for the competitive advantages and disadvantages arising from Government ownership, which can be broadly categorised as cost of capital, taxes and other charges
- setting the price of the services to cover those costs, including a required rate of return.

The Tribunal assessed whether the pricing methodology the SVO used to determine the prices included in each of the tenders in question was consistent with these criteria. It broke the pricing process into the following five steps:



It then examined each of these steps in turn, and assessed whether the SVO's approach in each step complies with NSW competitive neutrality principles and policies. Its assessment and findings for each step are discussed below.

### 4.1 Define the cost object

The *Guidelines for Pricing of User Charges* require agencies to set the price of a good or service sold in a competitive market so that it at least covers the *avoidable cost* of production.<sup>7</sup> However, the guidelines recognise that a price that covers avoidable costs only is a minimum price that should not continue beyond the short term. They suggest that in the longer term, in most cases where a good or service is not provided on an ad hoc basis, agencies should

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<sup>6</sup> NSW Treasury, *Guidelines for Pricing of User Charges*, June 2001, p 10.

<sup>7</sup> Avoidable cost is defined as costs that would be avoided if a good or service is not produced.

endeavour to charge prices that cover the *fully distributed costs*<sup>8</sup> of production. The overriding principle is 'the efficient allocation of resources'.<sup>9</sup>

Given the three to four year duration of mass valuation contracts, and the fact that these contracts are the SVO's major source of revenue, the Tribunal believes that the tender bids for these contracts should be priced to cover the fully distributed costs of providing the valuation services.

***Finding 1: The cost object of the SVO for mass valuation contracts should be to recover fully distributed costs.***

## **4.2 Determine costs**

In determining the costs it will need to recover through the prices included in its tenders for mass valuation contracts, the SVO assesses the resources required for it to comply with the request for tender, and assigns costs to those resources. The Tribunal considered both these aspects.

### **4.2.1 Assessing the resource requirements**

When determining its tender bid prices, the SVO considers the resources required, and applies full cost recovery service rates to these resources to establish an estimated total cost of service delivery (that is, fully distributed cost) as a hurdle rate. This hurdle rate is used as a minimum bid price that may then be adjusted upwards based on market place considerations.

The SVO made a substantial loss on one of the contracts that was the subject of complaint, and would have made a substantial loss on another if it had been awarded to the SVO. In the first case, the SVO has asserted that this was due to an underestimation of resource effort and was not due to an intention to secure the contract at a loss.

In the second case, the SVO stated that its forecast productivity gains appeared to be overestimated. The incumbent private sector service provider's contract was extended for 12 months pending the calling for new tenders. When this occurred, the SVO put in a higher bid that more closely reflected the actual costs that it would incur, and the tender was awarded to a lower private sector bid.

The SVO provided the Tribunal with its unaudited cost monitoring spreadsheets for contracts for the Canterbury/Bankstown, Warringah, Upper North Sydney and North Harbour areas. These spreadsheets support the SVO's view that the prices it included in its tenders for these contracts will enable it to meet or exceed full cost recovery. Although the contracts are only in the early stages of completion, there is no evidence to suggest any unexplainable differences exist between the costs the SVO budgeted for in preparing its tenders and the actual costs it is incurring in fulfilling the contracts.

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<sup>8</sup> Fully distributed costs include both the direct costs of the production of a good or service and an allocation of indirect costs, such as capital costs and corporate support.

<sup>9</sup> NSW Treasury, *Guidelines for Pricing of User Charges*, June 2001, p 16.

*Finding 2: The SVO's application of its pricing methodology appears to have been flawed in some instances, as it underestimated the resource requirements for two of the contracts it tendered for. However, there is no evidence that it has done so in costing the other four tenders.*

### 4.2.2 Assigning costs

The *Guidelines for Pricing of User Charges* require the inclusion of direct costs in the cost of providing the good or service and the allocation of indirect costs to the cost of providing the good or service.<sup>10</sup>

The SVO's pricing methodology involves determining full cost recovery service rates by applying a multiplicative factor to base salary rates. The multiplicative factor accounts for targeted efficiencies, recovery of business unit direct and indirect costs, a share of the Department of Commerce's costs, all relevant taxes, and an allowance for a profit margin.

The Department of Commerce costs included in the multiplicative factor are divided into costs for shared business services and governance costs<sup>11</sup>. These costs are allocated on the basis of various cost drivers. Up until 30 June 2003, governance costs were not allocated to the SVO for inclusion in its profit and loss account, however, the pricing model has always included both cost components.

The SVO provided the Tribunal with worksheets that show the construction of the individual tender bids, including the calculation of the multiplier. The Tribunal has not undertaken an audit of these worksheets.

*Finding 3: The tender bids constructed by the SVO include direct costs, indirect costs and a margin equating to a rate of return.*

### 4.3 Add net competitive advantages

The *Guidelines for Pricing of User Charges*<sup>12</sup> state that typical competitive advantages that Government agencies receive as a result of their public sector ownership include:

- taxes that they may not pay but their private sector competitors are required to pay
- a lower cost of capital
- any other material costs that they do not bear purely as a result of their government ownership status.

The net value of these advantages needs to be included when calculating the cost of a good or service to determine a competitively neutral price. For example, where taxes and charges are not currently paid on business activities, the notional incidence should be calculated and factored into the price.<sup>13</sup> This includes for example, government guarantee fees on debt financing and taxes such as land tax, transfer duty, motor vehicle registration duty and local council rates.

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<sup>10</sup> NSW Treasury, *Guidelines for Pricing of User Charges*, June 2001, p 16.

<sup>11</sup> Governance costs are support costs for strategic management and corporate governance activities undertaken on behalf of the organisation.

<sup>12</sup> NSW Treasury, *Guidelines for Pricing of User Charges*, June 2001, p 6.

<sup>13</sup> NSW Treasury, *Guidelines for Pricing of User Charges*, June 2001, p 13.

### **4.3.1 Tax advantages**

Although SVO does not pay income tax, income tax equivalents, or dividends directly to NSW Treasury, it does contribute to income tax equivalents and dividends paid to NSW Treasury as part of the Office of Government Business as a whole, based on its recorded surplus.

The SVO's multiplicative factor includes payroll tax payable directly by the business unit. The SVO leases its major assets and as these lease arrangements are mainly with the private sector they already reflect taxes that would be incurred by the private sector.

Therefore, the SVO advised that it did not directly incur some taxes including transfer duty, land tax and local council rates. However, for the reason given above, the Tribunal doesn't consider that the non-payment of these taxes confers a material advantage to the SVO.

*Finding 4: The Tribunal has not identified any material tax exemptions.*

### **4.3.2 Other competitive advantages**

#### *Regulatory requirements*

The SVO does not appear to benefit from exemptions from regulatory requirements. The valuers it employs are subject to the same registration and licensing requirements as their counterparts in the private sector. The SVO provides financial assistance to valuers to meet their professional requirements.

#### *Benefits that accrue to SVO as part of the Department of Commerce*

The SVO has the potential to benefit from economies that derive from it being part of a much larger entity with diverse functions (eg, in bill paying, payroll and insurance costs). However, given the size and inclusions in the overheads that are added to the SVO's tender prices, there is no indication that competitive neutrality principles have been breached as these benefits accrue as a result of scale rather than government ownership.

#### *Insurance costs*

Crown's complaint implied that the SVO may benefit from lower insurance costs (particularly professional indemnity insurance costs) as a result of its public ownership.

The SVO holds professional indemnity, public liability and workers compensation insurance as part of a broader policy held by the Department of Commerce with the Treasury Managed Fund (TMF). The cost of its motor vehicle insurance is incorporated into its vehicle leasing arrangements. The TMF is the General Government sector's self-insurance scheme, which is owned and underwritten by the NSW Government.

The TMF sets premiums based on a fully funded basis.<sup>14</sup> The SVO has advised that the Department of Commerce's insurance premium is based on the Department's level of budgeted revenue. Within the Department, the SVO is allocated a proportion of this premium based on its level of revenue.

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<sup>14</sup> NSW Treasury website, [www.treasury.nsw.gov.au/insure/tmf.htm](http://www.treasury.nsw.gov.au/insure/tmf.htm)

The Australian Government Competitive Neutrality Complaints Office recently commented on the “substantial difference” between the level of professional indemnity premiums paid by the Australian Valuation Office (AVO) and its private competitors. While the AVO incurred premiums of approximately 0.25 per cent of gross annual turnover, it noted that “currently, PI premiums for large private firms of valuers undertaking work with a moderate level of risk attached to it are typically equivalent to 7 to 10 per cent of gross annual turnover.”<sup>15</sup>

The SVO’s all-inclusive liability premium represents around 0.86% of gross revenue. This premium is not disaggregated into components for professional indemnity and public liability, however the SVO has advised that professional indemnity accounts for the majority of the premium. The disparity between commercial valuers and the SVO’s premium may be partly due to the different risk profile of the organisations. However, the difference suggests that some increase to the SVO’s premium may be required on competitive neutrality grounds. Determination of the magnitude of any adjustment is outside the scope of this investigation.

*Finding 5: The SVO should investigate the necessity for and magnitude of a competitive neutrality adjustment to their insurance premiums. The Tribunal has not found the need to make competitive neutrality adjustments for other miscellaneous items that the SVO may have omitted in its tender pricing.*

#### **4.4 Allow for commercial rate of return**

A private sector business requires a commercial rate of return on their investment. To achieve this, prices need to cover, over the medium term, the full cost of service provision, including an appropriate rate of return on the assets employed.

The *Guidelines for Pricing of User Charges* note that:

A government owned business unit should be able to compete on the same basis as a private sector operator. Therefore, a stand alone business unit will be deemed to be pricing in a competitively neutral way if the business unit as a whole is earning a commercial rate of return over the medium term (ie around five years).<sup>16</sup>

In setting a commercial rate of return requirement over the medium term, the guidelines recognise that a government agency may have fluctuating annual returns, as may a private business. Therefore, if an agency does not budget for, or achieve, a commercial rate of return in a particular year, this of itself does not indicate a failure to comply with competitive neutrality.

One way to assess the SVO’s rate of return is to look at its return on assets – that is, its profit (before interest) divided by its assets. However, the Tribunal has not used this approach for two reasons:

- First, the SVO’s financial accounts show that it has a small asset base with a low dollar fixed asset value. Instead of owning fixed assets, it pays for its use of fixed assets through cost allocations from the Department of Commerce and lease arrangements

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<sup>15</sup> Australian Government Competitive Neutrality Complaints Office, *Australian Valuation Office, Investigation No. 11, May 2004*, p 7.

<sup>16</sup> NSW Treasury, *Guidelines for Pricing of User Charges*, June 2001, p 16.



with private sector firms. Its asset base predominantly comprises current assets, mostly relating to “Unbilled Work in Progress”. The variability of this small asset base means that large variations in the measured rate of return are likely, even with a constant profit outcome.

- Second, the SVO has advised that does not have an agreed rate of return target as part of its Statement of Business Intent with NSW Treasury. Instead it has used an anecdotal concept of industry return to generate the capital maintenance allowance in its pricing model. The SVO has advised that it is currently attempting to negotiate a financial model with NSW Treasury to enable target rates of return to be set.

Given these facts, the Tribunal has examined the SVO’s rate of return by considering what a reasonable profit margin in excess of costs incurred would be.

The multiplicative factor in SVO’s pricing model includes a rate of return in the form of an allowance for ‘capital maintenance’. This allowance reflects the need to cover future capital expenditure and provide a return on assets. When taking market considerations into account, the SVO allowed profit margins that are comparable with industry benchmarks in determining the prices it included in its tenders.

The Tribunal has considered the SVO’s medium term profit relative to total revenue by examining the SVO’s revenue and expenditure statements for the four financial years to 2002/03. Despite budgeting for losses of \$561,000 in 2001/02 and \$355,000 in 2002/03, it achieved positive outcomes over each of the last four years. The SVO’s operating profit over the medium term averaged 4.2 per cent of total revenue (Table 1). This is comparable with that of the SVO’s commonwealth equivalent, the AVO, which achieved a profit of 4.5 per cent of total revenue over the same period (Table 2).<sup>17</sup>

**Table 1 State Valuation Office financial outcomes**

	<b>1999/00</b>	<b>2000/01</b>	<b>2001/02</b>	<b>2002/03</b>	<b>Average</b>
Total operating revenue	14,391	12,475	12,270	11,731	12,717
Operating profit/(loss)	979	517	446	265	552
Operating profit as a percentage of revenue	6.8%	4.1%	3.6%	2.3%	4.2%
Return on total assets	7.8%	8.1%	59.4%	18.8%	23.5%
Return on net assets	12.2%	351.7%	71.0%	29.3%	116.1%

Source: SVO Financial Statements (2000, 2001, 2002, 2003).

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<sup>17</sup> In contrast to the SVO, the AVO’s asset base includes fixed assets such as land and buildings and property, plant and equipment. Because of the disparity in asset bases, the Tribunal has not compared the return on assets between the two businesses in assessing the SVO’s financial performance.

**Table 2 Australian Valuation Office financial outcomes**

	1999/00	2000/01	2001/02	2002/03	Average
Total operating revenue (\$'000)	18,126	17,742	19,120	18,379	18,342
Operating profit/(loss) (\$'000)	1,556	930	1,063	330	970
Operating profit as a percentage of revenue	5.5%	5.2%	5.6%	1.8%	4.5%
Return on total assets	11.0%	8.3%	8.5%	3.3%	7.8%
Return on net assets	25.0%	18.4%	20.0%	8.3%	17.9%

Source: Australian Taxation Office Annual Report (2000, 2001, 2002, 2003).

The Tribunal notes, however, that this analysis of the SVO's rate of return may be affected by the SVO's choice of accounting model. Until 30 June 2003, not all of the SVO's allocations of corporate costs included in the calculation of the charge-out rates for mass valuations tender bids were included as expenses in the SVO's Income and Expenditure Statement. The Tribunal understands that the SVO converted to a full cost allocation model commencing 1 July 2003, but back adjustments for prior years have not been calculated. If the size of such adjustments were significant, they would offset the reported profits.

*Finding 6: The SVO's reported returns for the four years to 30 June 2003 compare favourably with available industry benchmarks. However, these reported returns overstate the SVO's financial outcomes because of the exclusion up until 30 June 2003 of some corporate overheads.*

## 4.5 Determine competitively neutral price

Based on the available information, the Tribunal believes the methodology the SVO used to determine the prices included in the tenders that are the subject of the complaints is consistent with the NSW principles of competitively neutral pricing, with the following qualifications:

- In determining the costs of providing the services, the SVO miscalculated its resource requirements in two of the tenders subject to complaint. This led to it making a substantial loss in one case and would have led to a loss in the other if the SVO had been awarded the contract.
- The SVO did not explicitly nominate the competitive advantages it receives from Government ownership and adjust its costs accordingly. However, the overhead and margin allowances it did include appear to account for most material items, with the exception of its insurance premiums which require further investigation.
- The profit figures reported in the SVO's Income and Expenditure Statement up to 30 June 2003 are overstated because not all corporate overheads were included. However, in pricing its individual tenders the relevant corporate overheads were included.

In relation to the first point above, the Tribunal notes the SVO's admission (and associated explanations) that it incorrectly assessed the resource requirements in these cases. However, the Tribunal makes no finding on the intent of the SVO in underestimating resources.

*Finding 7: The Tribunal finds that the methodology the SVO used in calculating its tender prices complies with the principles of competitively neutral pricing. However, in two of its tenders (City of Whitehorse and Sydney City) it used an incorrect assessment of resource requirements in applying this methodology.*

## **5 OVERALL FINDINGS AND RECOMMENDATIONS**

The tenders that are the subject of complaint have been constructed to include appropriate adjustments for tax and other material costs not borne by the SVO purely as a result of its government ownership status. The individual tenders include a profit margin that appears appropriate, based on the estimated scope of the work.

The Tribunal has received no evidence to suggest that the application of the pricing methodology to tender bids for Canterbury/Bankstown, North Harbour, Upper North Sydney and Warringah is not consistent with competitive neutrality principles. However, for the City of Whitehorse and Sydney City tenders, the SVO underestimated resource requirements. Because of insufficient information, the Tribunal makes no finding on whether this underestimation was done in breach of the competitive neutrality principles.

In the area of insurance premiums, the Tribunal recognises that the insurance premium paid by the SVO appears lower than that of private sector valuers. As such, it recommends that the SVO should investigate the necessity for and magnitude of competitive neutrality adjustments to their insurance premiums.

The SVO has reported for the four years up to 30 June 2003 an overall profit margin that compares favourably with industry benchmarks. However, the reported overall SVO profit margin has been distorted by the exclusion of some corporate overheads. The SVO may have reported significantly reduced margins if, based on available information, adjustments were made for these exclusions.

As the SVO is a business unit within the Department of Commerce, the Tribunal found it difficult to isolate and assess compliance with the individual requirements of competitive neutrality. To assist with future reviews of compliance, the Tribunal recommends that the SVO improves its documentation and explanation, particularly in relation to:

- scoping of the work required to fulfil a contract it tenders for, and how this relates to the tender as submitted
- the risk assessment process adopted in putting together bids and calculating contingency allowances
- choice of cost drivers adopted in allocating overheads
- derivation of the capital maintenance figure (which includes an allowance for rate of return)
- derivation of the staff utilisation rate
- how the various matters subject to review under the competitive neutrality guidelines (eg taxes applicable to private sector firms) are accounted for
- adopting common classifications of cost items for the purpose of constructing its tender bids and in its published income and expenditure statement.

The SVO and Matheson have advised that since the complaints were lodged the SVO has withdrawn from the City of Whitehorse contract because of significant cost overruns. The SVO, in line with the Department of Commerce strategy, is now focusing on its core business of serving clients within NSW.

The SVO have also advised that the Sydney City contract was extended for one year to the incumbent contractor, Quotable, following the lodgement of Quotable's competitive neutrality complaint. The Sydney City valuation contract was subsequently returned to tender. The SVO's resubmitted tender was higher to correct for previously overestimated efficiency gains, and was unsuccessful against lower private sector bids.

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