Energy: 2017–18 results of financial audits

Report 9: 2018–19

Queensland Audit Office

Better public services

Queensland Audit Office
Better public services

Your ref:
Our ref: 11941
Damon Olive—3149 6064

22 November 2018

The Honourable C Pitt MP
Speaker of the Legislative Assembly
Parliament House
BRISBANE QLD 4000

Dear Speaker

Report to parliament

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009*, and is titled *Energy: 2017–18 results of financial audits* (Report 9: 2018–19).

In accordance with s.67 of the Act, would you please arrange for the report to be tabled in the Legislative Assembly.

Yours sincerely

Brendan Worrall
Auditor-General

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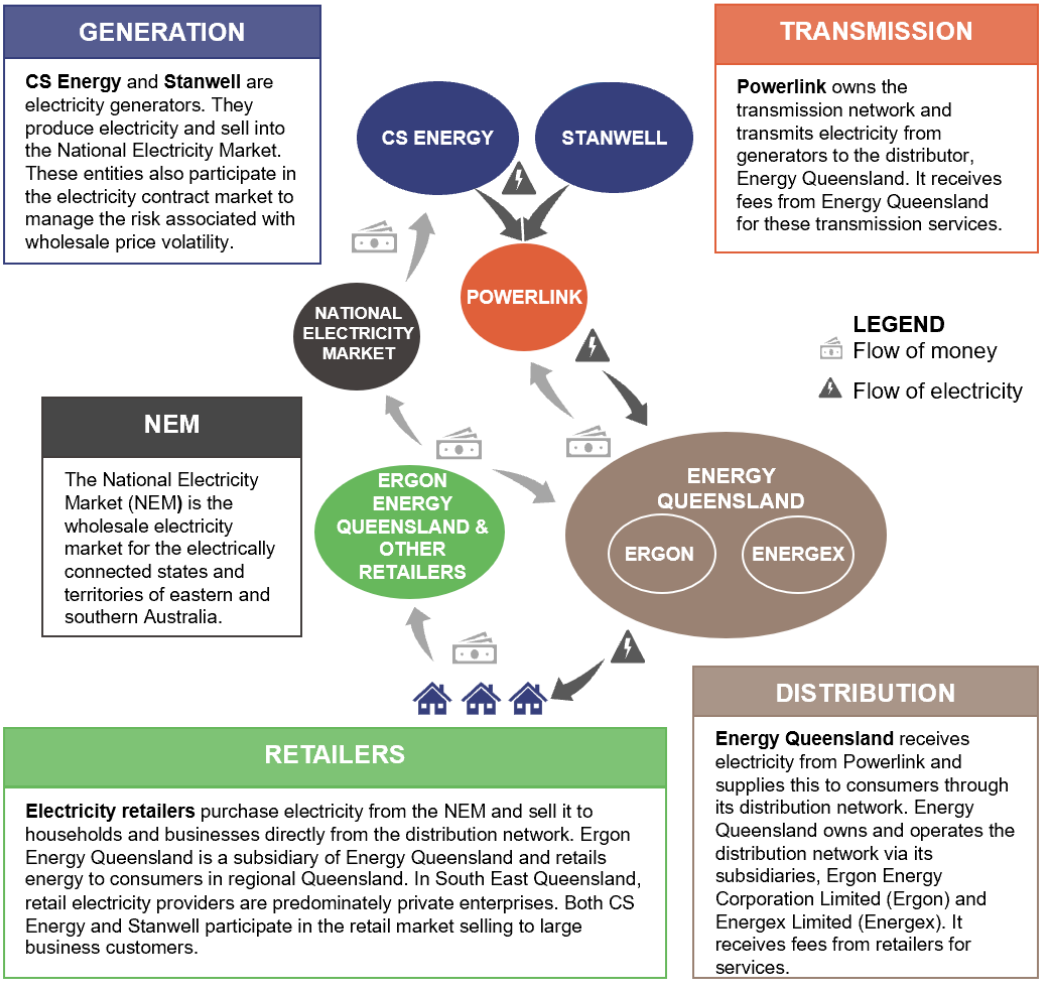
Summary

This report summarises our financial audit results of the Queensland Government's energy entities. The sector comprises the following government-owned corporations and their controlled entities:

- CS Energy Limited (CS Energy)
- Stanwell Corporation Limited (Stanwell)
- Queensland Electricity Transmission Corporation Limited (Powerlink)
- Energy Queensland Limited (Energy Queensland)
- Ergon Energy Queensland Pty Ltd (Ergon Energy Queensland).

The following diagram depicts the entities' roles in the Queensland energy sector supply chain.

Figure A
Queensland energy sector



Results of our audits

We issued unmodified audit opinions for all energy sector financial statements. In doing so, we confirm that readers can rely upon the audited financial statements of the energy entities. Most entities have implemented year-end close processes that have allowed them to produce quality financial statements in a generally timely manner.

We express an ***unmodified opinion*** when the financial statements are prepared in accordance with the relevant legislative requirements and Australian accounting standards.

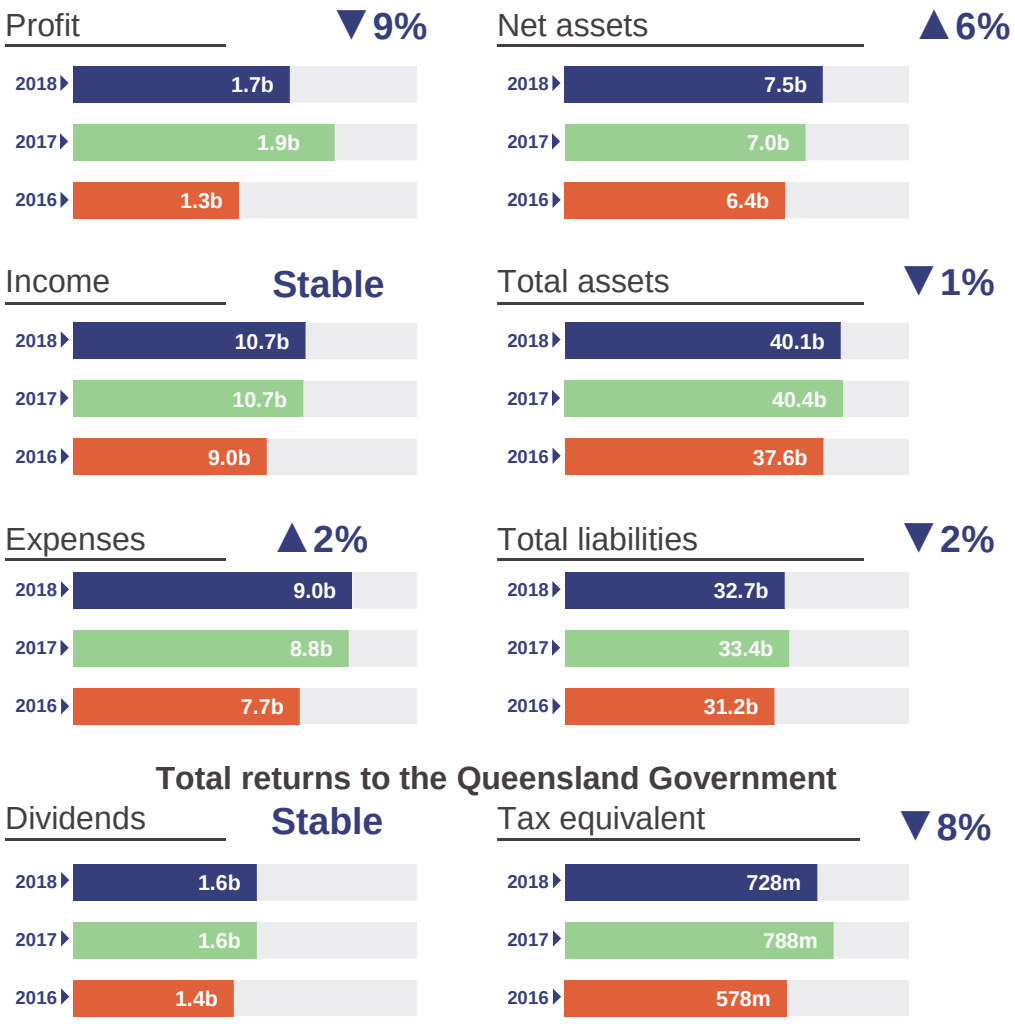
We also provided assurance over the Regulatory Information Notices that Energex and Ergon provided to the Australian Energy Regulator (AER). The AER determines the maximum income these entities can earn. To enable the AER to make these determinations, they issue notices to collect information from the entities. These notices are subject to an audit or a review, depending on whether they are based on actual data or estimated data. We issued to Energex and Ergon six unmodified audit opinions on actual information and five conclusions about estimated data for the regulatory information notices they submitted to the AER.

All audits were completed within legislative and AER deadlines.

In addition to the government-owned corporations, the sector also includes 30 government-owned corporation subsidiaries. Ergon Energy Queensland is the only government-owned corporation subsidiary that prepares separate financial statements. The remainder either have an exemption from the Australian Securities and Investment Commission or are not required to prepare financial statements under the *Corporations Act 2001* (as they are dormant or small companies).

Financial performance, position and sustainability

Figure B
Whole of Queensland energy sector financial snapshot



Source: Queensland Audit Office.

Understanding financial performance

In 2017–18, overall profit for the energy sector decreased by $169.6 million (nine per cent) from 2016–17. The largest contributors to the decline in profits were transmission (Powerlink) and distribution (Energy Queensland)—a reduction of $255.8 million (21 per cent). The Australian Energy Regulator (AER) reduced the maximum income these entities can earn which brought their combined income down by $492.9 million (seven per cent) from 2016–17. Their expenses also decreased by $237.1 million (four per cent) compared to the previous year, due to reduced borrowing costs and income tax expense.

In contrast, the combined profits of generators have increased by $86.2 million (14 per cent), compared to the previous year. Income grew by $504.5 million, faster than expenses. This was due to several factors:

- Income from electricity retail sales increased by $229.1 million (24 per cent). Stanwell expanded its contracts with large commercial and industrial customers to provide electricity and CS Energy formed a joint venture with Alinta Energy to supply electricity to residential and small business customers.
- Stanwell's share of income from coal export sales grew by $134.1 million (150 per cent) this year.
- Wholesale electricity sales increased by $101.4 million (four per cent) due to higher realised prices in 2017–18. Generators manage price volatility by entering into fixed-price electricity contracts. When the fixed price is higher than the wholesale price, this usually translates into a higher realised price.

Expenses incurred by generators increased by $418.3 million, with the primary drivers being:

- Fuel costs rising $139 million from the previous year due to more electricity generation. The government's direction to return Swanbank E gas-fired power station to service to put downward pressure on wholesale prices was also a factor, as it uses gas which is more expensive.
- Impairment expense increased by $297.5 million. In 2017–18, Stanwell recorded an impairment expense of $67.1 million for the Swanbank E power station. But the large increase from 2016–17 was the result of a negative impairment expense of $242.4 million recorded in that year by CS Energy. The negative amount was a reversal of previous impairment expense.

Returns to the state government consist of dividends and tax equivalent payments. Government-owned corporations (GOCs) are required to pay dividends and, based on profits, to make income tax equivalent payments to the state government. Total returns to the state government amount to $2.3 billion in 2017–18, a slight decrease of $40.1 million (two per cent) from the previous year. This was primarily due to the reduced profits from the sector.

In 2017–18 the Queensland Government returned $1.1 billion to consumers:

- $493.0 million in Community Service Obligation (CSO) paid through Energy Queensland to cover the cost of providing electricity to regional Queenslanders
- $292.0 million in solar bonus scheme payments facilitated through Energy Queensland
- $134.2 million in payments under the Affordable Energy Scheme
- $194.4 million in electricity rebates and concessions for eligible customers.

This was an increase of over $340 million from the returns in the previous year.

Understanding financial position

Net assets increased by $421.5 million (six per cent) from the previous year. Although total assets decreased by $289.7 million (one per cent), there was a larger decrease in total liabilities of $711.2 million (two per cent).

The decrease in total assets in 2017–18 was due to two key factors:

- Receivables declined by $107.8 million, primarily due to the decrease in Energy Queensland's community service obligation receivable.
- Other assets decreased by $452.4 million, predominantly due to the downward revaluation of financial instruments.

These were offset by increases in property, plant, and equipment (PPE) of $307.5 million (one per cent), resulting from capital additions and fair value re-measurements of transmission and distribution assets.

The decrease in total liabilities in 2017–18 was due to three key factors:

- CS Energy made loan repayments to Queensland Treasury Corporation amounting to $242.3 million.
- Energy Queensland made $292 million in Solar Bonus Scheme payments to customers.
- Financial instrument liabilities held by Stanwell and CS Energy declined in value.

Understanding sustainability

The energy sector is faced with challenges relating to affordability, reliability, and sustainability. There is also uncertainty around a national energy policy that integrates improved system reliability, affordability and reduced emissions as part of increasing investment in renewable energy.

In Queensland, the state government released the *Powering Queensland Plan* that sets out measures, at a cost of $1.16 billion, to ensure affordable, secure, and sustainable energy supply for Queensland.

In 2016–17, the National Electricity Market (NEM) experienced high volatility and record high wholesale prices. As part of the *Powering Queensland Plan*, the Queensland Government directed Stanwell to undertake bidding strategies to place downward pressure on wholesale electricity prices and to return Swanbank E gas-fired power station to service during peak periods. Wholesale electricity prices in the NEM were less volatile in 2017–18, compared to the previous year.

The *Powering Queensland Plan* also reaffirms the state's commitment to a 50 per cent renewable energy target by 2030. Actions undertaken during 2017–18 to achieve this target include:

- announcing the plan to create CleanCo, a third government-owned generator aimed at increasing market competition. CleanCo is expected to deliver 1 000 MW of renewable energy capacity by 2025
- launching the Solar 150 program, a large-scale solar investment program supporting up to 150 MW of solar power generation in Queensland
- commencing the process for a reverse auction for up to 400 MW of renewable energy capacity where private entities submit bids for renewable energy projects that the state government will provide support for.

Returns to the state government from the generators totalled $927.3 million in 2017–18, a 44 per cent increase from the previous year. Returns from generation have been increasing since 2015–16. However, transitioning to renewable energy sources may impact the demand for electricity that is generated by coal-fired power plants, including CS Energy and Stanwell. Consequently, this may affect their income growth potential and the amount of returns to the state government.

Income from transmission and distribution is declining. The AER regulates this income by setting a ceiling on the revenue that these entities can collect. The current AER determinations for Energex and Ergon cover the period 2015 to 2020. In 2015, the Queensland Government directed Energex and Ergon Energy to not challenge AER's decision on network income, thereby locking in lower network tariffs between 2015 and 2020. The current AER determination for Powerlink covers the period 2017 to 2022 and allows for an average annual income that is $240.4 million (25 per cent) lower than the previous determination. Returns to the state government from transmission and distribution dropped by $322.0 million (18 per cent) from the previous year.

Internal controls

We did not identify any significant deficiencies in internal controls.

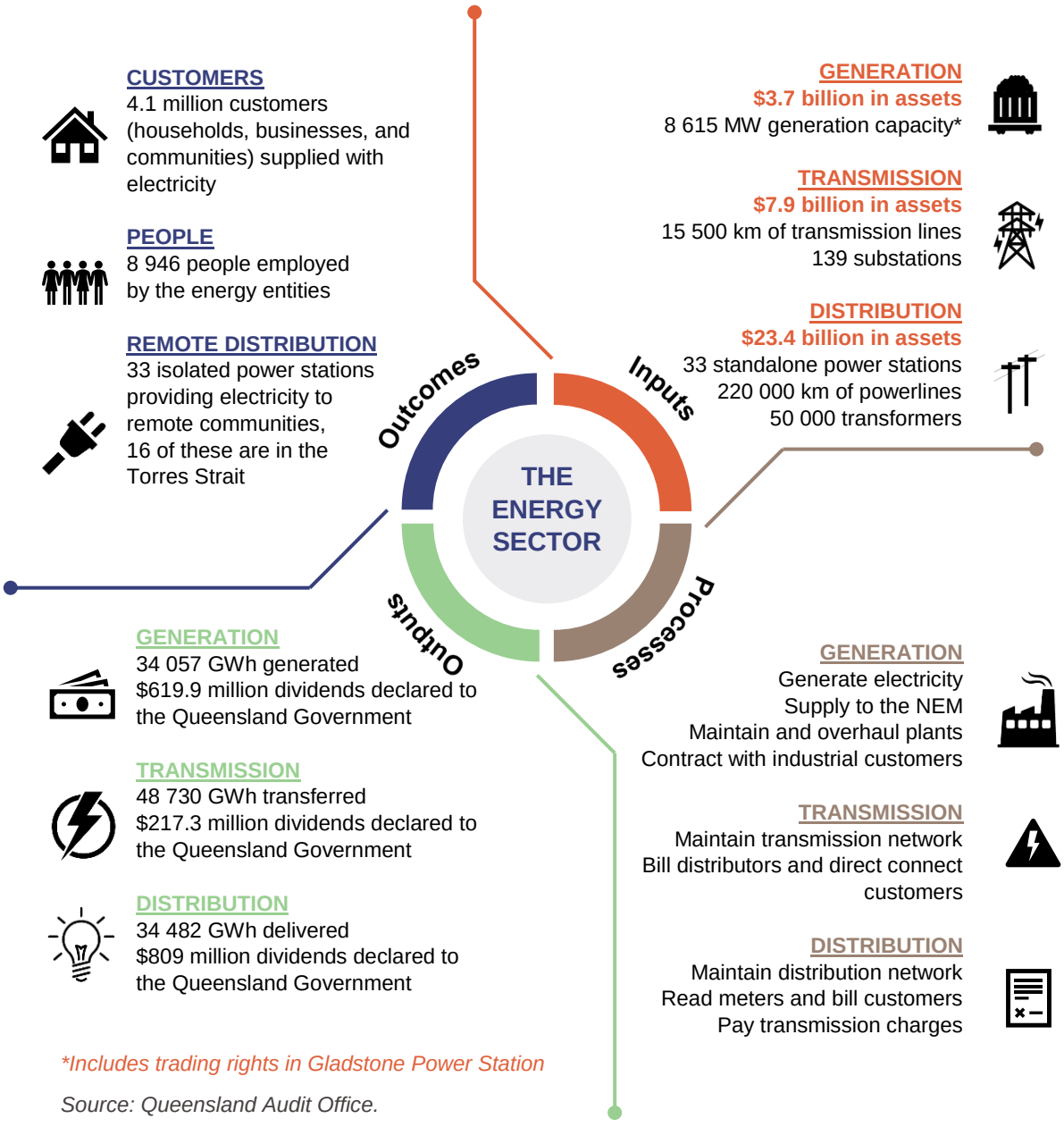
We assessed the control environments of all energy entities as effective, and we could rely on the internal control systems used to produce financial statements.

1. Sector overview

This chapter provides a sector overview to help readers understand the audit findings and conclusions.

In Queensland, most electricity is generated, transmitted, and distributed by state government-owned corporations (GOCs). Electricity retailing outside of South East Queensland is also mostly state owned. Figure 1A provides an overview of the electricity supply chain, including the inputs, processes, outputs, and outcomes for the sector.

Figure 1A
Queensland energy supply chain in 2017–18



**Includes trading rights in Gladstone Power Station*

Source: Queensland Audit Office.

2. Results of our audits

This chapter delivers the audit opinion results and evaluates the timeliness and quality of reporting.

Conclusion

All energy entities have generally effective year-end close processes. This allows them to produce quality financial statements in a timely manner. We issued unmodified audit opinions for the financial statements of each of the entities. Readers can rely on the results in the financial statements. All audits were completed within legislative deadlines.

The AER uses Regulatory Information Notices (RINs) to collect information from the transmission and distribution entities to make decisions about the maximum income these entities can earn for a specified period. These notices are subject to an audit (if the information is based on actual data) or a review (if the information is based on estimated data). We issued to Energex and Ergon, six unmodified audit opinions and five review conclusions regarding the information they provided to the AER. All opinions and conclusions were issued within AER deadlines.

Audit opinion results

Figure 2A details the audit opinions we issued for the 2017–18 financial year.

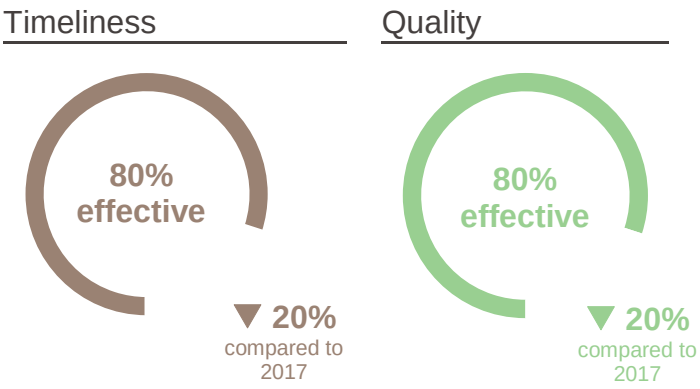
Figure 2A
Audit opinions issued for the 2017–18 financial year

Element of energy supply chain	Entity	Date audit opinion issued	Type of audit opinion issued
Generation	CS Energy Limited	31.08.18	Unmodified
	Stanwell Corporation Limited	28.08.18	Unmodified
Transmission	Powerlink	24.08.18	Unmodified
Distribution	Energy Queensland Limited	23.08.18	Unmodified
Retail	Ergon Energy Queensland Pty Ltd	21.08.18	Unmodified

Source: Queensland Audit Office.

Financial statement preparation

Figure 2B
Effectiveness of financial statement preparation processes



Source: Queensland Audit Office.

The timeliness and quality of financial statements in 2017–18 across the sector is lower than the previous year. During the year, CS Energy and Stanwell had complex accounting issues that were not resolved prior to year-end. This resulted in their respective ratings for timeliness and quality being lower this year.

Our assessment criteria and results are outlined in Appendix C.

Key audit matters

The Australian Auditing and Assurance Standards Board has adopted the international standard *ISA 701 Communicating Key Audit Matters in the Independent Auditor's Report* for audits of listed entities. We have voluntarily adopted this standard for the energy sector.

Key audit matters include areas that, in our professional judgement, pose a higher risk of material misstatement. A misstatement is material if it has the potential to influence the decisions made by users of the financial statements. These matters often relate to property, plant, and equipment. Of the six key audit matters we reported, property, plant and equipment accounted for three. In our independent auditor's reports, we have reported on why the key audit matters were significant and the procedures we performed to address the matters.

The full list of key audit matters reported is detailed in Appendix D.

Entities not preparing financial statements

Not all Queensland public sector energy entities produce financial statements.

When entities are part of a group and are secured by a deed of cross guarantee (with other entities in that group agreeing to cover debts), they are not required to prepare financial statements. In addition, small companies that meet specific criteria under the *Corporations Act 2001* do not have to prepare financial statements.

The list of entities not preparing financial statements is detailed in Appendix E.

Regulated information notices

Every five years, the AER issues a determination that sets a ceiling on the revenue that distribution and transmission entities can earn. In setting the revenue ceiling the AER allows for, what it considers to be the efficient costs to maintain and operate the network, (including operating and maintenance expenses, capital expenditure, asset depreciation, and a tax allowance) and a commercial return on capital. The current AER approved determination for distribution entities covers the 2015–20 period. A regulatory proposal for the 2020–25 period is due to be submitted by the distribution entities to the AER by 31 January 2019.

To monitor outcomes against current determinations, and to prepare for future determinations, the AER uses Regulatory Information Notices (RINs). These notices collect financial and non-financial information from the distribution and transmission entities each year. For each notice, a set of templates is completed by the entity with an explanatory document about how these templates have been prepared. This is called the basis of preparation. These notices are subject to an audit (if the information is based on actual data) or a review (if the information is based on estimated data).

Results of audits and reviews of regulated information notices

Figure 2C details the results of the regulatory audits and reviews undertaken in 2017–18 for Energex and Ergon. The review of the regulatory proposals for the 2020–25 period is scheduled for completion in January 2019.

Figure 2C
Results of Energex and Ergon regulatory audits and reviews for 2017–18

Entity	Engagement	Type of information	Certification date	Type of report issued
Ergon	Annual performance	Financial	31.10.18	Audit (actual data)
	Economic benchmarking	Financial	31.10.18 31.10.18	Audit (actual data) Review (estimated data)
	Category analysis	Financial	31.10.18 31.10.18	Audit (actual data) Review (estimated data)
		Non-financial	31.10.18	Review (actual and estimated data)
Energex	Annual performance	Financial	31.10.18	Audit (actual data)
	Economic benchmarking	Financial	31.10.18 31.10.18	Audit (actual data) Review (estimated data)
	Category analysis	Financial	31.10.18	Audit (actual data)
		Non-financial	31.10.18	Review (actual and estimated data)

Source: Queensland Audit Office.

In all opinions and conclusions, we highlighted that the Regulatory Information Notices were prepared according to AER requirements and were not intended for other users.

Quality of regulated templates

AER regulated notices require the submitted information to be based on actual data. In some instances, Energex and Ergon did not report actual information due to system limitations and due to the additional costs in providing actual information. In these instances, the AER indicated that estimated information should be reported and the reasons why actual information was not provided should be included in the basis of preparation.

3. Financial position, performance, and sustainability

This chapter analyses the financial position, performance, and sustainability of energy entities.

The information in an entity's financial statements describes its main transactions and economic events for the year. Over time, financial statements also help users to understand the sustainability of the entity and its industry.

Our analysis helps users understand and use the financial statements by clarifying the financial effects of significant transactions and events in 2017–18. We also analyse relevant financial ratios to highlight organisational performance issues.

Additionally, our analysis alerts users to future challenges, including existing and emerging risks the entities face.

Conclusion

Profits for the energy sector declined by $169.6 million (nine per cent) this year, due in part to the Australian Energy Regulator (AER) reducing the allowable income that the Queensland transmission and distribution businesses could earn.

However, profits from generation grew by $86.2 million (14 per cent) compared to 2016–17. The generators achieved higher realised prices from sales of electricity. The generators also expanded their retail businesses during the year. Stanwell Corporation Limited (Stanwell) secured more long-term contracts with large business customers. CS Energy Limited (CS Energy) entered into a joint venture with Alinta Energy to break into the residential retail market.

The Queensland Competition Authority (QCA) sets the retail electricity tariff rates that Ergon Energy Queensland Pty Ltd charges residential customers. In 2017–18, QCA increased the retail tariff rates which contributed to the increase in profits from retail of $143.1 million. However, the profitability of Ergon Energy Queensland remains reliant on the state government continuing to subsidise the cost of distribution charged to consumers in regional Queensland.

Expenses for the sector have increased by $181.2 million (two per cent) from the previous year. The main contributor was the increase in fuel costs incurred in increased electricity generation.

The total return of the energy sector to the Queensland Government through dividends and taxation for 2017–18 is $2.3 billion, which has decreased by $40.1 million (two per cent) from 2017 ($2.4 billion). This was brought about by the decline in overall profitability of the energy sector.

Total assets and liabilities remained relatively constant in 2017–18, decreasing only by $289.7 million (one per cent) for assets and $711.2 million (two per cent) for liabilities, which resulted in a $421.5 million (six per cent) increase in net assets.

In 2017, the Queensland Government announced the *Powering Queensland Plan,* which set out strategies to address the challenges of affordability, security, and sustainability of energy supply. During the 2017–18 financial year, a number of measures from the plan were enacted to reduce volatility of National Electricity Market (NEM) wholesale electricity prices in Queensland, and to help achieve the state's renewable energy target. These include:

- directing Stanwell to return the Swanbank E gas-fired power station to service to assist in meeting peak demand
- directing Stanwell to change its bidding strategies to put downward pressure on wholesale electricity prices
- announcing its plan to create a third state-owned electricity generator, CleanCo
- supporting a large-scale solar investment program expecting to deliver up to 150 MW of solar power
- progressing with the reverse auction process for up to 400 MW of renewable energy capacity where private entities are invited to bid for renewable energy projects that will be supported by the state government.

Understanding financial performance

In examining the financial performance of the energy sector, we have considered profit and returns to shareholders during the year.

Figure 3A
Energy sector operating profits

	2018	2017	2016	2017–18 movement	
Generation	$722 million	$636[1] million	$147 million	▲	Increased due to higher realised prices
Transmission	$167 million	$351 million	$218 million	▼	Decreased due to AER caps on network use of system income
Distribution	$546 million	$761 million	$808 million	▼	Decreased due to AER caps on network use of system income
Retail	$263 million	$120 million	$134 million	▲	Increased due to tariff price increases as per QCA determination

[1] 2017 figures have been restated in the 2018 financial year.

Source: Queensland Audit Office.

Generation profits have increased by $86.2 million (14 per cent). This was predominantly due to higher realised prices, coupled with growth in retail income and increases in coal rebates. The growth in income is slightly offset by an increase in fuel expenses, electricity and energy services expenses, and asset impairment losses.

Transmission profits have decreased by $183.8 million (52 per cent) and distribution profits have decreased by $215.1 million (28 per cent), primarily due to lower allowed income as determined by the AER.

Retail profits have increased by $143.1 million (119 per cent), with higher retail tariffs determined by the QCA and decreased transmission network charges. This profit includes the community service obligation of $493 million received from the government.

Figure 3B
Energy sector total returns to government

	Generation	Transmission	Distribution	Retail[1]
2018	$927 million	$293 million	$865 million	$289 million
2017	$645 million	$511 million	$1 045 million	$213 million
2016	$404 million	$313 million	$1 180 million	$163 million

[1] Dividends declared by Ergon Energy Queensland (Retail) are paid internally to the parent entity within the Energy Queensland group.

Source: Queensland Audit Office.

The energy sector's total returns to the Queensland Government comprise of dividends and tax equivalent payments. In 2017–18, these returns decreased by $40.1 million (two per cent), to $2.3 billion.

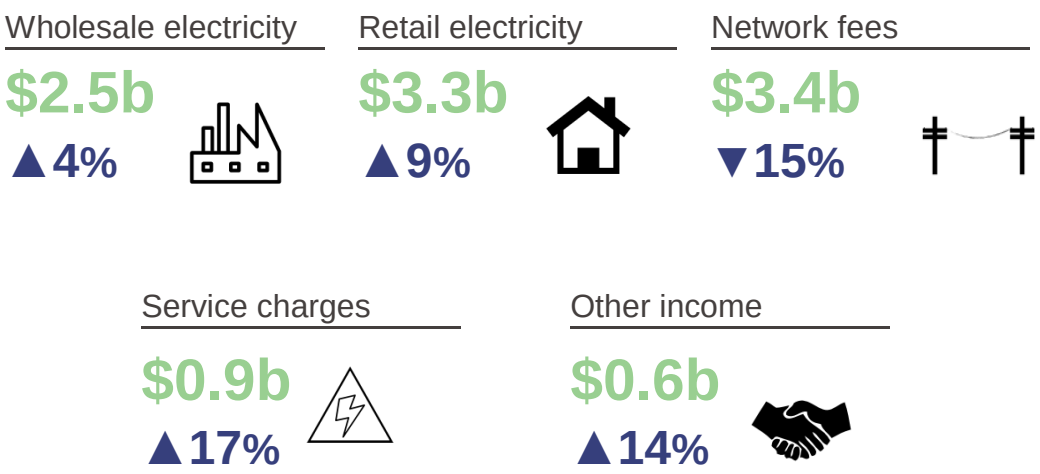
Dividends of $1.6 billion were declared by the energy entities, which is consistent with the amount declared in 2016–17. The combined dividends declared by CS Energy and Stanwell increased by $236.4 million (62 per cent). However, dividends from transmission decreased by $143.8 million, with special dividends reducing by $110 million compared with 2016–17. Energy Queensland's dividends dropped by $72 million, due to reduced profitability.

The remaining portion of the total returns to government is $728.1 million in tax equivalent payments. Due to the decrease in net profit across the sector, tax equivalents are $60.7 million (eight per cent) less than 2016–17.

In 2017–18 the Queensland Government returned $1.1 billion to consumers, an increase of over $340.0 million above the amount provided in 2016–17.

Income

Figure 3C
Major income for energy entities 2017–18



Source: Queensland Audit Office.

Total income for the energy sector remained stable at $10.7 billion in 2017–18, an $11.6 million (less than one per cent) increase from previous year.

The primary sources of income in the sector are the wholesale of electricity generated into the National Electricity Market (NEM), the on-sale of NEM-purchased energy to retail customers, the collection of fees for the transmission and distribution of energy across the network, and services charges. Income is also generated from other sources, including coal rebates, gas sales, financial risk management, and capital contributions received from commercial customers to connect to or expand energy networks.

Figure 3D
Income by supply chain element

	Generation	Transmission	Distribution	Retail
2018	$4.6 billion	$1.0 billion	$2.9 billion	$2.2 billion
2017[1]	$4.1 billion	$1.4 billion	$3.1 billion	$2.1 billion
2016	$2.7 billion	$1.2 billion	$3.1 billion	$2.0 billion

[1] 2017 figures have been restated in the 2018 financial year.

Source: Queensland Audit Office.

Events and transactions affecting income this year

Wholesale electricity prices are less volatile

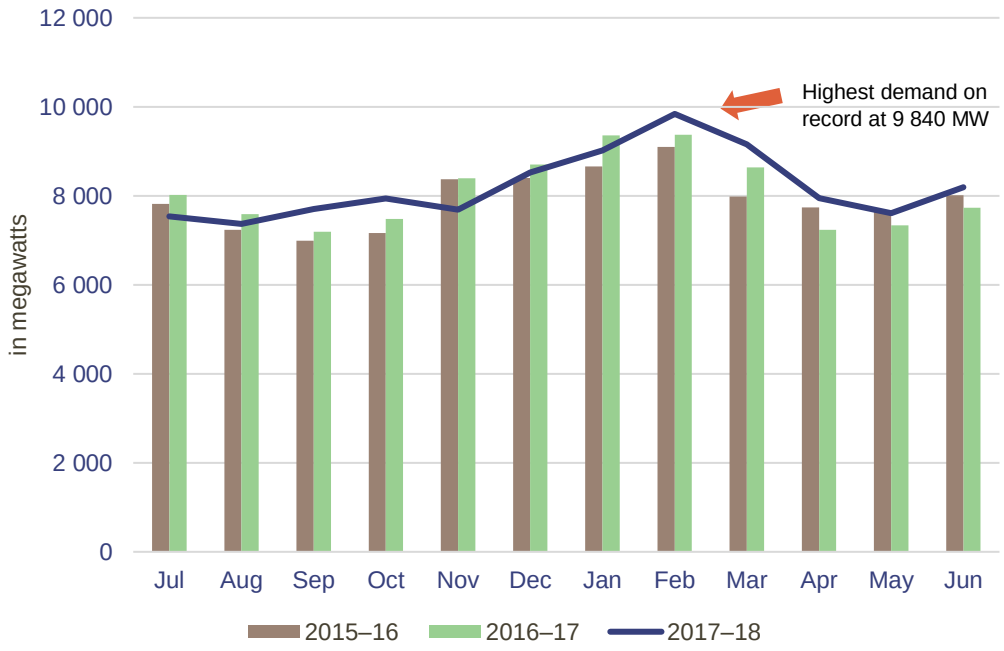
During the 2016–17 financial year, the market saw record high NEM wholesale prices. This year, demand was consistent with the previous year (one per cent decrease) but average NEM wholesale prices in Queensland were less volatile.

In response to the high wholesale energy prices experienced in 2017, the Queensland Government announced the *Powering Queensland Plan,* which included measures to minimise price volatility and apply downward pressure on wholesale electricity prices. Two of these measures impacted Stanwell, requiring a change to their bidding strategies and the return of Swanbank E power station to service during peak summer periods.

Swanbank E is a 385 MW gas-fired power plant which had not operated since 2014. Stanwell had secured gas supply arrangements for Swanbank E that allowed it to purchase gas at prices lower than market value. Since 2014, Stanwell on-sold this gas to third parties instead of using it to generate electricity at the power plant. Swanbank E's return to service resulted in increased gas consumption of $68.8 million (100 per cent) and a decline in gas sales of $18.0 million (19 per cent).

Figure 3E shows the peak electricity demand for each month for the last three financial years. The summer of 2017–18 was the second warmest on record in Australia, and a new peak electricity demand record was set, reaching 9 840 MW in February 2018. The previous record was in February 2017, at 9 369 MW. Swanbank E's return to service in 2018 added more generation capacity and electricity supply to the market, to meet the demand during these peak periods.

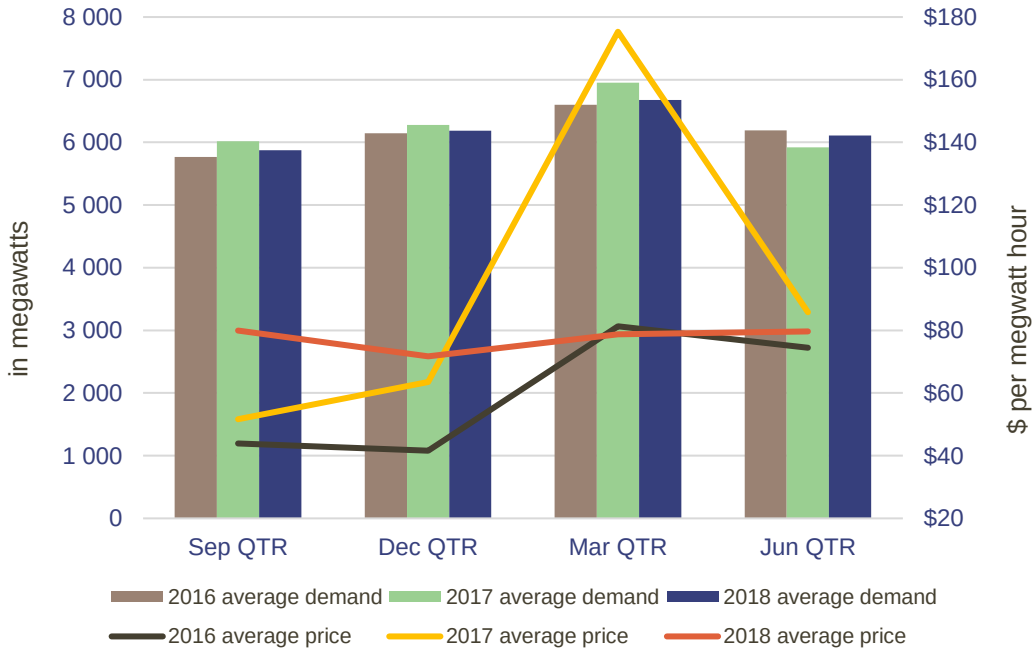
Figure 3E
Peak electricity demand in Queensland per month



Source: Queensland Audit Office.

Figure 3F shows the movement in quarterly Queensland wholesale prices against average demand for the past three years. Even though the highest peak demand on record was experienced in February 2018, average demand throughout the year was slightly lower than 2017. The changes in bidding strategies for Stanwell and the return of Swanbank E to service contributed to less volatility in wholesale electricity prices in 2018 compared to the previous year. The average wholesale price in Queensland in 2018 was $72 per MWh which was lower than 2017, but was above the 2014 to 2016 average price which ranged between $50 to $60 per MWh. The 2018 wholesale price in Queensland was also lower than the average wholesale prices in other states which ranged between $82 to $93 per MWh.

Figure 3F
Average demand and wholesale prices in Queensland



Source: Queensland Audit Office.

In 2017–18, income from wholesale electricity sales saw an increase of $101.4 million (four per cent) from the previous year. Average realised prices per megawatt hour increased from $65.89 in 2016–17 to $73.39 in 2017–18. Generators are exposed to price movements in the electricity market. To manage this risk, they enter into electricity sales and derivative contracts that allow them to receive a fixed price. When the fixed price is higher than the wholesale price, this usually translates into a higher realised price for the generator, and higher income.

Growth in the generators' retail portfolio

In 2017–18, generators' electricity retail sales increased by 24 per cent from the previous year, to $1.2 billion.

CS Energy's retail income increased by $38.1 million in 2017–18. During the year, CS Energy entered into a 50-50 joint venture arrangement with Alinta Energy to supply electricity to residential and small business customers within South East Queensland. Under the arrangement, CS Energy provides the wholesale electricity and Alinta Energy performs the retail function.

Stanwell's retail income increased by 22 per cent to $1.1 billion in 2017–18. It secured new long-term energy contracts with commercial and industrial customers.

Electricity retail sales have increased on average by 53 per cent throughout the past five years, as generators have expanded their customer base. This is part of their risk management and diversification of operations to enhance sustainability.

Additional income from the sale of coal

Stanwell has a standing coal supply agreement from the Curragh mine for its Stanwell power station. The agreement also entitles Stanwell to a rebate from export sales of coal. During 2017–18, income from this agreement increased by $134.1 million (150 per cent), contributing $223.7 million. This growth was brought about by higher prices and volume of coal exported.

Transmission and distribution income is regulated by the AER

The AER caps the amount of income that Powerlink and Energy Queensland can earn from regulated services. The AER achieves this by regulating the income that the transmission and distribution businesses can recover from their customers. The most recent AER determinations have focused on efficiencies and, as a result, income allowances for Powerlink and Energy Queensland decreased in 2017–18.

Powerlink's 25 per cent decrease in income for transmitting energy was a result of AER's new determination for allowable income. This translated into a 25 per cent reduction for the 2017–22 regulatory control period (compared with 2016–17).

Energy Queensland's income from distributing energy decreased in 2017–18 by $466 million (18 per cent). This is a result of a decrease in the AER allowable network income of 25 per cent for Ergon and 10 per cent for Energex.

Ergon Energy Queensland's retail income has increased

Due to the high costs associated with supplying energy to customers in regional Queensland, energy prices for these customers are regulated and capped by the QCA. Under the current tariff structure, all retail household customers in Queensland pay the same price for energy, regardless of location. Higher tariff rates set by the QCA have predominantly driven the three per cent increase in retail income in 2017–18.

Cost of government support for energy supply to regional customers has decreased

Providing electricity to regional Queensland costs more than supplying electricity to customers in South East Queensland. This cost is subsidised by the Queensland Government through Community Service Obligation (CSO) payments to Energy Queensland. Energy Queensland forecasts the costs to provide these services to regional Queensland which in 2017–18 was $493 million. This was a $105 million decrease from the previous year.

The CSO subsidy offsets network and energy expenses, reducing the total expense reported by Energy Queensland. Without this funding, Ergon Energy Queensland would have recorded a loss of $229.4 million in 2017–18.

Future challenges and emerging risks

Demand for electricity generated by government-owned coal-fired generators may decrease

The Australian Energy Market Operator (AEMO) forecasts that, over the next 20 years, business demand for energy will remain flat while net residential demand will decline, primarily due to increases in generation from photovoltaic (PV) rooftop solar-power systems and initiatives to increase energy efficiency.

Through the *Powering Queensland Plan,* the Queensland Government has confirmed its commitment to a 50 per cent renewable energy target by 2030. However, there is uncertainty around national energy policy after the federal government abandoned the National Energy Guarantee which would have supported the orderly transition to renewable energy sources.

The required growth in renewable energy may result in lower demand and a lower market share for coal-fired power plants. Decreasing demand for energy generated by coal-fired power plants may impact on the ability of government-owned generators to maintain income growth in future financial years. In response, generators continue to diversify their operations by expanding into the retail market and exploring alternative ways to generate value from their asset base.

Establishment of a new renewable energy focused generator

As part of the *Powering Queensland Plan,* on 30 August 2018 the Queensland Government announced its plans to create a third government-owned corporation (GOC), referred to as CleanCo. CleanCo will be a renewable energy-focused electricity generator and is expected to help decrease electricity prices and provide more reliable energy for Queenslanders.

CleanCo is expected to deliver 1 000MW of renewable energy capacity by 2025 and will support Queensland's renewable energy target of 50 per cent capacity by 2030. Once it is operational, existing renewable and low-emission energy generation assets currently owned by CS Energy and Stanwell will transfer to CleanCo to form part of its foundation portfolio of assets. The Queensland Government will ensure that CS Energy and Stanwell continue to remain commercially viable over the medium-to-long term.

CleanCo is expected to be trading in the NEM by mid–2019, subject to receiving regulatory approvals.

Investment in 150 megawatts of solar power generation

The Queensland Government is investing in renewable energy generation in Queensland. It has committed to support the Solar 150 program, a large-scale project expected to deliver of up to 150 MW of privately-owned solar power. The state government entered into a 20-year agreement with private solar generators to provide support payments in return for any environmental certificates generated by the solar power plants. The Department of Natural Resources Mines and Energy holds the obligation on behalf of the state government for the life of the agreement. As at 30 June 2018, this liability amounts to $121.7 million.

In June 2018, Stanwell executed an agreement with the Queensland Government where it will fulfil the state government’s contractual obligations for the next 12 months.

Sustainability of networks in Queensland

Distribution costs in regional Queensland are high, as a relatively small number of customers are serviced across the largest electricity supply area in Australia. The costs of maintaining a large and ageing network increase the risk that current profitability levels may not be sustainable without adequate capital investment.

Competition from alternative technology may also affect the profitability of network service providers. In response, the network service providers are looking to expand their unregulated business to invest in micro-grids and virtual power plants. During the year, Energy Queensland, through its subsidiary, launched the Yurika Virtual Power Plant.

AASB 15 Revenue from contracts with customers—application to energy sector

The new Australian Accounting Standard (AASB) 15 *Revenue Contracts with Customers* applies to energy entities from 1 July 2018. This standard is more complex and includes more judgements than the previous standards.

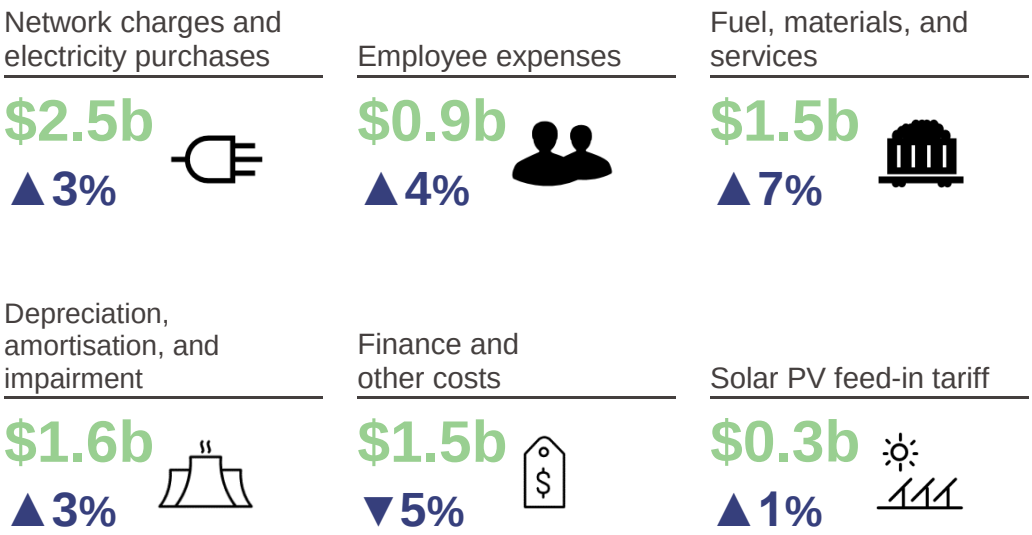
Energy entities have various sources of revenue and income. These mainly include the sale of energy generated into the NEM, the collection of fees for the transmission and distribution of energy, and the on-sale of NEM-purchased energy to retail customers.

The energy entities have assessed the impact of this new standard and concluded that the impact will not be material to their financial statements. We have reviewed their assessment as part of the audit.

Expenses

Expenses remained relatively stable during the year. The energy sector recorded total expenses of $9.0 billion in 2017–18, an increase of two per cent from 2016–17.

Figure 3G
Major expenses for energy entities in 2017–18



Source: Queensland Audit Office.

Events and transactions affecting expenses this year

Network charges and electricity purchases have increased

Across the sector, network charges and electricity purchases increased by $78.5 million (three per cent) in 2017–18. For the generators, these costs were $107.5 million (seven per cent) higher than the previous year, as a result of growth in their retail portfolio.

However, Energy Queensland's transmission network costs and electricity purchases decreased by $29 million (three per cent), primarily due to Powerlink's lower AER determination.

Generation fuel and coal costs have increased

The generators incurred $660.5 million in fuel and coal costs in 2017–18, an increase of $139 million (27 per cent) from the previous year.

CS Energy's costs increased by $72.4 million (51 per cent) from the previous year as it generated more electricity. This was made possible by improved plant availability and better reliability of the power stations. In 2017–18, CS Energy spent $42.8 million in capital additions and overhauls to improve the performance of power stations.

Stanwell's fuel costs grew by $66.6 million (18 per cent), predominantly due to the return to service of the Swanbank E gas-fired power station.

Materials and services have decreased

A total of $817.1 million in materials and services was incurred by the entities during 2017–18, a decrease of $43.6 million (five per cent) from the previous year. The movement was mainly attributable to a reduction in contractor and consultant costs for Energy Queensland.

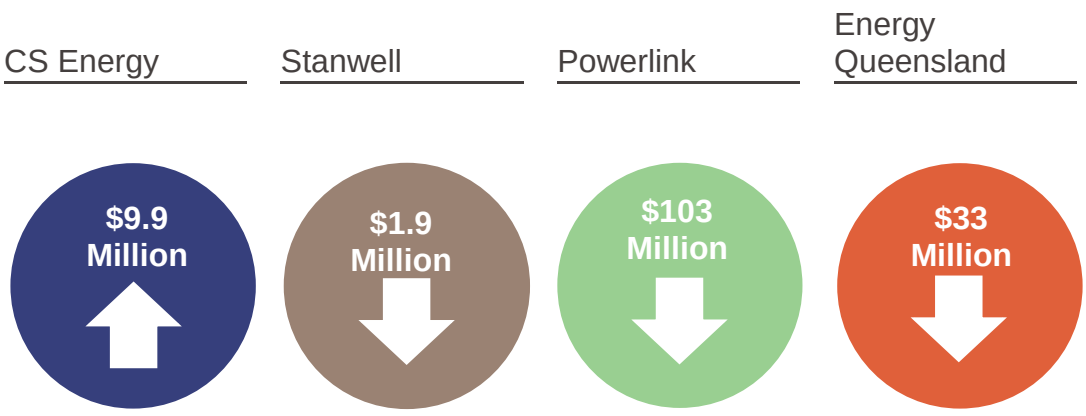
Employee benefits expenses have increased

Employee benefits expenses increased by $32.9 million (four per cent) to $885.1 million in 2017–18. This is predominantly attributable to wage increases as outlined in their enterprise agreements. There was limited movement in the number of full-time equivalent (FTE) employees across the sector. At the end of 2017–18, there were 8 946 energy sector FTE employees, compared to 8 990 in 2016–17 (decrease of 44). Stanwell's and Powerlink's combined FTE increased by 85, while CS Energy and Energy Queensland's combined FTE decreased by 129.

Interest expense has decreased

The energy entities' interest expense decreased by $128.1 million to $1 billion in 2017–18 ($1.1 billion in 2016–17). In 2017–18, two entities re-negotiated their interest rates with Queensland Treasury Corporation (QTC). Under current arrangements with QTC, energy entities are not required to repay their principal borrowings. Except for CS Energy, all energy entities, made interest only repayments during 2017–18.

Figure 3H
Movement in interest expense in 2017–18



Source: Queensland Audit Office.

Onerous contracts

A provision for onerous contracts is recognised when the expected benefits from a contract are lower than the unavoidable cost of meeting the contract obligations. When this occurs, entities must record a provision in their financial statements.

This provision is re-measured each year to assess the expected cost of terminating the contract compared with the expected net cost of continuing with the contract.

CS Energy has reported an onerous contract related to the supply of energy to a private operator. Fluctuations in the value of this provision impact on CS Energy's profit. The impact in 2017–18 was a $35.2 million decrease in expenses ($37.5 million in 2016–17), as the value of the provision decreased.

Future challenges and emerging risks

Solar photovoltaic feed-in tariff

The Solar Bonus Scheme was closed to new customers in July 2012. However, existing customers who maintain their eligibility will continue to receive the bonus feed-in tariff until 1 July 2028, when the scheme is legislated to finish. During 2017–18, Energy Queensland paid customers $292 million in solar PV feed-in tariffs, which included eligible customers under the Solar Bonus Scheme.

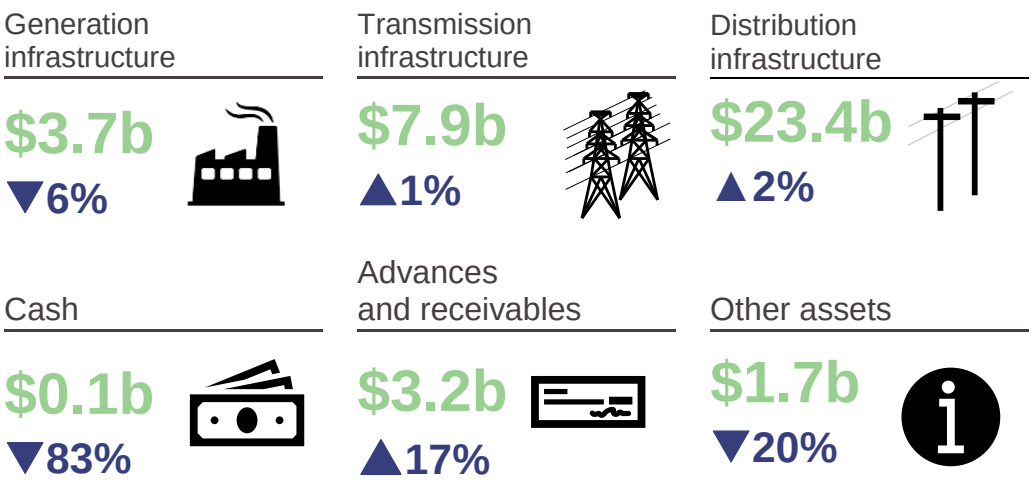
Under the *Powering Queensland Plan,* the Queensland Government removed the cost of the Solar Bonus Scheme from network tariffs by paying Energy Queensland a grant to fund the Solar Bonus Scheme until the end of 2020. The grant payment ensured payments made to eligible customers would not be affected and the cost of the scheme will be met by the Queensland Government instead of electricity customers.

The anticipated cost of the Solar Bonus Scheme over the next two years to 30 June 2020 is $528 million. Energy Queensland has reported this future obligation as a liability.

Understanding financial position

Net assets increased by $421.5 million (six per cent) in 2017–18. This was primarily due to increases in property, plant, and equipment associated with fair value re-measurements, and the reduction in the liability relating to the Solar Bonus Scheme.

Figure 3I
Total assets for all entities by type for 2017–18



Note: Generators report their assets at cost (what they paid for them) while network entities report at fair value (what they would receive for the assets in the market), which limits comparability across the sector.

Source: Queensland Audit Office.

Events and transactions affecting assets this year

Cash-management arrangements decreased cash holdings

In 2016, as part of its *Debt Action Plan*, the Queensland Government announced measures to reduce general government debt. This included cash-management arrangements for GOCs to better use the cash they hold by requiring the GOCs to forecast cash flows for a 12-month period and to advance any surplus cash to Queensland Treasury.

Any advances made will earn market-based interest. If the requirements of the entities change, they are entitled to recall the cash. As such, the level of GOC advances fluctuates over time. This has no impact on total assets as the movement of cash has been recognised in receivables as an advances facility.

The following advance facility amounts were transacted with Queensland Treasury during 2017–18:

- Stanwell transferred $829.2 million
- CS Energy transferred $235.0 million
- Powerlink recalled $33.9 million
- Energy Queensland recalled $443 million.

Taking out the effect of these cash transfers on receivables, this balance has decreased by $107.8 million during the year. This is mostly attributable to the reduction in the community service obligation (CSO) receivable by Energy Queensland from the state government. The CSO payment helps fund the cost of providing electricity to regional Queensland customers.

Decrease in other assets

Across the sector, other assets reduced by $452.4 million (21 per cent) this financial year. This is mainly attributable to the revaluation of financial instruments held by the generators and the retailer. Financial instruments held by the sector are mostly electricity derivative contracts. Generation and retail entities enter into these contracts to manage the risk associated with volatility of electricity prices. Typically, they lock in a fixed price for electricity that will be produced or consumed in the future. Derivative contracts are held at fair value. When the market price for electricity is lower than the fixed price, this results in a higher fair value. When the market price is higher than fixed price, this results in a lower fair value.

Impairment losses were recognised on gas-fired generation assets

Stanwell recognised a $67.1 million impairment loss for its Swanbank E gas-fired power station. Entities record an impairment loss when an asset's carrying amount exceeds the amount that can be recovered through use or sale of the asset. This decreases profit as the loss is recognised as an expense in the income statement.

Prior to 2018, the power station was inactive primarily due to high operating costs. Stanwell had existing gas supply arrangements for Swanbank E, which allowed it to purchase gas at prices lower than market. Swanbank E was not used because it was more economical to on-sell the gas to third parties than to use it to generate electricity. This meant that the cost to operate the power station was higher than income earned from the electricity generated by the power station. The return to service also requires additional capital expenditure to overhaul the power station. These factors resulted in an impairment loss as the cash outflows associated with operating the power plant are higher than the cash inflows from the income stream it produces.

Value of transmission and distribution assets remained stable

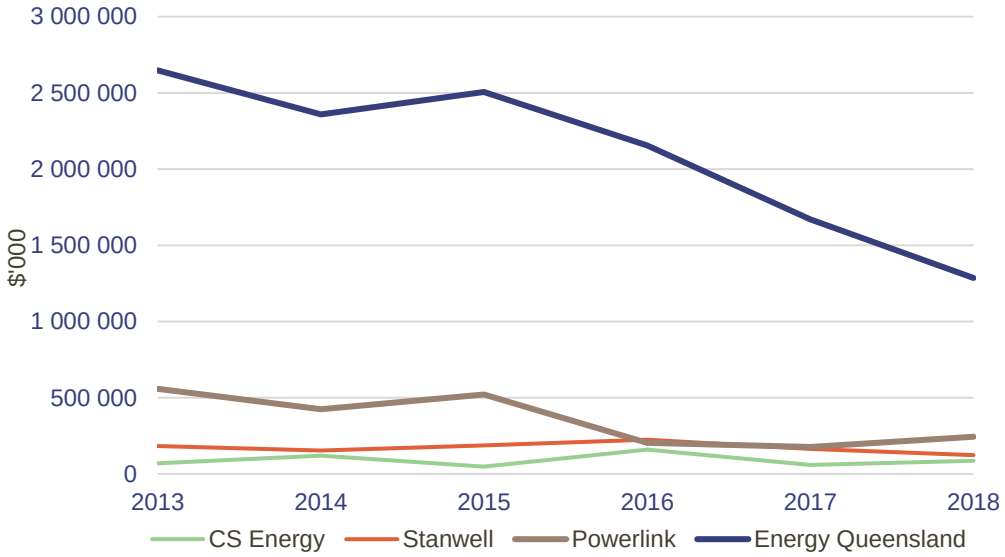
At 30 June 2018, Powerlink and Energy Queensland held combined transmission and distribution assets of $31.3 billion, an increase of $533.9 million (two per cent).

All network entities record assets at fair value in their financial statements. The fair value is calculated from forecasted cash inflows and cash outflows generated by the entity's infrastructure assets. Every year, each entity revisits the fair value of its assets. In the 2018 financial year, Powerlink and Energy Queensland revalued their infrastructure assets upwards by $269.9 million—representing a fair value increase of less than one percent.

Capital expenditure decreased from prior years and is below budget

The energy entities budgeted a combined $1.8 billion for capital expenditure, with 76 per cent of this budgeted by Energy Queensland to maintain and increase network performance and capacity. Actual capital expenditure for the sector was under budget by $45.4 million (less than one per cent).

Figure 3J
Capital expenditure over past six years



Source: Queensland Audit Office.

Figure 3J shows that the capital expenditure of the sector has been declining since 2015, particularly Energy Queensland's. This is part of the merger savings from the formation of Energy Queensland. Reduced capital expenditure is expected until 2019–2020.

The capital replenishment ratio for 2017–18 was 1.16, indicating that entities are spending more on assets than they are recording as depreciation. The ratio decreased from last year (1.41) due to lower capital spending on assets.

Future challenges and emerging risks

Queensland's energy sector faces several challenges in designing, constructing, maintaining, and operating its generation and supply assets.

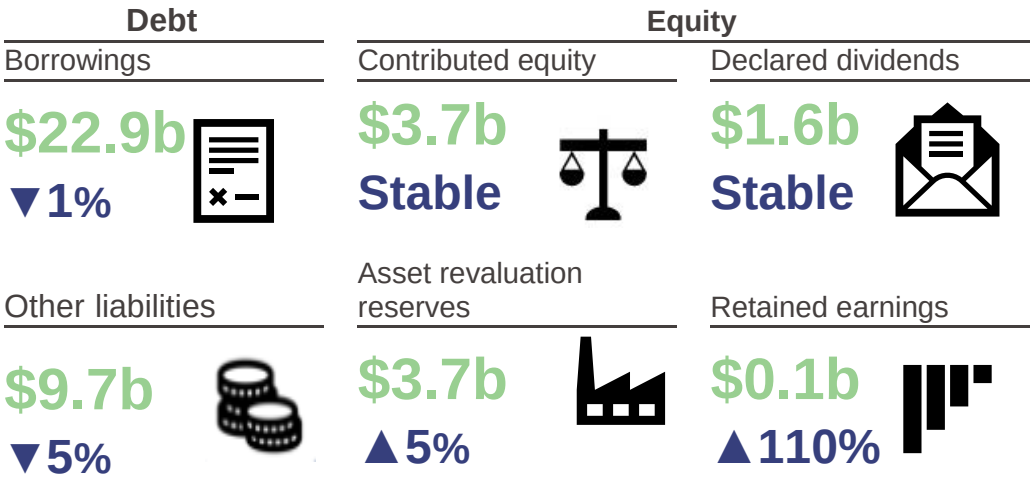
Future changes in technology and uncertainty over federal energy policy, including the renewables will affect methods of generation and the use of large distribution networks. Changes in the generation and supply structure and products will be assessed for impacts on expected asset use and value to owners.

Stanwell's Burdekin hydro-electric power station

Part of the *Powering Queensland Plan* is to deliver a $386 million Powering North Queensland Plan to strengthen and diversify the north's energy supply. This includes an investment to help fund the Burdekin power station, a 50 MW hydro-electric power station. In 2017, Stanwell was directed by the state government to reinvest $100 million of its dividend to develop a business case for the hydro-electric power station. A feasibility study has been completed, but a detailed business case is yet to be completed.

Debt and equity

Figure 3K
Major components of debt and equity for energy entities for 2017–18



Source: Queensland Audit Office.

The energy sector holds $22.9 billion in borrowings and $7.5 billion in equity. Borrowings have remained relatively stable compared with 2016–17 (a decrease of one per cent), whilst equity has increased by $421.5 million (six per cent). The 2017–18 debt to equity ratio for the sector (76 per cent) is consistent with 2016–17 (77 per cent) and continues to be within industry benchmarks.

Retained earnings are prior year profits that have not been paid out as dividends.

The *asset revaluation reserves* represent the valuation increases above the historical cost of the entity's assets.

Contributed equity is the investment in the entity by shareholders.

Other liabilities decreased by $539.7 million (five per cent) in 2017–18.

As part of the *Powering Queensland Plan*, Energy Queensland received a grant of $771 million in June 2017 from the Queensland Government to fund the three-year Solar Bonus Scheme. This amount was recognised as a liability, reflecting the obligation to pay this to customers in the future. In 2017–18, Energy Queensland made $292 million in solar bonus scheme payments to customers and hence decreased its liabilities.

As part of their risk management, the generators also hold financial instruments that are classified as liabilities. These are also mostly electricity derivative contracts. These have declined in value by $664.2 million.

Events and transactions affecting debt and equity this year

Dividends declared and paid

Each entity sets the percentage of profits that it will return as a dividend, which is agreed with the Queensland Government. The profit used as a base for dividend declaration is sometimes adjusted for certain non-cash transactions such as unrealised gains and impairment expense. This year the following entities declared dividends totalling $1.6 billion:

- CS Energy declared a dividend of 80 per cent of its profits after adjustments, resulting in a dividend payable of $125.7 million.
- Stanwell declared a dividend of 100 per cent of its profits after adjustments, resulting in a dividend payable of $494.2 million.
- Powerlink declared 100 per cent of profits or $167.3 million and paid interim special dividends of $50 million (2016–17: special dividends of $160 million).
- Energy Queensland declared 100 per cent of profits or $809 million as dividends (this incorporates the dividends received from its subsidiary Ergon Energy Queensland).

Borrowings for the sector decreased by one per cent. Dividends were funded through cash and were declared from profits and reserves. All dividends declared are consistent with the requirements of the *Government Owned Corporations Act 1993* and the *Corporations Act 2001*.

Typically, the energy entities declare a final dividend in one year and pay the dividend in the following year. This year, the energy entities paid a combined $1.5 billion in dividends to the Queensland Government, compared to $0.7 billion in the previous year.

Future challenges and emerging risks

Returns to the state have decreased

Returns to the state government consist of dividends and income tax equivalents. Total returns to the state government amount to $2.3 billion, a decrease of $40.1 million (two per cent) from the previous year.

Figure 3L
Breakdown of total returns to the state government in millions

Source: Queensland Audit Office.

Returns from generation have been increasing since 2015–16. This is due to the increased profitability of the generators. However, as demand for electricity generation by coal-fired power plants may decline in the future, returns from generation may decline as well.

Transmission contributed $293.1 million in total returns in 2017–18, a $218 million decrease from the previous year. 2016–17 saw the largest returns in three years, due to the payment of a special dividend of $160 million. The current AER determination for Powerlink allows for an average annual income that is 25 per cent lower than the previous determination. This may impact future returns to state.

Returns from Energy Queensland comprise the largest percentage for the entire sector. In 2017–18, it declared $809 million in dividends and recognised $345 million in tax equivalents to the state government. This is an eight per cent decrease from the previous year, caused by the reduction in profits. The current AER determination for Energy Queensland's businesses is expected to negatively impact profits in the future. This may affect returns to the state government as well.

The Queensland Government continues to require a dividend of 100 per cent of the energy sector's net profits after tax, except for CS Energy. CS Energy has accumulated historical losses which precludes it from declaring and paying out 100 per cent of its profits as dividends.

In the current year, all final dividends were paid out of net profit after tax. This year special dividends of $50 million were paid by Powerlink (down from $160 million in the prior year). Special dividends are generally paid out of cash or reserves, and any ongoing dividends of this nature may deplete the net assets of these entities.

The Queensland Government budget has forecast earnings before interest and taxes from the energy sector to decrease to $2.6 billion by 2021–22 due to expected reductions in regulated wholesale generation and electricity earnings. This represents a 26 per cent decrease compared to actual earnings before interest and taxes in 2017–18. In addition, it is expected that new renewable entrants will enter the wholesale market, which will increase competition.

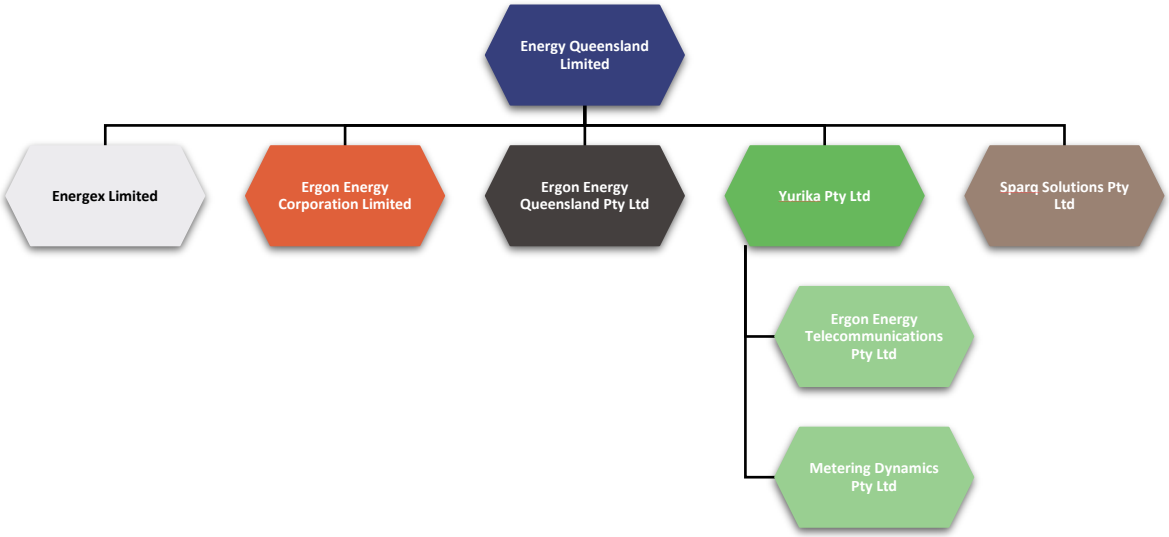
Energy Queensland Limited

Energy Queensland was established on 30 June 2016. It took control of the Energex and Ergon Energy groups to merge distribution operations across the state. The objective was to improve cost management and create efficiencies with the potential to lower electricity prices. The merger was expected to result in cost savings of approximately $562 million against forward estimates at that time. These will be realised over a five-year period until 2019–20.

Structure

In 2017–18, further organisational restructure occurred within the group to ensure clear separation of its distribution business, retail operations, and its new energy services business. The current structure of Energy Queensland is shown below.

Figure 3M
Structure of Energy Queensland Limited



Source: Queensland Audit Office.

Ergon Energy Queensland Pty Ltd (EEQ), the retail arm of the group, was a subsidiary of one of the distribution entities, Ergon Energy Corporation Limited (Ergon), in the previous year. In 2017–18, EEQ became a direct subsidiary of Energy Queensland Limited to establish a distinct separation of the retail operations from the distribution business. This is part of compliance with AER ringfencing requirements.

The AER requires distribution companies to separate distribution operations from other services to ensure distribution services do not cross-subsidise other operations or discourage competition. This is called *ringfencing*.

During the year, Energy Queensland established its new energy services group, focused on building a portfolio of businesses to improve the value proposition to customers. This group will offer products and services such as metering, utility services, micro-grids, distributed energy resources, and telecommunications. The group is comprised of Yurika Pty Ltd (Yurika), Ergon Energy Telecommunications Pty Ltd (Nexium), and Metering Dynamics Pty Ltd (Metering Dynamics). In the previous year, Yurika and Metering Dynamics were part of the Energex group and Nexium was a subsidiary of Ergon.

Systems and processes

During the year, Energy Queensland continued to streamline and consolidate its systems and processes.

Historically, when entities in the energy sector have restructured, they have continued to work with multiple financial information systems for several years, rather than consolidate their financial information into one system.

Energy Queensland will align the systems used by Ergon and Energex through the implementation of a new enterprise resource planning and enterprise asset management (ERP EAP) system. The new ERP EAP system will cover key functionalities including finance, human resources, payroll, environmental health and safety, procurement, work programming, and asset management. The total funding allocation for this project, approved by the AER, is $228.9 million. Implementation of the new system is expected to commence during 2018–19, and the system is expected to be fully functional within three years.

In 2016–17, we identified inconsistencies between the policies and processes of Ergon and Energex. Property, plant, and equipment is the only significant item in the financial statement affected by these inconsistencies. As at the end of 2017–18, these remain unresolved. These are expected to be resolved during the new ERP EAP system implementation process, which will commence from 2018–19. Management has assessed that the impact of these on the financial statements is not material.

People

The continued streamlining and consolidation of business processes within Energy Queensland resulted in changes to its workforce.

During 2017–18, Energy Queensland restructured its executive management team, and rationalised the executive general manager roles from eight to six. The new structure is expected to increase executive focus on critical governance functions.

There was a net reduction of 96 FTE employees at Energy Queensland during the year. Redundancies during the year saw a decrease of 216.9 FTE employees (three per cent of total employees). Total termination payments amounted to $39 million.

4. Internal controls

This chapter evaluates the effectiveness of the internal controls designed, implemented, and maintained by entities in the sector as they relate to our audit.

Through our analysis, we aim to promote stronger internal control frameworks. We also aim to mitigate financial losses and damage to public sector reputation by initiating effective responses to identified control weaknesses.

Conclusion

We concluded the control environment was suitably designed and implemented for all energy entities. Therefore, we chose to rely on the internal control systems of all entities.

- We did not identify any significant deficiencies (high risk matters) in the sector relating to internal controls. We identified eight control deficiencies (low to moderate risk matters) across the sector in 2018.
- The energy entities have accepted our recommendations and are working on addressing the deficiencies.

Our audit of internal controls

We assess internal controls to ensure they are suitably designed to:

- prevent, or detect and correct, material misstatements in the financial report
- achieve compliance with legislative requirements
- use public resources effectively.

Where we identify controls that we plan to rely on, we test how effectively these controls are operating to ensure they are functioning as intended.

We are required to communicate to management any deficiencies in internal controls.

Our rating of internal control deficiencies

Our rating of internal control deficiencies allows management to gauge relative importance and prioritise remedial actions.

We increase the rating from a deficiency to a significant deficiency when:

A *deficiency* arises when internal controls are ineffective or missing, and are unable to prevent, or detect and correct, misstatements in the financial statements. A deficiency may also result in non-compliance with policies and applicable laws and regulations and/or inappropriate use of public resources.

- we consider immediate remedial action is required
- there is a risk of material misstatement in the financial statements
- there is a risk to reputation
- the non-compliance with policies and applicable laws and regulations is significant
- there is potential to cause financial loss including fraud
- management has not taken appropriate, timely action to resolve the deficiency.

Control deficiencies categorised by COSO component

We categorise internal controls using the Committee of the Sponsoring Organizations of the Treadway Commission (COSO) internal controls framework, which is widely recognised as a benchmark for designing and evaluating internal controls.

The framework identifies five components that need to be present and operating together for a successful internal control system. These components are explained in Appendix G.

Figure 4A shows control deficiencies (categorised by COSO component) reported to management for the 2017–18 financial year.

Figure 4A
Summary of internal control deficiencies for the energy sector

Control environment *Structures, policies, attitudes, and values that influence daily operations*	**Risk assessment** *Processes for identifying, assessing, and managing risk*	**Control activities** *Implementation of policies and procedures to prevent or detect errors and safeguard assets*	**Information and communication** *Systems to capture and communicate information to achieve reliable financial reporting*	**Monitoring activities** *Oversight of internal controls for existence and effectiveness*
1 deficiency identified	No deficiencies identified	7 deficiencies identified	No deficiencies identified	No deficiencies identified

Source: Queensland Audit Office adapted from Committee of the Sponsoring Organizations of the Treadway Commission (COSO) internal controls framework.

Control environment

Control environment

1 deficiency

In 2017–18, we identified one deficiency in the control environment of one of the energy entities relating to general information technology governance. This issue is being addressed by management.

Control activities

Control activities

7 deficiencies

In 2017–18, we identified five deficiencies in general information technology controls relating to user access, system capability, and system changes. We also identified two deficiencies in manual control activities relating to authorisations, validations, and reconciliations. These issues were isolated and have either been resolved or are being addressed by management.

Status of internal control deficiencies

Management, and those charged with governance, are responsible for the efficient and effective operation of internal controls. An audit committee may be established to assist those charged with governance to obtain assurance over internal control systems. An audit committee is responsible for considering audit findings, management responses to those findings, and the status of audit recommendations.

We have analysed the appropriateness and timeliness of remedial action undertaken to resolve any audit matters we have identified. Figure 4B outlines the status of internal control deficiencies reported, as at 31 August 2018.

Figure 4B
Status of control issues reported to management for 2017–18

Note: Out of the eighteen deficiencies where corrective action is underway, eight are considered resolved by the entities and will be verified during the 2018–19 audit.

Source: Queensland Audit Office.

There were no significant control deficiencies noted in 2017–18. All entities have either addressed their identified control deficiencies or are currently undertaking corrective action by management. Where corrective action is underway, we urge audit committees to monitor whether management is meeting the agreed milestone dates for all issues reported. Proactive and timely resolution of control deficiencies indicates a strong control environment.

Appendices

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A. Full responses from agencies

As mandated in Section 64 of the *Auditor-General Act 2009*, the Queensland Audit Office gave a copy of this report with a request for comments to the Minister for Natural Resources, Mines and Energy; the Director-General, Department of Natural Resources, Mines and Energy; and the Acting Under Treasurer, Queensland Treasury for comment.

We also provided a copy of this report to the heads of the following entities with an option of providing a response:

- CS Energy Limited
- Stanwell Corporation Limited
- Queensland Electricity Transmission Corporation Limited (trading as Powerlink Queensland)
- Energy Queensland Limited.

We provided a copy of this report to the Premier and Minister for Trade; Deputy Premier, Treasurer and Minister for Aboriginal and Torres Strait Islander Partnerships; and the Director-General, Department of the Premier and Cabinet for their information.

The heads of these agencies are responsible for the accuracy, fairness and balance of their comments.

This appendix contains their detailed responses.

Comments received from Acting Under Treasurer, Queensland Treasury

Queensland Government

Queensland Treasury

Our Ref: 04750-2018
Your Ref: 11941

12 NOV 2018

Mr Brendan Worrall
Auditor-General of Queensland
Queensland Audit Office
PO Box 15396
CITY EAST QLD 4002

Dear Mr Worrall Brendan

Thank you for your letter of 23 October 2018 regarding the Queensland Audit Office (QAO) draft report *Energy: 2017-18 Results of Financial Audit* (the Report) and the opportunity to provide comments.

The draft report presents a useful overview of the energy sector entities in Queensland. I understand Queensland Treasury officers have discussed the draft report with the QAO and provided comments.

I note that unmodified audit opinions were provided on all financial statements for 2017-18 for the energy sector entities. I welcome the QAO's advice that all energy entities are financially sustainable, noting that Ergon Energy Queensland remains reliant on the state government continuing to subsidise the cost of distribution charged to regional customers.

I am pleased to note that the report acknowledges that while the Queensland Government receives revenue from the sector, it also actively reinvests in the energy sector to help manage cost of living pressures. To that end, as noted in your report, the Government provided over $1.1 billion in assistance to Queensland consumers in 2017-18, a $349 million increase from the previous year.

I have been advised by my officers that the engagement and discussions with the QAO on the draft report have been very positive, and I appreciate the QAO's consultative approach.

If you would like to discuss any of the comments please contact Mr Rimu Nelson, Director, Shareholder and Structural Policy Division on (07) 3035 3342 or rimu.nelson@treasury.qld.gov.au.

Yours sincerely

Mary-Anne Curtis
Acting Under Treasurer

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B. Legislative context

Framework

Energy entities prepare their financial statements in accordance with the following legislative frameworks and reporting deadlines.

Entity type	Entity	Legislative framework	Legislated deadline
Government-owned corporations (GOC)	Stanwell Corporation Limited CS Energy Limited Queensland Electricity Transmission Corporation Limited (trading as Powerlink Queensland) Energy Queensland Limited (EQL)	• *Government Owned Corporations Act 1993* • *Corporations Act 2001* • *Corporations Regulations 2001*	31 August 2018
Controlled entities	Ergon Energy Queensland Pty Ltd	• *Corporations Act 2001* • *Corporations Regulations 2001*	31 October 2018

Source: Queensland Audit Office.

Accountability requirements

The *Government Owned Corporations Act 1993* establishes four key principles for government-owned corporations:

- clarity of objectives
- management autonomy and authority
- strict accountability for performance
- competitive neutrality.

Queensland state government financial statements

Each year, Queensland state public sector entities must table their audited financial statements in parliament.

These financial statements are used by a broad range of parties including parliamentarians, taxpayers, employees, and users of government services. For these statements to be useful, the information reported must be relevant and accurate.

The auditor-general's audit opinion on these entities' financial statements assures users that the statements are accurate and in accordance with relevant legislative requirements.

We express an unmodified opinion when the financial statements are prepared in accordance with the relevant legislative requirements and Australian accounting standards. We modify our audit opinion when financial statements do not comply with the relevant legislative requirements and Australian accounting standards, and are not accurate and reliable.

Sometimes we include an emphasis of matter in our audit reports to highlight an issue that will help users to better understand the financial statements. An emphasis of matter does not change the audit opinion.

C. Our assessment of financial statement preparation

In assessing the effectiveness of financial statement preparation processes we considered the timeliness of financial statements and the quality of financial statements.

We assess financial statement preparation processes under the following criteria.

Timeliness of draft financial statements

We assessed the timeliness of draft financial statements by considering whether entities prepared financial statements according to the timetables set by management. This includes providing auditors with the first complete draft of financial statements by the agreed date. A complete draft is one that management is ready to sign and where no material errors or adjustments are expected.

Rating scale	Assessment criteria—timeliness of draft financial statements
Timely	Acceptable draft financial statements received on or prior to the planned date
Generally timely	Acceptable draft financial statements received within two days after the planned date
Not timely	Acceptable draft financial statements received more than two days after the planned date

Quality of draft financial statements

We assessed the quality of financial statements in terms of adjustments made between the first draft of the financial statements and the final version we receive. This includes adjustments to current year, prior year and other disclosures. This is an indicator of how effective review of the financial statements is at identifying and correcting errors.

Rating scale	Assessment criteria—quality of draft financial statements
No adjustments	No adjustments were required
No significant adjustments	Immaterial adjustments to financial statements
Significant adjustments	Material adjustments to financial statement components

Result summary

This table summarises our assessment of the five entities' financial statement preparation processes.

Entity	Timeliness of draft financial statements	Quality of draft financial statements
CS Energy Limited	●	●
Energy Queensland Limited	●	●
Ergon Energy Queensland Pty Ltd	●	●
Powerlink	●	●
Stanwell Corporation Limited	●	●

Source: Queensland Audit Office.

D. Key audit matters

This table summarises the key audit matters reported for the significant public sector entities in the energy sector.

Key audit matter	Entity
Valuation of property, plant, and equipment	CS Energy Limited Stanwell Corporation Limited Energy Queensland Limited Powerlink
Depreciation and useful lives	Energy Queensland Limited Powerlink
Provisions for restoration, rehabilitation, and decommissioning	Stanwell Corporation Limited
Provisions for onerous contract	CS Energy Limited
Measurement and recognition of unbilled revenue	Ergon Energy Queensland Pty Ltd
Measurement of derivative financial instruments	Stanwell Corporation Limited Ergon Energy Queensland Pty Ltd CS Energy Limited

Source: Queensland Audit Office.

E. Entities not preparing financial reports

The auditor-general will not issue audit opinions for the following controlled public sector entities for the 2017–18 financial year, as they have not produced a financial report.

Public sector entity	Reason for not preparing financial reports
Generation	
Controlled entities of Stanwell Corporation Limited	
Mica Creek Pty Ltd	Deed of cross guarantee ASIC order
SCL North West Pty Ltd	Deed of cross guarantee ASIC order
Energy Portfolio 1 Pty Ltd	Dormant
Glen Wilga Coal Pty Ltd	Dormant
Goondi Energy Pty Ltd	Non-reporting
Tarong Energy Corporation Pty Ltd	Dormant
Tarong Fuel Pty Ltd	Deed of cross guarantee ASIC order
Tarong North Pty Ltd	Non-reporting
TEC Coal Pty Ltd	Deed of cross guarantee ASIC order
TN Power Pty Ltd	Deed of cross guarantee ASIC order

Source: Queensland Audit Office.

Public sector entity	Reason for not preparing financial reports
Controlled entities of CS Energy Limited	
Aberdare Collieries Pty Ltd	Deed of cross guarantee ASIC order
Callide Energy Pty Ltd	Deed of cross guarantee ASIC order
CS Energy Group Holdings Pty Ltd	Dormant
CS Energy Group Operations Holdings Pty Ltd	Dormant
CS Kogan (Australia) Pty Ltd	Deed of cross guarantee ASIC order
CS Energy Kogan Creek Pty Ltd	Deed of cross guarantee ASIC order
CS Energy Oxyfuel Pty Ltd	Deed of cross guarantee ASIC order
Kogan Creek Power Pty Ltd	Deed of cross guarantee ASIC order
Kogan Creek Power Station Pty Ltd	Deed of cross guarantee ASIC order
Transmission	
Controlled entities of Powerlink	
Harold Street Holdings Pty Ltd	Deed of cross guarantee ASIC order
Powerlink Transmission Services Pty Ltd	Deed of cross guarantee ASIC order
Distribution	
Controlled entities of Energy Queensland Limited	
Energex Limited	Deed of cross guarantee ASIC order
Varnsdorf Pty Ltd	Dormant
VH Operations Pty Ltd	Dormant
Ergon Energy Corporation Limited	Deed of cross guarantee ASIC order
SPARQ Solutions Pty Ltd	Deed of cross guarantee ASIC order
Yurika Pty Ltd (formerly Energy Impact Pty Ltd)	Deed of cross guarantee ASIC order
Metering Dynamics Pty Ltd (formerly Metering Dynamics Business Support Pty Ltd)	Deed of cross guarantee ASIC order
Ergon Energy Telecommunications Pty Ltd	Non-reporting

Note: Entities are also not required to prepare financial statements when they have obtained an exemption through ASIC as they were part of a larger group, secured by a deed of cross guarantee with their parent entity to cover debts.

Energy Impact Pty Ltd was renamed to Yurika Pty Ltd in the 2017–18 financial year. It now includes the entities Metering Dynamics Pty Ltd and Ergon Energy Telecommunications Pty Ltd.

Source: Queensland Audit Office.

F. Financial snapshot

Entity	Total assets	Total liabilities	Total income	Total expenses (excl tax)	Profit after tax	Dividends declared	Total borrowings
	For the year ending 30 June 2018 Amounts in $'000						
CS Energy	2 157 436	1 480 116	1 130 470	802 062	230 980	125 731	642 710
Ergon Energy Queensland	1 190 357	1 190 357	2 201 238	1 825 716	263 178	176 653	-
Energy Queensland	25 710 000	22 155 000	5 111 000	3 957 000	809 000	809 000	16 265 000
Powerlink	8 282 786	6 492 613	1 026 109	783 003	167 325	217 325	5 265 221
Stanwell	3 965 108	2 526 411	3 446 566	2 745 766	490 824	494 183	821 866

Source: Queensland Audit Office.

Entity	Total assets	Total liabilities	Total income	Total expenses (excl tax)	Profit after tax	Dividends declared	Total borrowings
	For the year ending 30 June 2017 Amounts in $'000						
CS Energy	2 201 988	1 722 443	959 085*	555 408*	282 584	122 912	812 081
Ergon Energy Queensland	831 970	793 838	2 130 063	1 959 081	120 075	162 192	-
Energy Queensland	26 008 000	22 437 000	5 265 000	4 007 000	881 000	881 000	16 267 000
Powerlink	8 296 506	6 582 350	1 365 021	863 892*	351 166	361 166	5 265 221
Stanwell	3 898 536*	2 623 618*	3 113 443	2 619 557*	353 009*	260 567	822 104

* Prior year comparatives have been restated.

Source: Queensland Audit Office.

G. Our audit of internal controls

Internal controls are designed, implemented, and maintained by entities to mitigate risks that may prevent them from achieving reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations.

In undertaking our audit, we are required under the Australian auditing standards to obtain an understanding of an entity's internal controls relevant to the preparation of the financial report.

We assess internal controls to ensure they are suitably designed to:

- prevent, or detect and correct, material misstatements in the financial report
- achieve compliance with legislative requirements
- ensure appropriate use of public resources.

Our assessment determines the nature, timing, and extent of the testing we perform to address the risk of material misstatement in the financial statements.

Where we believe the design and implementation of controls is effective, we select the controls we intend to test further by considering a balance of factors, including:

- significance of the related risks
- characteristics of balances, transactions, or disclosures (volume, value, and complexity)
- nature and complexity of the entity's information systems
- whether the design of the controls addresses the risk of material misstatement and facilitates an efficient audit.

Where we identify deficiencies in internal controls, we determine the impact on our audit approach, considering whether additional audit procedures are necessary to address the risk of material misstatement in the financial statements.

Our audit procedures are designed to address the risk of material misstatement, so we can express an opinion on the financial report. We do not express an opinion on the effectiveness of internal controls.

Internal controls framework

We categorise internal controls using the Committee of Sponsoring Organizations of the Treadway Commission (COSO) internal controls framework, which is widely recognised as a benchmark for designing and evaluating internal controls.

The framework identifies five components for a successful internal control system. These components are explained in the following paragraphs.

Control environment

- Cultures and values
- Governance
- Organisational structure
- Policies
- Qualified and skilled people
- Management's integrity and operating style

The control environment is defined as the structures, policies, attitudes, and values that influence day-to-day operations. As the control environment is closely linked to an entity's overarching governance and culture, it is important that the control environment provides a strong foundation for the other components of internal control.

In assessing the design and implementation of the control environment we consider whether:

- those charged with governance are independent, appropriately qualified, experienced, and active in challenging management. This ensures they receive the right information at the right time to enable informed decision-making
- policies and procedures are established and communicated so people with the right qualifications and experiences are recruited, they understand their role in the organisation, and they also understand management's expectations regarding internal controls, financial reporting, and misconduct, including fraud.

Risk assessment

- Strategic risk assessment
- Financial risk assessment
- Operational risk assessment

Risk assessment relates to management's processes for considering risks that may prevent an entity from achieving its objectives, and how management agrees risks should be identified, assessed, and managed.

To appropriately manage business risks, management can either accept the risk if it is minor or mitigate the risk to an acceptable level by implementing appropriately designed controls. Management can also eliminate risks entirely by choosing to exit from a risky business venture.

Control activities

- General information technology controls
- Automated controls
- Manual controls

Control activities are the actions taken to implement policies and procedures in accordance with management directives and ensure identified risks are addressed. These activities operate at all levels and in all functions. They can be designed to prevent or detect errors entering financial systems.

The mix of control activities can be categorised into general information technology controls, automated controls, and manual controls.

General information technology controls

General information technology controls form the basis of the automated systems control environment. They include controls over information systems security, user access, and system changes. These controls address the risk of unauthorised access and changes to systems and data.

Automated control activities

Automated controls are embedded within information technology systems. These controls can improve timeliness, availability, and accuracy of information by consistently applying predefined business rules. They enable entities to perform complex calculations when processing large volumes of transactions. They also improve the effectiveness of financial delegations and the segregation of duties.

Manual control activities

Manual controls contain a human element, which can provide the opportunity to assess the reasonableness and appropriateness of transactions. However, these controls may be less reliable than automated elements as they can be more easily bypassed or overridden. They include activities such as approvals, authorisations, verifications, reconciliations, reviews of operating performance, and segregation of incompatible duties. Manual controls may be performed with the aid of information technology systems.

Information and communication

- Non-financial systems
- Financial systems
- Reporting systems

Information and communication controls are the systems used to provide information to employees, and the ways in which responsibilities are communicated.

This aspect of internal control also considers how management generates financial reports, and how these reports are communicated to internal and external parties to support the functioning of internal controls.

Monitoring activities

- Management supervision
- Self-assessment
- Internal audit

Monitoring activities are the methods management uses to oversee and assess whether internal controls are present and operating effectively. This may be achieved through ongoing supervision, periodic self-assessments, and separate evaluations. Monitoring activities also concern the evaluation and communication of control deficiencies in a timely manner to effect corrective action.

Typically, the internal audit function and an independent audit and risk committee are responsible for implementing controls and resolving control deficiencies. These two functions work together to ensure that internal control deficiencies are identified and then resolved in a timely manner.

H. Glossary

Term	Definition
Accountability	Responsibility of public sector entities to achieve their objectives of delivering reliable financial reporting, effective and efficient operations, compliance with applicable laws, and reports to interested parties.
Auditor-General Act 2009	An act of the State of Queensland that establishes the responsibilities of the auditor-general, the operation of the Queensland Audit Office, the nature and scope of audits to be conducted, and the relationship of the auditor-general with parliament.
Australian accounting standards	The rules by which financial statements are prepared in Australia. These standards ensure consistency in measuring and reporting on similar transactions.
Australian Accounting Standards Board (AASB)	An Australian Government agency that develops and maintains accounting standards applicable to entities in the private and public sectors of the Australian economy.
Average pool price	The Australian Energy Market Operator publishes a half-hourly spot pool price for energy supplied into the national electricity market base. An average pool price can be determined across any given period.
Capital expenditure	Expenditure to acquire assets or improve the service potential of existing assets that is capitalised to the balance sheet.
Contributed equity	Investment in an entity by shareholders.
Community service obligations	Government payments to commercial entities to provide services that are not in the entity's commercial interests.
Debt to equity ratio	This ratio shows to what extent an entity is financed by debt. It may also be referred to as the gearing or leverage ratio. It is calculated as total debt divided by contributed equity.
Discount rate	Interest rate used to calculate the present day value.
Emphasis of matter	A paragraph included with an audit opinion to highlight an issue that the auditor believes the users of the financial statements need to be aware of. The inclusion of an emphasis of matter paragraph does not modify the audit opinion.
Going concern	An entity is expected to be able to pay its debts as and when they fall due, and to continue to operate without any intention or necessity to liquidate or wind up its operations.
Impairment	When an asset’s carrying amount exceeds the amount that can be recovered through use or sale of the asset.

Term	Definition
Megawatt hours	A megawatt hour (Mwh) is equal to 1 000 kilowatts of energy used continuously for one hour.
Net assets	Total assets less total liabilities.
Net debt	Total Queensland Treasury Corporation borrowings less cash.
Net result (WOG)	Calculated by subtracting an entity's total expenses from its total revenue. The net result is designed to show what the entity has earned or lost in a given period of time.
Terminal value	Terminal value represents all future cash flows in an asset valuation model. In a discounted cash flow valuation, the cash flow is projected for each year into the future for a certain number of years, after which annual cash flows cannot be forecast with reasonable accuracy. At that point, rather than attempting to forecast the varying cash flow for each individual year, a single value representing the discounted value of all subsequent cash flows is used. This single value is referred to as the terminal value.
Useful life	The number of years the entity expects to use an asset (not the maximum period possible for the asset to exist).

Auditor-General reports to parliament

Reports tabled in 2018–19

1. Monitoring and managing ICT projects
   Tabled July 2018
2. Access to the National Disability Insurance Scheme for people with impaired decision-making capacity
   Tabled September 2018
3. Delivering shared corporate services in Queensland
   Tabled September 2018
4. Managing transfers in pharmacy ownership
   Tabled September 2018
5. Follow-up of Bushfire prevention and preparedness
   Tabled October 2018
6. Delivering coronial services
   Tabled October 2018
7. Conserving threatened species
   Tabled November 2018
8. Water: 2017–18 results of financial audits
   Tabled November 2018
9. Energy: 2017–18 results of financial audits
   Tabled November 2018

Report cost

This report cost $85 000 to produce.

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ISSN 1834-1128.

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