Queensland Audit Office
better public services

Energy: 2016–17 results of financial audits

Report 9: 2017–18

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Reference to comments

In accordance with section 64 of the *Auditor-General Act 2009,* we provided a copy of this report to all relevant agencies, as per the list at Appendix A. In reaching our audit conclusions, we have considered their view and represented them to the extent we deemed relevant and warranted in preparing this report.

We received a response from the Deputy Premier, Treasurer, Minister for Aboriginal and Torres Strait Islander Partnerships, Queensland Treasury. The response is in Appendix A.

Report cost

This audit report cost $105 000 to produce.

Your ref:
Our ref: 11631

Queensland Audit Office
better public services

20 February 2018

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

Dear Mr Speaker

Report to Parliament

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009*, and is titled *Energy: 2016–17 results of financial audits* (Report 9: 2017–18).

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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Report structure

CHAPTER 1

Provides a sector overview to assist readers in understanding the audit findings and conclusions.

CHAPTER 2

Delivers the audit opinion results and evaluates the timeliness and quality of reporting.

CHAPTER 3

Analyses the financial performance, position, and sustainability of the entities.

CHAPTER 4

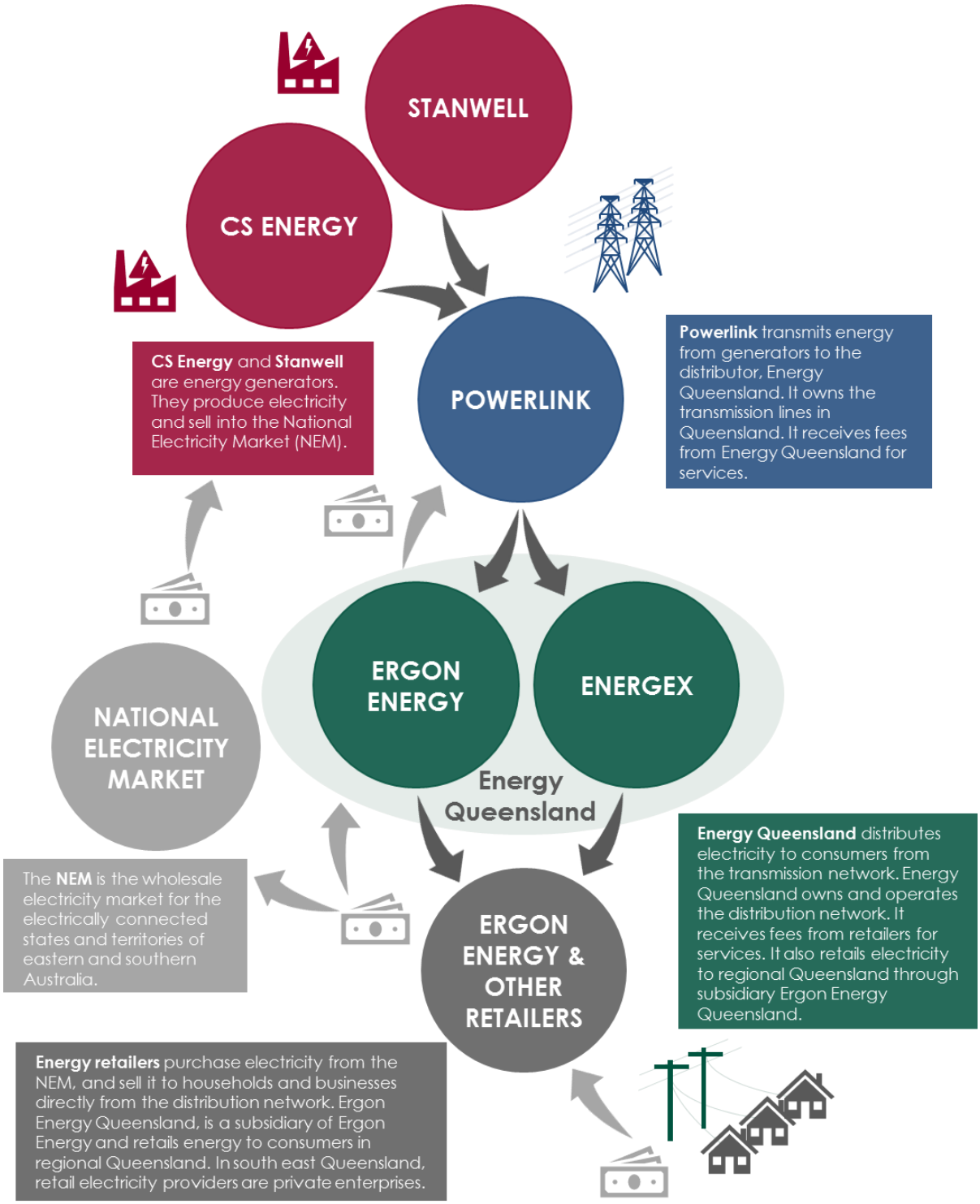
Assesses the strength of the internal controls designed, implemented, and maintained by entities in the energy sector.

Contents

Summary

This report summarises the results of our financial audits of the Queensland Government's energy entities.

Figure A
Queensland energy entities included in this report



* Energy generators and retailers manage price risk relating to changes in the price of electricity in the National Electricity Market using hedging strategies.

Source: Queensland Audit Office.

Results of our audits

We issued unmodified audit opinions for the financial statements of each entity. We do this when the financial statements are prepared in accordance with the relevant legislative requirements and Australian accounting standards. In doing so, we confirm that readers can rely upon the audited financial statements of the energy entities. All entities have strong year end close processes that have allowed them to produce high quality financial statements in a timely manner.

We also considered the 'regulatory information notices' Energex and Ergon provided to the Australian Energy Regulator (AER). The AER specifies the income the entities can earn. In doing so, it issues notices for 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.

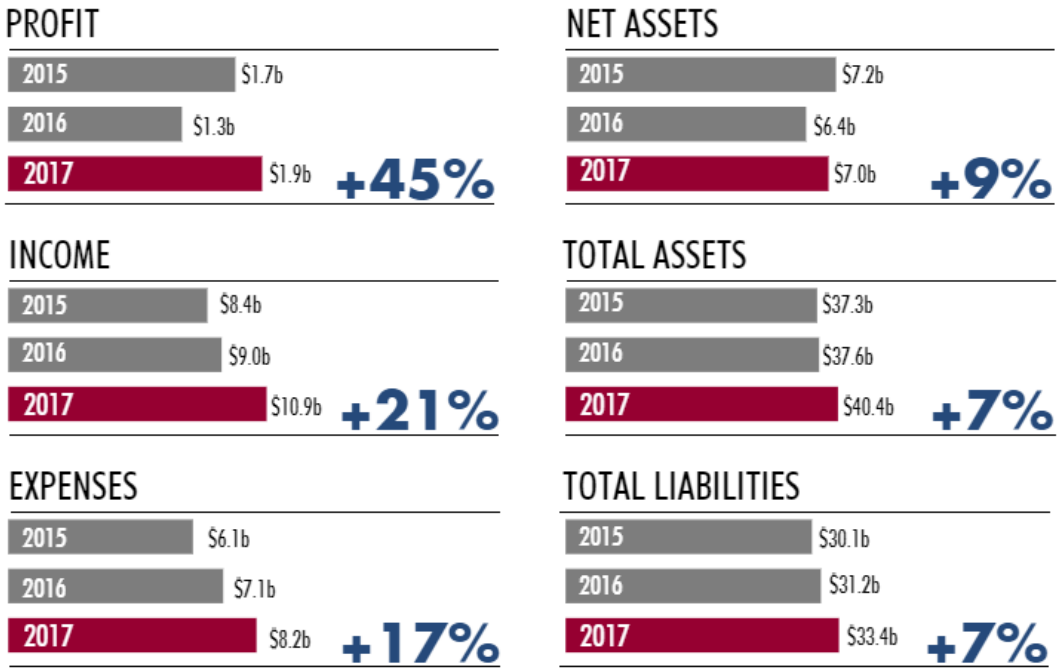
We issued six unmodified audit opinions on actual information and six conclusions about estimated data to Energex and Ergon for the regulatory information notices they submitted to AER.

All audits were completed within legislative and AER deadlines.

The energy sector includes 31 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.

The increased profitability of the energy sector was primarily due to the profitability of the energy generators (CS Energy and Stanwell) in 2016–17. This year, their income increased by $1.2 billion, while expenses increased by $614 million. This resulted in an increase in profit from energy generators of $511 million from 2015–16.

The energy generators sell energy into the National Electricity Market (NEM) at market rates. In 2016–17, average market energy prices rose to record highs. This increase in price increased generation income without impacting on operating expenses. Demand for energy generation also increased in 2016–17, resulting in the generators increasing production by 24 per cent and increasing both income and operating expenses.

During Q1 2017, Queensland experienced record maximum electricity demand due to several factors including; aging/closing of power stations and gas supply restrictions in southern states; uncertain carbon policy at the federal level; and increased demand at peak times including a particularly hot summer in 2017.

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. If the amount which can be recovered later increases, the impairment can be reversed. The generators' profitability was further increased by CS Energy reversing historical impairment losses of $242 million due to improved certainty and reliability of coal supply to two of their three power stations.

Total assets for the entities increased by $2.8 billion (seven per cent) from 2015–16. This growth was primarily due to an increase of $724 million to property, plant, and equipment. Queensland Government's $771 million Solar Bonus Scheme payment made to Energy Queensland Limited (Energy Queensland) increased their cash position. This cash was subsequently included in Energy Queensland's advance to the state under the Queensland Government's cash management arrangements, which decreased cash holdings and increased receivables.

Total liabilities for the entities increased by $2.2 billion (seven per cent) from 2015–16. This increase was primarily due to:

- Energy Queensland paid its dividend to the state government at a different time to the prior year. In 2015–16 the dividend was both declared and paid by 30 June 2016. In 2016–17, the dividend was declared but not paid and instead was recorded as a $881 million liability at 30 June 2017.
- Energy Queensland received a Solar Bonus Scheme payment from the state government. As this income has not yet been earned, Energy Queensland recorded a $771 million liability at 30 June 2017.

Borrowings remained unchanged in 2016–17.

Dividends declared to the state government increased by $155 million (11 per cent) from 2016. This increase was due to the increase in profitability of the generators.

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.

Energy Queensland Limited

Energy Queensland Limited (Energy Queensland) was established on 30 June 2016. It took control of the Energex and Ergon Energy groups to merge electricity distribution across the state. The purpose of this structural change was to lower energy prices in the long term by removing the duplication of distribution activities.

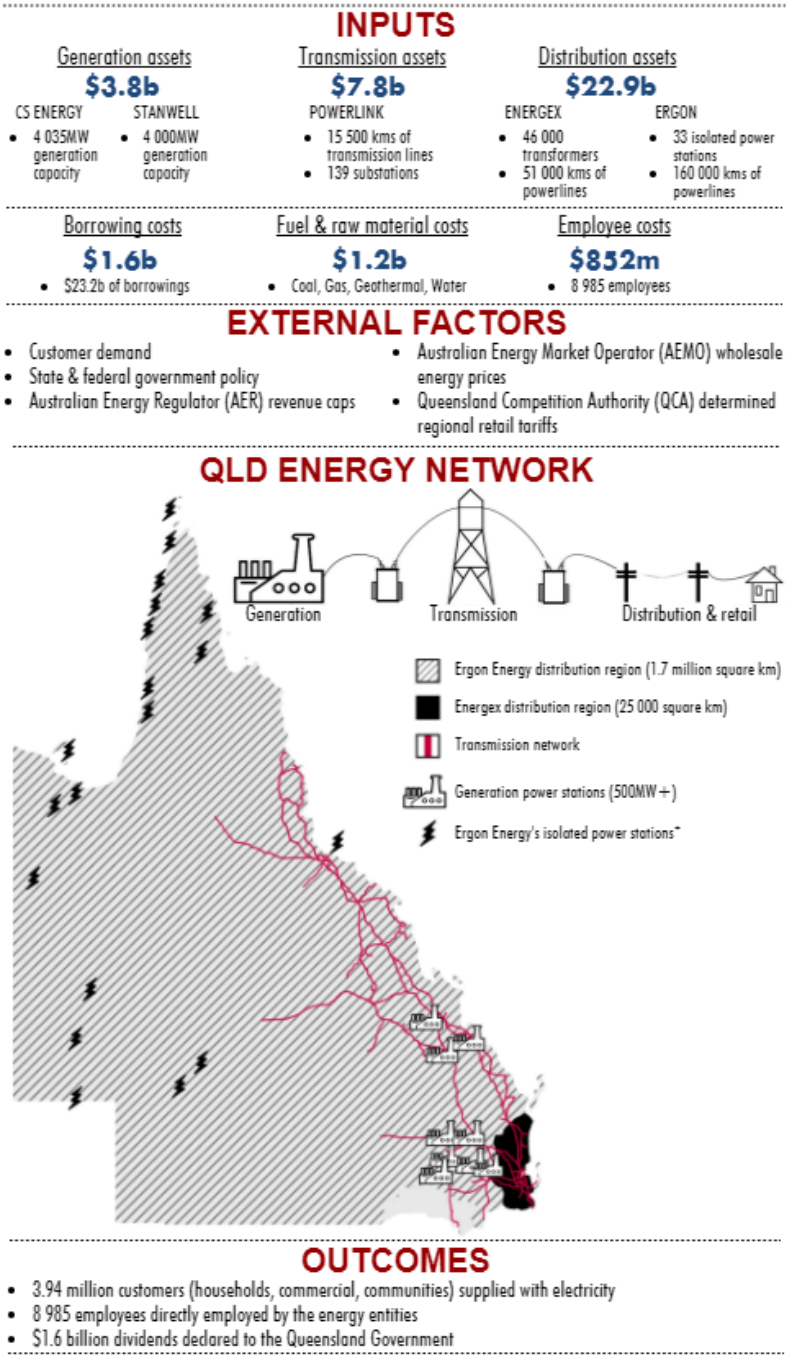
In 2017, Energy Queensland returned a profit of $881 million (2016: $942 million). This decrease of $61 million (six per cent) was attributable to increased finance costs of $148 million due to increased borrowings, as well as an increase of $78 million in transmission charges. Transmission charges are passed through to Energy Queensland's customers. These increases in expenses were partly offset by a $134 million increase in retail sales income.

1. Sector overview

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 energy supply chain, including the inputs, external factors, energy network, and outcomes for the sector.

Figure 1A
Queensland energy supply chain in 2016–17



* Ergon Energy owns and operates 33 isolated power stations, which provide electricity to communities that are too remote to connect to the national grid. Sixteen of these power stations are located on islands in the Torres Strait.

Source: Queensland Audit Office.

2. Results of our audits

Introduction

This chapter examines the reliability of information reported by the entities that were subjected to audit. We also analyse the quality and timeliness of financial reporting.

Conclusion

All energy entities have strong year end close processes. This allows them to produce high 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 Australian Energy Regulator (AER) specifies the majority of income the transmission and distribution entities can earn. In doing so, it issues notices for information from the entities. These notices are subject to audit or a review, depending on whether they are based on actual data or estimated data. We issued six unmodified audit opinions about data provided by Ergon and Energex to AER based on actual information, and six conclusions about estimated data. All opinions and conclusions were issued within AER deadlines.

Financial statement audit opinion results

Figure 2A details the audit opinions we issued for the 2016–17 financial year.

Figure 2A
Audit opinions issued for the 2016–17 financial year

Supply chain element	Entity	Date issued	Audit opinion issued
Generation	CS Energy	31.08.17	Unmodified
	Stanwell	30.08.17	Unmodified
Transmission	Powerlink	24.08.17	Unmodified
Distribution	Energy Queensland Limited	18.08.17	Unmodified
Retail	Ergon Energy Queensland Pty Ltd	18.08.17	Unmodified

Source: Queensland Audit Office.

Financial statement preparation

Energy entities have effective year end close processes, producing timely and high quality financial reports.

Figure 2B
Effectiveness of financial statement preparation processes

Source: Queensland Audit Office.

All energy entities prepared draft financial statements on time. The key components in their draft financial statements did not require adjustment prior to certification. The implementation of effective year end close processes, financial management processes, and internal review processes contributed to this result.

Our assessment criteria are outlined in Appendix G.

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 voluntarily adopted this standard for all energy entities at 30 June 2017.

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 valuation of property, plant, and equipment and to revenue recognition. This accounted for five of the eight matters reported. This year 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

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. Small companies that meet specific criteria under the *Corporations Act 2001* also do not have to prepare financial statements. Appendix E lists the entities not preparing financial statements in 2016–17.

Regulated information notices

Every five years, the AER sets a ceiling on the income or prices that distribution and transmission entities can earn or charge. This is known as an income or price cap.

The AER approves the income proposed by the networks to cover their efficient costs (including operating and maintenance expenses, capital expenditure, asset depreciation costs, and a tax allowance) and to provide a commercial return on capital. To help in doing this, the AER issues notices for financial and non-financial information from network businesses each year.

For each notice a set of templates is completed, together with an explanatory document about how these templates have been prepared. This is called the basis of preparation. The information is subject to either an audit or a review depending on whether it is based on actual or estimated data.

Results of audits and reviews of regulated information notices

Figure 2C details the results of the regulatory audits and reviews undertaken in 2016–17 for Energex and Ergon Energy.

Figure 2C
Results of Energex and Ergon Energy regulatory audits and reviews for 2016–17

Entity	Engagement	Type of information	Certification date	Type of report issued
Ergon	Annual performance	Financial	31.10.17	Audit (actual data)
	Economic benchmarking	Financial	31.10.17 31.10.17	Audit (actual data) Review (estimated data)
	Category analysis	Financial	31.10.17 31.10.17	Audit (actual data) Review (estimated data)
		Non-financial	31.10.17	Review (actual and estimated data)
Energex	Annual performance	Financial	31.10.17	Audit (actual data)
	Economic benchmarking	Financial	31.10.17 31.10.17	Audit (actual data) Review (estimated data)
	Category analysis	Financial	31.10.17 31.10.17	Audit (actual data) Review (estimated data)
		Non-financial	31.10.17	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 Energy did not report actual information due to system limitations and the cost efficiency of providing actual information. In these instances, the AER indicated that estimated information should be reported and that the reasons why actual information was not provided should be included in the basis of preparation.

3. Financial position, performance, and sustainability

Introduction

In this chapter, we assess the position, performance, and sustainability of energy entities.

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

Our analysis helps users understand and use the financial statements by clarifying the financial effects of significant transactions and events in 2016–17. We also use metrics such as ratio analysis 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 have increased significantly, due to increased demand for energy and record highs in market energy prices. Profits have increased across four of the five entities. The profitability of the retail entity (Ergon Energy Queensland) is reliant on the state government continuing to subsidise the cost of distribution charged to consumers in regional Queensland.

The energy entities did not enter into any additional borrowings during the year after the debt held by transmission and distribution entities was increased by $5 billion in 2015–16.

Assets increased by seven per cent this financial year, primarily because of increases in property, plant, and equipment due to capital expenditure of $2.07 billion across the sector and because of a reversal of a $242 million impairment on generation assets. Entities record an impairment expense when an asset's carrying amount exceeds the amount that can be recovered through use or sale of the asset. If the amount which can be recovered later increases, the impairment can be reversed.

Understanding financial performance

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

Figure 3A
Energy sector operating profits

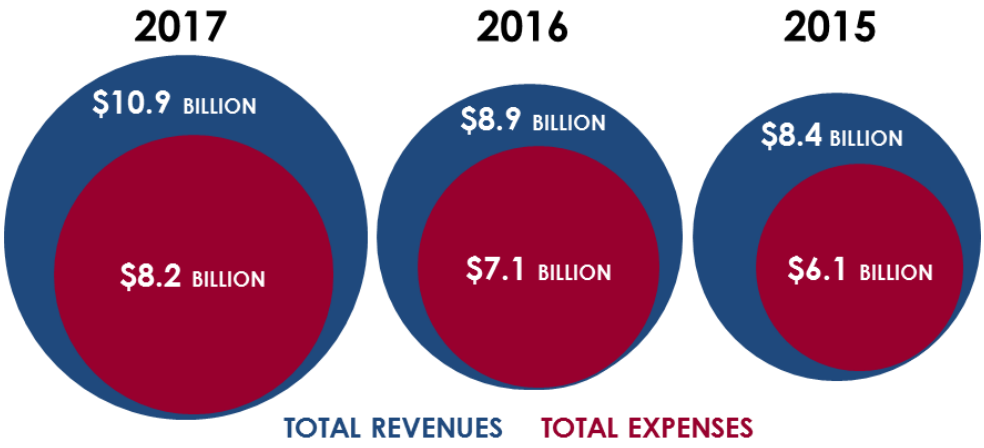
	2017	2016	2015	
GENERATION	$658 MILLION	$147 MILLION	$379 MILLION	INCREASED DUE TO RECORD HIGH AVERAGE MARKET PRICES AND INCREASED DEMAND
TRANSMISSION	$351 MILLION	$218 MILLION	$156 MILLION	INCREASED DUE TO AER CAPS ON REVENUE, AND CATCH UP OF PREVIOUS UNDER-RECOVERIES
DISTRIBUTION	$761 MILLION	$808 MILLION	$1.00 BILLION	DECREASED DUE TO AER CAPS ON DISTRIBUTION REVENUE
RETAIL	$120 MILLION	$134 MILLION	$204 MILLION	DECREASED DUE TO RECORD HIGH AVERAGE MARKET PRICES FOR PURCHASING ENERGY

Source: Queensland Audit Office.

This year, profits for the sector increased by $583 million (45 per cent). This was mostly because of increased profits from energy generation. Average market prices for energy in 2016–17 were the highest on record ($93.12 per megawatt hour).

Operational expenses for generation also increased, but to a lesser degree ($640 million, or an increase of 25.2 per cent from 2015–16).

Figure 3B
Energy sector income and expenses



Source: Queensland Audit Office.

The state government subsidises the cost of distributing energy to regional Queensland by paying grant funding through a community service obligation payment to Ergon Energy Queensland. Without this funding, energy retail would have recorded a loss of $478 million in 2016–17.

This year, $1.62 billion of dividends were declared for payment to the state government. This was an increase of 11 per cent, primarily because of increased profits.

Figure 3C
Energy sector dividends

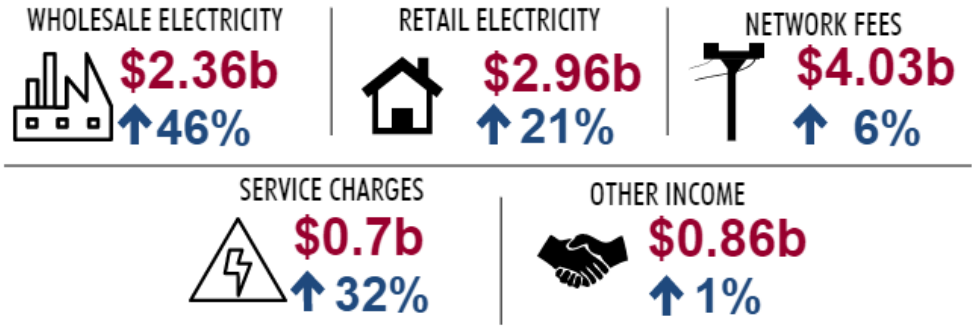
	2017	2016	2015
GENERATION	$383 MILLION	$326 MILLION	$90 MILLION
TRANSMISSION	$361 MILLION	$218 MILLION	$1.28 BILLION
DISTRIBUTION	$719 MILLION	$821 MILLION	$3.07 BILLION
RETAIL	$162 MILLION	$106 MILLION	$145 MILLION

* Dividends declared by Ergon Energy Queensland (retail) are paid internally to parent entities within the Energy Queensland group. Dividends declared by the energy transmitter (Powerlink) include a special dividend of $160 million.

Source: Queensland Audit Office.

Income

Figure 3D
Major income for energy entities 2016–17



Source: Queensland Audit Office.

Income for the energy sector increased by $1.9 billion to $10.91 billion from last year. This represents an increase of 19 per cent.

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

Figure 3E
Income by supply chain element

	2017	2016	2015
GENERATION	$4.28 BILLION	$2.69 BILLION	$2.58 BILLION
TRANSMISSION	$1.37 BILLION	$1.17 BILLION	$996 MILLION
DISTRIBUTION	$3.13 BILLION	$3.10 BILLION	$3.12 BILLION
RETAIL	$2.13 BILLION	$2.03 BILLION	$2.03 BILLION

Source: Queensland Audit Office.

Events and transactions affecting income this year

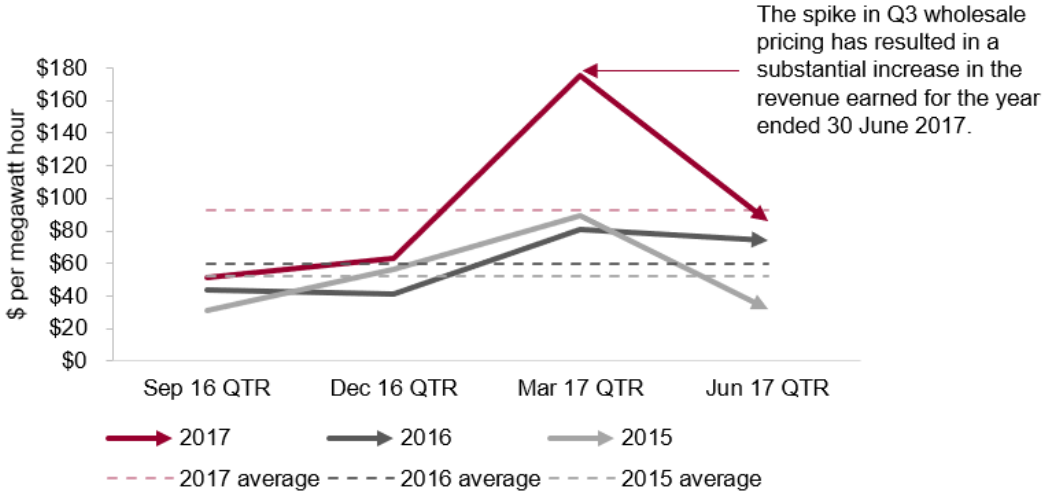
Generation income has increased by 46 per cent since last year

The increase in income from generation is well above historical trends (nine per cent average growth over the last five years). Figure 3F outlines income by supply chain element over the last three years. Generation income is dependent on both demand for energy and the variable price received.

CS Energy and Stanwell increased production by 24 per cent this year because of increased market demand for energy. The energy requirements to produce, transport and export liquefied natural gas, and high summer temperatures contributed to increased market demand.

NEM wholesale prices were 55 per cent higher than last year, mainly due to increase in demand. Figure 3F details the increase in quarterly Queensland wholesale prices over the past five years.

Figure 3F
NEM Queensland wholesale quarterly and annual average prices: 2015–2017



Source: Queensland Audit Office.

In response to increased wholesale energy prices, the Queensland Government announced the *Powering Queensland Plan* in June 2017. The plan includes measures to secure the Queensland electricity supply and maintain energy affordability.

Transmission and distribution income is regulated by the AER

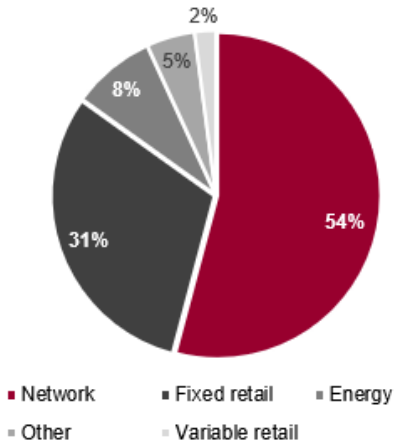
Regulation of transmission and distribution income means the income Powerlink and Energy Queensland can earn is capped by the Australian Energy Regulator (AER). Most recent AER determinations have focused on efficiencies and as a result, income allowances have decreased.

The merger of Energex and Ergon into Energy Queensland was part of the Queensland Government's plan to create efficiency and reduce cost duplication. Energy Queensland's income from distributing energy has remained constant this year. While the use of the energy distribution systems increased in line with the sector, the AER's cap on income decreased in its regulatory determinations applying between 2015 and 2020.

Powerlink's 18 per cent increase in income for transmitting energy was primarily the result of increased use of the transmission network.

Ergon Energy's retail income has increased to $2.1 billion (seven per cent) this year

Figure 3G
Cost breakdown of the most common household tariff in regional Queensland



Source: Oueensland Audit Office

Due to high costs associated with supplying energy to customers in regional Queensland, energy prices for these customers are regulated and capped by the Queensland Competition Authority.

Under the current tariff structure, retail household customers pay the same price for energy, regardless of location in regional Queensland. Figure 3G shows the breakdown of the most common tariff applied to regional household customers.

Increased use of energy by customers combined with higher tariffs approved by the regulator has resulted in a notable increase in retail income 2016–17.

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

Because the cost of supplying energy to regional customers is higher than the tariffs allowed by the Queensland Competition Authority, as mentioned earlier, the state government provides financial support to Ergon Energy.

In 2016–17, the cost to government increased by 10 per cent to $598 million from last year. This was due to increased consumption of energy by consumers and increased market prices for energy. Funding per customer is higher in isolated areas of Queensland as the cost of supplying energy is higher; however, the tariffs remain constant.

This funding is presented in the income statement as a community service obligation, which offsets network and energy expenses and reduces the total expense reported in the income statement.

Retail income—generators

The retail income of generators increased by 76 per cent from last year to $877 million. This growth was driven by increases in wholesale prices and the amount of electricity sold to customers throughout the year. Retail income growth has increased on average by 56 per cent throughout the past five years as generators have expanded their retail customer base.

Future challenges and emerging risks

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

The Australian Energy Market Operator forecasts that after 2019–20, total demand for energy will flatten in Queensland after liquefied natural gas operations reach full production.

In June 2017, the Queensland Government released the *Powering Queensland Plan*. The plan includes a number of measures at a cost of $1.16 billion undertaken by the Queensland Government by reinvesting the profits of the energy generators. The measures are aimed at ensuring affordable, secure and sustainable energy supply.

Several of the measures are expected to impact on electricity prices in the wholesale energy market, namely:

- returning Swanbank E gas-fired power station to service—by 1 January 2018
- directing Stanwell Corporation to undertake bidding strategies to place downward pressure on wholesale prices.

The remaining measures are intended to put downward pressure on retail prices, and include:

- providing electricity price relief by investing $771 million to cover the cost of the Solar Bonus Scheme, reducing the 2017–18 increase for the typical regional Queensland household from 7.1 per cent to 3.3 per cent, and for the typical small business from 8.2 per cent to 4.1 per cent
- investigating the restructure of the government owned corporation generators and establishing a 'CleanCo'
- delivering a $386 million Powering North Queensland Plan to strengthen and diversify the north's energy supply.

Further, through the *Powering Queensland Plan,* the Queensland Government has confirmed its commitment to a 50 per cent renewable energy target by 2030. 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 are diversifying their operations by expanding into the retail market and exploring alternative ways to generate value from their asset base.

AER continues to place downward pressure on charges for transmission

The income able to be earned by Powerlink by the AER will decrease by 36 per cent next year. Powerlink is focused on cost efficiencies and is aiming to expand its non-regulated income sources (those not covered by the AER). Income from non-regulated sources grew by 10 per cent in the current year.

Sustainability of networks in Queensland

Distribution costs per regional Queensland customer 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 increases 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.

AASB 15 *Revenue from Contracts with Customers*—application to energy sector

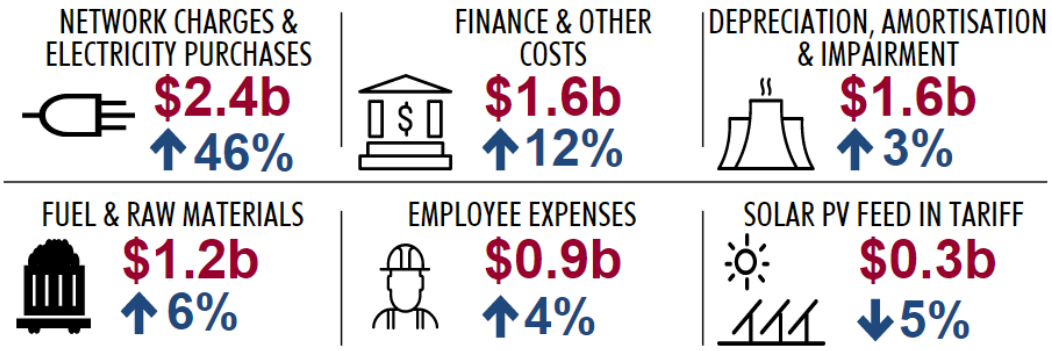
The revenue and income of energy entities will be affected by the new Australian Accounting Standard (AASB) 15 *Revenue Contracts with Customers* from 1 January 2019. This standard is more complex and includes more judgements than the current equivalent standards.

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 energy purchased from the NEM to retail customers. Each of these sources will need to be analysed to determine what changes will be required.

Given the variety of sources of revenue and income, contracts that span multiple years, and the complexity of the new standards, energy entities should not underestimate the effort required to prepare themselves. They may have to make changes to systems, processes, accounting policies, and in some instances, contracts.

Expenses

Figure 3H
Major expenses for energy entities in 2016–17



Source: Queensland Audit Office.

The energy sector recorded expenses of $8.2 billion in 2016–17, an increase of 15 per cent from 2015–16. This was largely due to the increased cost of energy purchased from the NEM by Ergon Energy Queensland for supply to retail customers.

Events and transactions affecting expenses this year

Increased network charges and electricity purchases

Network charges recorded by the energy entities have increased in 2016–17, due to increased market demand and increased AER caps for Powerlink. Network charges are passed through to customers from electricity retailers. In 2016–17, Ergon Energy Queensland and Stanwell purchased energy from the NEM to supply their retail customers. In addition to its generation activities, Stanwell retails energy to several large commercial entities. The cost of the purchases has increased in line with higher average market prices and increased demand.

Fuel costs and raw materials

The generators incurred $520 million in fuel costs in 2016–17, which was an increase of 13 per cent from last year. This correlates with an increase in energy demand, both in Queensland and interstate. Queensland exports energy to New South Wales, using an interconnector in the transmission network. The cost of fuel remained constant as both CS Energy and Stanwell have coal supply arrangements in place.

Employee benefits expenses have stayed constant

Employee benefits expenses increased by four per cent to $852 million in 2016–17. This increase is attributable to wage growth as there has been limited movement in the number of employees across the sector.

Energy sector employees

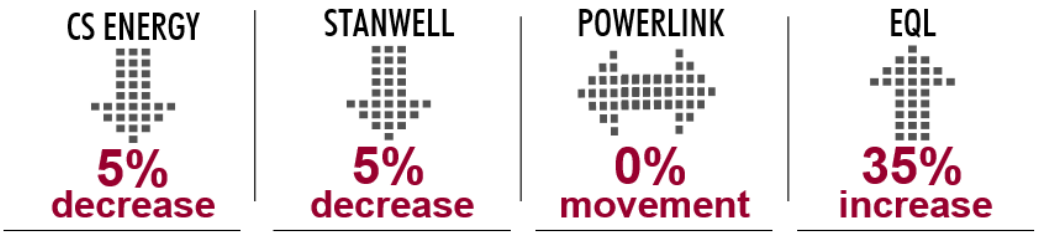
8 985 in 2016–17

8 958 in 2015–16

Interest expense

The energy entities recorded interest expense of $1.2 billion in 2016–17, compared to $0.96 billion in the previous year.

Figure 3I
Movement in interest expense in 2016–17



Source: Queensland Audit Office.

During 2015–16, the debt held by Energy Queensland increased by $4.2 billion as a result of Queensland Government policy decisions. As the increase occurred at the end of 2015–16, the full impact on interest expense was experienced for the first time in 2016–17. Energy Queensland's increased interest expense contributed to a decrease in Energy Queensland's profitability.

Under current arrangements with the Queensland Treasury Corporation, energy entities are not required to repay their principal borrowings. All energy entities have made interest only repayments during 2016–17.

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 the lower of the expected cost of terminating the contract and 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. While this has historically been quite volatile, the impact in 2016–17 was a $37 million decrease in expenses, as the value of the provision decreased.

Future challenges and emerging risks

Solar feed-in tariff

Energy Queensland paid $290 million in solar photovoltaic (PV) feed-in tariffs in 2016–17. This included the customers who received the 44c feed-in tariff from the prior scheme—the Solar Bonus Scheme.

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.

Under the *Powering Queensland Plan,* the Queensland Government removed the cost of the Solar Bonus Scheme from network tariffs until the end of 2020. This removal will not affect payments made to eligible customers under the scheme. It means the costs 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 three years is $771 million. This amount was paid in full to Energy Queensland in June 2017 to fund the expense for the next three years. Energy Queensland reported the payment as unearned income.

Over the past three years, the Solar Bonus Scheme has cost customers not participating in the scheme a total of $913 million. Strict eligibility criteria have seen the annual cost of the solar bonus feed-in tariff reduce by five per cent each year over the past three years. It will continue to decrease each year until the end of the scheme.

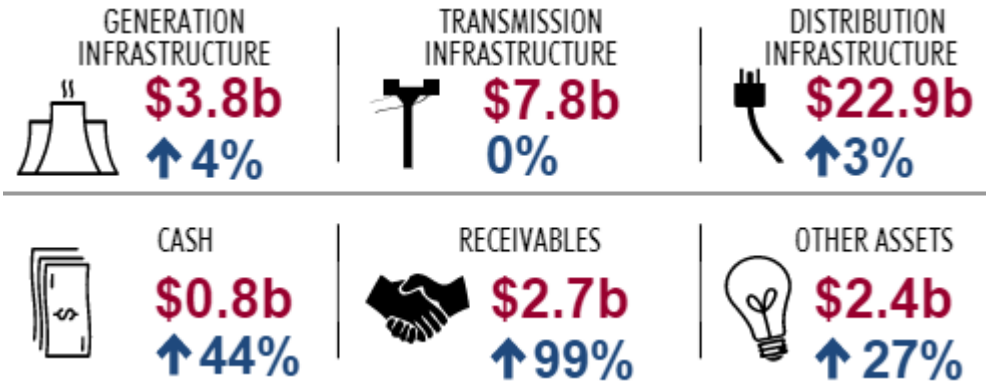
Understanding financial position

Net assets increased by $184 million (2.5 per cent) in 2016–17. This was primarily due to increases in property, plant, and equipment associated with capital expenditure and a reversal of an impairment. The capital replenishment ratio for 2016–17 was 1.32, indicating that entities are spending more on assets than they are recording as depreciation. The ratio decreased from last year (1.79) due to lower capital spending on assets.

The impact of capital expenditure on net assets was offset by an increase in dividends declared to shareholders from retained earnings and reserves.

Assets

Figure 3J
Total assets for all entities by type for 2016–17



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 and increased receivables

As part of its *Debt Action Plan*, the Queensland Government has announced measures to reduce general government debt. This includes arrangements with government owned corporations (GOC) to better use cash held by these entities.

GOCs, including energy entities, will be required to forecast cash flows for a 12-month period and advance any surplus cash to Queensland Treasury. The arrangement allows the GOCs to recall cash should their cash flow requirements change. GOCs will receive market based interest on their deposits.

Between 28 June 2017 and 30 June 2017, Powerlink and Energy Queensland transferred $1.3 billion in surplus cash held to Queensland Treasury.

After this transfer, the cash held by energy entities remained $231 million higher than the previous year. This was due to a $415 million increase in cash held by the generating entities, offset by lower cash held by Powerlink and Energy Queensland.

Impairment losses were reversed on coal-fired generation assets

The generators, CS Energy and Stanwell, record their assets at historical cost. The value of these assets increased to $3.8 billion in 2016–17 (an increase of three per cent). This increase was primarily due to CS Energy reversing historical impairment losses of $242 million.

The impairment loss was previously recognised due to a lack of reliable and certain coal supply and ongoing litigation with Anglo American Metallurgical Coal (Anglo) impacting on the operations of the Callide B and Callide C power stations.

In October 2016, Anglo sold the Callide Mine to Batchfire Resources Limited and CS Energy entered into a revised coal supply agreement. The revised agreement resulted in improved coal price, quantity, and quality, and improved long-term reliability of coal supply. These factors supported the reversal of the historical impairment losses recorded in the statement of comprehensive income.

Value of transmission and distribution assets remained constant

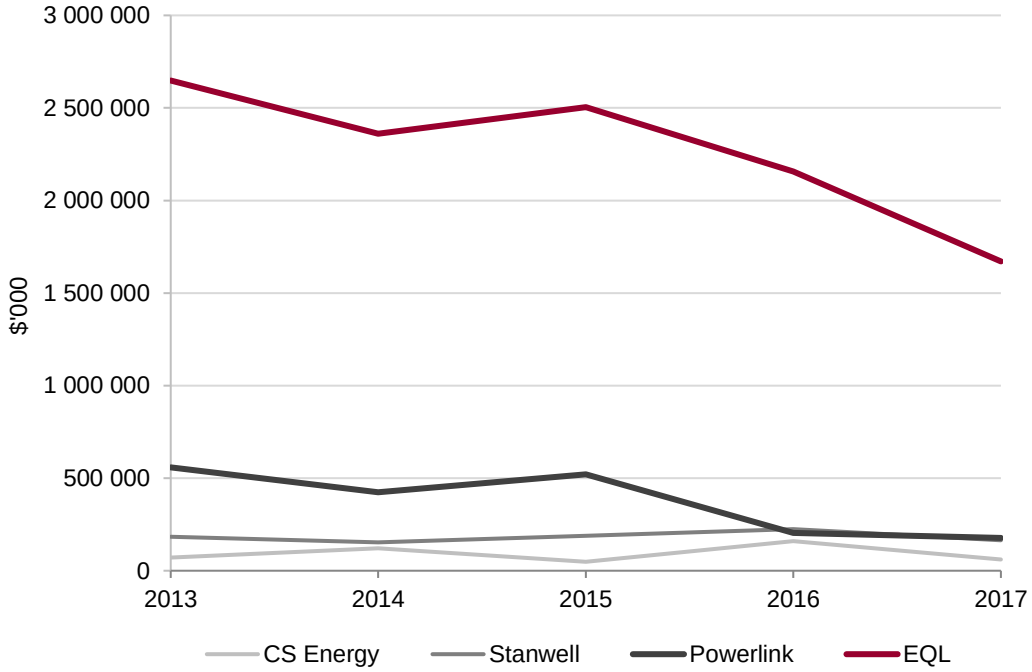
At 30 June 2017 Powerlink and Energy Queensland Limited held combined transmission and distribution assets of $29.3 billion.

All network entities record assets at fair value in their financial statements. They revisit the amounts recorded each year to reassess the valuation—whether each asset's recorded value represents what can be recovered from it during the period the entity owns it. This year, Powerlink and Energy Queensland revalued their infrastructure assets upwards by $314 million—representing one per cent of the value of the assets.

Capital expenditure decreased from prior years and is below budget

The energy entities had total capital expenditure of $2.07 billion in 2016–17. This was a decrease of $673 million (25 per cent) compared to 2015–16. Total expenditure planned for 2017–18 is $1.85 billion, with 87 per cent aimed at improving and reinforcing the efficiency and reliability of the transmission and distribution network. Capital expenditure will be prioritised and will focus on effectively using existing assets.

Figure 3K
Capital expenditure over past five years



Note: Ergon and Energex have been included under Energy Queensland for the 2013, 2014, and 2015 years.

Source: Queensland Audit Office.

Future challenges and emerging risks

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

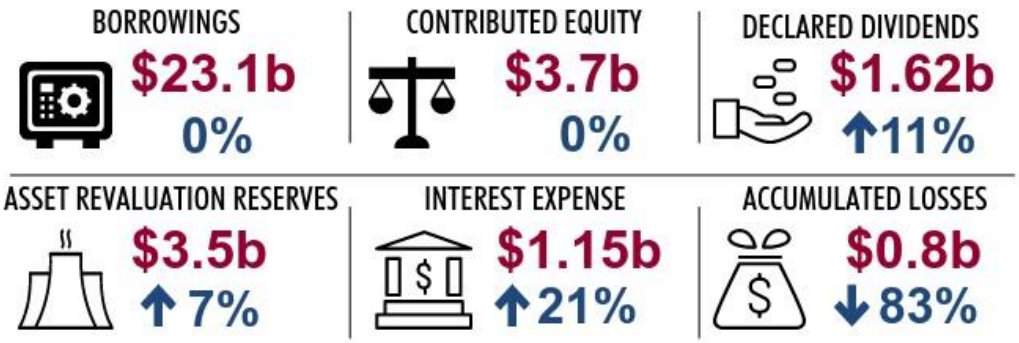
Future changes in technology and renewable policies will affect methods of generation and the use of large distribution networks. Changes in the generation and supply structure and products will be assessed for impacts on expected asset use and value to owners.

Stanwell Burdekin hydro-electric power station

During the year, Stanwell was directed by the state government to reinvest $100 million of its dividend in a proposed hydro-electric power station at Burdekin Falls Dam. Stanwell has completed pre-feasibility studies and a business case for the project is expected to be finalised by mid-2018.

Debt and equity

Figure 3L
Major components of debt and equity for energy entities for 2016–17



Note: Contributed equity Includes equity adjustments relating to the formation of Energy Queensland.

Source: Queensland Audit Office.

Equity: includes shares held by Queensland Government ministers on behalf of the state government, equity adjustments relating to the formation of Energy Queensland, reserves, and accumulated earnings and losses.

The energy sector holds $23.1 billion in borrowings and $7 billion in equity. The debt to equity ratio for the sector (77 per cent) is consistent with 2016–17 and continues to be within industry benchmarks. The credit ratings of the entities have not changed.

Events and transactions affecting debt and equity this year

Increased borrowings and the impact on interest expense

The entities did not enter into any additional borrowings during 2016–17. The Queensland Government, through policy decisions including increased dividends and the Energy Queensland restructure, increased the borrowings held by transmission and distribution networks by $5 billion in 2015–16.

Due to the increase in borrowings in late 2015–16, total interest expense has increased in the 2016–17 year by 21 per cent ($197 million). The increased borrowing costs will continue to affect the profitability of entities.

Dividends declared increase while dividends paid drop due to large payments last year

Each entity sets the percentage of profits that entities will return as a dividend, which is agreed with the Queensland Government. This year the following entities declared dividends of $1.62 billion:

- Stanwell retained $100 million, reduced the remaining profits by $15 million to reflect non-cash transactions and declared $261 million of profits.
- CS Energy reduced profits by $129 million to reflect non-cash transactions and declared a dividend of 80 per cent of remaining profits or $123 million.
- Powerlink retained $150 million and declared the remaining $201 million of profits.
- Energy Queensland declared 100 per cent of profits or $881 million (this incorporates the dividends received from its subsidiary Ergon Energy Queensland).

In addition to the year end dividends, Powerlink also paid interim special dividends of $160 million ($150 million in 2015–16).

Prior to 2016–17, the sector's dividends were funded through a mix of cash and increased borrowings, and were declared from profits and reserves. Borrowings for the sector did not increase this year. Dividends were funded solely through cash and were declared from profits and reserves.

CS Energy reported a net profit before tax this year of $283 million and has accumulated losses of $566 million. It declared a dividend of $123 million this year, compared to $13.8 million last year, both declared solely from reserves. Prior to this, the last dividend declared by CS Energy was in 2008–09.

Typically, the energy entities declare a final dividend in one year and pay the dividend in the following year. In 2015–16, Energy Queensland effectively paid dividends relating to two financial years, being:

- the $3.2 billion dividend declared in 2014–15 by Energex and Ergon prior to Energy Queensland taking control of both entities
- the $927 million dividend declared in 2015–16 for Energy Queensland.

This inflated the dividend paid in 2015–16 and resulted in comparatively low dividends paid in 2016–17. This year, the energy entities paid a combined $704 million in dividends to the state government, compared to $5.5 billion in the previous year.

Future challenges and emerging risks

The Queensland Government continues to require a dividend of 100 per cent of energy net profits after tax for all entities except CS Energy. During the last two years, a mixture of net profit after tax and special dividends have been paid to the state government using cash and additional borrowings, through realised accumulated earnings and unrealised asset revaluation reserves. While this continues, there is a risk of depleting cash and reserves, resulting in a limited ability to fund future dividends with increased debt.

This aligns with the Queensland Government budget, which has forecasted earnings from the energy sector to decrease to $2.4 billion by 2020–21 due to expected reductions in wholesale generation and electricity earnings.

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. Energy Queensland is a GOC and Energex and Ergon are now GOC subsidiaries.

Figure 3M
Structure of Energy Queensland Limited

Source: Queensland Audit Office.

The purpose of this change was to improve cost management and create efficiencies with the potential to lower energy prices long term. The reorganisation of systems, processes, and people is a challenge affecting Energy Queensland, and the plans for transition span several years.

In 2016–17, we assessed the control environment as effective, despite ongoing change.

Processes

Since 30 June 2016, Energy Queensland has reported the results and position of the group in a single set of financial statements. Australian accounting standards require Energy Queensland to apply consistent accounting policies in its group financial statements.

The focus of our audit is on processes affecting the financial statements, and our analysis is limited to these processes. During the year, Energy Queensland consolidated several of its governance and financial processes. Progress on resolving the inconsistencies in policies and processes is monitored by the head of internal audit. We believe this process is being completed at a reasonable pace, with adequate visibility being provided to the audit committee and the board.

Property, plant, and equipment is the only significant item in the group financial statements ($22.9 billion) for which we have identified inconsistencies in policies and processes. Management assessed the impact of each inconsistency and addressed several when preparing the financial statements to ensure the financial statements were materially correct. Others require more detailed investigation and will be addressed during 2017–18.

Prior to the establishment of Energy Queensland, Energex and Ergon used a joint venture entity, SPARQ, to deliver their information technology (IT) support. SPARQ operated with its own management and governance structure and collected income for services provided to Energex and Ergon ($201 million in 2015–16). Energy Queensland now treats SPARQ as a business unit rather than a service provider. SPARQ is led by the Chief Information Officer of Energy Queensland instead of having its own executive structure.

In merging Energex and Ergon's processes, Energy Queensland must continue to comply with the 'ringfencing' guidelines of the Australian Energy Regulator (AER). Under these guidelines, the AER requires distribution companies to separate their distribution and other services to ensure the distribution services do not cross-subsidise other services or discourage competition.

Systems

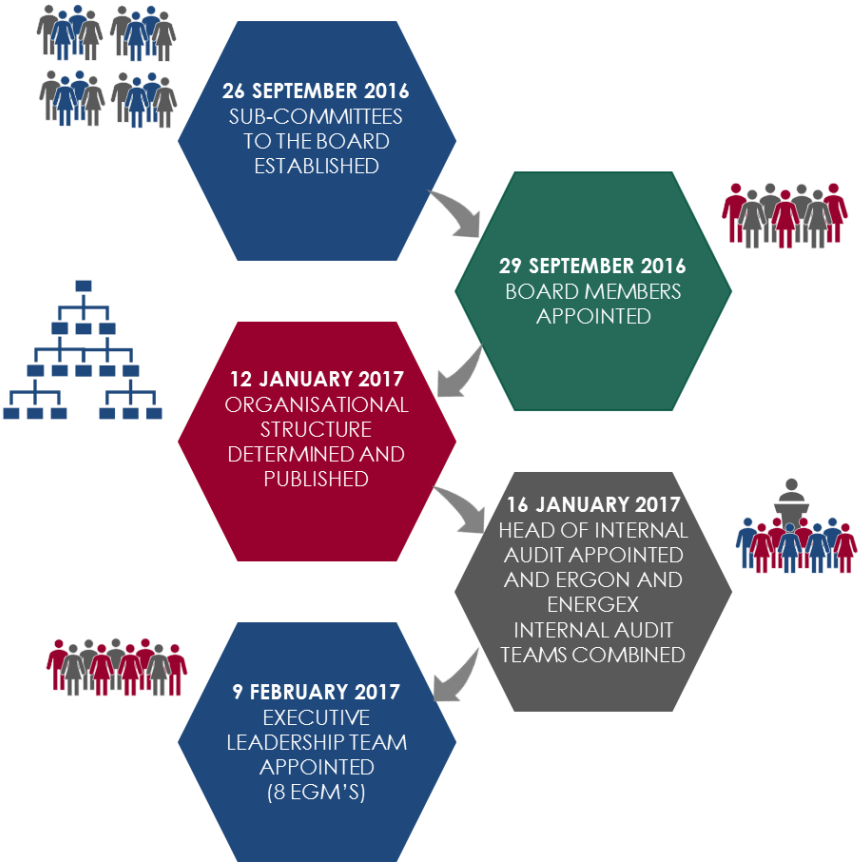
Historically, when entities in the energy sector have restructured, they have continued to work with multiple financial information systems for several years, rather than consolidating their financial information into one system. We often identify control deficiencies relating to information systems in these entities.

Energy Queensland has begun reviewing the systems currently used and where deemed applicable, is planning to align the systems used by Ergon and Energex. We expect the updated system to be in place within three years.

People

During 2016–17, Energy Queensland took steps to consolidate the management and governance structures of Ergon and Energex as outlined below.

Figure 3N
Timeline of organisational changes at Energy Queensland



Source: Queensland Audit Office.

During 2016–17, Energy Queensland offered employees voluntary redundancies, and 383 employees (five per cent of total employees) received termination payments with a total value of $61 million (including the payout of annual and long service leave). The voluntary redundancy process was supported by Energy Queensland's successful application to the Australian Taxation Office for an Early Retirement Scheme to be made available to Energy Queensland employees under 65 (approved on 1 March 2017).

4. Internal controls

Introduction

This chapter evaluates the effectiveness of internal controls as they relate to our audit.

Through our analysis, we aim to promote stronger internal control frameworks, and 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. Consequently, we relied on the internal control systems of the entities.

- We did not identify any significant deficiencies (high risk matters) in the sector relating to internal controls. We identified 16 control deficiencies (low to moderate risk matters) across the sector.
- The energy entities have accepted our recommendations and are working on addressing the deficiencies by 1 July 2018.

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. We also assess whether they achieve compliance with legislative requirements and make appropriate use of public resources. 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 deficiencies in internal controls to management.

Our rating of internal control deficiencies

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.

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:

- 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 the 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 F.

Figure 4A shows the 16 control deficiencies (categorised by COSO component) reported to management at 31 August 2017.

Figure 4A
Number and category 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 & 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	15 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 activities

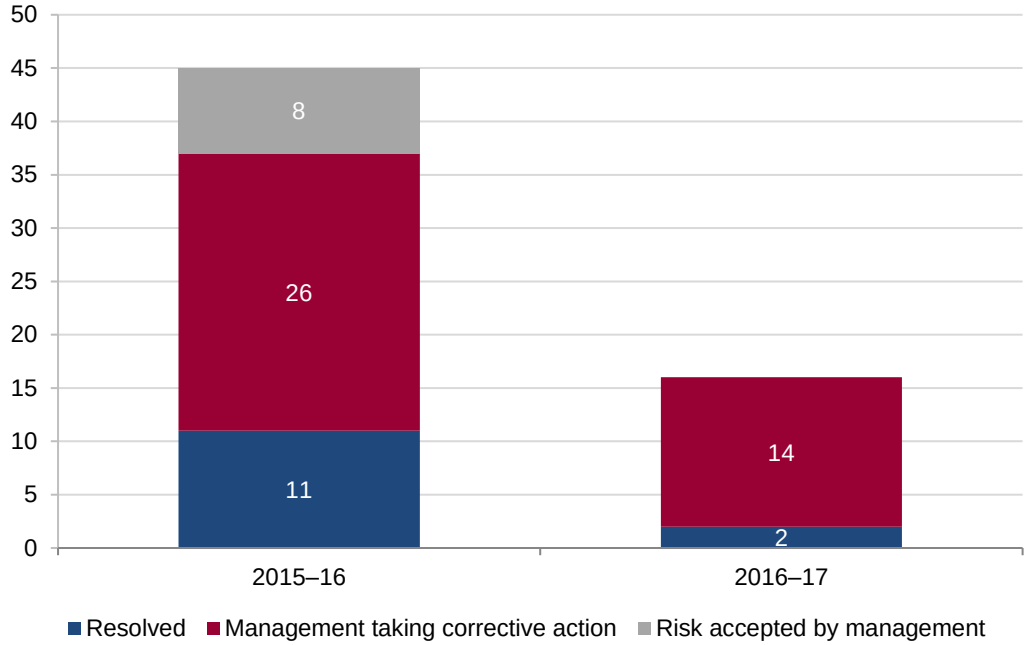
In 2016–17, we identified nine deficiencies in general information technology controls relating to user access, system capability, and system changes. We also identified six deficiencies in manual control activities relating to authorisations, validations, and reconciliations. These issues were isolated and 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. Audit committees are in place 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, as at 31 August 2017, of internal control deficiencies reported over the last two years.

Figure 4B
Status of internal control deficiencies for 2015–16 and 2016–17



Source: Queensland Audit Office.

All entities either addressed their identified control deficiencies or are on track to do so by the agreed dates. 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

Appendix 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 comment to the Minister for Natural Resources, Mines and Energy; the Director-General, Department of Natural Resources, Mines and Energy; and the 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:

- Stanwell Corporation Limited
- CS Energy 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 to our audit recommendations.

Comments received from Deputy Premier, Treasurer, Minister for Aboriginal and Torres Strait Islander Partnerships, Queensland Treasury

Queensland Government

Deputy Premier
Treasurer
Minister for Aboriginal and Torres Strait Islander Partnerships

1 William Street
GPO Box 611 Brisbane
Queensland 4001 Australia
Telephone +61 7 3719 7100
Email deputy.premier@ministerial.qld.gov.au

ABN 90 856 020 239

Our Ref: 00638-2018
Your Ref: Dominika Ryan 3149 6163

16 FEB 2018

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

Dear Mr Worrall

Thank you for your letter of 18 December 2017 regarding the Queensland Audit Office (QAO) draft report Energy: 2016-17 Results of Financial Audits (the Report) and the opportunity to provide comments.

I understand that officers from Queensland Treasury have discussed the draft report with officers of the QAO.

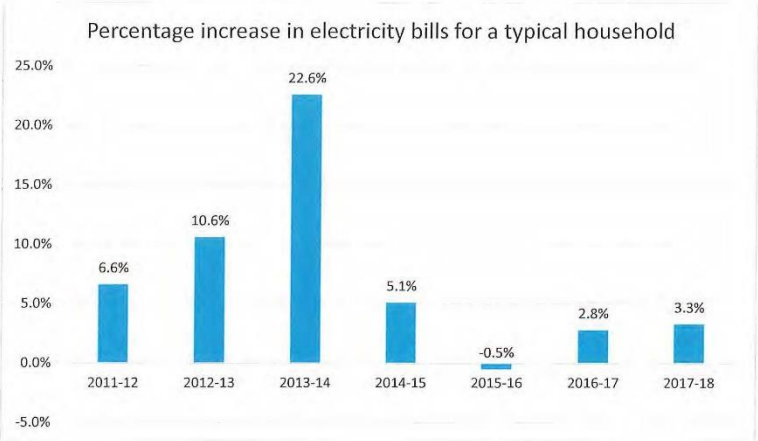
I note that the QAO provided unmodified audit opinions on the financial statements for 2016-17 for all energy sector entities. I welcome the QAO's view that the implementation of effective year end close processes, financial management processes and internal review processes by the entities contributed to this result.

Higher electricity prices are a challenge being faced by all jurisdictions in the National Electricity Market. As you note in the report, this reflected energy supply restrictions in southern states and uncertain carbon policy at the federal level.

I am pleased to note the Report recognises the significant investments by this Government aimed at putting downward pressure on electricity prices under its Powering Queensland Plan. These initiatives reinvest the dividends received from energy businesses into measures aimed at ensuring affordable, secure and sustainable energy supply for Queensland homes, businesses and industry.

Queensland has already seen the benefits of its actions to reduce wholesale prices with the 2018 forward contract price in Queensland falling by 18 per cent (as at 18 January 2018) since the announcement.

I also note over the term of the Palaszczuk Government average prices for households have increased an average of just 1.9 per cent per year. This compares to a total increase of 43 per cent for the average household when the LNP Government was in power. The below chart demonstrates this Government's success in keeping electricity prices low compared to the former LNP Government.



Source – Queensland Competition Authority

If you would like to discuss any of the comments please contact Mr Rimu Nelson, Director, Shareholder and Structural Policy Division on

Yours sincerely

JACKIE TRAD MP
DEPUTY PREMIER
Treasurer
Minister for Aboriginal and Torres Strait Islander Partnerships

Appendix B—The Queensland Audit Office

The auditor-general, supported by the Queensland Audit Office, is the external auditor of the state's public sector. Each year, through our financial audit program, we form independent audit opinions about the reliability of financial statements produced by state and local government entities.

We provide independent assurance directly to parliament about public sector finances. We also help the public sector meet its accountability obligations. Our role and the work we do is critical to the integrity of our system of government.

The auditor-general must prepare reports to parliament on each audit conducted. These reports must state whether the financial statements of a public sector entity have been audited. They may also draw attention to significant breakdowns in the financial management functions. This report satisfies these requirements.

Appendix C—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 (Stanwell) CS Energy Limited (CS Energy) Queensland Electricity Transmission Corporation Limited (Powerlink) Energy Queensland Limited (Energy Queensland)	▪ *Government Owned Corporations Act 1993* ▪ *Corporations Act 2001* ▪ Corporations Regulations 2001	31 August 2017
Controlled entities	Ergon Energy Queensland Pty Ltd (Ergon Energy Queensland)	▪ *Corporations Act 2001* ▪ Corporations Regulations 2001	31 October 2017

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 where 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 better understand the financial statements. These do not change the audit opinion.

Appendix D—Key audit matters

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

Key audit matter	Entity
Valuation of the carrying amount of property, plant, and equipment	CS Energy Limited
Valuation of supply system assets	Energy Queensland Limited Powerlink Queensland
Depreciation and useful lives	Energy Queensland Limited Powerlink Queensland
Provisions for restoration, rehabilitation, and decommissioning	Stanwell Corporation Limited
Provisions for onerous contract	CS Energy Limited
Recognition of unbilled revenue sales	Ergon Energy Queensland
Calculation of community service obligation earned	Ergon Energy Queensland
Measurement of derivative financial instruments	Stanwell Corporation Limited Ergon Energy Queensland

Appendix E—Entities not preparing financial reports

The auditor-general will not issue audit opinions for the following entities controlled by Stanwell, CS Energy, Powerlink and Energy Queensland for the 2016–17 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
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
Manzillo Insurance (PCC) Ltd—Cell Enmach	Non-reporting

Public sector entity	Reason for not preparing financial reports
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
Energy Impact Pty Ltd	Non-reporting
Metering Dynamics Business Support Pty Ltd	Non-reporting
Varnsdorf Pty Ltd	Non-reporting
VH Operations Pty Ltd	Non-reporting
Ergon Energy Corporation Limited	Deed of cross guarantee ASIC order
Ergon Energy Telecommunications Pty Ltd	Non-reporting
Sparq Solutions Pty Ltd	Deed of cross guarantee ASIC order

Note: Manzillo Insurance (PCC) Ltd—Cell EnMach was established in Guernsey, and is therefore exempt from audit by us under s.32 of the *Auditor-General Act 2009*. It is not required to produce financial statements in Guernsey. The company's results were consolidated into CS Energy Limited's Australian financial statements. ASIC—Australian Securities and Investments Commission (ASIC). Entities are also not required to prepare financial statements when they have obtained an exemption through the ASIC as they were part of a larger group, secured by a deed of cross guarantee with their parent entity to cover debts.

Source: Queensland Audit Office.

Appendix F—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 designed to prevent, or detect and correct, material misstatements in the financial report, and achieve compliance with legislative requirements and appropriate use of public resources.

Our assessment determines the nature, timing, and extent of testing we perform to address the management assertions at 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 management assertions at risk 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.

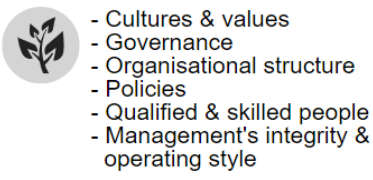
Our audit procedures are designed to address the risk of material misstatement, so we can express an opinion on the financial report. We do not express an opinion on the effectiveness of internal controls.

Internal controls framework

We categorise internal controls using the Committee of 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 for a successful internal control system. These components are explained in the following paragraphs.

Control environment



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, ensuring 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 achieve appropriate management of 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. Risks can also be eliminated 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, and 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 in processing large volumes of transactions, and improve the effectiveness of financial delegations and 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 processes used to control how 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. They 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.

Appendix G—Our criteria for assessing financial statement preparation

Our assessment of the effectiveness of financial statement preparation processes involved considering three components—the year end close process, and the timeliness and quality of financial statements.

We assess financial statement preparation processes under the following criteria.

Year end close process

State public sector entities should have a robust year end close process to enhance the quality and timeliness of the financial reporting processes. This year we assessed processes for year end financial statement preparation against the following key targets where applicable:

- prepare pro-forma financial statements by 30 April
- resolve known accounting issues by 30 April
- complete non-current asset valuations by 31 May
- complete early close processes
- conclude all asset stocktakes by 30 June.

These targets were developed based on advice previously issued by the Under Treasurer in 2014, and better practice identified in other jurisdictions.

Rating scale	Assessment criteria—year end close process
● Fully implemented	All key processes completed by the target date
● Partially implemented	Three key process completed within two weeks of the target date
● Not implemented	Less than two key processes completed within two weeks of the target date

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 greater than two days after the planned date

Quality of draft financial statements

We calculated the difference between the first draft financial statements submitted to audit and the final audited financial statements for the key financial statement components of total revenue, total expenses, and net assets. Our quality assessment is based on the percentage of adjustments across each of these components.

Rating scale	Assessment criteria—quality of draft financial statements
● No adjustments	No adjustments were required
● No significant adjustments	Adjustments for any of the three key financial statement components of total revenue, total expenses and net assets were less than five per cent
● Significant adjustments	Adjustments for any of the three key financial statement components of total revenue, total expenses and net assets were greater than five per cent

Appendix H—Glossary

Term	Definition
Accountability	Responsibility of public sector entities to achieve their objectives in reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws, and reporting 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	Amount capitalised to the balance sheet for contributions by an entity to major assets owned by the entity, including expenditure on: ▪ capital renewal of existing assets that returns the service potential or the life of the asset to that which it had originally ▪ capital expansion, which extends an existing asset at the same standard to a new group of users.
Community service obligations	Government payments to commercial entities to provide services that are not in the entity's commercial interests.
Depreciation	The systematic allocation of a fixed asset's capital value as an expense over its expected useful life to take account of normal usage, obsolescence, or the passage of time.
Discount rate	Interest rate used to calculate the present day value.
Emphasis of matter	A paragraph included with the audit opinion to highlight an issue of which the auditor believes the users of the financial statements need to be aware; the inclusion of an emphasis of matter paragraph does not modify the audit opinion.
Going concern	Means 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.
Net assets	Total assets less total liabilities.

Term	Definition
Net debt	Total QTC borrowings less cash.
Megawatt hours	A megawatt hour (Mwh) is equal to 1 000 kilowatts of energy used continuously for one hour.
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).

Source: Queensland Audit Office.

Auditor-General reports to parliament

Reports tabled in 2017–18

Number	Title	Date tabled in Legislative Assembly
1.	Follow-up of Report 15: 2013–14 Environmental regulation of the resources and waste industries	September 2017
2.	Managing the mental health of Queensland Police employees	October 2017
3.	Rail and ports: 2016–17 results of financial audits	December 2017
4.	Integrated transport planning	December 2017
5.	Water: 2016–17 results of financial audits	December 2017
6.	Fraud risk management	February 2018
7.	Health: 2016–17 results of financial audits	February 2018
8.	Confidentiality and disclosure of government contracts	February 2018
9.	Energy: 2016–17 results of financial audits	February 2018

Contact the Queensland Audit Office