



**Consideration of Auditor-General
Report 4: 2019-20—*Water: 2018-19*
*results of financial audits***

**Report No. 47, 56th Parliament
State Development, Natural Resources and
Agricultural Industry Development Committee
March 2020**

State Development, Natural Resources and Agricultural Industry Development Committee

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Abbreviations

Auditor-General's report	<i>Water: 2018-19 results of financial audits (Report 4: 2019-20)</i>
Category one water board	For-profit water authorities established under the <i>Water Act 2000</i>
Category two water board	Not-for-profit water authorities, other than category one authorities
GAWB	Gladstone Area Water Board
LSA	<i>Legislative Standards Act 1992</i>
MIWB	Mount Isa Water Board
QAO	Queensland Audit Office
QCA	Queensland Competition Authority
Queensland Urban Utilities/QUU	Central SEQ Distributor-Retailer Authority (trading as Queensland Urban Utilities)
Seqwater	Queensland Bulk Water Supply Authority (trading as Seqwater)
Sunwater	Sunwater Limited
Unitywater	Northern SEQ Distributor-Retailer Authority (trading as Unitywater)

Chair's foreword

This report presents a summary of the State Development, Natural Resources and Agricultural Industry Development Committee's examination of the Auditor-General's report, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*.

The committee's task was to consider the Auditor-General's findings in relation to financial audits of the state government's main water sector entities, including bulk water suppliers and distributor-retailers across south-east and regional Queensland.

The Queensland Audit Office focused on how water entities use complex models to measure their assets and also assessed the adoption of the new revenue and lease standards, which came into effect on 1 July 2018 and 1 July 2019 respectively. The Queensland Audit Office made 22 recommendations to address deficiencies and business improvement opportunities.

The committee reviewed the report and discussed its conclusions and recommendations with the Auditor-General.

On behalf of the committee, I thank the Auditor-General and the Queensland Audit Office for their assistance with the committee's examination of this report.

I commend this report to the House.



Chris Whiting MP

Chair

Recommendation

The committee recommends that the Legislative Assembly note this report.

1 Introduction

1.1 Role of the committee

The State Development, Natural Resources and Agricultural Industry Development Committee (committee) is a portfolio committee of the Legislative Assembly which commenced on 15 February 2018 under the *Parliament of Queensland Act 2001* and the Standing Rules and Orders of the Legislative Assembly.¹

The committee's areas of portfolio responsibility are:

- State Development, Manufacturing, Infrastructure and Planning
- Natural Resources, Mines and Energy, and
- Agricultural Industry Development and Fisheries.

Pursuant to s 94(1)(a) of the *Parliament of Queensland Act 2001*, the committee has responsibility within its portfolio areas for the assessment of the integrity, economy, efficiency and effectiveness of government financial management by:

- examining government financial documents, and
- considering the annual and other reports of the Auditor-General.

1.2 Role of the Auditor-General

The role of the Auditor-General is to provide the Legislative Assembly with independent assurance of public sector accountability and performance. This is achieved through reporting to the Legislative Assembly on the results of its financial and performance audits.

A financial audit assesses whether the information contained in the financial statements of public sector entities is accurate, can be relied upon and is prepared in accordance with Australian Accounting Standards and relevant legislative requirements.²

The Auditor-General's report titled *Water: 2018-19 results of financial audits (Report 4: 2019-20)* (Auditor-General's report) was prepared under Part 3 Division 3 of the *Auditor-General Act 2009* and was tabled in the Legislative Assembly in accordance with s 67 of that Act.

1.3 Referral of the Auditor-General's Report

Standing Order 194B provides that the Committee of the Legislative Assembly shall as soon as practicable after a report of the Auditor-General is tabled in the Legislative Assembly, refer that report to the relevant portfolio committee for consideration.

A portfolio committee may deal with this type of referral by considering and reporting on the matter and making recommendations about it to the Legislative Assembly.³

On 24 October 2019, the Auditor-General's report was tabled and referred to the committee for consideration and report.

1.4 Examination process

On 17 February 2020, the committee held a public briefing on the Auditor-General's report and heard from the Auditor-General and officers from the Queensland Audit Office (QAO). See Appendix A for a list of witnesses. A copy of the transcript is available on the committee's webpage.⁴

¹ *Parliament of Queensland Act 2001*, section 88 and Standing Order 194.

² Queensland Audit Office Practice Statement – Financial statement audit, p 1.

³ *Parliament of Queensland Act 2001*, s 92(3).

⁴ <https://www.parliament.qld.gov.au/work-of-committees/committees/SDNRAIDC/inquiries/current-inquiries/AG4Water2019-20>

2 Examination of the Auditor-General's Report

2.1 Background

The Auditor-General's report summarises the results of the financial audits of five Queensland public sector water entities:

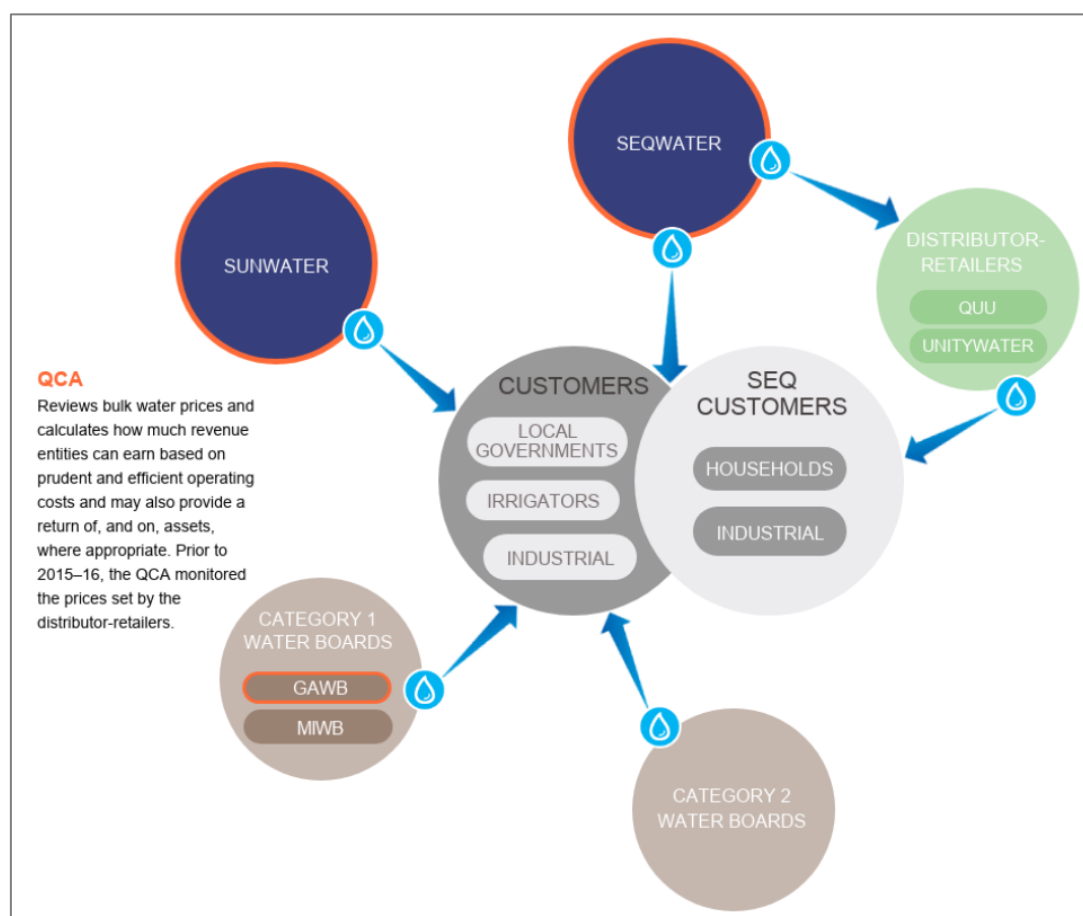
- Seqwater (bulk water supplier)
- SunWater (bulk water supplier)
- Queensland Urban Utilities (distributor-retailer)
- Unitywater (distributor-retailer)
- Mount Isa Water Board (category 1 water board).

A sixth water entity, Gladstone Area Water Board, was not included in the Auditor-General's report, as the board was granted an extension to its legislative timeframe for finalising its audited financial statements as they did not have directors in place at the time the financial statements were due to be signed. Gladstone Area Water Board was later assessed through an independent auditor's report on 13 November 2019.⁵

The smaller category 2 boards and local governments which also provide water services in Queensland were outside the scope of the Auditor-General's report.

The following diagram illustrates these entities' roles in the water supply chain in Queensland.

Figure 1: Major state and local government owned entities of the Queensland water sector



Source: Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 3.

⁵ Gladstone Area Water Board 2019 Annual Report, pp 83-85.

The water entities prepare their financial statements in accordance with the legislative frameworks and reporting deadlines shown in Figure 2.

Figure 2: Legislative frameworks for the water sector

Entity type	Entity	Legislative framework	Legislated deadline
Statutory bodies	• Queensland Bulk Water Supply Authority (trading as Seqwater)	• <i>Financial Accountability Act 2009</i> • Financial and Performance Management Standard 2009	31 August 2019
	• Northern SEQ Distributor-Retailer Authority (trading as Unitywater)	Unitywater and Queensland Urban Utilities only: • <i>South-East Queensland Water (Distribution and Retail Restructuring) Act 2009</i>	
	• Central SEQ Distributor-Retailer Authority (trading as Queensland Urban Utilities)		
	• Gladstone Area Water Board		
	• Mount Isa Water Board		
Government owned corporations (GOC)	• Sunwater Limited	• <i>Government Owned Corporations Act 1993</i> • <i>Corporations Act 2001</i> • Corporations Regulations 2001	31 August 2019

Source: Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 25.

2.2 Audit conclusions

The QAO provided unmodified audit opinions on the financial statements for 2018-19 for the five water sector entities. This means that the financial statements of the examined water sector entities had been prepared in accordance with legislative requirements and Australian accounting standards. QAO stated:

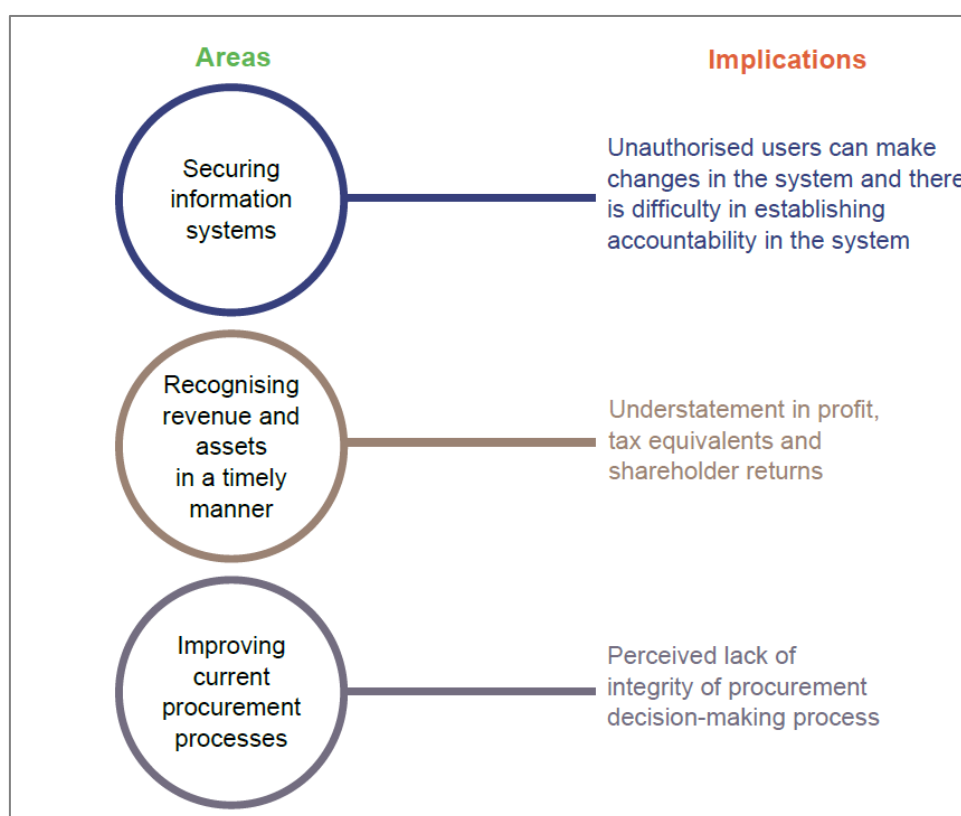
Water entities implemented year end processes that resulted in the timely delivery of draft financial statements. The financial statements were of good quality, but two entities made immaterial changes in 2018–19.⁶

The QAO also examined the effectiveness of the internal controls of water entities to ensure they were suitably designed to prevent, or detect and correct, material misstatements in the financial report. The QAO found that the control environment for each entity was generally effective, and the overall sustainability of the entities remains stable in the short term.

The QAO identified one significant deficiency (high risk matter) relating to targeted fraud attempts in a water entity where employee bank account details were changed. It also identified 12 control deficiencies (low to moderate risk matters) and 10 business improvement opportunities across the sector. Figure 3 sets out the main areas of deficiencies in 2018-19 and the implications for water entities.

⁶ Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 5.

Figure 3: Areas of deficiencies and implications for entities



Source: Queensland Audit Office, Water: 2018-19 results of financial audits (Report 4: 2019-20), p 9.

In relation to the recommendations to all water entities to improve internal controls and processes, the Auditor-General advised the committee that:

... a number of the deficiencies do relate to information systems controls, and that is an ongoing concern for me as the Auditor-General because that is a theme in a number of sectors that does make these entities more vulnerable to fraud. ... That message does not seem to be getting through, not only to this sector but to all sectors, because even as recently as this year there has been another potential [cybersecurity] fraud ... so it is still happening even though we have been publicising it since before I came into the role.⁷

The QAO noted that water entities are quite responsive to improvements recommended by the QAO:

Based on the results of the sector in terms of control deficiencies that we have seen, certainly we do indicate agreed time lines for them to remedy going forward. Of all the control deficiencies that we have noted in the past, the majority of those have been resolved in quite quick time frames. It is one of those where the audit committee then needs to hold management to account to fix those. The key one was rectified very quickly. They had the processes and procedures in place to make sure that did not happen again.⁸

2.2.1 Financial performance of water entities

As part of its analysis of entities' financial statements, the Auditor-General's report sets out a financial snapshot of the Queensland water sector:

- Revenue - \$3.5 billion (6.0% increase from 2017-18)
- Expenses - \$2.9 billion (5.2% increase from 2017-18)

⁷ Public briefing transcript, Brisbane, 17 February 2020, p 2.

⁸ Public briefing transcript, Brisbane, 17 February 2020, p 2.

- Assets - \$22.8 billion (1.1% increase from 2017-18)
- Liabilities - \$15 billion (0.4% increase from 2017-18).⁹

The QAO analysis showed that the sector profits increased 19.1 per cent from the previous year to \$0.4 billion in 2018-19, largely as a result of ‘urban bulk water prices moving closer to cost-recovery levels, which has led to higher operational revenue’.¹⁰ In 2018-19, the combined shareholder returns of entities increased by 17.7 per cent to \$0.2 billion,¹¹ as four of the five water entities achieved operating profits. QAO noted that:

*Seqwater continues to make an operating loss, attributed to the historical under-recovery of the cost of providing bulk water services, and interest expense associated with loans incurred from the merger with other bulk water entities and investments into drought resilient infrastructure.*¹²

The QAO reported that during 2018–19:

- *Total dividends to the state government were \$56.1 million (increase of \$15.2 million from 2017–18). Dividends as a percentage of profit have remained consistent year-on-year except for 2016–17, when Sunwater kept 100 per cent of its profits to contribute to future dam improvement projects.*
- *Total participation returns to participating local governments were \$188 million (increase of \$21.5 million from 2017–18). Participation returns remained stable year-on-year except for 2017–18, when Unitywater made a one-off tax adjustment to align the useful lives of certain asset classes for both accounting and tax purposes, which reduced its profits.*¹³

2.3 Future challenges and emerging risks

The Auditor-General’s report identified future challenges and emerging risks in relation to:

- drought-declared areas and related water infrastructure projects¹⁴
- dam improvement programs¹⁵
- developer contributions to distribution networks.¹⁶

These areas of emerging risk are likely to have impacts upon the financial performance of water entities in the future.¹⁷

The Auditor-General’s report provided an action point for water entities to ensure their financial statements reflect the impact of extreme weather events.¹⁸ The QAO noted that Seqwater included a weighting for the likelihood of drought occurrence as an assumption in its asset valuation as at 30 June 2019,¹⁹ and advised that:

Seqwater modelled a different model for drought scenarios. Severe water restrictions potentially coming in will increase operational costs. It will potentially increase prices. We are then asking agencies, whilst they are modelling those potential increases further into the future, to look at

⁹ Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 10.

¹⁰ Public briefing transcript, Brisbane, 17 February 2020, p 2.

¹¹ Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 13.

¹² Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 10.

¹³ Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 13.

¹⁴ Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 14.

¹⁵ Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 19.

¹⁶ Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 20.

¹⁷ Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, pp 1-2.

¹⁸ Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 18.

¹⁹ Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 18.

*what that means for the agencies themselves in terms of the valuation of those assets, to assess what it does for things like pricing and then assess potential increases on that. It is taking into account the major scenarios and disclosing those in the financial statements so that readers are aware of the impact of significant drought.*²⁰

The QAO also advised that cost recovery for Seqwater's investment in the Western Corridor Recycled Water Scheme continues:

*Their regulatory pricing resets on 1 July 2021. Going forward, every time after that they will look at ways to ensure their revenue covers their cost base. Seqwater's intention is to pay back their water grid manager debt by 2028. The pricing scenario that currently sits there obviously assists with that intention. As things move in terms of drought and things become more expensive in terms of operational costs and the like, that will need to be factored into the next reset period again for prices because things will start moving in term of how expensive water becomes.*²¹

The Auditor-General's report noted that extreme weather conditions in Queensland 'increase the need to prioritise water security projects, which will require investment in the near future by the state and the water entities'.²²

3 Committee recommendation

The committee commends the QAO for its report, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*.

The committee recommends that the Legislative Assembly note the contents of this report.

²⁰ Public briefing transcript, Brisbane, 17 February 2020, p 3.

²¹ Public briefing transcript, Brisbane, 17 February 2020, p 6.

²² Queensland Audit Office, *Water: 2018-19 results of financial audits (Report 4: 2019-20)*, p 1.

Appendix A – Officials at public briefing on 17 February 2020

Queensland Audit Office

- Mr Brendan Worrall, Auditor-General
- Mr Patrick Flemming, Assistant Auditor-General
- Mr Vaughan Stemmett, Sector Director