



# ***STATE DEVELOPMENT AND REGIONAL INDUSTRIES COMMITTEE***

**Members present:**

Mr CG Whiting MP—Chair  
Mr MJ Hart MP  
Mr RI Katter MP (virtual)  
Mr JE Madden MP  
Mr JJ McDonald MP  
Mr TJ Smith MP

**Staff present:**

Ms S Galbraith—Committee Secretary  
Ms R Stacey—Assistant Committee Secretary

## **PUBLIC BRIEFING—CONSIDERATION OF THE AUDITOR-GENERAL'S REPORT NO. 9 OF 2020-21 TITLED *WATER 2020***

### **TRANSCRIPT OF PROCEEDINGS**

**MONDAY, 8 MARCH 2021**

**Brisbane**

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### **The committee met at 10.45 am.**

**CHAIR:** Good morning. I declare this public briefing open. I would like to begin today's proceedings by acknowledging the traditional owners of the land on which we meet today. My name is Chris Whiting, member for Bancroft and chair of the committee. The other committee members with us today are: Mr Jim McDonald, deputy chair and member for Lockyer; Mr Michael Hart, member for Burleigh; Mr Robbie Katter, member for Traeger, who is joining us via telephone; Mr Jim Madden, member for Ipswich West; and Mr Tom Smith, member for Bundaberg.

The purpose of today's briefing is to hear from the Queensland Auditor-General and officers from the Queensland Audit Office to assist the committee with its consideration of the Auditor-General's report No. 9 of 2020-21 titled *Water 2020*. I remind committee members that officers are here today to provide factual or technical information. Any questions seeking an opinion about policy should be directed to the minister or left to debate on the floor of the House.

The committee's proceedings are proceedings of the Queensland parliament and are subject to the standing rules and orders of the parliament. Media may be present and will be subject to my direction. The media rules endorsed by the committee are available from committee staff. All those present today should note that it is possible you might be filmed or photographed during the proceedings.

I ask officials that if you take a question on notice you provide the information to the committee by 12 noon on Monday, 15 March 2021. Finally, I remind everyone to turn their mobiles phones to silent mode.

**FLEMMING, Mr Patrick, Assistant Auditor-General, Queensland Audit Office**

**STEMMETT, Mr Vaughan, Senior Director, Queensland Audit Office**

**WORRALL, Mr Brendan, Auditor-General, Queensland Audit Office**

**CHAIR:** Good morning and thank you all for appearing before the committee today. I invite you to make an opening statement, after which committee members will have questions for you.

**Mr Worrall:** Firstly, congratulations on your appointment to the committee. We look forward to working with you to inform you about public sector performance and assist you in holding entities to account.

Thank you for the opportunity to brief the committee on the *Water 2020* report, which was tabled in January. This report summarises the results of the six main state and local government owned water entities. These include: Queensland Bulk Water Supply Authority, which trades as Seqwater; Sunwater Ltd; the Central SEQ Distributor-Retailer Authority, which trades as Urban Utilities; the Northern SEQ Distributor-Retailer Authority, which trades as Unitywater; and the Gladstone Area Water Board and the Mount Isa Water Board.

Our report includes an interactive map of Queensland allowing you to explore entities' financial performance, dam storage levels, the number of dams and drought-declared areas. We issued unmodified audit opinions for five of the six water entities. Seqwater received a qualified opinion for not recording a liability and a matching expense which we assessed to be of significant value. The liability and expense was due to an unfavourable judgement relating to the 2011 South-East Queensland floods class action in 2019. Sunwater appropriately recorded its share of the liability and a matching expense of \$330 million. The combined profit of the sector was reduced by the expense and, as a result, shareholder returns were lower than in previous years.

In a recent ministerial media statement, dated 26 February 2021, the state government and the dam operator Sunwater, who collectively represent 50 per cent of the liability, have agreed to pay victims of the 2011 Wivenhoe Dam flood disaster \$440 million. The settlement is still to be formally documented and will require court approval. Seqwater, who represent the other 50 per cent of the liability, are appealing the judgement. We will continue to monitor developments as they relate to

each entity. Apart from this non-recorded liability and expense, all entities' financial reports are reliable and comply with relevant laws and standards that were prepared in a timely manner and were of good quality.

In terms of overall performance of the sector, profits were down \$207 million, which is a decrease of \$198 million. This was mostly due to the class action expense that I mentioned. Combined shareholder returns to the state and local governments were \$294 million, which is a decrease of \$127 million from the prior year. This reflects the lower profits of the sector. Total assets were \$24 billion, which was an increase of \$648 million from 2018-19. This was mainly due to increased investment in infrastructure assets by the distributor-retailers. Total liabilities for the sector were \$16 billion, which is an increase of less than one per cent from the prior year.

Overall, we found the internal controls water entities have in place to ensure reliable financial reporting are generally effective but can be improved. We identified more weaknesses in the systems entities used to prepare financial statements. Security of information systems is an issue in four of the six entities and continues to be the most common weakness across the public sector.

Entities were not directly affected by the financial impact of COVID-19, but the entities extended assistance to their customers to help with their water bills. The sector has several projects underway to address the issue of water supply in drought areas. For communities that are experiencing severe drought, interim solutions are in place to help them receive continuous water supply.

Long-term water security projects are either in the early stages of planning or feasibility studies, preconstruction or under construction. These projects take significant time and resources to plan and construct. These are likely to impact on the sector's return to shareholders over the next decade. The committee may benefit in hearing from the entities themselves including their progress in implementing our recommendations. I welcome any questions the committee has on the report.

**CHAIR:** Thank you very much, Mr Worrall. I will start with a question in relation to the security of information systems. In report No. 19 of 2016-17 titled *Security of critical water infrastructure* that same issue was raised then by the Queensland Audit Office. I will point out a couple of things that were said in that report. It was found that the entities 'were not well prepared to respond to cyber attacks'. For example, all entities had undertaken 'security reviews and penetration tests' that an attacker could exploit but 'did not promptly address all the security issues raised by those reviews'. It was also found that 'entities did not design their networks to provide adequate protection for control systems'—that is, to 'secure the servers and workstations that connect users with the control systems'. It is a concern that the Audit Office has again picked up that these entities are lacking, as we said, security of information systems. It is a concern for members of parliament that these entities persist in not fully addressing all of those issues raised. It may be an option to bring those entities in for a briefing.

In terms of what the Audit Office can do—you have made recommendations in your report—do you work with these entities at all to go through how they can improve their IT systems? Is that something that you do as part of your functions?

**Mr Worrall:** I might make a couple of comments. The report you refer to predates my time as Auditor-General.

**CHAIR:** It does indeed.

**Mr Worrall:** I definitely know of the report. That was specifically into dam security. The recommendation we have in this report is probably broader than just dam security; it is covering other corporate systems. It is a recommendation that we have included in other sector reports as well. It is off the back of the report we did on cybersecurity last year I think it was—it might have been in 2019—where we looked at three entities: a department, a statutory body and a local government. We basically tried to access their secure data, and we were able to do that.

I am on the record in reports saying that cybersecurity is the biggest risk that the state faces at the moment. It is an ongoing risk. It is a risk that will continually change. That is why we are trying to keep it front and centre. All entities need to be vigilant. They need to make sure that their governance practices have direct oversight of their mitigation strategies around cybersecurity.

The other thing that is happening in this sector is that the state requires from its departments an annual attestation to—I will get the title wrong but it used to be known as the Queensland chief information officer. I think it is now known as the Queensland Government Customer and Digital Group. The good thing about the attestation happening this year is that they have to get some assurance around it, whereas in the past it was just the entities filling out a return. Now they have to provide some assurance. That is a good thing.

In terms of what we do to assist entities, I would say a few things. I think the cybersecurity report that we did is a really good base for entities to focus on. There are some requirements. The Australian signals corps have about 10 things you need to do to defend yourself against cyberthreats. In that report we call out that if you implemented the top three you would mitigate your risks by 85 per cent, from memory. There are some practical things that entities should be doing that are contained in that report. This is trying to remind them.

In terms of any deficiencies that we see, we will report those in a management letter. In terms of what is reported to parliament, there is a lower level of detail that could be reported at the entity level which may not necessarily find its way into parliament. Each year we track the status of recommendations that come out of financial audits. The other thing we are doing this year for the first time is deploying a tool to the state entities so they can report the status of any recommendations that we have made in a report to parliament that concerns them either specifically or generally. Typically, we have gathered that information on an annual basis to inform us of the strategic audit plan. Now we are in the process of automating that process. I plan to publish that information in a report to parliament later this year. It will not have any assurance from me; I will just be reporting what the entities have told us of the status of the recommendations. That should provide not just this committee but all committees and all members a greater line of sight of recommendations that are made and the status of those recommendations. In a way, it is like a self-reporting tool, which I think will provide further transparency to members around what is happening.

There are other things we do. We do blog posts. There might be some practice guides that we put out from time to time as well. We are not just trying to come up with recommendations; we are trying to point them in the right direction, if that makes sense.

**CHAIR:** I am quite interested to hear that there will be a report coming to parliament later this year on tracking the status of those recommendations.

**Mr Worrall:** Yes. From memory we have gone back to 2015-16 recommendations. Any recommendations from that year onwards will be reported in this report, but it will be entities indicating what the status is.

**CHAIR:** Certainly it would be quite useful to this committee when that report comes through that we get the entities in.

**Mr HART:** Don't the entities report in their annual reports how they are tracking on your recommendations?

**Mr Worrall:** There is no requirement for them to do that. Some may do that voluntarily but there is no requirement for them to do that. From my point of view, one of the safety nets is the audit committees these entities have, because one of the functions should be for that audit committee to hold management to account about recommendations that come from QAO or that come from internal audit or any other assurance they might have. There is currently no requirement for them to publish that information. If some are doing it, that is a good thing I would say.

**Mr McDONALD:** Mr Worrall, I appreciate the report and the \$330 million liability that Seqwater were looking at and reporting as their qualified audit. We now know that is \$440 million, as you properly outline, for the government and Sunwater as what is recognised as a 50 per cent share. How does that translate, given the gearing that Seqwater have and their ability to pay that? Is that a liability that the shareholders will be faced with or is there an indemnity by government? How does that work?

**Mr Worrall:** I might start and Vaughan might jump in. You are quite right: the \$440 million relates to the 30 per cent and the 20 per cent share. The other 50 per cent is relating to Seqwater. As we pointed out, they have not recognised a liability. We have mentioned in the report that their reasoning for that is that they did not think it could be reliably estimated. That is why we qualified the opinion. At the whole-of-the-government level, in the consolidated financial statements of the state, they did make a provision. It is just at Seqwater where there is no recognition of a liability.

In terms of their gearing, you are quite right: their gearing is quite tight and it has been for a number of years. They have been on a price pathway to return to profitability, so recognising this liability will definitely be an impost on them. At the moment I do not have that line of sight on how they are going to fund that. Presumably they will have to take on more debt, I imagine, to fund that. I do not know if Vaughan wants to add something there.

**Mr Stemmett:** Seqwater is a very highly geared agency and they do rely on the current state government in terms of solvency and future solvency. For Sunwater as well, that has put them in a position where they are trading in losses and, again, the board relies on the government's support in Brisbane

that instance. Noting that both agencies have insurance coverage that applies to this situation, depending on the outcome of the final court decision in terms of quantum that will determine any likely insurance that is paid.

**CHAIR:** Members should bear in mind our sub judice rule because there are outstanding court cases regarding this.

**Mr HART:** If Seqwater had recognised this on their books, would that have changed the dividend they paid to the government?

**Mr Stemmett:** Seqwater did not pay a dividend to the government. They actually retained the profit they made of circa \$17 million. There was no dividend that was paid, and that was an agreement with the shareholding minister.

**Mr MADDEN:** Gentlemen, I welcome you here on International Women's Day. It is a very auspicious day. In my electorate of Ipswich West we are surrounded by some very important water infrastructure. There is good news and bad news with regard to that. Wyaralong Dam is about to be connected to the grid, which is great news. Just announced in the last few days are restrictions on the recreational use of Moogerah Dam. There are also concerns about the water levels in Wivenhoe Dam. That is because of the drought. Brendan, can you provide the committee with some information on the implications and challenges of the drought for water entities and across the sector generally?

**Mr Worrall:** Obviously water security is definitely an issue, in terms of both water supply and dam safety. You would be aware that we are currently doing a performance audit on the regulation of dam safety in Queensland. That is not really about the continuity of water supply; it is more around whether dams are safe if there are water events or some sort of flood event. That is definitely an issue.

You are quite right: there are towns where water is still being moved around physically by road to ensure the continuity of the supply of water. We indicate in the report that at the moment people in Queensland have access to water but some of it is probably not elegant. Water being moved by truck to Stanthorpe is one that I can think of. I do not know if Vaughan wants to add anything to that.

**Mr Stemmett:** As the drought continues to ramp up, there will be additional financial implications relating to that on respective agencies, one of those obviously being the ramp-up of desalination. The desalination plant obviously will get used more often. It will supply more drinking water to South-East Queensland. In addition to that, the Western Corridor Recycled Water Scheme has yet to be turned on. That is a decision for government. At this point it has met the threshold. Once that gets turned on, it will have cost implications again. There are estimates of between \$10 million to \$20 million at both plants.

**Mr MADDEN:** Is that \$10 million to \$20 million per year?

**Mr Stemmett:** Yes. Again it depends on how severe the drought becomes. That is initial estimates from agencies. It has follow-on impacts to distributor-retailers as well with regard to water supply, as pricing will be ultimately impacted as well.

**Mr SMITH:** My question relates to the employee arrangements and the possible underpaying of employees. How was Sunwater and Seqwater made aware of this? Was it found internally through their own processes or through an external announcement from someone? Secondly, where are we in the process of making sure that for any employees who have been underpaid their costs and entitlements are being recovered?

**Mr Stemmett:** That was an internal investigation at both agencies. That was uncovered through their own due diligence process. It is a complicated situation as both agencies have common law type contracts in place and, due to interpretation of those, there are instances where some of those employees could actually be attached to the enterprise agreements. In saying that, all pay was paid correctly for employees on common law contracts, apart from some employees missing some entitlements under the enterprise agreement. Both agencies are currently still working through the finer details with regard to quantification, but both agencies have raised a provision under the accounting standards to account for that. We will work with the management of the respective agencies to close that out.

**Mr SMITH:** Is there a rough number of employees directly affected?

**Mr Stemmett:** I do not have that off the top of my head.

**Mr HART:** Brendan, you said before that four of the six water entities were not okay on their IT. Can you identify which ones they were?

**Mr Stemmett:** I can. Sunwater received a significant deficiency—three—relating to IT. The other one was on developer contributions at Unitywater.

**Mr HART:** When those companies work out their forward path, I assume they use a regulated asset base? Would they have any costs involved in upgrading their IT systems that were included in the RABs?

**Mr Stemmett:** No. The regulatory price would generally include things that cover, for Seqwater, the cost of debt. For Sunwater, it would be covering a certain amount of spend on dam improvement projects but nothing really specific to IT.

**Mr HART:** Would other GOCs inside the government allow for IT projects in their RABs?

**Mr Stemmett:** I could not comment on that.

**Mr HART:** Do any of you know that?

**Mr Worrall:** No, I am not sure of that one. We can take that on notice.

**Mr HART:** I know that CS Energy, Stanwell and Energy Queensland all allow for IT in their RABs. Is that a recommendation the Auditor-General would normally make to make sure those companies are allocating some funds to IT upgrades?

**Mr Worrall:** They definitely should be allocating funds to IT upgrades—absolutely. Whether it is part of the RAB we will have to clarify.

**CHAIR:** That could be taken as a question on notice.

**Mr Worrall:** Yes, I am happy to take that on notice.

**CHAIR:** Member for Burleigh, can you clarify the question about including IT upgrades on the regulated asset base?

**Mr HART:** Yes. Did your audit make any comments about the gearing of these entities?

**Mr Worrall:** We have certainly made comments in the past in relation to the gearing around Seqwater, because that has been a common theme before I came into this role. My understanding of that gearing actually goes back to the Seqwater grid. I think that is where that funding was deployed and that is how they got the debt. As I mentioned earlier, they are on this price pathway that was going to see them return to profitability for the first time. I am trying to remember where we have specifically mentioned this gearing. I know that we have mentioned gearing about other entities and benchmarks.

**Mr Stemmett:** The only gearing we have noted is Seqwater, obviously as it stands out. They do have a sizeable debt on their balance sheet. Approximately \$2 billion of that relates to the Water Grid Manager debt, which relates to the assets that were purchased. As a price path comes to a sense of normality and all agencies within the South-East Queensland council areas reach common pricing, that is when Seqwater would likely—

**Mr HART:** That is a five- or 10-year pathway, isn't it, and they are part of the way through it?

**Mr Stemmett:** I expect that all SEQ council areas will reach common pricing in 2020-21. The next price reset occurs on 1 July 2021.

**Mr HART:** It takes them a while after that to start to pay down that or change that gearing ratio?

**Mr Stemmett:** By 2028 it is expected they would have paid down the Water Grid Manager debt.

**Mr HART:** Does the Audit Office set any preferred gearing ratios for GOCs?

**Mr Worrall:** No, we do not. In other reports in the context of GOCs where they have had high gearing we have made comments and reports about whether they are within an industry benchmark, but I do not think we have done that in relation to the water entities. There have been other state GOCs where we have done that.

**Mr HART:** Would that be set against other states?

**Mr Worrall:** It is certainly something I do not think we have done for the water entities, but we have done it for GOCs where we have looked at their gearing ratios to see how that compares to industry and, in that case, it has been within industry benchmarks. We have made that statement. It is something we could consider in a future report.

**CHAIR:** Queensland is fairly unique in the sheer length of transmission. It stands us out from other states.

**Mr MADDEN:** I have a follow-up from something Mr Stemmett said. It is to do with the cartage of water. As I understand it, that is organised by either a water entity or, in Western Queensland where the councils still control the water entity, the council. They had the situation where water was

being carted to Ilfracombe for a considerable period of time until funding was available to get a desalination plant to convert water. With regard to that cost, using Longreach council as an example, do they have to bear that cost fully or is there some government funding, perhaps through QRAA or something like that—some drought assistance that compensates them for those costs?

**Mr Stemmett:** I am not sure on how that is funded. They are currently still carting water to different regions.

**Mr McDONALD:** Mr Worrall, I note in the report there was a table regarding improvements to Seqwater assets particularly, which is more in my area, and you did in your opening address talk about feasibility and early stages of some projects. Are Wivenhoe Dam improvements included in some of that feasibility that is not reported? I understand there is a current project that is occurring in that space.

**Mr Stemmett:** I think Wivenhoe Dam is included in that. It is their future dam improvement projects and they are doing some work on that.

**Mr McDONALD:** Is that under Somerset, because it is not in the table in the report?

**Mr Stemmett:** I believe so.

**Mr McDONALD:** That is certainly a vital part of South-East Queensland's water security.

**Mr Stemmett:** It is probably not as large as the dam improvement programs that I have listed in G1. I think that calls out the majority of the larger projects that Seqwater is working on.

**CHAIR:** I have been remiss. Member for Traeger, did you have a question at all?

**Mr KATTER:** No, thank you.

**Mr HART:** I refer to the \$440 million that Seqwater is going to have to pay. Does it have sufficient funds in its balance sheet to meet that debt?

**Mr Stemmett:** The \$440 million is not the funding that Seqwater will pay; that is the funding that has been agreed by the state and Sunwater to pay. The funding that Seqwater will likely pay will be any amount that is quantified by a court. At the moment they will not have enough capital to pay that and they will likely need, obviously, shareholder support.

**Mr HART:** Subject to the court decision. It is \$440 million at the moment, is it not?

**CHAIR:** Bear in mind we are talking about something that is currently active in the courts, I would caution everyone.

**Mr Worrall:** The other thing that Vaughan mentioned earlier is that these entities also have insurance in place, so that could come into play.

**Mr HART:** They are not self-insured?

**Mr Worrall:** Sorry?

**Mr HART:** Seqwater is not self-insured?

**Mr Stemmett:** It has insurance policies in place with commercial agencies.

**Mr HART:** Did you look to see whether an insurance policy would be sufficient to cover it?

**Mr Stemmett:** We cannot comment on that. It is before the courts.

**CHAIR:** I would caution everyone going further into this when it is directly before the courts.

**Mr McDONALD:** One of the big issues that agriculture communities right across the state face is the impost of part A, or the fixed charges, when it comes to water assets that do not have water in them. It is a very large financial risk for the operators. Was there any reporting by the entities regarding allowances for that and seeing more flexible arrangements, given the ongoing drought conditions?

**Mr Stemmett:** I think that attaches to the irrigation pricing that is actually the regulated price. At the moment for Sunwater it does not necessarily fully recover the costs for the provision of water. In addition to that, because of that it does place pressure on the valuation of any assets that supply water to agriculture. Other than that, I cannot comment any further.

**Mr McDONALD:** What do they record on their balance sheet? Is it cost value or replacement value?

**Mr Stemmett:** For Sunwater it is direct cost and then for Seqwater it is fair value.

**Mr McDONALD:** I understand with Seqwater that QCA, who set those prices, look at a lower bound pricing structure as opposed to a cost-reflective pricing structure, and we welcome the determination of that. Did you look at the lack of flexibility provided to the water entities in charging through those QCA processes?

**Mr Stemmett:** I think that will come through in overall solvency of agencies and as to why they make profits or losses. Certainly for Sunwater, 25 per cent of their revenue is irrigation. The 70 per cent component is industry. In that scenario they have fixed price contracts, so the industrial component of their client base does actually prop up the irrigation. For Seqwater it is one where the price path is currently trying to achieve that common price but, yes, we certainly do look at that as part of valuation and the extent of the assets.

**Mr McDONALD:** Is there any other information you could provide to the committee about the ongoing implications of drought and preparations for the longer term future that the entities are undertaking?

**Mr Stemmett:** We could. It does become quite complex because it does cover a raft of different asset bases and agencies as a collective.

**CHAIR:** We are delving into opinion here.

**Mr HART:** Typically, does the Auditor-General prefer to see assets valued at cost base or fair value? Do you have a position on that?

**Mr Worrall:** The accounting standards or the Treasury guidelines do allow for historical cost, but conceptually I think fair value is more useful, not just externally but also internally, because historical cost is not updated to what the underlying value is, based on how much it might cost to replace or how much revenue can be generated from that. It is just at a point in time.

**Mr HART:** How do these companies determine their value?

**Mr Worrall:** It can depend on whether it is a revenue-generating entity. If it is a revenue-generating entity it is really based on the future revenue streams that it is going to generate from those assets as the fair value measurement.

**Mr HART:** How does that fit in with a regulated asset base? That is a reverse situation, is it not?

**Mr Worrall:** There would still be value in use. The regulated asset base is really providing a path point that can be earned from those assets, and that would be the path that would be fed into their model to value those assets based on the revenue that can be generated.

**CHAIR:** Can I suggest that we are getting into realms that are probably best directed to the entities themselves instead of the Queensland Audit Office.

**Mr HART:** I am asking about the Auditor-General's Office.

**CHAIR:** Certainly, and the Auditor-General will give information as far as he knows, but certainly there may be some questions there that are best directed to the entities.

**Mr HART:** The Auditor-General looks at a whole lot of GOCs.

**Mr Worrall:** Typically if they are a for-profit entity their fair value will be from value and use of those assets.

**CHAIR:** There being no further questions, I will now close this public briefing. Thank you very much for your time today. We have one question on notice regarding building in costs of IT upgrades into the RAB. Is that for all GOCs or water specifically?

**Mr HART:** All GOCs.

**CHAIR:** If we could have an answer to that question provided by 12 noon on Monday, 15 March 2021. Refer to the broadcast of this briefing to clarify any of those questions. The broadcast will be available on Parliament TV later today. Thank you all for your attendance at today's briefing. A transcript of these proceedings will be available on the committee's parliamentary webpage in due course. I declare the briefing closed.

**The committee adjourned at 11.25 am.**