Transport: 2017–18 results of financial audits

Report 11: 2018–19

Queensland Audit Office

Better public services

Queensland Audit Office
Better public services

Your ref:
Our ref: 12038

11 December 2018

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

Dear Speaker

Report to parliament

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009*, and is titled Transport: 2017–18 results of financial audits (Report 11: 2018–19).

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

Yours sincerely

Brendan Worrall
Auditor-General

Contents

Summary

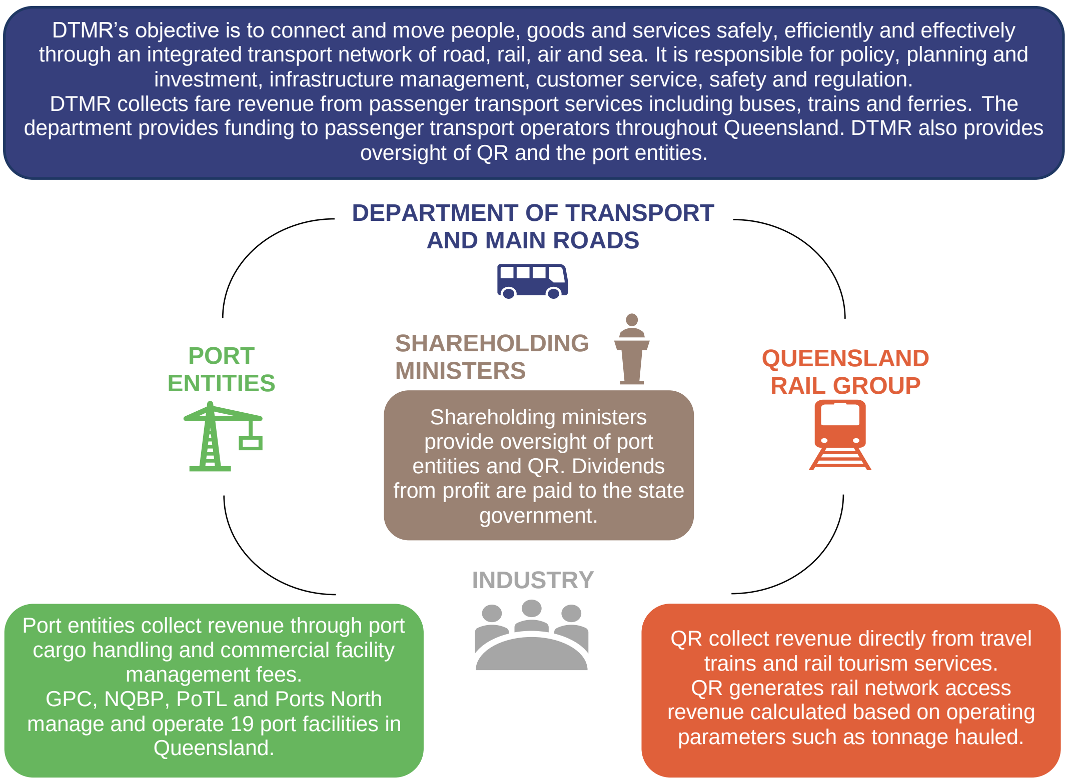
This report summarises our financial audit results of seven transport entities:

- Department of Transport and Main Roads (DTMR)
- Queensland Rail Group (QR) including:
  - Queensland Rail
  - Queensland Rail Limited (QRL)
- Government Owned Corporations (GOCs) including:
  - Gladstone Ports Corporation Limited (GPC)
  - North Queensland Bulk Ports Corporation Limited (NQBP)
  - Port of Townsville Limited (PoTL)
  - Far North Queensland Ports Corporation Limited (trading as Ports North).

Gold Coast Waterways Authority (GCWA), Transmax Pty Ltd (wholly owned by DTMR) and Cross River Rail Delivery Authority (CRRDA) are smaller entities that contribute to the transport network. The results from our financial audits of these smaller entities are outside the scope of this report.

Figure A shows the roles of and services provided by the transport entities.

Figure A
Queensland transport sector



Source: Queensland Audit Office.

Results of our audits

Consistent with 2016–17, we issued unmodified audit opinions on all financial statements this year within the statutory deadline of 31 August 2018. In doing so, we confirm that readers can rely on the audited financial statements of the transport entities.

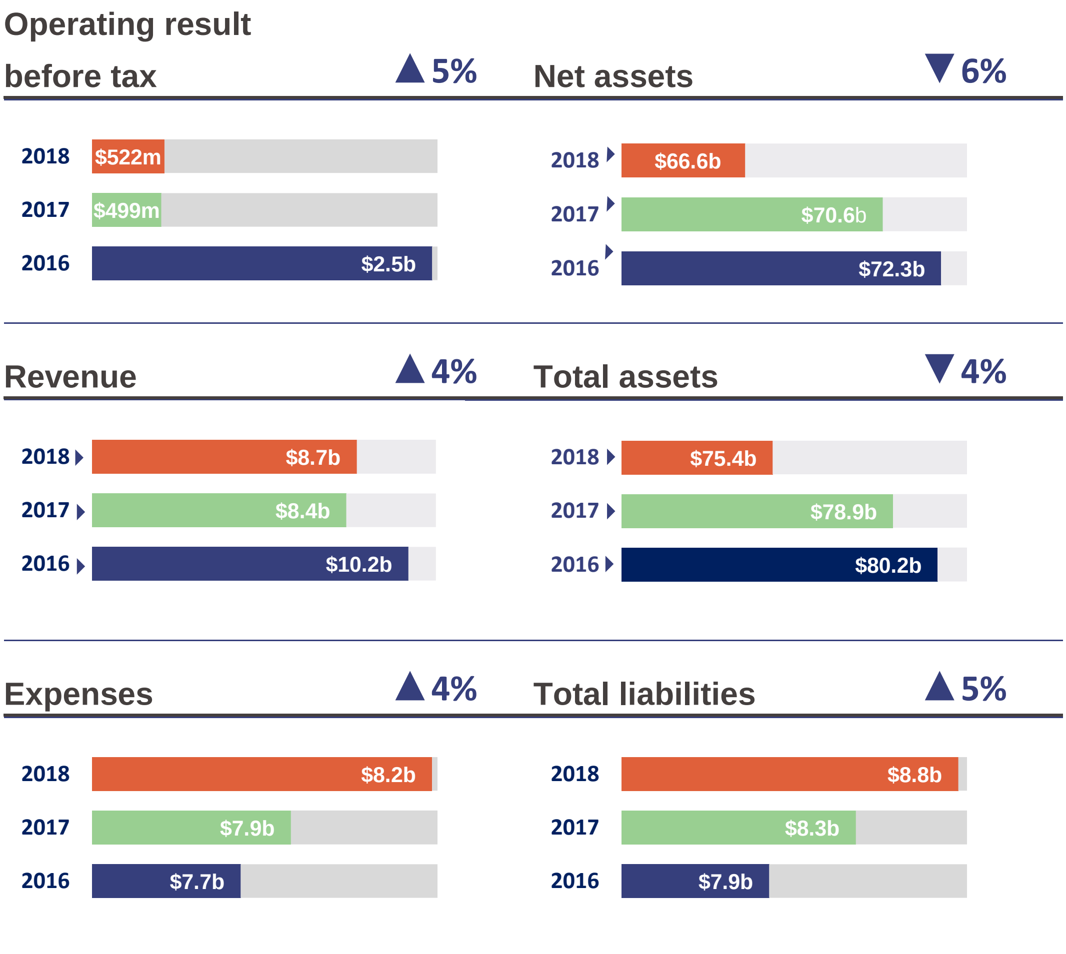
Continued emphasis is required within the transport sector to improve financial reporting practices despite progress noted on the year-end close processes.

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

None of the six subsidiary companies within the transport sector prepared financial statements for 2017–18. These entities were either dormant or small, and therefore did not need to prepare financial statements under the *Corporations Act 2001*.

Financial performance, position and sustainability

Figure B
Aggregate transport entities' financial snapshot



Source: Queensland Audit Office.

Understanding financial performance

The combined operating result for the transport entities was positive for the third consecutive year. In 2017–18, the operating result before tax was $522 million—an increase of $23 million (five per cent) from the prior year.

Total revenue for the transport entities increased by $351 million to $8.7 billion. The increase was primarily driven by an increase appropriation to DTMR ($190 million) and additional funding to QR for the transport service contract ($64 million).

Total expenses also increased by $329 million (four per cent) due to increased supplies and services and employee expenses. These increases were largely driven by additional rail network services and Commonwealth Games-related expenses.

Total dividends to the state amounted to $195 million, an increase of $21 million (12 per cent) from the prior year. This was primarily due to PoTL declaring dividends this year (nil in 2016–17) together with an increased dividend from QR.

Understanding financial position

For the third consecutive year, the net assets for the transport entities have decreased. Total assets decreased by $3.5 billion (four per cent) and total liabilities increased by $447 million (five per cent) from the prior year.

Transport entities added $2.5 billion of new infrastructure assets during the year; however, the revaluation of infrastructure assets resulted in a $6.1 billion decrease at 30 June 2018. This decrease was mostly attributed to DTMR where improved expectations about the availability of funds to replace road infrastructure resulted in lower asset valuations.

The net revaluation for port entities increased by $311 million with GPC making up the majority of the increase.

As part of the state government's Debt Action Plan, transport entities transferred $298 million of surplus cash to Queensland Treasury to reduce the general government sector borrowings.

The increase in total liabilities was predominantly attributed to a $259 million increase in finance lease liabilities at DTMR relating to Gold Coast Light Rail Stage 2 and New Generation Rollingstock (NGR) trains.

Internal controls

In 2016–17, we identified a significant deficiency in the internal controls used to monitor database changes at GPC. This significant deficiency was re-raised during the 2017–18 financial year as not all aspects of the recommendation were fully implemented. Corrective action by management is underway with the plan to resolve the outstanding recommendations during the 2018–19 financial year.

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

1. Sector overview

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

This report focuses on the results of audits for 2017–18 transport entities under the Minister for Transport and Main Roads.

Direction and oversight of the transport sector in Queensland is provided by the Department of Transport and Main Roads (DTMR) whose primary role is to plan, manage and deliver Queensland's integrated transport environment to achieve sustainable transport solutions for road, rail, air and sea.

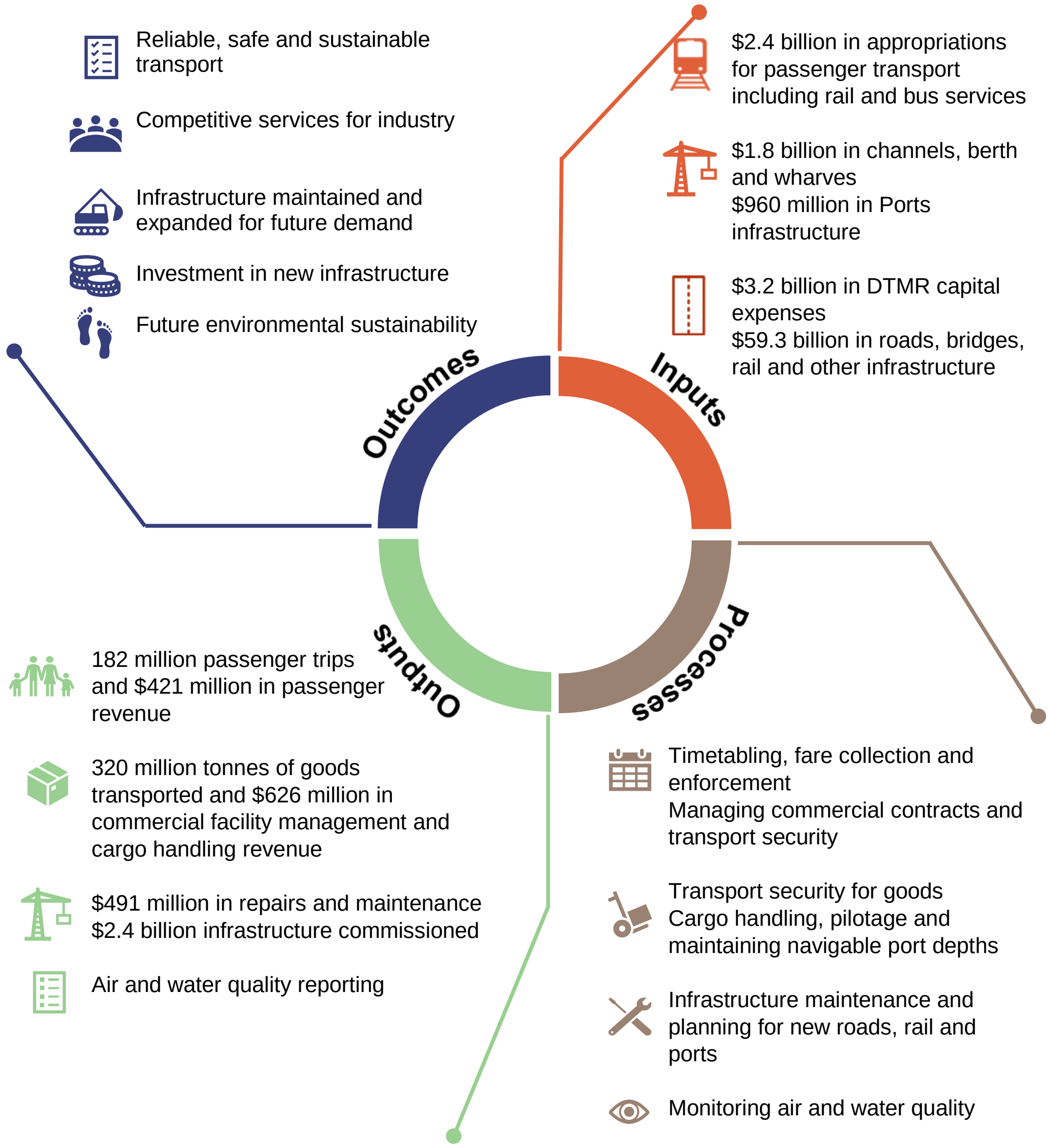
To help move Queenslanders across this vast state, DTMR brings together many transport operators from the state government, local government and the private sector. This report focuses on the state government entities.

Machinery-of-government changes in 2017–18 resulted in the transfer of the Priority Ports Team from the Department of State Development, Manufacturing, Infrastructure and Planning to DTMR.

Queensland Treasury and DTMR provides oversite on the performance of the four state-owned port corporations who are responsible for collectively managing 19 ports on behalf of two shareholding ministers (the Treasurer and the Minister for Transport and Main Roads).

Figure 1A details the major inputs, processes, outputs, and outcomes for the transport sector.

Figure 1A
Function level inputs, processes, outputs and outcomes



2. Results of our audits

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

Conclusion

We issued unmodified audit opinions for each of the transport entities. Readers can rely on the results in the financial statements. All financial statements were prepared within the legislative deadlines.

Most transport entities have effective year-end processes and can produce draft financial statements on a timely basis. Continued emphasis is required within this sector to improve the quality of financial reporting practices in complex areas such as asset valuations and tax accounting.

Audit opinion results

All transport entities met their legislative deadline of 31 August 2018 (as in 2016–17). The table below details the unmodified audit opinions we issued for the 2017–18 financial year.

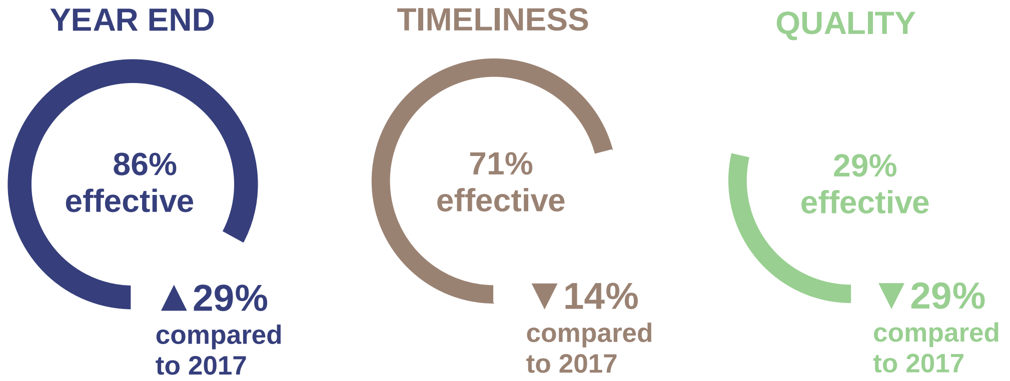
Figure 2A
Date of unmodified audit opinions issued for 2017–18

Entity type	Entity (trading names)	Date audit opinion issued
Department	Department of Transport and Main Roads	29.08.2018
Statutory body	Queensland Rail	30.08.2018
Wholly owned subsidiary of a statutory body	Queensland Rail Limited	30.08.2018
Government owned corporations	Gladstone Ports Corporation Limited	31.08.2018
	North Queensland Bulk Ports Limited	24.08.2018
	Port of Townsville Limited	28.08.2018
	Far North Queensland Ports Corporation Limited	30.08.2018

Source: Queensland Audit Office.

Financial statement preparation

Figure 2B
Effectiveness of financial statement preparation processes



Source: Queensland Audit Office.

Continued emphasis is required within the transport sector to improve financial reporting practices despite progress on the year-end close processes.

Asset valuation is a significant component of financial statement preparation for transport entities. The Department of Transport and Main Roads (DTMR) showed leadership by completing assets valuations by the 16 April 2018. Given the complexity of these assets, we welcome the commitment from the department to continue to improve the valuation process.

Gladstone Ports Corporation Limited (GPC) experienced issues in its asset valuation review process, which had flow-on effects on the timeliness and quality of its financial statements.

Ports North provided draft financial statements after the agreed date and Port of Townsville Limited (PoTL) recorded material tax adjustments that affected the timeliness and quality of their financial statements.

Although all transport entities met their statutory deadline to complete their audits, we encourage them to continue to bring forward their financial reporting timetables to address complex areas of accounting such as asset valuations, tax accounting and new accounting standards. Earlier audit committee (or its equivalent) endorsement of their financial statements would also give transport entities a better opportunity to resolve potential issues should they arise.

The results of our assessment for each entity and our assessment criteria are outlined in in Appendix C.

Key audit matters

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

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 mostly relate to major events and transactions that occur during the period, and those areas requiring significant application of judgement and estimation.

We voluntarily included key audit matters in our independent auditor's report for all transport entities. The key audit matters covered the valuation of property, plant and equipment and the estimation of useful lives for depreciation expense. We 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.

Regulated infrastructure

The Queensland Competition Authority (QCA) regulates access to essential infrastructure in Queensland, including rail transport infrastructure. QR has given to the QCA an access undertaking, which sets out the general terms and conditions under which QR will provide access to its below-rail infrastructure, including the tariff QR can charge customers.

Under the access undertaking, QR is required to prepare specific financial statements for QCA on the below-rail services QR delivered during the year.

Results of our audit of regulated below-rail services

We issued an unmodified audit opinion on the financial statements for below-rail services provided by QR for 2016–17 on 18 December 2017. We also included an emphasis of matter in our audit report to highlight that the report is specifically for the regulator and that the information is not intended for other users.

Emphasis of matter is 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.

Major certifications

DTMR is required to acquit some of the funding and/or expenses to third parties including the Australian Government. They do this by providing a detailed breakdown of revenue and/or expenses to these third parties. We certify that this information is accurate and complete.

We issued unmodified opinions for the *Interstate Road Transport Act 1985* and *Infrastructure Investment Programme (National Land Transport) Act 2014* for the 2016–17 financial year.

Entities not preparing financial statements

Not all Queensland public sector transport entities produce financial statements. Dormant or small companies that meet specific criteria under the *Corporations Act 2001* are not required to prepare financial statements.

The full list of entities not preparing financial statements in 2017–18 is detailed in Appendix E.

3. Financial position, performance, and sustainability

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

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

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

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

Conclusion

The transport entities are financially sound and can pay their debts when they fall due.

The appropriation to the Department of Transport and Main Roads (DTMR) increased by $190 million and the rail transport service contract revenue at Queensland Rail (QR) increased by $64 million. Expenses also increased by $329 million (four per cent) due to increased supplies and services, a key driver being payments to operators of rail, bus, and ferry services, and employee expenses.

Higher dividends were declared this year due to higher profit at QR and the Port of Townsville Limited (PoTL) declared dividend of $15 million (nil in 2016–17).

Net assets declined by six per cent from 2016–17, primarily as a result of revaluation decreases of infrastructure assets at DTMR. Total liabilities of the transport entities did not change substantially from the prior year.

Transport entities are preparing for four new accounting standards covering revenue from contracts with customers, income for not-for-profit entities, leases, and service concession arrangements. The effect of these new accounting standards will have an impact on their financial reports. They are on track to implement the new standards.

Understanding financial performance

Overall in 2017–18, transport entities' operating result before tax increased by $23 million (five per cent) to $522 million. All entities reported positive operating results.

DTMR's operating surplus increased by $23 million to $217 million largely driven by capital contributions from third parties such as natural disaster relief and recovery arrangements and local governments.

QR's profit before tax increased by $17 million to $160 million. This was mainly due to increased revenue from the rail transport service contract and network access revenue. The delayed retirement of the electric multiple-unit train fleet resulted in lower depreciation at QR.

Gladstone Ports Corporation (GPC), North Queensland Bulk Ports Corporation Limited (NQBP), and PoTL reported lower profits than in prior year. Constrained port trade due to supply-chain challenges, recognition of impairment losses resulting from revaluation of non-current assets, and increased repair and maintenance costs from tropical cyclone Debbie reduced profitability of these port entities.

Figure 3A
Transport entities profit after tax and declared dividends

	2018	2017	2016		2017–18 movement
Operating result before tax	**$522 million**	**$499 million**	**$2.5 billion**	▲	Increase in appropriation revenue and TSC revenue
Declared Dividends	**$195 million**	**$174 million**	**$631 million**	▲	Increase mainly due to PoTL declaring dividends this year (nil in 2016-17) together with an increase in QR's current year profit

Source: Queensland Audit Office.

In 2015–16, the transport entities reported a $2.5 billion operating result before tax. This was significantly higher than the recent performance due to a one-off $1.7 billion revaluation reversal which was recorded in the operating result of DTMR. From this year's profit, QR and three port entities declared dividends of $195 million.

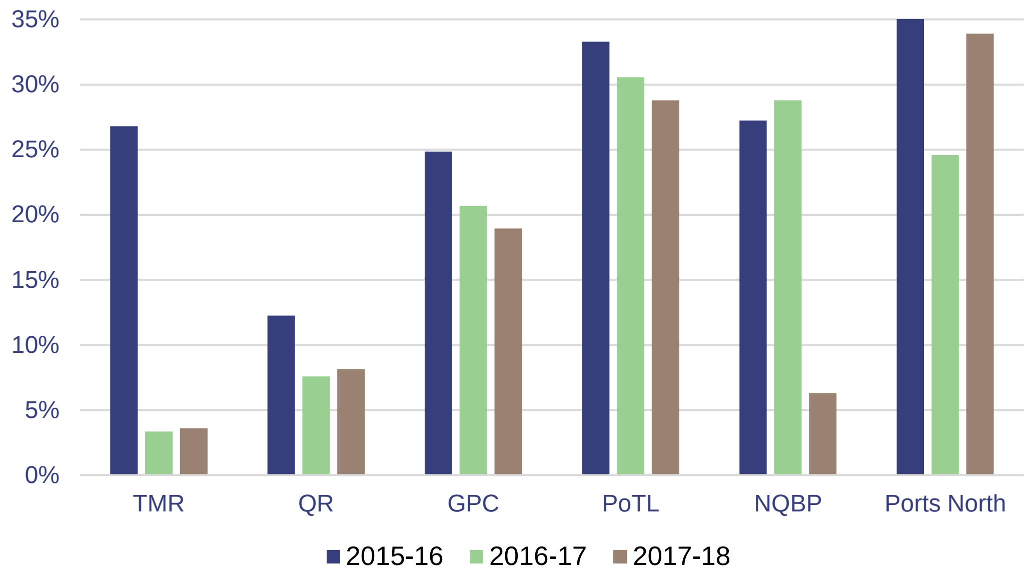
Operating Ratio

The operating ratio is a key indicator of the strength of financial performance and should be positive over the medium to longer term if an entity is to remain financially sustainable.

The operating ratio is the operating result before tax, expressed as a percentage of total revenue. It shows the capacity to meet operating expenses from operating revenue, with a positive ratio indicating funds are also available for capital expenses and shareholder returns.

Operating ratios have remained positive over the past three years for all transport entities.

Figure 3B
Operating ratio for transport sector entities



Source: Queensland Audit Office.

As mentioned above, DTMR's operating ratio for 2015–16 was affected by a one-off $1.7 billion revaluation reversal which was recorded in the operating result. The department has maintained an operating ratio between three and four per cent for the past two years.

Revaluation movement is the act of recognising a reassessment of the carrying amount of a non-current asset to its fair value as at a particular date.

The reduction in operating ratio for NQBP was due to a downward revaluation movement and increased repair and maintenance costs from tropical cyclone Debbie.

The improvement in operating ratio of Far North Queensland Ports Corporation Limited (Ports North) was due to increased trade related revenues with project cargo for the Mt Emerald Wind Farm and Amrun projects, increased number of cruise and super yacht visits, property revenue growth, and marine pilotage revenue.

Revenue

Figure 3C
Major revenue for all entities by type for 2017–18

Appropriations revenue
$5.0b
▲4%

Rail transport service contract
$1.6b
▲4%

User charges and fees
$723m
▼1%

Other revenue
$756m
▲12%

Cargo handling & commercial management revenue
$626m
▲5%

Source: Queensland Audit Office.

The transport entities receive revenue from sources inside and outside the Queensland Government. The majority (76 per cent) comes from internal sources.

Total revenue for the transport entities was $8.7 billion in the 2017–18 financial year, an increase of $351 million (four per cent) from the prior year.

DTMR's appropriation revenue increased by $190 million (four per cent). The additional appropriation was provided to cover increased employee expenses, additional road maintenance and additional temporary staff and services required for the Commonwealth Games delivery. The additional appropriation was also used to cover increased expenses under the rail transport service contract with Queensland Rail Limited (QRL).

Grants and contributions and network access revenue account for the majority of other revenue (59 per cent). Grants and contributions increased by $38 million (17 per cent) from the prior year. This was primarily because of the increase in grants received by DTMR from the Department of Innovation, Tourism Industry Development and Commonwealth Games ($23 million increase) in relation to the Gold Coast 2018 Commonwealth Games.

QR's network access revenue increased by $15 million (nine per cent) mainly due to stronger coal transport on the West Moreton Line.

Events and transactions affecting revenue this year

Extended funding for rail transport services

A rail transport service contract exists between DTMR and QRL for the provision of agreed rail transport services on behalf of the state of Queensland. Under the contract, QRL receives periodic payments from DTMR for the delivery of train services and maintenance of infrastructure.

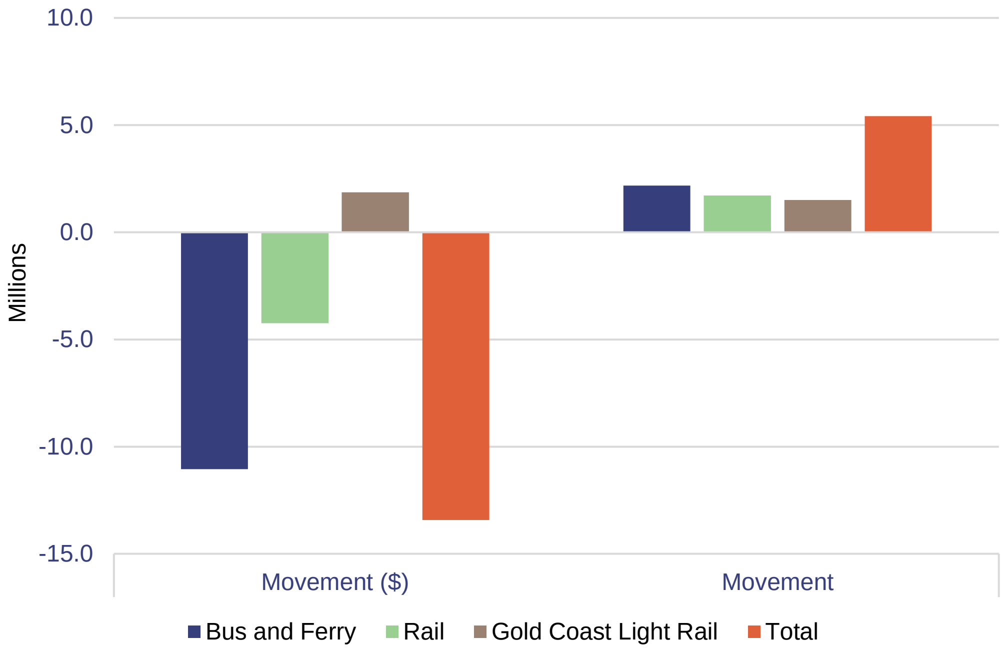
This year, the transport service contract with QRL increased by $64 million (four per cent) to $1.6 billion. The contract between DTMR and QRL was extended in June 2018 for another two years until 30 June 2020.

Increasing customer patronage

User charges and fees are predominately made up of fare revenue (47 per cent) from bus, ferry, rail, and light rail services. DTMR collects this fare revenue from passengers through TransLink. The department provides funding to passenger transport operators from the state government, local government and private sector.

Figure 3D shows the movement in DTMR's fare revenue and patronage between 2017–18 and 2016–17.

Figure 3D
Movement in fare revenue and patronage by transport mode



Source: Queensland Audit Office.

The fare revenue collected by DTMR decreased by $13 million (four per cent) in 2017–18, even though patronage increased by five million trips (three per cent) across all modes of transport. This was mainly due to the full year impact of the implementation of the Fairer Fares package in 2017–18 (half year impact in 2016–17).

Bus and ferry continue to be the most utilised modes of public transport, earning 52 per cent of total fare revenue in both 2016–17 and 2017–18. They also accounted for 66 per cent of total patronage in 2017–18.

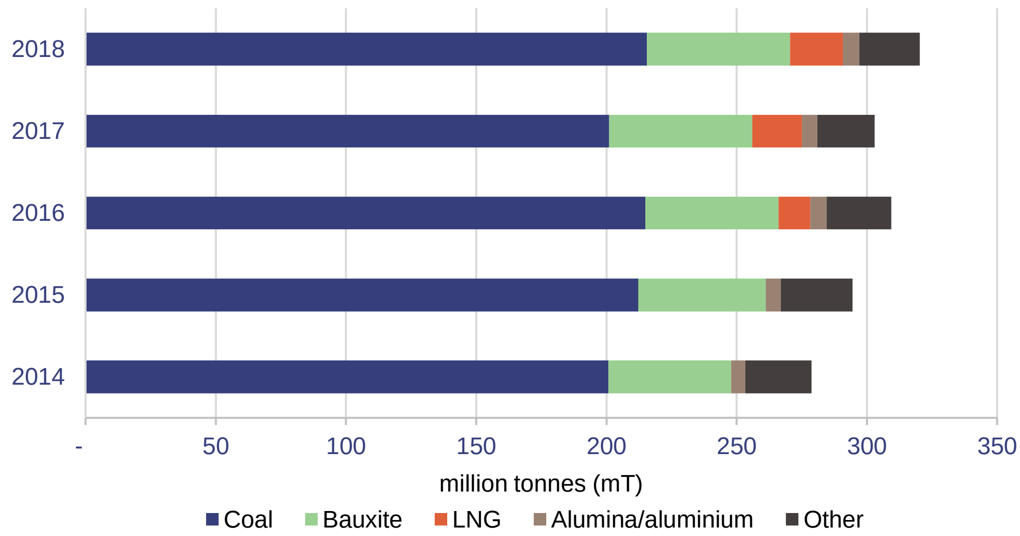
Increasing port throughput

The port entities collect revenues based on the number of vessel movements, size of the vessel, time spent at the port, services provided, and weight of the goods loaded or unloaded from the vessel.

The quantity of commodities and cargo transported, exported, and imported also affects the revenue generated by port entities. This year, cargo handling charges and commercial facility management revenue increased by five per cent.

Figure 3E shows the most significant import and export commodities for the port entities in the last five years.

Figure 3E
Port entities throughput by commodity in the last five years



Source: Queensland Audit Office.

Cargo-handling revenue predominantly relates to the exporting of coking coal and thermal coal at GPC. Coal still represents the commodity with the most tonnes exported through port entities. This year, coal throughput increased by 5.7 percent.

Bauxite and liquified natural gas (LNG) exports remained consistent in 2017–18.

Future challenges and emerging risks

New accounting standards–AASB 15 *Revenue from contracts with customers and* AASB *1058 Income for Not-for-Profit entities*

These two new accounting standards come into effect for not-for-profit government entities for financial years commencing on or after 1 January 2019. AASB 15 applies to for-profit government entities from 1 January 2018. For some entities, accounting for revenue under these standards will be more complex and will require more judgement than before. It can also change the timing of when they are allowed to record revenue in their financial statements.

Transport entities have commenced their initial assessment and do not expect the financial impacts to be significant. Work is still required to finalise accounting policy changes and updates to financial management practice manuals. We will work with transport entities to ensure they are on track to implement the new standards.

Network access revenue and cargo handling charges

QR's network access revenue was $178 million in 2017–18, representing an increase of $15 million (nine per cent) from the prior year. The Queensland Competition Authority has issued QR with an Initial Undertaking Notice requiring it to submit a draft access undertaking that would take effect in 2020. The outcome of this undertaking will influence QR's network access revenue.

Expenses

Figure 3F
Major expenses for all entities by type for 2017–18

Supplies & Services
$4.2b
▲9%

Employee Expenses
$1.6b
▲9%

Depreciation & amortisation
$1.6b
▲4%

Grants & subsidies
$459m
▼25%

Finance costs & other expenses
$406m
▼0.82%

Source: Queensland Audit Office.

Total expenses for all transport entities were $8.2 billion in 2017–18, an increase of $329 million (four per cent) from the prior year.

Events and transactions affecting expenses this year

Operating cost increases

The total supplies and services expenses for transport entities increased by $350 million (nine per cent) to $4.2 billion. DTMR's expenditure on supplies and services increased by $311 million from 2016–17 due to higher contractor expenses; the increases to the QRL rail transport service contract; and additional special transport services incurred for the Gold Coast 2018 Commonwealth Games.

Employee expenses increased by $134 million for the transport entities. QR had an increase of $86 million, primarily due to recruitment activities to increase the number of train drivers, guards and support staff to sustainably deliver more frequent services as recommended in the Strachan Commission of Inquiry. DTMR had an increase of $45 million, primarily due to increased wages and salaries for additional employees hired during the year for the Gold Coast 2018 Commonwealth Games.

Depreciation and amortisation expenses increased overall for the transport entities, primarily due to an increase of $82 million for DTMR-controlled roads, bridges, leased assets for the Gold Coast Light Rail Stage 2 project and New Generation Rollingstock trains. In contrast, QR's depreciation and amortisation expenses decreased by $32 million, mainly due to lower depreciation associated with the delayed retirement of the electric multiple unit train fleet and lower amortisation of intangibles.

Operating cost decreases

Grants and subsidies' expenses decreased by $150 million (25 per cent) from the prior year. This was primarily due to a lower level of expenses incurred by DTMR in 2017–18 in comparison to 2016–17 for the relocation of utilities in preparation for the Gateway Upgrade North project and the finalisation of major local government infrastructure projects.

Future challenges and emerging risks

The New Generation Rollingstock delivered under the public-private partnership service concession are coming online. As more of these trains become operational, maintenance and depreciation expenses are expected to increase.

Public–private partnership is an arrangement where private organisations participate in, or support, the provision of public infrastructure in partnership with one or more public authorities.

Expenses are also budgeted to increase under the rail transport service contract with QRL to improve the capacity and efficiency of the network.

Understanding financial position

Assets decreased by $3.5 billion (four per cent) while liabilities increased by $447 million (five per cent). As a result, the transport entities' combined net asset position decreased by $4.0 billion (six per cent).

Although the transport entities added $2.5 billion of new infrastructure assets, the revaluation of infrastructure assets at 30 June 2018 resulted in a $6.1 billion decrease.

The net revaluation for all port entities increased by $311 million with GPC making up the majority of the increment.

The transport entities transferred $298 million to Queensland Treasury as part of the state government's revised cash management arrangements.

Liabilities increased predominantly due to a $259 million increase in lease liabilities at DTMR relating to the delivery of the Gold Coast Light Rail Stage 2 and New Generation Rollingstock trains.

Assets

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

Infrastructure	Land & buildings	Work-in-progress
$59.3b	$6.3b	$3.4b
▼8%	▲3%	▼0.5%
Other property, plant and equipment	**Cash, investment properties & other financial assets**	**Channels & swing basins**
$2.5b	$2.5b	$1.3b
▲48%	▲21%	▲4%

Source: Queensland Audit Office.

Total assets for the transport entities were $75.3 billion as at 30 June 2018 ($78.8 billion in 2016–17), consisting primarily of infrastructure assets (79 per cent of total assets). These infrastructure assets include roads, motorways, railway networks, and port infrastructure assets used for passenger and trade transport.

Events and transactions affecting assets this year

Movement in infrastructure assets

Infrastructure asset balances of all transport entities decreased by $4.9 billion (eight per cent) from the prior year. Figure 3H shows the most significant movements for infrastructure assets during this financial year.

Figure 3H
Movements in infrastructure assets for all entities by type in 2017–18

Opening balance	Plus additions and transfers from work-in-progress	Less disposals and other transfers out	Less depreciation	Less revaluation adjustment	Closing balance
$64.2 Billion	$2.5 Billion	$21 million	$1.3 Billion	$6.1 Billion	$59.3 Billion

Source: Queensland Audit Office.

Transport entities are continually replacing and increasing their infrastructure assets. DTMR infrastructure investment is the highest of all transport entities. This year $1.9 billion of road infrastructure assets were created across Queensland.

QR had $569 million of infrastructure and rollingstock additions and completed work in progress assets. Major projects included Toowoomba Range Clearance upgrade, Coomera to Helensvale duplication, and South East Queensland Track and Level Crossing reconditioning.

DTMR completed a full management valuation of the road infrastructure network assets as at 30 June 2018. The valuation methodology adopted to calculate fair value is based on current replacement cost. It is the estimated cost to replace an asset with an appropriate modern equivalent using current construction materials and standards, adjusted for changes in utilities and service level capacity. The valuations are dependent on certain key assumptions requiring significant management judgement.

A key assumption that affects the valuation is judgements made around the department’s ability to fund the future replacement of road infrastructure. These judgements result in changes to the estimated remaining useful lives of assets. When expectations of fiscal availability are improved, for accounting purposes the remaining useful life is decreased because it is expected that assets will be replaced in a shorter period of time.

This year DTMR’s estimates of fiscal availability improved. In reducing the remaining useful lives of infrastructure assets, accumulated depreciation for roads’ ($4.5 billion) and structures’ ($1 billion) was increased. This results in lower infrastructure asset values.

DTMR’s final valuation was a $6.2 billion decrease to infrastructure assets. The remaining transport entities had a $136 million infrastructure valuation increase which made the total for the sector a $6.1 billion infrastructure valuation decrease.

Measuring port entities assets value

Port entities' assets such as channels, swing basins (large bodies of water built to allow ships to turn or reverse direction), wharves, land, and buildings are measured using fair value, estimated using an income-based valuation approach. This year, three out of four port entities revalued their property, plant and equipment assets upwards by a total of $319 million (14 per cent). NQBP property, plant and equipment had a net revaluation downwards by $8 million (one per cent).

GPC recorded a $275 million increase due to increases in revenue and future cash flow forecasts offset by an increase in weighted average cost of capital used in the discount rate.

Cash management arrangements for government-owned corporations

In the 2016–17 budget, the state government announced measures as part of its Debt Action Plan to reduce the general government sector borrowings. This included cash management arrangements with government-owned corporations (GOCs) to better utilise the cash they hold. GOCs were required to forecast cash flows for a 12-month period and advance any surplus cash to the state government. If the requirements of the entities change, they are entitled to recall the cash, where necessary, and receive market-based interest on their deposits.

There is no impact on total assets as the movement of cash has been recognised in receivables as an advance facility. All port entities are affected by this arrangement. As at 30 June 2018, total cash advanced under this facility was $298 million.

Future challenges and emerging risks

Integrated transport transformation

The transport landscape in Queensland is changing. Increasing costs and rising demand are challenging the sector to find sustainable solutions to maintain transport infrastructure and services. Technology is rapidly advancing and customer needs are evolving.

On 12 December 2017, the Auditor-General tabled *Integrated Transport Planning* (Report 4: 2017–18). In this audit, we examined whether the state's approach to strategic transport planning enables effective use of transport resources, and a transport system that is sustainable over the long term.

Planning plays a critical role in delivering a single integrated transport network that connects Queensland's people, and facilitates a growing economy. This includes the Queensland Transport and Roads Investment Program 2018–19 to 2021–22, which outlines approximately $21.7 billion of investment in roads and transport infrastructure across Queensland.

Assets currently under construction, or recently completed, include the Moreton Bay Rail Link, Gold Coast Light Rail Stage 2 project, the New Generation Rollingstock (NGR) trains and the related maintenance facilities. The NGR project involves the purchase of 75 new six-car train sets for South East Queensland under a public-private partnership arrangement.

The NGR assets are provided by DTMR and operated by QR in accordance with the rail transport service contract. The first NGR passenger services began running in December 2017 on the Gold Coast and Airport lines, with follow-up services on the Doomben line in May 2018. The new trains are being progressively rolled out across the entire South East Queensland passenger rail network. At the end of June 2018, a total of 38 trains were delivered to Queensland. The complete rollout of this fleet is expected to take several years. QR has been monitoring the transition to the NGR and it is expected that some existing rollingstock will be retired in future reporting periods.

Cross River Rail is a 10.2 kilometre rail line between Dutton Park and Bowen Hills which includes 5.9 kilometres of tunnel under the Brisbane River and the CBD. The project also includes four new underground stations at Boggo Road, Woolloongabba, Albert Street and Roma Street as well as station upgrades for the Dutton Park station and the Exhibition station.

DTMR is developing a Rail Network Strategy to ensure there is a coordinated approach to rail transformation in Queensland. The strategy will develop future service plans and clarify the required investments to enable the rail network to function coherently and deliver a customer-focused service, maximising the government's $5.4 billion investment in Cross River Rail.

The implementation of the Cross River Rail project is expected to have significant impacts on QR operations in terms of timetable, crew, infrastructure and associated cost implications. QR is continuing to deliver operational activities associated with the introduction of NGR trains and supporting the government in planning for Cross River Rail and other rail-related programs.

A ***Tunnel, Stations and Development*** public–private partnership will deliver the underground section of the project whilst a ***Rail, Integration and Systems Alliance*** will deliver the design, supply and installation of the supporting rail systems and integration of Cross River Rail into QR's train network and upgrade to Exhibition Station.

DTMR's forward budget also reflects significant investment in infrastructure projects which include upgrading the Pacific Motorway (M1) between Varsity Lakes and Tugun from four to six lanes; constructing a new 26-kilometre section of the Bruce Highway from Cooroy to Curra (Section D), including a bypass of Gympie; and widening the Pacific Motorway and extending the busway from Eight Mile Plains to Daisy Hill.

In addition, DTMR has embarked on a two-year project entitled Road Asset Valuation Improvement. The objective of this project is to improve the accuracy of road asset valuations, streamline processes, strengthen internal controls and identify a fixed asset register that would integrate various operational and valuation activities.

Key future projects to affect port entities include progressing approvals for the Cairns Shipping Development Project (Ports North), Clinton Vessel Interaction Project (GPC) and progressing works for the Channel Capacity Upgrade project (PoTL).

Componentisation

Componentisation is an approach where property, plant and equipment that have major identifiable components with substantially different useful lives are identified and these assets are treated as separate components and depreciated over their own useful lives. The objective is to ensure that the asset balances are fairly stated in the balance sheet and that the income statement appropriately reflects the consumption of economic benefits inherent in those assets.

QR will be implementing a new framework from 1 July 2018 to improve the management of its property, plant and equipment. All asset classes will be recognised at their optimum componentised level to better reflect useful lives. The replacement framework will drive improved estimation of useful lives in subsequent reporting periods at both the main asset and componentised asset level.

Valuation of port entities assets

Cash generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of cash inflows from other assets or groups of assets.

Valuation of port entities' infrastructure assets using an income approach is a complex exercise involving significant management judgements, estimates and assumptions. The complexity will be further compounded by the treatment of right-of-use assets upon the introduction of AASB 16 *Leases*, for reporting periods beginning on or after 1 January 2019.

The approaches to the valuation of cash generating units (CGU) with right-of-use assets, especially sea bed leases, is still evolving. The cash flows and corresponding liabilities of right-of-use assets can either be included in the CGU within the income-based valuation model or excluded and valued separately from the valuation model. The two approaches will result in different valuation outcomes. This accounting treatment is still under review and we will work with the port entities and Queensland Treasury to ensure a consistent approach is adopted.

Service concession arrangements

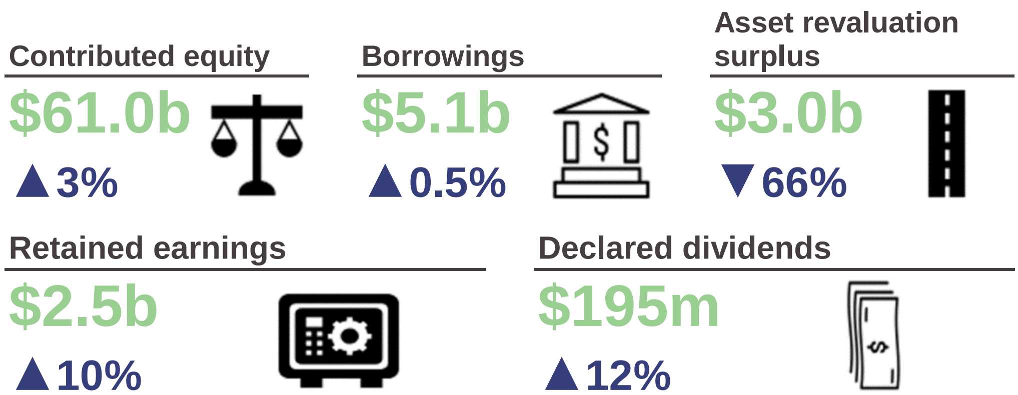
New accounting standard AASB 1059 *Service Concession Arrangements: Grantors* will introduce a new control concept to the recognition of service concession assets and related liabilities.

Some off-balance-sheet arrangements, such as the Airport Link tunnel and the Gateway and Logan motorways, will be recognised as several-billion-dollar assets and liabilities. The impact on financial statements is expected to be significant.

The Australian Accounting Standards Board proposes to defer the application date of this standard for annual reporting periods beginning on or after 1 January 2020 instead of 1 January 2019. DTMR has commenced assessments on each public–private agreement and is on track to implement the standard when it becomes effective.

Debt and equity

Figure 3I
Debt and equity components for all entities by type for 2017–18



Source: Queensland Audit Office.

The transport entities combined hold $66.6 billion in equity and $5.1 billion in borrowings. Equity includes contributed equity held by the Queensland government, transactions with owners (such as dividends), asset revaluation reserves and retained earnings. Debt in the transport sector is made up of borrowings from Queensland Treasury Corporation.

Events and transactions affecting debt and equity this year

Movement in equity

Contributed equity increased by three per cent primarily due to state and Australian Government equity injections paid by Queensland Treasury to DTMR in 2017–18. Asset revaluation surplus decreased primarily because of adjustments related to revaluation decreases of infrastructure assets at DTMR. Retained earnings had increased by 10 per cent mainly due to DTMR's operating surplus of $206.9 million.

Contributed equity is the investment in the entity by shareholders.

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

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

Movement in debt

The transport entities' borrowings increased by $24 million (0.5 per cent) in 2017–18.

QR increased borrowings by $83 million to fund asset acquisitions. DTMR paid $67 million in borrowings back to Queensland Treasury Corporation.

All other entities in the sector have not significantly increased their debt this year and have paid interest costs for all debt.

Declared dividends

The state government set the dividend policy for each entity.

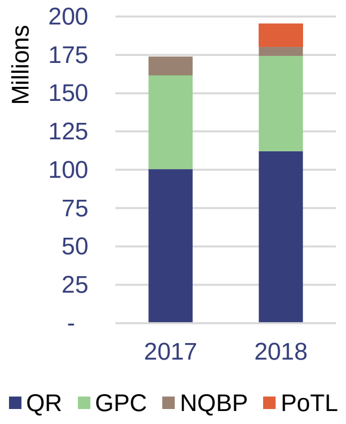
Dividends are a portion of a statutory body or government-owned corporation's profits which it pays to its shareholders.

During 2017–18, QR and three port entities declared total dividends of $195 million ($174 million in 2016–17).

This year's higher dividends to the state government are mostly due to higher profit at QR and the PoTL declared dividend of $15 million (nil in 2016–17).

Ports North received approval to retain their 2017–18 profits as a partial contribution to costs associated with the Cairns Shipping Development project.

Figure 3J
Declared dividends



Source: Queensland Audit Office.

Future challenges and emerging risks

AASB 16 *Leases*

The introduction of AASB 16 *Leases*, for reporting periods beginning on or after 1 January 2019, will introduce a single lease accounting model for lessees. This will result in almost all operating leases being recognised on the balance sheet, as the distinction between operating and finance leases is removed. Under this standard, most leases previously not reported as assets and liabilities will be brought onto the balance sheet. The timing of recognition of expenses will also change.

In 2017–18, the transport entities, as lessees, collectively reported future operating lease commitments of approximately $436 million. Some of these will be brought onto the balance sheet as right-of-use assets, with corresponding liabilities, when this standard becomes effective.

DTMR makes up $398 million (91 per cent) of future operating lease commitments for the transport entities. Although the department has not yet quantified the impact of the new standard on their financial statements, they have commenced an investigation into a system solution to manage the significantly high number of leases.

NQBP is the only port entity that has initially quantified the impact of this standard and expects to include a lease liability of $29 million in its 2019–20 financial statements. However, the accounting treatment for the corresponding right-of-use asset is still under review by NQBP.

4. Internal controls

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

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

Conclusion

We assessed the control environments for each entity. In most cases we found they were suitably designed to prevent, or detect and correct, material misstatements in their financial statements and non-compliance with legislative requirements. For those entities, the control environment supported our reliance on their internal control systems.

We did not identify any new significant internal control deficiencies in the sector. We are satisfied that most transport entities have implemented corrective action to rectify the deficiencies raised in prior years. Two unresolved control deficiencies are on track to fully implement our recommendations during the 2018–19 financial year.

Our audit of internal controls

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

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

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

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

Our rating of internal control deficiencies

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

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

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

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

Control deficiencies categorised by COSO component

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

The framework identifies five components that need to be present and operating together for a successful internal control system. Appendix G explains these components.

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

Figure 4A
Summary of internal control deficiencies for the transport entities

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

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

Monitoring activities

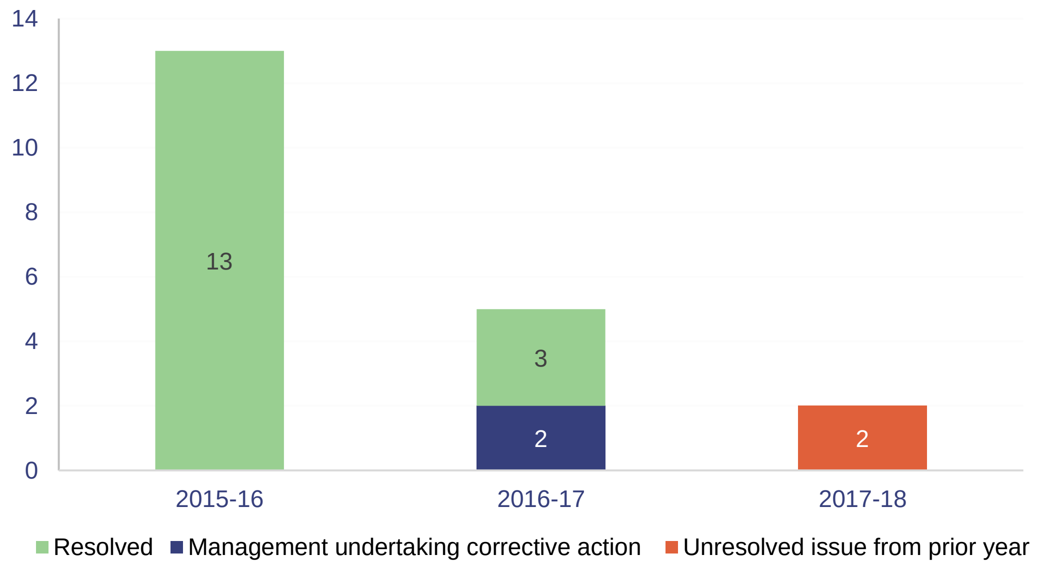
In 2016–17, we identified a significant deficiency over database change monitoring controls at GPC. The accounting system database did not have adequate logging and monitoring of changes made by users. This significant deficiency was re-raised during the 2017–18 financial year as not all recommendations were fully implemented. Management plans to resolve the outstanding issues by the date agreed with the audit and compliance committee.

Status of internal control deficiencies

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

We have analysed the appropriateness and timeliness of remedial action undertaken to resolve any audit matters we have identified. Figure 4B presents the status of internal control deficiencies reported over the last three years at 31 August 2018. The two issues in 2017–18 were re-raised from the prior year.

Figure 4B
Status of control issues reported to management over the last three years



Source: Queensland Audit Office.

We are working with GPC to address their unresolved control deficiencies. The GPC audit committee is also monitoring the corrective action which is underway. We expect the resolution of these issues to occur during the 2018–19 financial year.

Appendices

A. Full responses from agencies

As mandated in Section 64 of the *Auditor-General Act 2009*, the Queensland Audit Office gave a copy of this report with a request for comments to the:

- Premier and Minister for Trade
- Deputy Premier, Treasury and Minister for Aboriginal and Torres Strait Islander Partnerships
- Minister for Transport and Main Roads
- Director-General, Department of Transport and Main Roads
- Heads of the following entities:
  - Department of Transport and Main Roads (DTMR)
  - Queensland Rail Group including
    - Queensland Rail (QR)
    - Queensland Rail Limited (QRL)
  - Gladstone Ports Corporation Limited (GPC)
  - North Queensland Bulk Ports Corporation Limited (NQBP)
  - Port of Townsville Limited (PoTL)
  - Far North Queensland Ports Corporation Limited (trading as Ports North)
- Under Treasurer, Queensland Treasury.

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

This appendix contains their detailed responses to our report.

Comments received from Director-General, Department of Transport and Main Roads

Queensland Government

Office of the Director-General

Department of Transport and Main Roads

CEIVED
26 NOV 2018
QUEENSLAND AUDIT OFFICE

CONFIDENTIAL

Our ref: DG36012

Your ref: 12038

20 NOV 2018

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

Dear Mr Worrall

Thank you for your letter of 7 November 2018 about your proposed report to Parliament titled *Transport: 2017–18 results of financial audits.*

I note the new format of your report in summarising the results for the Queensland transport sector, including the results for the Department of Transport and Main Roads (TMR), and those of the Queensland Rail group and the four port entities. I understand that Queensland Rail and the port authorities have also been given the opportunity to comment on your proposed report.

In 2017–18, TMR recorded strong financial performance and delivered timely, high-quality financial reporting processes with sound internal controls. The TMR operating result of $217 million before tax represents capital contributions from other entities, such as the Queensland Reconstruction Authority or local government organisations. It reflects our diligent fiscal management practices which are reinforced through robust control processes.

The decrease in TMR's total assets relates to changes in asset useful lives being aligned with fiscal availability and reflects TMR's increasing investment in the road infrastructure network. TMR's continued improvements to the annual road infrastructure asset valuation process resulted in the valuation being completed two months earlier in 2017–18, and further improvements are planned for 2018–19.

It is pleasing to see that unmodified audit opinions were provided on the 2017–18 financial statements for each of the transport entities, that all entities are financially sound, and that TMR had no outstanding audit issues for the year.

A key objective for the Queensland Government is ensuring that government-owned enterprises operate as efficiently as possible and can adapt to changing market conditions. In this regard, the report notes that port entities have been able to sustain profitability despite constrained port trade and revenues and continuing impacts from Tropical Cyclone Debbie, and have demonstrated their ability to manage their expenses and better utilise the cash they hold.

1 William Street Brisbane
GPO Box 1549 Brisbane
Queensland 4001 Australia

Telephone +61 7 3066 7316
Facsimile +61 7 3066 7122
Website www.tmr.qld.gov.au
ABN 39 407 690 291

The performance, sustainability and internal control environments of the port entities will continue to be monitored by the government to ensure continued improvement, prudent investment and the delivery of effective and efficient transport services.

Officers from TMR will continue to work with Queensland Rail and the port entities to support their strategic financial management and continued improvement in their financial reporting.

Specific minor feedback on your report as it relates to TMR, has been provided directly to Mr Vaughan Stemmett from your office.

The positive working relationship between officers from TMR and QAO is welcomed and has contributed to a cooperative and efficient financial statements process in 2017–18. I look forward to continuing and enhancing this relationship in 2018–19.

If you require further information, I encourage you to contact Mr John Mullin, Director (Financial Accounting), TMR, by email at john.w.mullin@tmr.qld.gov.au or telephone on 3066 6114.

I trust this information is of assistance and look forward to receiving your final report.

Yours sincerely

Neil Scales
Director-General
Department of Transport and Main Roads

Comments received from Chairman, Gladstone Ports Corporation

Gladstone Ports Corporation
Growth. Prosperity. Community.

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27 NOV 2018
QUEENSLAND AUDIT OFFICE

#1461127 POS:KB
Our Ref: Peter O'Sullivan

23 November 2018

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

Dear Mr Worrall

TRANSPORT: 2017-18 RESULTS OF FINANCIAL AUDITS

Thank you for providing a copy of the report: Transport: 2017-18 results of financial audits.

Gladstone Ports Corporation (GPC) is pleased to have received an unmodified opinion for the 2017-18 financial year, confirming that it has complied with the Australian Accounting Standards and relevant legislative requirements within legislative timeframes.

GPC continues to strive to achieve ratings of fully "Effective" in all areas in future audits and has worked with the QAO to resolve the issues raised in the Closing Report dated 29 August 2018.

INTERNAL CONTROLS

The significant deficiency and deficiency identified are now resolved, with the required corrective actions completed in October 2018. The implementation of improved database capabilities and reporting controls, has addressed the outstanding gaps in the database solution, and the implementation of security software and related controls has enhanced the JDE application solution.

Further details of how the two deficiencies (one Significant Deficiency and one Deficiency) have been addressed and completed is referenced in the table below.

GPC firmly believes that these deficiencies have been completely addressed, as per the original audit findings and is working with QAO to complete the retesting.

GPC has also reviewed the data changes across the financial period with no discrepancies discovered and confirming no fraudulent activity occurred.

AUDIT ASSESSMENT – EFFECTIVENESS OF FINANCIAL STATEMENTS PREPARATION PROCESS

GPC accepts and acknowledges the revaluation of property, plant and equipment did not meet QAO expectations, with significant movements noted in the computed valuation from July to August 2018.

Due to the valuation movements, the timelines of our draft report were issued three days later than the planned date which then impacted the Quality of the Draft Financial Statements.

Gladstone Ports Corporation Limited
T: +61 7 4976 1333 • Fax: +61 7 4972 3045 • 40 Goondoon St/PO Box 259, Gladstone QLD, 4680, AUSTRALIA • www.gpcl.com.au
ACN 131 965 896 ABN 96 263 788 242

Gladstone Ports Corporation
Growth, Prosperity, Community.

GPC will continue to enhance the revaluation process to ensure it is conducted in accordance with required audit standards.

GPC also confirms its commitment to meet future time and quality expectations.

Yours sincerely

PETER CORONES AM
CHAIRMAN

Gladstone Ports Corporation Limited
T: +61 7 4976 1333 • Fax: +61 7 4972 3045 • 40 Goondoon St/PO Box 259, Gladstone QLD, 4680, AUSTRALIA • www.gpcl.com.au
ACN 131 965 896 ABN 96 263 788 242

Gladstone Ports Corporation

Deficiency / Issue	Consequence / Significance / Potential Impact	QAO Recommendations	Actions undertaken to 30 June 2018	Actions completed to date
Significant Deficiency: **JDE Security – Logging and monitoring of Database Changes** *Observations:* Fusion 5 and JDE IT staff hold administrator privileges to the JDE production database. This level of access allows users to implement data fixes. GPC does not log and monitor changes to the JDE database production environment.	A user can make unauthorised changes caused by fraud or error which management may not detect in a timely manner. Lack of effective IT general controls such as monitoring and logging database changes increase audit substantive testing which is highly resource intensive.	We recommend GPC management: 1. Perform an assessment of compensating controls over the period when the control was not operating to ascertain that there has been no event that has occurred doe to fraud or error. 2. Perform a risk assessment to identify the transactions to be logged. 3. Activate the logging function within the JDE production database and periodically monitor this log. This can include review of data edits / modification, patches / software fixes and upgrades. 4. Reconcile change approvals to the log of changes.	1. GPC performed a check of data fixes to production environment under IS Change Management standards effective 1st August 2016. One change was recorded (approved in line with required process). *Note: Additionally, no discrepancies were discovered in the annual financial statements in 2016-2017 statements, indicating no fraudulent activities occurred.* 2. Risk analysis for period between 1/7/2016 and 30/8/2016 showed no changes to data through the previously Project controlled change management. *Note: This risk analysis report has since been unable to be located, and has been reported to the QAO as unable to be recovered.* 3. Limitation and registration of personnel having Administrator database access, with monthly reviews to ensure compliance. *Note: Manual Control* 4. Change approvals/records reconciled against application changes monthly. *Note: Manual Control*	1. JDE Database (SQL) – system accounts were secured by 9/9/2018 (passwords changed and stored in a restricted password controlled location. 2. JDE Database (SQL) – upgraded from Standard to Enterprise edition, giving additional monitoring capabilities. Monitoring is in place and operational, allowing reports and reviews to be completed as required. Reviews are performed weekly and monthly. Database monitoring includes record of all data edit/modification, patches, software fixes/upgrades. 3. Separation of Duties now exists between the Server and Database, preventing log tampering. New restricted access groups are in place for the Database, Server and Application elevated access, to allow and prevent access to users, and GPC have active monitoring for any changes to group members in place (notification to IS Security team). 4. Patching – has been completed for Operating Systems, Databases and Application, and all are completely up-to-date, with scheduled update windows planned for future.

Gladstone Ports Corporation Limited
T: +61 7 4976 1333 • Fax: +61 7 4972 3045 • 40 Goondoon St/PO Box 259, Gladstone QLD, 4680, AUSTRALIA • www.gpcl.com.au
ACN 131 965 896 ABN 96 263 788 242

Gladstone Ports Corporation

Deficiency / Issue	Consequence / Significance / Potential Impact	QAO Recommendations	Actions undertaken to 30 June 2018	Actions completed to date
Deficiency: **JDE Security – User access management, monitoring and logging** Observations: GPC is not currently monitoring high-risk security transactions in an environment where, an external service provider (Fusion 5) supports the JDE application and the network. 10 users (vendor and GPC employees) have this administrator access. Further, GPC has not developed and approved a security matrix for JDE user accounts and profiles. There is no evidence of periodic review over dormant accounts in the JDE application to ensure they are deactivated in a timely manner. We understand that management are currently in the process of developing reports to review JDE user accounts.	In an environment where high-risk security transactions are not monitored, there is an increased risk that privileged users can process unauthorised financial transactions. In the current environment, GPC may not identify unauthorised activity in a timely manner which may misstate its financial statements.	We recommend that GPC management ensure: 1. System logs are used to regularly monitor the following activities; a. Adding or deleting a user account b. Adding or modifying privileges / profiles to an account c. Creating, modifying or deleting a profile d. Enabling or disabling a user account and e. Logs on the use of system accounts or generic accounts with elevated privileges. 2. Procedures are implemented to remove inactive JDE users' accounts. 3. Periodic reviews of user access are undertaken to ensure access held is commensurate with job responsibilities. 4. The creation and approval of a baseline for all user profiles and a security matrix for user accounts based on job requirements.	1. All JDE access changes are required to be approved by appropriate manages through the IS Service Request system. Logs are reviewed by the IS security officer on a monthly and quarterly basis. *Note: the implementation of JDE security software as per point 5 below has superseded this).* 2. Procedure for AD disabling requests updated to add step to include JDE account disabling where required. Monitoring for stale accounts is performed as per the account management processes, with 90 day disable for inactive accounts. 3. JDE security roles matrix to be adhered to be SMEs and JDE Administrator. All exceptions will be approved by the relevant manager and Finance Manager. 4. Setup of baseline for user profiles and security and segregation of duties will be reviewed and implemented in the new JDE security software (as per point 5 below). 5. GP has implemented QSoftware to manage JDE security and separation of duties. This has been in place and operational from June 2018. Changes made from reported issues are recorded in the Service Request system.	1. QSoftware – User Access Manager installation completed, allowing for roles to be analysed. This identified 95 roles in total, of which 21 were not in use. These roles have been removed. 2. JDE Application – system and service (generic) accounts have all had passwords reset to secure these accounts, and are stored with limited access to only GPC personnel. 3. Server Access – restrictions have been tightened, with group policy removing non-authorised users every fifteen minutes, and restricted access groups in place. 4. Separation of Duties now exists between the Server and Database, preventing log tampering. New restricted access groups are in place for the Database, Server and Application elevated access, to allow and prevent access to users, and have active monitoring for changes to group members in place. 5. Monthly QSoftware Audit Reports – were completed for all sections of the business, with identified actions completely remediated, each month from June 2018 onwards. 6. Several process and control documents have been created and/or updated, to address the new requirements implemented, and have been communicated amongst GPC and Fusion 5 (JDE Managed Service vendor) support teams.

Gladstone Ports Corporation Limited
T: +61 7 4976 1333 • Fax: +61 7 4972 3045 • 40 Goondoon St/PO Box 259, Gladstone QLD, 4680, AUSTRALIA • www.gpcl.com.au
ACN 131 965 896 ABN 96 263 788 242

Comments received from Acting Under Treasurer, Queensland Treasury

Queensland Government

Queensland Treasury

Our Ref: 04989-2018
Your Ref: 12038

2 8 NOV 2018

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

Dear Mr Worrall

Thank you for providing an opportunity to review the Queensland Audit Office (QAO) report titled *Transport: 2017-18 Results of Financial Audits* (the report), covering the Department of Transport and Main Roads (DTMR), Queensland Rail (QR) Group, and the Government-owned port corporations.

I note that unmodified audit opinions were provided for the 2017-18 financial statements for all the Queensland transport entities, and that the QAO concludes that all the rail and port entities are financially sound and can pay their debts when they fall due.

A key objective for the Queensland Government is ensuring that these enterprises operate as efficiently as possible and can adapt to changing market conditions.

In this regard, the report notes the transport entities have demonstrated continued profitability whilst seeing increased expenses, constrained port trade and revenues. Significant expenditure on repairs following Tropical Cyclone Debbie in 2017 has increased infrastructure investment.

The report identifies the financial impacts of the increased expenditure for the 2018 Commonwealth Games (the Games) and the investments in services and employee recruitment in response to the recommendations of the 2017 Strachan Commission of Inquiry. These investments helped ensure a successful delivery of additional services for the Games, while also seeing an overall increase in total patronage across the transport network.

The Queensland Government supports these investments in improved rail operations, hiring practises and customer services, and will monitor progress toward increased safety, efficiency and commercial competitiveness in QR's services.

1 William Street
GPO Box 611 Brisbane
Queensland 4001 Australia
Telephone +61 7 3035 1933
Website www.treasury.qld.gov.au
ABN 90 856 020 239

I appreciate the guidance provided regarding potential impacts on financial statements arising from the introduction of new accounting standards AASB 15 and AASB 16 and note the transport entities are preparing for implementation after 1 January 2019.

Regarding the internal control deficiencies identified in 2017-18, I note the QAO's conclusion that most entities had no issues, and that the two unresolved items carried over from the 2016-17 audits are on track to be fully resolved during the 2018-19 financial year.

The performance, sustainability and internal control environments of all transport entities will continue to be monitored to ensure continued improvement, prudent investment and the delivery of transport services. Future consultation with QR and the ports regarding the 2017-18 audit findings will also be undertaken to ensure continued improvement in the quality and timeliness of financial reporting and management.

Once again, thank you for the opportunity to comment on the report. I understand officers from Queensland Treasury have discussed these matters with the QAO, along with minor suggestions relating to presentation and drafting of the report.

Yours sincerely

Mary-Anne Curtis
Acting Under Treasurer

B. Legislative context

Framework

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

Entity type	Entity	Legislative framework	Legislated deadline
Department and Statutory body/authority	Department of Transport and Main Roads Queensland Rail	• *Financial Accountability Act 2009* • *Financial and Performance Management Standard 2009*	31 August 2018
Wholly owned subsidiary of a statutory body	Queensland Rail Limited	• *Corporations Act 2001* • *Corporations Regulations 2001*	31 August 2018
Government owned corporations (GOC)	Far North Queensland Ports Corporation Limited Gladstone Ports Corporation Limited North Queensland Bulk Ports Limited Port of Townsville Limited	• *Government Owned Corporations Act 1993* • *Corporations Act 2001* • *Corporations Regulations 2001*	31 August 2018

Source: Queensland Audit Office.

Accountability requirements

The *Financial Accountability Act 2009* applicable to Department of Transport and Main Roads and Queensland Rail requires department and statutory bodies/authorities to:

- establish and keep funds and accounts that comply with the prescribed requirements
- establish and maintain appropriate systems of internal control and risk management
- achieve reasonable value for money by ensuring the operations of the statutory body are carried out efficiently, effectively and economically.

The *Government Owned Corporations Act 1993* applicable to the four port entities, 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 public sector entities must table their audited financial statements in parliament.

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

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

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

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

C. Our assessment of financial statement preparation

In assessing the effectiveness of financial statement preparation processes we considered three components—the year-end close process, the timeliness of financial statements, and the quality of financial statements.

Result summary

This table summarises our assessment of transport entities' financial statement preparation processes across the seven transport entities producing a financial report.

Entity	Financial statement preparation		
	Year-end close process	Timeliness of draft financial statements	Quality of draft financial statements
Department of Transport and Main Roads	🟢	🟢	🟢
Queensland Rail	🟢	🟢	🟡
Queensland Rail Limited	🟢	🟢	🟡
Gladstone Ports Corporation Limited	🟡	🔴	🔴
North Queensland Bulk Ports Corporation Limited	🟢	🟢	🟢
Port of Townsville Limited	🟢	🟢	🔴
Far North Queensland Ports Corporation Limited	🟢	🔴	🟡

Source: Queensland Audit Office.

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:

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

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

D. Key audit matters

This table summarises the key audit matters reported for the seven transport entities.

Key audit matter	Entity
Valuation of road infrastructure assets	Department of Transport and Main Roads
Valuation of property, plant and equipment	Queensland Rail Queensland Rail Limited Gladstone Ports Corporation Limited North Queensland Bulk Ports Corporation Limited Port of Townsville Limited Far North Queensland Ports Corporation Limited
Depreciation and useful lives	Department of Transport and Main Roads Queensland Rail Queensland Rail Limited Gladstone Ports Corporation Limited North Queensland Bulk Ports Corporation Limited Port of Townsville Limited Far North Queensland Ports Corporation Limited

Source: Queensland Audit Office.

E. Entities not preparing financial reports

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

Public sector entity	Reason for not preparing financial reports
Controlled entities of Gladstone Ports Corporation Limited	
Gladstone Marine Pilot Services Pty Ltd	Board of director's determination
Gladstone WICET Operations Pty Ltd	Dormant
Controlled entities of Queensland Rail Limited	
On Track Insurance Pty Ltd	Board of directors' determination
Controlled entities of North Queensland Bulk Ports Limited	
Mackay Ports Limited	Dormant
Ports Corporation of Queensland Limited	Dormant

Source: Queensland Audit Office.

F. Financial snapshot

For the year ending 30 June 2018
Amounts in $'000

Entity	Total assets	Total liabilities	Total income	Total expenses (excl tax)	Operating result before tax	Dividends declared	Borrowings		
							Finance costs	New borrowings	Repayment of borrowings
DTMR	63 712 233	2 372 514	6 006 492	5 790 104	216 388	–	95 848	–	67 467
QR	7 180 287	4 357 307	1 959 975	1 800 413	159 562	112 253	183 665	130 000	46 725
GPC	2 666 018	1 415 581	483 104	391 586	91 518	61 945	37 475	–	1 979
NQBP	736 677	364 550	111 966	104 925	7 041	6 000	6 868	10 000	–
PoTL	641 791	187 033	77 298	55 041	22 257	15 011	4 632	–	111
Ports North	415 970	72 750	74 350	49 139	25 211	–	–	–	–

Source: Queensland Audit Office.

For the year ending 30 June 2017
Amounts in $'000

Entity	Total assets	Total liabilities	Total income	Total expenses (excl tax)	Operating result before tax	Dividends declared	Borrowings		
							Finance costs	New borrowings	Repayment of borrowings
DTMR	67 731 350	2 191 415	5 776 159	5 582 382	193 777	–	97 367	–	83 434
QR	7 055 163	4 227 621	1 882 774	1 740 190	142 584	100 515	183 760	296 725	–
GPC	2 391 180	1 067 943	470 856	373 597	97 259	61 037	37 571	317 641	–
NQBP	731 523	359 561	109 173	77 758	31 425	12 350	5 288	110 000	–
PoTL	595 331	159 734	69 259	48 097	21 162	–	4 885	38 000	18 371
Ports North	378 618	60 926	53 821	40 598	13 223	–	–	–	–

Source: Queensland Audit Office.

G. Our audit of internal controls

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

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

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

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

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

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

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

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

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

Internal controls framework

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

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

Control environment

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

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

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

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

Risk assessment

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

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

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

Control activities

- General information technology controls
- Automated controls
- Manual controls

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

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

General information technology controls

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

Automated control activities

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

Manual control activities

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

Information and communication

- Non-financial systems
- Financial systems
- Reporting systems

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

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

Monitoring activities

- Management supervision
- Self-assessment
- Internal audit

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

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

H. Glossary

Term	Definition
Accountability	Responsibility of public sector entities to achieve their objectives of delivering reliable financial reporting, effective and efficient operations, compliance with applicable laws, and reports to interested parties.
Acquisition	Establishing control of an asset, undertaking the risks and receiving the rights to future benefits as would be conferred with ownership, in exchange for the cost of acquisition.
Amortisation	The systematic allocation of the depreciable amount of an intangible asset over its useful life.
Asset valuation	The process of determining the fair value of an asset.
Audit committee	A committee intended to provide assistance to the accountable officer or statutory body in discharging their obligations. Duties and responsibilities can involve oversight of all or a combination of the following: • effectiveness and reliability of internal controls • quality and integrity of accounting and reporting practices • effectiveness of performance management • legal and regulatory compliance • auditor's qualifications and independence and • performance of the internal audit function and external auditors.
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.
Audit opinion	A written expression of the auditor’s overall conclusion on the financial report based on audit evidence obtained.
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.
Capital expenses	Expenses to acquire assets or improve the service potential of existing assets that is capitalised to the balance sheet.
Cash generating unit	The smallest identifiable group of assets that generates cash inflows and outflows that can be measured.
Contributed equity	Investment in an entity by shareholders

Term	Definition
Control environment	The structures, policies, attitudes and values that influence daily operations. A component of internal control that provides the foundation for other elements of internal control.
Controlled entity	Entity controlled or owned by one or more public sector entities.
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.
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.
Emphasis of matter	A paragraph included with an audit opinion to highlight an issue that the auditor believes the users of the financial statements need to be aware of. The inclusion of an emphasis of matter paragraph does not modify the audit opinion.
Fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
Financial Accountability Act 2009	An Act of the State of Queensland that establishes accountability for the administration of the state's finances and financial administration of departments and statutory bodies, as well as annual reporting to parliament by departments and statutory bodies.
Financial and Performance Management Standard 2009	Subordinate legislation of the State of Queensland that provides a framework for an accountable officer of a department, or a statutory body, to develop and implement systems, practices, and controls for the efficient, effective, and economic financial and performance management of the department or statutory body.
Governance	The arrangements in place at an entity to plan, direct and control its activities to achieve its strategic and operational goals.
Impairment	When an asset's carrying amount exceeds the amount that can be recovered through use or sale of the asset.
Legislative deadline	In this context, the date prescribed by legislation for a public sector entity to finalise its financial statements or annual report.
Management	Those with the executive responsibility for conducting an entity's operations.
Materiality	This relates to the size or nature of the item or error judged against the circumstances of its omission or misstatement. Information is material if its omission or misstatement could influence the economic decisions of users.

Term	Definition
Misstatement	A difference between the amount, classification, presentation, or disclosure of a reported financial report item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.
Net assets	Total assets less total liabilities.
Non-current assets	An entity's long-term investments, where the full value will not be realised within the financial year. These assets are capitalised rather than expensed, meaning that the cost of the asset can be allocated over the number of years for which the asset will be in use, instead of allocating the entire cost to the financial year in which the asset was purchased.
Public–private partnership	An arrangement where private organisations participate in, or support, the provision of public infrastructure in partnership with one or more public authorities.
Public sector entity	A department, statutory body, government owned entity, local government, or a controlled entity.
Revaluation movement (increments or decrements)	The act of recognising a reassessment of the carrying amount of a non-current asset to its fair value as at a particular date.
Risk management	The systematic identification, analysis, treatment, and allocation of risks. The extent of risk management required will vary depending on the potential effect of the risks.
Significant deficiency	A deficiency, or combination of deficiencies, in internal control that requires immediate remedial action.
Unmodified audit opinion	An unmodified opinion is expressed when the financial statements are prepared in accordance with the relevant legislative requirements and Australian accounting standards.
Useful life	The number of years the entity expects to use an asset (not the maximum period possible for the asset to exist).

Auditor-General reports to parliament

Reports tabled in 2018-19

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

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Connect with QAO on LinkedIn

T: (07) 3149 6000
M: qao@qao.qld.gov.au
W: qao.qld.gov.au
53 Albert Street, Brisbane Qld 4000
PO Box 15396, City East Qld 4002

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