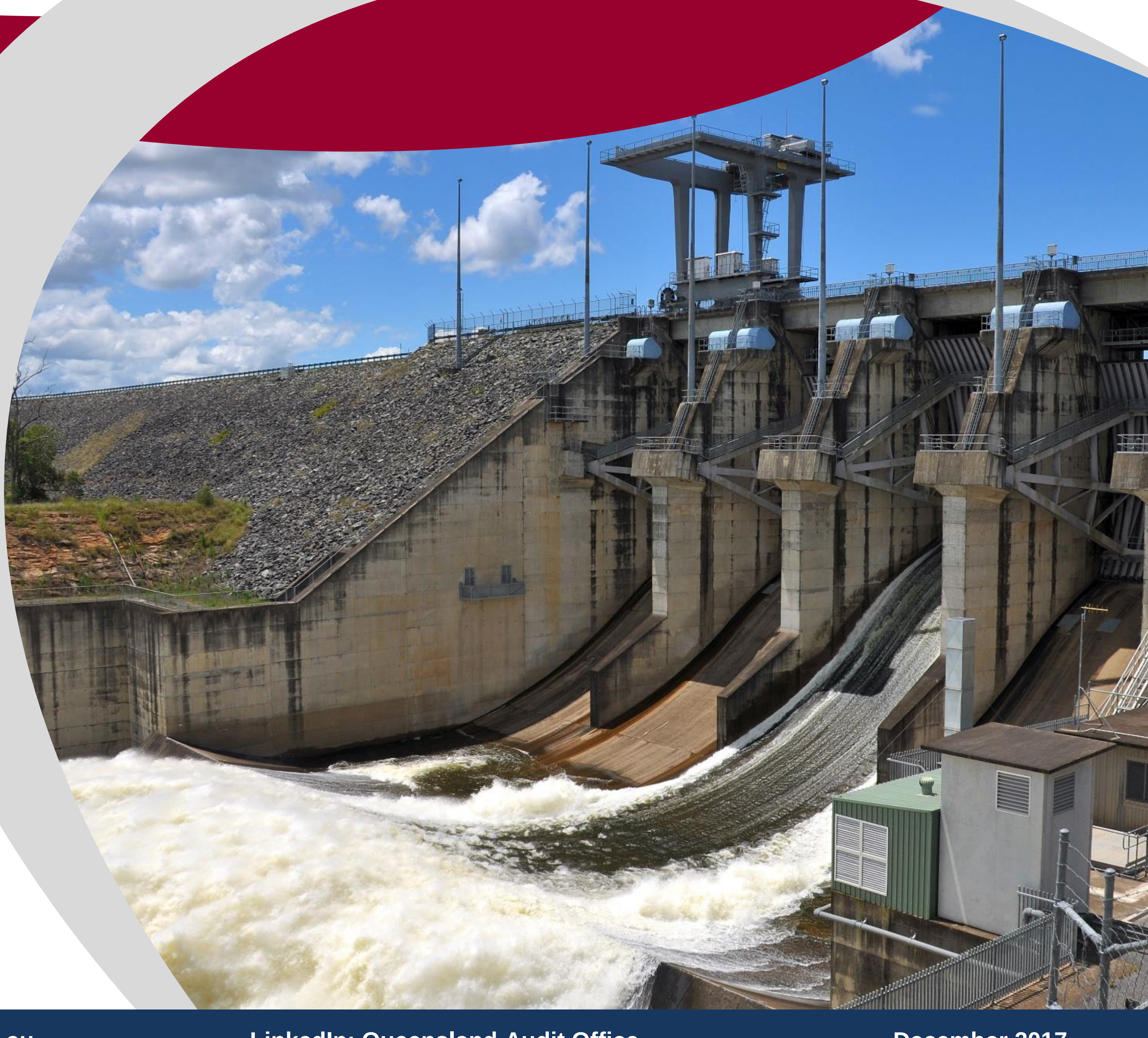
Queensland Audit Office
*better public services*

# Water: 2016–17 results of financial audits

## Report 5: 2017–18



## Contact details

The Financial Audit Division of the Queensland Audit Office is the custodian of this report. All comments and enquiries should be directed to:

| | |
|---|---|
| Location | Level 14, 53 Albert Street, Brisbane Qld 4000 |
| PO Box | 15396, City East Qld 4002 |
| Telephone | (07) 3149 6000 |
| Email | qao@qao.qld.gov.au |
| Online | www.qao.qld.gov.au |

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## Reference to comments

In accordance with section 64 of the *Auditor-General Act 2009,* we provided a copy of this report to Minister for Main Roads, Road Safety and Ports and Minister for Energy, Biofuels and Water Supply; Minister for State Development and Minister for Natural Resources and Mines; the Director-General, Department of Energy and Water Supply; the Chief Executive Officer, Queensland Competition Authority and the Under Treasurer, Queensland Treasury. In reaching our audit conclusions, we have considered their views and represented them to the extent we deemed relevant and warranted in preparing this report.

Responses were received from the Department of Premier and Cabinet, Queensland Treasury, and SunWater Limited. The responses are in Appendix A.

## Report cost

This audit report cost $100 000 to produce.

Your ref:
Our ref: Water RtP

QAO
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14 December 2017

Mr Neil Laurie
The Clerk of the Parliament
Parliament House
BRISBANE QLD 4000

Dear Mr Laurie

**Report to Parliament**

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009*, and is titled *Water: 2016–17 results of financial audits* (Report 5: 2017–18).

In accordance with s.67 of the Act, would you please arrange for the report to be tabled. In accordance with s59A of the Parliament of Queensland Act and Standing Order 31, I request that this document be tabled during the period that the Legislative Assembly is dissolved.

Yours sincerely

Brendan Worrall
Auditor-General

**Queensland Audit Office**
Level 14, 53 Albert Street, Brisbane Qld 4000
PO Box 15396, City East Qld 4002

Phone 07 3149 6000
Email qao@qao.qld.gov.au
Web *www.qao.qld.gov.au*

## Report structure

**CHAPTER 1**

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

**CHAPTER 2**

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

**CHAPTER 3**

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

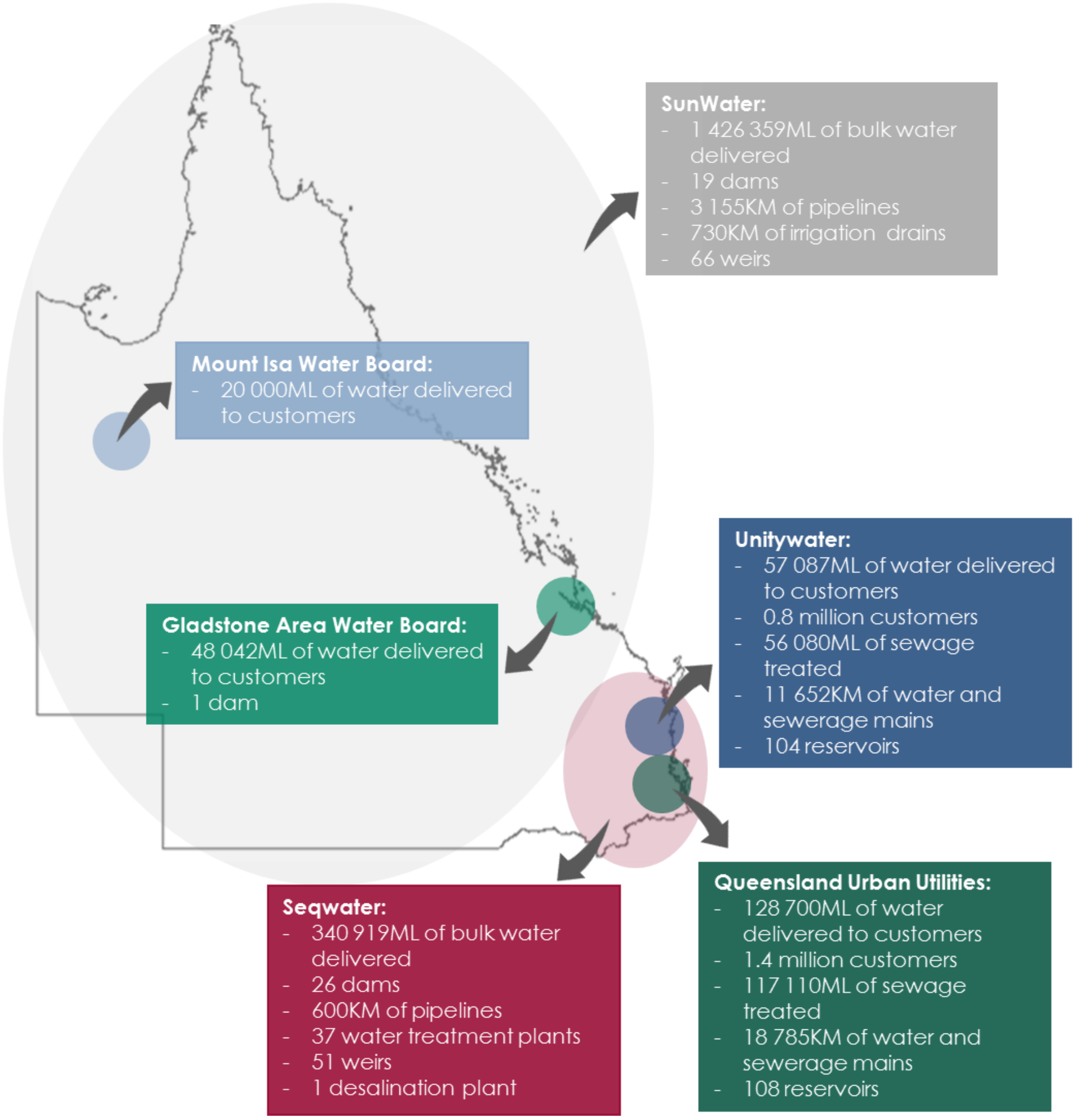
**CHAPTER 4**

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

# Contents

# Summary

**Figure A**
**Queensland water sector entities included in this report**




*Source: Queensland Audit Office.*

River Improvement Trusts, Water Authorities, Water Boards and Drainage Boards provide services to local councils and small communities. Local governments source and sell water to their ratepayers from a number of surface and groundwater sources. The results from our financial audits of these smaller water boards and councils are outside the scope of this report.

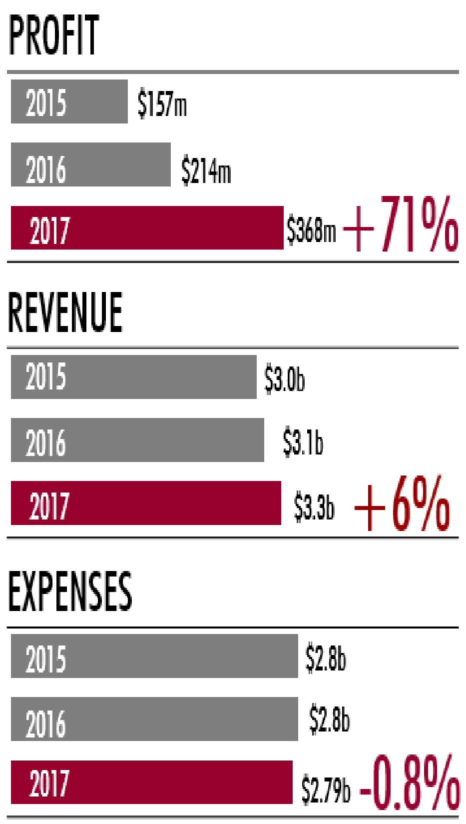
## Results of our audits

We issued unmodified audit opinions on all financial statements this year within the statutory deadline of 31 August 2017. We do this when the financial statements are prepared in accordance with the relevant legislative requirements and Australian accounting standards, and can be relied upon.

Water entities used good financial reporting practices to produce high quality financial statements in a timely manner for 2016–17. Entities with issues last year put appropriate processes in place and made information available by the agreed timeframes this year.

Seqwater met the statutory reporting deadline this year for the first time in three years, after the quality of the asset valuation process improved.

## Financial performance, position, and sustainability



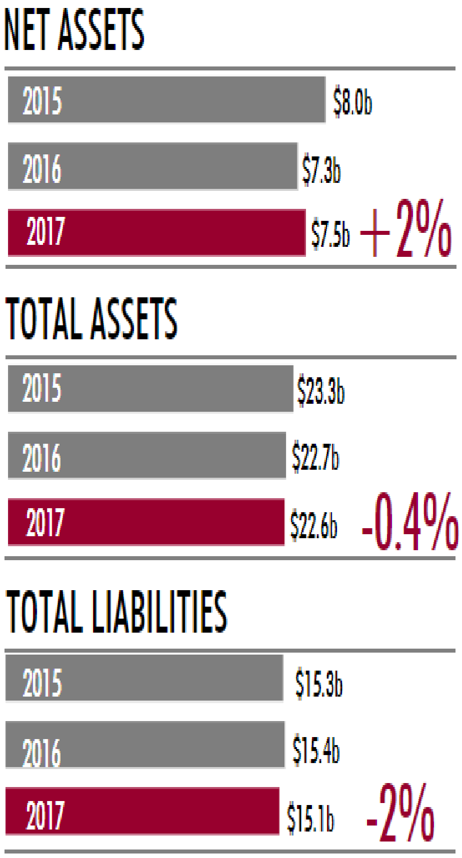

*Source: Queensland Audit Office.*

For the third consecutive year, the water sector has reported an increase in its operating profits, with four entities having profits after income tax greater than prior years. This has been driven by population growth, consumer demand for water, and pricing increases across the sector.

Entities have worked towards maintaining and containing expenses through implementing cost reduction strategies.

Returns to the state government have reduced in the current year to $8 million ($168 million in 2015–16). The state has not requested a dividend from SunWater and its profit of $36 million has been retained. SunWater will use the retained profits for dam safety works. Due to operating losses, Seqwater has continued to make no dividend payments to the state in 2016–17.

The returns made by the distributor-retailers of water to their participating local governments amounted to $202 million for 2016–17 (2016: $170 million), up $31.5 million from 2015–16.




*Source: Queensland Audit Office.*

Asset and liability balances have remained generally consistent with the prior year.

All water entities are financially sustainable, although Seqwater's sustainability is dependent on the pricing methodology set by the state government. This methodology requires Queensland Competition Authority (QCA) to provide revenue allowances sufficient to meet the cost to supply bulk water and to repay water grid manager debt by 2028.

A significant contributor to the reduction in total liabilities this year is that this is the first year Seqwater has paid its interest costs for all its debt, rather than capitalising these costs associated with water grid manager debt—which in the past increased its debt.

As part of the water sustainability programs being implemented, entities are investing in water saving and storage infrastructure programs along with the Queensland Government. The 2017–18 State Budget committed $225 million over four years to implement the findings of the Townsville Water Security Taskforce.

## Internal controls

This year we identified two significant deficiencies in control activities at SunWater relating to individuals' access abilities in the finance system and conflicts in roles and responsibilities in the accounts payable section. Management is on track to resolve the issues by the date agreed with the Audit, Finance and Risk Committee.

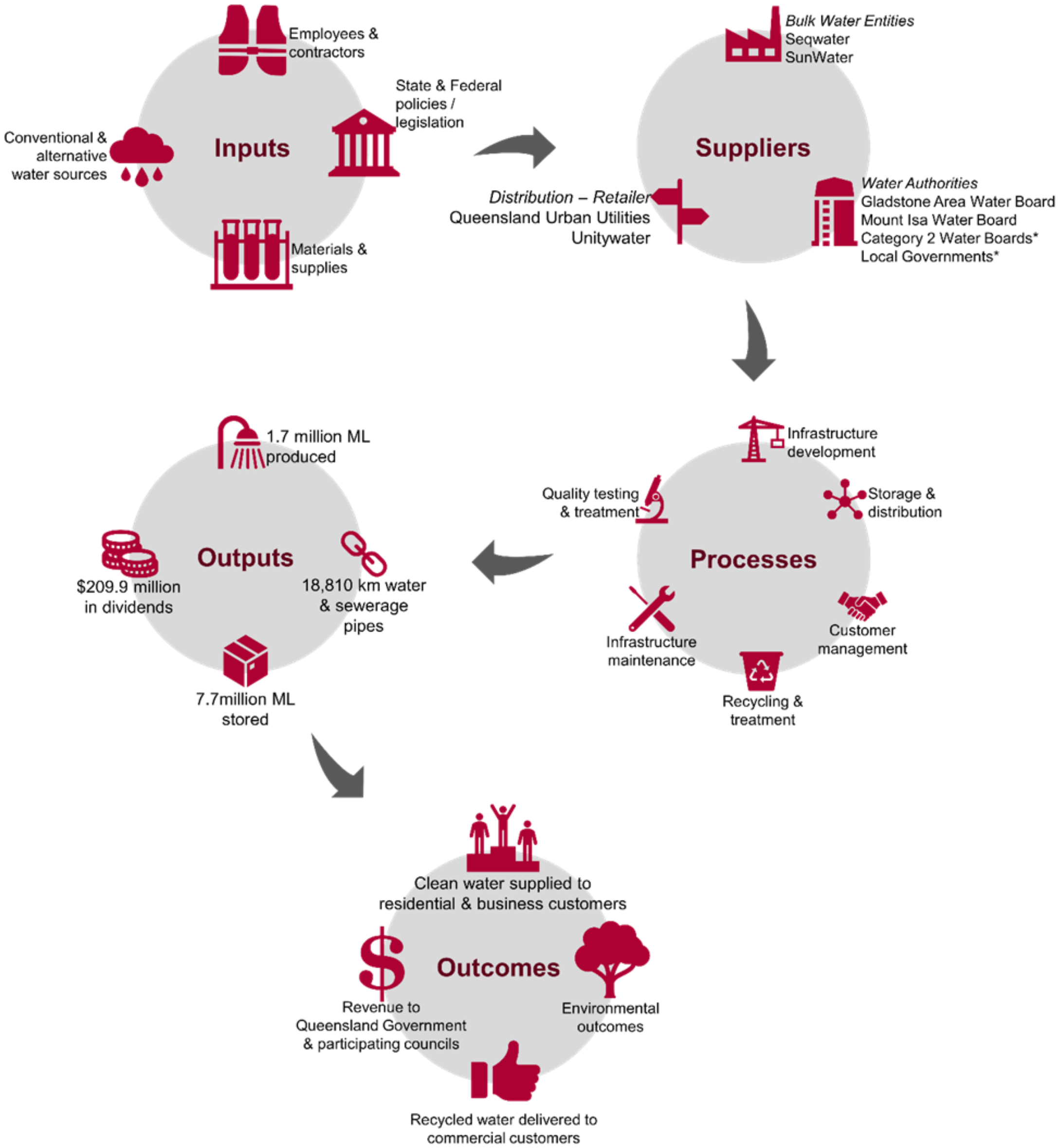
We assessed the control environments of all remaining entities as effective, and we were able to rely on the internal control systems used to produce financial statements.

# 1. Sector overview

In Queensland, water is used primarily by households, agriculture, mining, electricity generation, tourism, and manufacturing industries. Direction and oversight of the water sector in Queensland is provided by the Department of Energy and Water Supply.

Figure 1A details the major state and local government-owned entities that make up the water supply chain, as well as the inputs, suppliers, processes, outputs, and outcomes for the sector.

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




Note: *Output figures exclude these entities.

*Source: Queensland Audit Office.*

Appendix B outlines the entities operating in the water sector in Queensland.

# 2. Results of our audits

## Introduction

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

## Conclusion

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

All water entities have effective year end close processes allowing them to produce high quality financial statements in a timely manner. There were no material adjustments to the financial reports as a result of improved asset valuation and reporting practices.

Seqwater's financial report met the legislative deadline for the first time in three years.

## Audit opinion results

All water entities met their legislative deadline of 31 August (2015–16: 83 per cent). The table below details the unmodified audit opinions we issued for the 2016–17 financial year.

**Figure 2A**
**Date of unmodified audit opinions issued for 2016–17**

| Element of water supply chain | Entity (trading names) | Date audit opinion issued |
|---|---|---|
| Bulk water suppliers | Mount Isa Water Board | 23.08.17 |
| | SunWater Limited | 29.08.17 |
| | Seqwater | 30.08.17 |
| | Gladstone Area Water Board | 30.08.17 |
| Distributor-retailers | Queensland Urban Utilities | 23.08.17 |
| | Unitywater | 30.08.17 |
| Controlled entities | Australian Water Recycling Centre of Excellence Ltd | 28.03.17[a] |
| | Healthy Waterways Limited | [b] |
| | Eungella Water Pipeline Pty Ltd | 26.10.2017[c] |

Notes:

[a] This entity ceased trading at 31 December 2016. We issued our audit opinion of 28 March 2017 and it was deregistered on 5 July 2017.

[b] The entity no longer fits within our mandate of being a public sector entity.

[c] Statutory date for issuing an audit opinion is 31 October 2017.

*Source: Queensland Audit Office.*

## Financial statement preparation

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

**Figure 2B**
**Effectiveness of financial statement preparation processes**


*Source: Queensland Audit Office.*

The quality of processes and financial statements has improved in comparison with the prior year. A greater emphasis has been placed on improving the quality and timeliness of asset valuations. Management ensured that valuations were completed earlier along with pro forma financial statements being provided at or before the agreed milestone dates.

Water entities have effective internal review processes to identify and correct errors before draft financial statements and/or financial reporting packs are provided for audit. They also resolve material accounting issues through the reporting period. We did not identify any material changes to the financial statements for the water entities.

Our assessment criteria are outlined in Appendix E.

## 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 are those 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 Seqwater and SunWater that included 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.

## Entities not preparing financial statements

Not all Queensland public sector water entities produce financial statements. Due to their size, three water entities are not required to prepare financial statements under the requirements of the *Corporations Act 2001*: North West Queensland Water Pipeline Pty Ltd, Burnett Water Pty Ltd, and Unitywater Properties Pty Ltd. The financial performance and position of these entities has been included in the results of their parent entities.

# 3. Financial position, performance, and sustainability

## Introduction

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

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

Our analysis helps users understand and use the financial statements by clarifying the financial effects of significant transactions and events in 2016–17. We also use metrics such as ratio analysis to highlight and provide insights into organisational performance.

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

## Conclusion

The water entities are financially sustainable, and are able to pay their debts as and when they fall due. Seqwater's sustainability depends on the future returns provided through pricing set by the Queensland Government, and on the security currently provided by the state for borrowings. SunWater's sustainability depends on the future returns provided through pricing set by the Queensland Government and funding of any shortfall in the Dam Safety Improvement Program.

Profits for the water sector have increased by 71 per cent ($154 million), from population growth and the resulting developer contributions to urban household infrastructure to distributor-retailers. Expenses have stabilised, and four of the six entities have profits after income tax greater than prior years.

The assets and liabilities of the water sector have not changed from last year, after five years of borrowings growth. Seqwater's debt has not increased for the first time since 2011–12.

## Understanding financial performance

Operating profits were achieved by five of the six water entities in 2016–17. Seqwater continues to make an operating loss largely reflecting the historical under-recovery of the cost of water. It also reflects their past acquisition of highly geared businesses (business with a lot of debt in relation to share capital) including climate-resilient manufactured water assets.

**Figure 3A**
**Profit after tax and returns to shareholders**

| | 2015 | 2016 | 2017 |
|---|---|---|---|
| PROFIT | $157 MILLION | $214 MILLION | $368 MILLION |
| SHAREHOLDER RETURNS | $137 MILLION | $469 MILLION | $210 MILLION |

*Source: Queensland Audit Office.*

During 2016–17, two entities in the sector (Gladstone and Mount Isa Area Water Boards) declared dividends of $8 million ($168 million in 2015–16) for return to state government. Dividends in 2016–17 are lower compared to the prior year, due to SunWater retaining its 2016–17 earnings to contribute to the dam safety works for the Burdekin Falls Dam. Seqwater continued to make no dividend payments to the state in 2016–17.

The returns made by the distributor-retailers of water to their participating local governments amounted to $202 million for 2016–17, up $31.5 million from 2015–16.

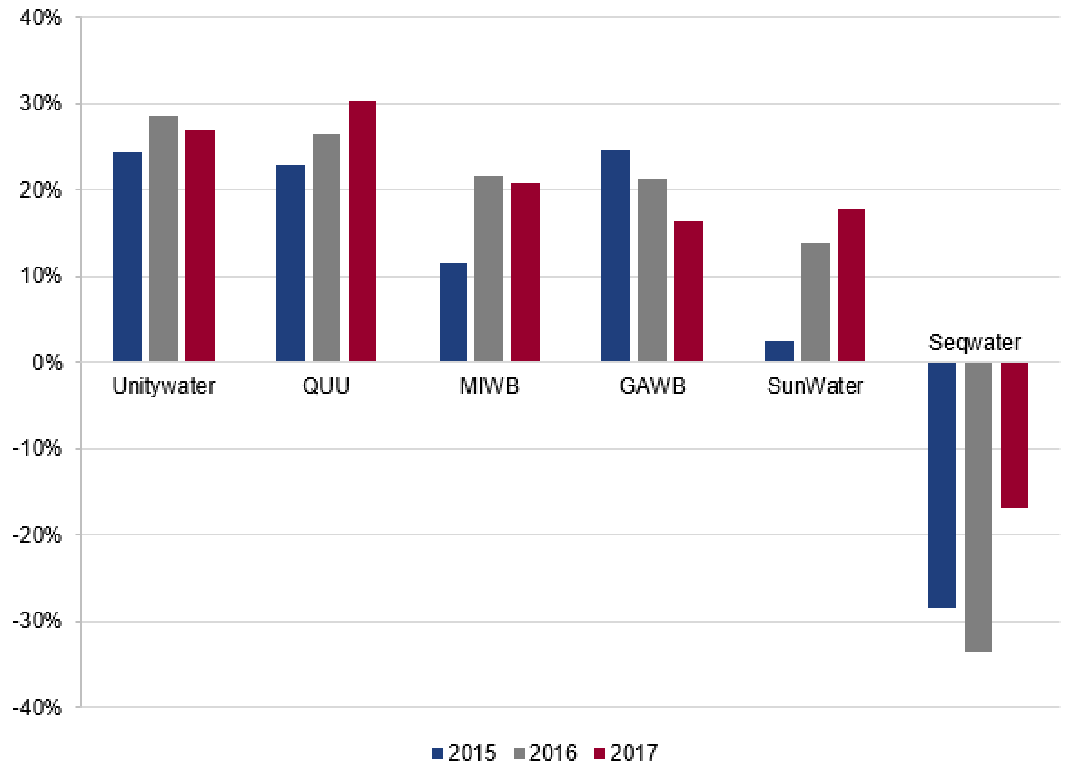
## Operating ratio

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. The operating ratio shows the capacity to meet recurrent operating expenditure from recurrent operating revenue, with a positive ratio indicating funds are also available for capital expenditure and shareholder returns.

Figure 3B shows the operating ratio of each water entity over the past three financial years.

**Figure 3B**
**Operating ratio for water entities**



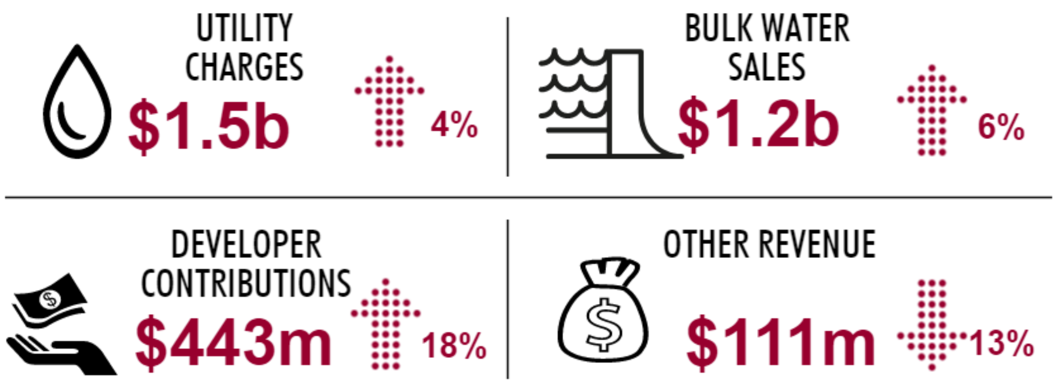

*Source: Queensland Audit Office.*

Operating ratios have remained positive over the past three years except for Seqwater.

Seqwater's ratio has improved by 17 per cent compared to the prior year. This has been achieved through increased water sales (increase in water prices of, on average, four per cent and demand volumes of four per cent), reduction in finance and borrowing costs (two per cent), and no asset valuation adjustments processed in the current year which affected the operating profit result.

## Revenue

**Figure 3C**
**Major revenue by type for in 2016–17 (all entities)**




*Source: Queensland Audit Office.*

Revenue received by the water sector predominantly comprises bulk water sales, utility charges and developer contributions—95 per cent in total for 2016–17.

The water entities reported $3.3 billion of revenue in the 2016–17 financial year, an increase of $119 million (six per cent) from the prior year. Increased demand from customers (distributors and local governments) has increased the demand for water from the bulk water suppliers. Price increases for all entities has also driven increases in revenue.

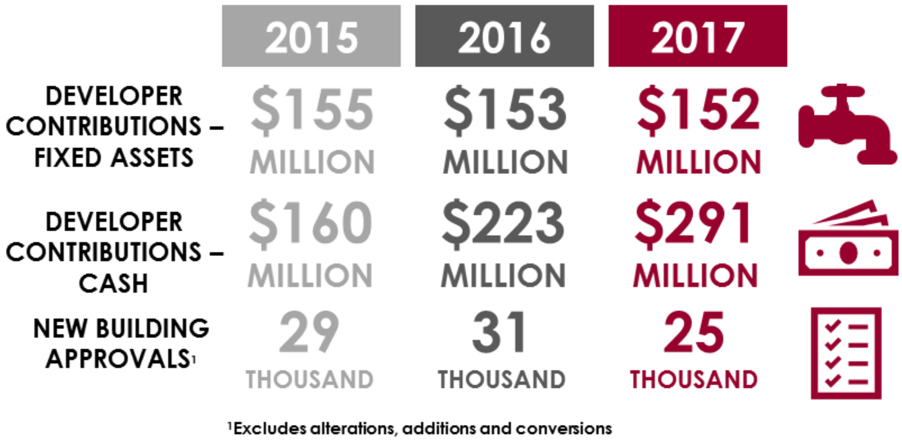
## Events and transactions affecting revenue this year

### Increased developer contributions

Developer contributions come in the form of cash contributions and donated assets. Entities use non-refundable contributions from developers to fund their asset replacement and expansion programs. Receiving infrastructure assets means that entities do not have to self-fund expansion or augmentation to the networks.

For the 2016–17 financial year, retail distributors reported a total revenue of $2 billion. This is broken down between customer and other revenue of $1.6 billion, and developer contributions of $443 million.

**Figure 3D**
**Three-year trend for developer contribution growth**




*Source: Queensland Audit Office.*

Over the past three years, contributions received from developers have increased by $129 million (41 per cent). In the same period there have been about 85 000 new building approvals within the eight local government councils serviced by Queensland Urban Utilities (QUU) and Unitywater. Further, in the 2015–16 year, seven of the eight councils were identified as being in the top 10 fastest growing local governments within the state. This growth in new building approvals and population means that the 2016–17 developer contributions are the largest since the inception of the two entities in 2010.

### Continued support for rural water supply

SunWater receives community service obligation (CSO) payments from the state. In 2016–17 it received $9.5 million (2015–16: $10.1 million) in CSO payments in recognition of the current rural water pricing policies. These policies determine how much irrigators are charged, the extent of urban water deliveries to a local council, and other activities for which there are no other revenue sources.

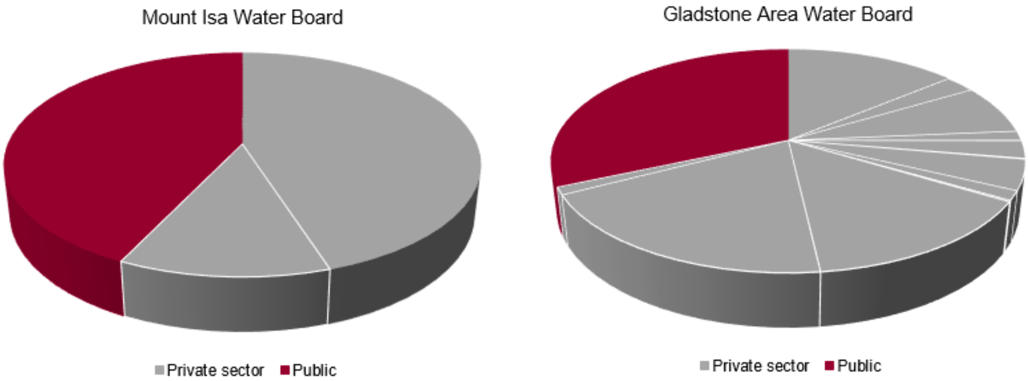
Seqwater also receives CSO payments from the state. In 2016–17 it received $2.1 million (2015–16: $2.4 million) to facilitate the provision of irrigation water to rural irrigators.

For the 2017–18 year, the state has budgeted to give SunWater $9.2 million in CSO payments. Sixteen per cent of this relates to the four irrigation schemes that may be transferred as part of the local management arrangements under the transition scheme. CSO payments to SunWater will be adjusted if the transition schemes are transferred.

### Customer concentrations in regional areas

Mount Isa Water Board and Gladstone Area Water Board provided a combined total of 68 000 ML to their customers in the 2016–17 year. Both entities have a higher proportion of customers in the private sector, particularly mining and gas. This is consistent with the industries in these areas. Mount Isa is particularly dependent on its two private-sector customers as they generate on average 57 per cent of total water sales.

**Figure 3E**
**Water sales by private and public sector customers**




*Source: Queensland Audit Office.*

Gladstone Water Board also depends on its private sector customers. However, as they have 17 core private customers, the risk of losing customers would not significantly affect the future going concerns of the entity.

## Future challenges and emerging risks

### Pricing for South East Queensland

In 2008, the Queensland Government established the South East Queensland bulk water price path with the objective of all South East Queensland council areas reaching a common bulk water price. The price path operates by limiting price increases in those council areas where the price paid for water is more closely aligned to the approved price, while slowly increasing prices for those council areas where the price of water is less than the approved price. By 2019–20, all council areas will have reached a common price for bulk water.

Seqwater has had restricted revenue and has taken on substantial debt to finance operations. At current levels it is not sustainable. This has been factored into pricing going forward. Seqwater will reach a sustainable revenue stream once the common price is reached in all council areas.

**Figure 3F**
**South East Queensland water price path sustainability**


*Source: Queensland Audit Office (indicative image).*

## Queensland Competition Authority bulk water price reset for Seqwater

The Queensland Competition Authority (QCA) is currently investigating the pricing practices relating to the monopoly business activity of bulk water supply by Seqwater. The objective of the review is to recommend bulk water prices for customers in South East Queensland for the period 1 July 2018 to 30 June 2021.

Bulk water prices set to 2021 and prices forecast to 2028 should provide Seqwater with sufficient revenue to recover the cost of providing bulk water supply and services over the period 2008–2028 (price path period). This includes recovering the previous revenue under-recovery known as price path debt.

## Pricing for outside South East Queensland

SunWater's current cost targets set by the QCA in the irrigation water price path do not reflect a rise in operating costs. Costs in the channel schemes vary because of electricity usage, operational costs and future capital expenditure all of which has to be recovered by SunWater through the price charged to irrigators or through a Government subsidy.

QCA will be undertaking a review in 2018 for SunWater's irrigation price path from 1 July 2019 to 30 June 2024.

## National Water Infrastructure Development Fund

The National Water Infrastructure Development Fund is an initiative of the Australian Government to start the detailed planning necessary to build or augment existing water infrastructure. Through the Department of Energy and Water Supply, Queensland entities have been allocated 15 feasibility studies totalling up to $24.8 million under Part 1 of the scheme.

SunWater has been allocated $10.0 million to conduct four feasibility projects (including Burdekin Falls Dam Raising) with completion dates by March 2018. The aims of the project are to identify and address:

- ways to increase capacity of current infrastructure to meet customer demands and improve operation and efficiencies
- environmental impacts of potential works and use of the water
- impacts of rising groundwater and increased groundwater salinity.

## AASB 15 *Revenue from Contracts with Customers*

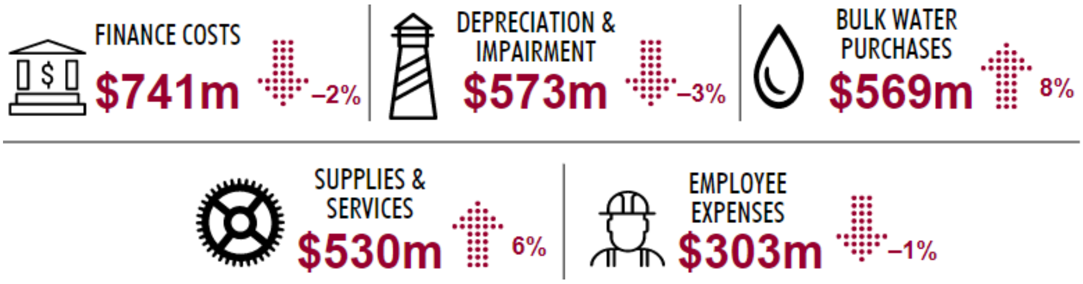
The revenue and income of water entities will be affected by the new Australian accounting standard (AASB) 15 *Revenue from Contracts with Customers* from 1 January 2019. This standard is more complex and includes more judgements than the current equivalent standards.

Water entities have various sources of revenue and income. These mainly include bulk water sales, utility charges, developer contributions, fees and charges, grants and subsidies, and interest revenue. Each of these sources will need to be analysed to determine what changes will be required.

Given the variety of sources of revenue and income, the large number of contracts, and the complexity of the new standards, water entities should not underestimate the effort required to prepare themselves as this may result in changes in systems, processes, accounting policies and in some instances, contracts.

## Expenses

**Figure 3G**
**Major expenses for all entities by type in 2017**

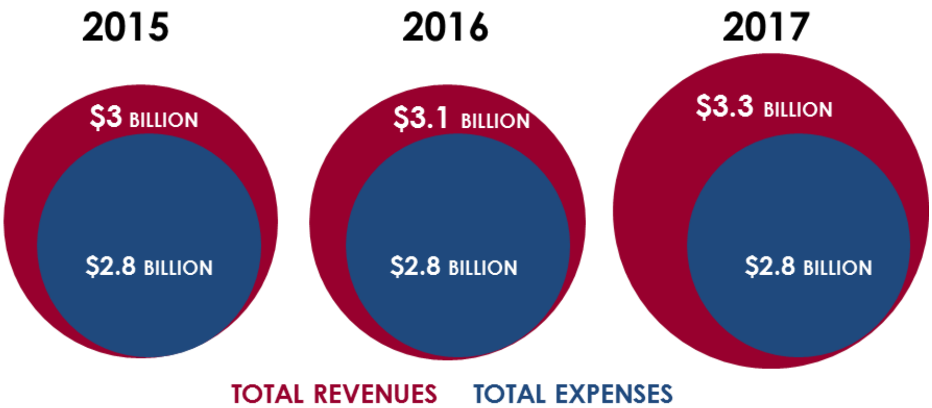



*Source: Queensland Audit Office.*

The water entities reported $2.8 billion of expenses in the 2016–17 financial year, a decrease of $23 million (-0.4 per cent) from the prior year.

- Finance costs are the most significant expense for the water sector and have continued to decrease this year (reduced by $15 million), in line with interest rates, and the commencement of interest charge repayments by Seqwater. Seqwater incurred 73 per cent of total finance costs for the sector as a result of the entity's highly geared financial position.
- Depreciation, although fairly constant, moves in line with the capitalisation of new projects, disposals, and revaluation of assets.
- Bulk water purchases by QUU and Unitywater have increased by $43.8 million compared to the prior year, due to an increase in demand by 8 782 ML, and bulk water price increases from Seqwater.

**Figure 3H**
**Revenue to expenses for the water sector**

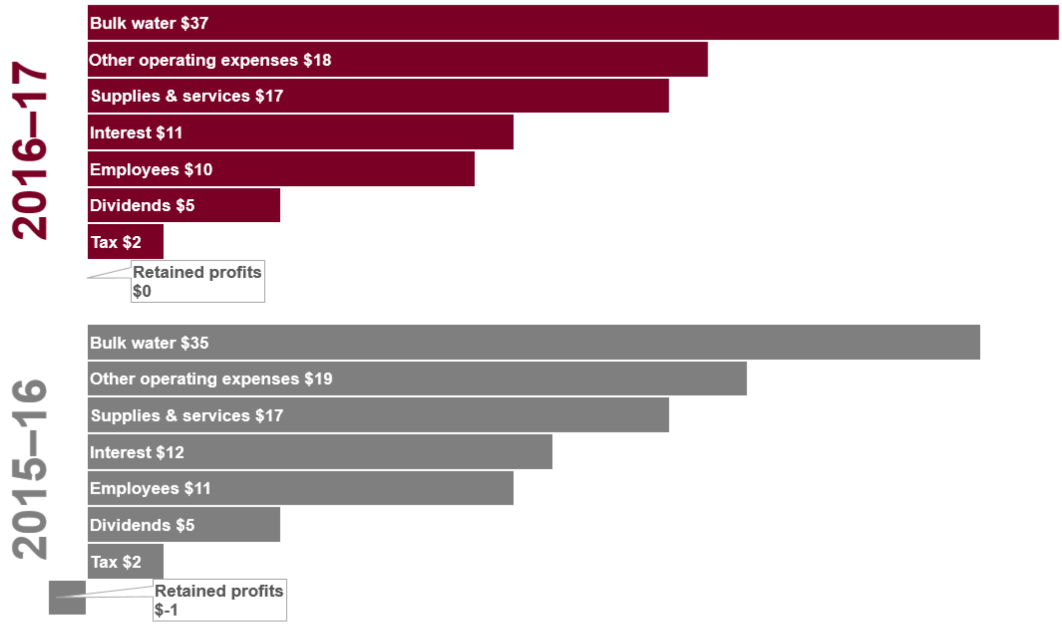



*Source: Queensland Audit Office.*

## Events and transactions affecting expenses this year

Over the past three years, the operating costs for Queensland Urban Utilities and Unitywater have grown by five per cent. Revenue for the same period has grown by 14 per cent; however, this has been driven by an increase of 40 per cent in developer contributions over the same period. For the analysis below, we have removed the developer contributions component to focus on the revenue received from customers. For every $100 received as revenue, both entities use $95 in the business for operating expenses, and $5 is returned to participating shareholding councils as dividends.

**Figure 3I**
**Expenses costs compared to revenue**




*Source: Queensland Audit Office.*

## Future challenges and emerging risks

The responsibility for dam safety in Queensland is the dam owner. Bulk water suppliers must ensure they manage the risks in accordance with the provisions from the *Water Supply (Safety and Reliability) Act 2008*.

All the operators have a dam safety improvement program in place. The program incorporates an ongoing series of inspections, engineering assessments, and comprehensive risk assessments for all referable dams, including changes in design standards, hydrologic data and methods, industry best practice, and regulatory requirements.

Dam safety improvements are a significant cost to the entities and are funded through:

- entities retaining dividends from shareholders
- additional funding from the state or Australian governments
- additional borrowings
- the current bulk water price.

A dam is referable if a failure impact assessment demonstrates there would be people at risk if the dam was to fail.

Dam safety is a major focus for SunWater and it commenced its program of work in 2005. For the 2016–17 year, SunWater has retained all of its 2016–17 dividend ($36 million), and the state government has agreed to provide a further $100 million towards improvement works. This is to ensure the Burdekin Falls Dam continues to meet design standards, supports the proposed hydro–electric power station, and allows for the potential raising of the dam wall.

At 30 June 2017, SunWater assessed that the future cost of its dam safety improvement program was estimated to be $902 million and is likely to be completed by December 2027.

These large projects of capital works are likely to significantly influence SunWater's financial performance and net flows to the government over the next 10 years.

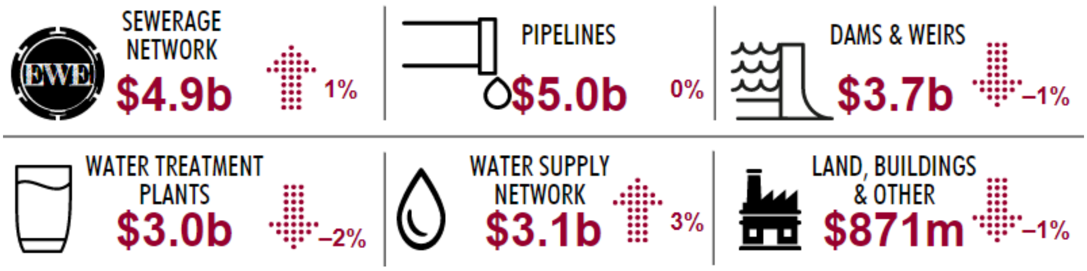
## Understanding financial position

Assets and liabilities decreased by 0.2 per cent and 1.5 per cent respectively this financial year. The combined net asset position increased by $184 million or 2.5 per cent primarily because of:

- increases in property, plant and equipment (PPE) due to additional developer-contributed assets, along with new capital projects commencing, being offset against entities drawing down on cash balances to pay dividends back to shareholders
- timing of dividend payments and return of capital to shareholders which were not required in the current year offset against new borrowings and accounting for movements in deferred tax liabilities.

## Assets

**Figure 3J**
**Total infrastructure and land and buildings for all entities by type for 2016–17**




Note: SunWater and Unitywater report their assets at cost while the remaining entities report at fair value, which limits comparability across the sector.

*Source: Queensland Audit Office.*

The water entities reported $22.6 billion of assets at 30 June 2017, consisting primarily of property, plant, and equipment (94.4 per cent of total assets) used to store and provide water to consumers, and treat waste water.

## Events and transactions affecting assets this year

The water sector provides vital infrastructure that facilitates and grows the economy. The sector manages a large number of complex, long-lived assets, almost all of which they own and control.

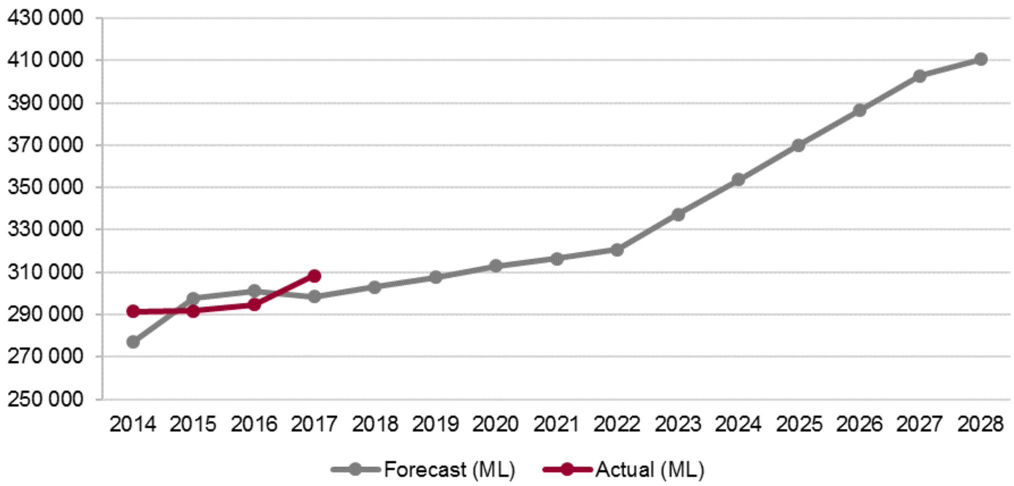
### Measuring the value of assets

Seqwater and Gladstone Area Water Board planned their asset valuation methodology and calculations. Both entities improved their processes from prior years and the valuations were available for audit review in a timely manner. We did not identify any material concerns with the quality of the asset valuations provided.

### Demand inputs for measuring asset values

Last year we reported that a future challenge for Seqwater was that demand for water was not reaching the levels originally expected. The demand assumption forms part of the assumptions and judgements used by management when they value their infrastructure assets and plan to recover debt through pricing. Figure 3K shows a comparison between forecast and actual demand for water for the past four financial years along with the projected future demand levels.

**Figure 3K**
**Demand forecasts versus actuals**




*Source: Queensland Audit Office.*

Over the four-year demand to actual assessment, the average variance was one per cent (12 117ML). Within this period, there have been offsetting variances attributed to actual population growth being lower than forecasted. Seqwater's future demand predictions for water consumption reflect future consumption and population growth. If these demand assumptions are not met Seqwater will incur short-term cash shortfalls which will be recovered in the next regulatory period. This means that under current pricing policy the repayment of debt is unaffected by actual demand being lower than forecast, but that short-term cash shortfalls may need to be met by additional short-term borrowings.

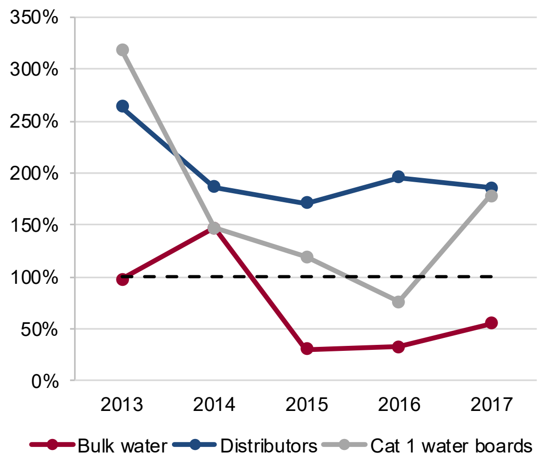
### Capital replenishment ratio

The capital replenishment ratio is a measure of investing sustainability. This ratio compares annual net purchases of non-financial assets to annual depreciation expense.

A ratio of less than 100 per cent may indicate that the size or condition of the overall asset base is diminishing.

A ratio of greater than 100 per cent means assets are being replaced or renewed at a greater rate than they are being depreciated.

**Figure 3L**
**Capital replenishment ratio**




*Source: Queensland Audit Office.*

The ratio for the total water sector has been above 100 per cent for four of the last five years. The replenishment of assets in the distributors has been consistently high with an average ratio of 199 per cent. This is expected given the population growth in six of the seven local governments who contribute to the strong population growth in South East Queensland over the last five years. The ratio for Mount Isa Water Board and Gladstone Area Water Board has been above 100 per cent for four of the last five years, with an average of 162 per cent.

The collective ratio for bulk water entities SunWater and Seqwater has been under 100 per cent for the past three years, indicating a decreasing asset base. Infrastructure plans include significant investment in bulk water infrastructure after the next 10 years, meaning the ratio will improve in the outer planning years.

## Future challenges and emerging activities

### Maintaining water security in South East Queensland

Seqwater manages and maintains $3.2 billion of climate resilient manufactured water assets including the Gold Coast Desalination Plant (GCDP) and the Western Corridor Recycled Water Scheme (WCRWS). Seqwater carries debt associated with these assets of $2.8 billion, along with maintenance responsibilities.

In 2016–17, the desalination plant produced 1 562 megalitres of water (3.2 per cent of total capacity), representing 0.5 per cent of total water supplied by Seqwater, and provides a source of water supply during drought and flood.

The plant currently operates in a 'hot standby' mode, which means it is operated at a level of water production required to maintain the plant in a state of readiness to deliver 33 per cent of capacity within 24 hours, and 100 per cent within 72 hours if required.

The WCRWS has remained in 'care and maintenance' mode throughout 2016–17, since reaching a fully decommissioned state in March 2015. This state encompasses the entire scheme including the three advanced water treatment plants and 210 km of pipelines. A small part of Luggage Point remains operational as part of the care and maintenance mode; however, no material water volumes can be produced by the scheme.

Figure 3M details the costs to maintain and operate the manufactured water assets in 2016–17 and a comparison with the prior year.

**Figure 3M**
**Manufactured water assets—annual maintenance and operating costs**


*Source: Queensland Audit Office.*

Due to the unpredictable nature of climate change, Seqwater has developed a drought response plan that is ready to be implemented should the trigger point be reached.

The first trigger point is 70 per cent of the combined volume of 12 major water grid storages.

At 60 per cent the Gold Coast Desalination Plant may be required to operate at maximum capacity, and recommissioning of the Western Corridor Recycled Water Scheme will commence so that purified recycled water can be supplied within a two-year timeframe into Wivenhoe Dam.

Seqwater will need to fund the costs of these responses when they are required.

**Trigger points**

**70%**—increase general water efficiency messaging

**60%**—up to full production Gold Coast Desalination Plant

**60%**—Western Corridor Recycled Water Scheme recommission commences

**20%**—contingent infrastructure construction commences

### Townsville water security plan

An intergovernmental taskforce to investigate short-, medium- and long-term solutions to water security for Townsville was provided on 30 June 2017. Recommendations in the draft report involving SunWater include:

- building an additional pipeline and pumps from Haughton Pump Station to Ross River Dam
- increasing pump station and channel capacity from Clare to Haughton Pump Station
- working towards improved energy solutions at new and existing pumps
- building a new pump station at Clare.

The Queensland Government as part of the 2017–18 State Budget committed $225 million over four years to implement the findings of the Townsville Water Security Taskforce.

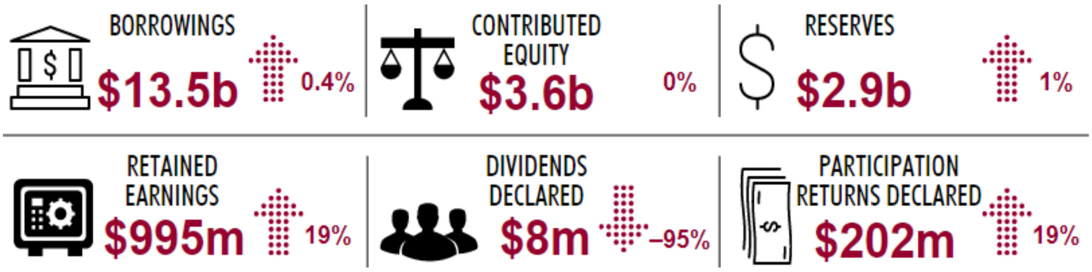
### Regional Queensland water security

SunWater, Gladstone Area Water Board and Building Queensland have developed a business case for the construction of the new Rookwood Weir.

SunWater will upgrade and expand Mareeba Dimbulah and Nogoa Mackenzie Water Supply Schemes, if the National Water Infrastructure Development Fund applications are successful. There are feasibility studies being undertaken to upgrade or expand Bundaberg Channels, Burdekin Haughton Channel Capacity, Nullinga Dam and Burdekin Falls Dam Raising.

## Debt and equity

**Figure 3N**
**Major components of debt and equity for all entities by type for 2016–17**




Note: Contributed equity is net of other transactions with owners.

*Source: Queensland Audit Office.*

At 30 June 2017, the water sector holds $13.5 billion in borrowings and $7.5 billion in total equity. Debt in the water sector is made up of borrowings from Queensland Treasury Corporation.

## Events and transactions affecting debt and equity this year

### Movement in debt

The entities' borrowings across the sector increased by $49 million in 2016–17. SunWater increased borrowings by $40 million to partially fund last year’s special dividend and repayment of capital. Gladstone Area Water Board borrowed $11.5 million to support the development and construction of a small dam.

Seqwater has not materially increased its debt this year and paid interest costs for all its debt, rather than capitalising these costs—which in the past increased its debt. Seqwater has met operating costs from operating revenue, in a period where actual consumption, and associated revenue, was lower than predicted.

Seqwater has a highly geared capital structure (86 per cent at 30 June 2017) as a result of historical under-recovery of operating costs and significant capital investment in prior years.

Figure 3O shows a breakdown of the debt held by Seqwater for the past three years.

**Figure 3O**
**Seqwater borrowings year on year**

| Facility | 30 June 2015 $000 | 30 June 2016 $000 | 30 June 2017 $000 |
|---|---|---|---|
| Water grid manager debt | 2 034 516 | 2 148 880 | 2 157 987 |
| Drought assets debt | 5 410 305 | 5 410 472 | 5 408 178 |
| Non-drought assets debt | 1 860 963 | 1 861 050 | 1 860 182 |
| **Total** | **9 305 784** | **9 420 402** | **9 426 338** |
| **Loan interest payable** | 35 565 | 35 819 | 41 755 |
| **Loan principal** | **9 949 971** | **10 064 335** | **10 064 335** |
| **Redraw facility** | **(679 752)** | **(679 752)** | **(679 752)** |

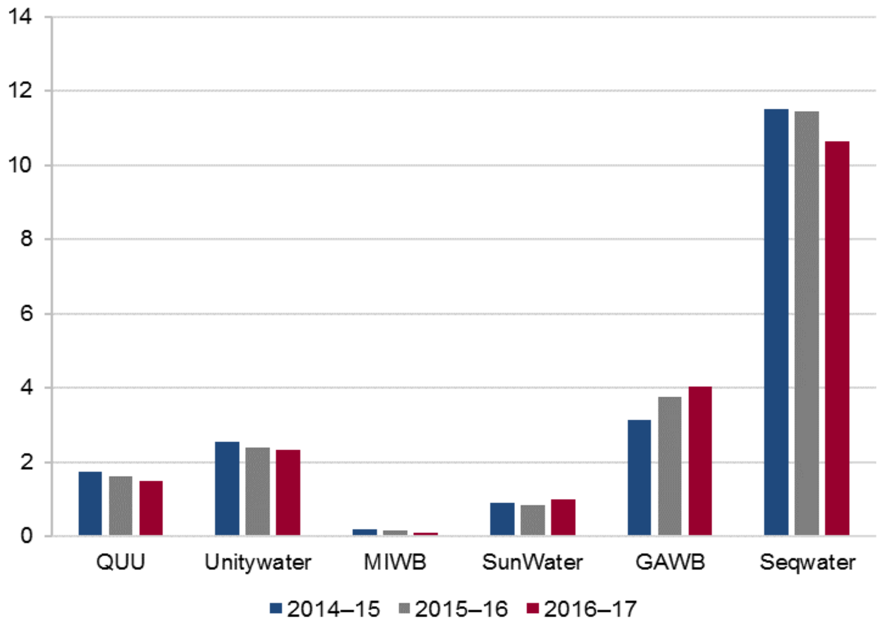
*Source: Queensland Audit Office.*

The QCA is currently assessing the future prices for Seqwater, which should allow for repayment of water grid manager debt by 2027–28.

## Debt to revenue ratio

As a sector, debt as at 30 June 2017 was over 4.1 times revenue, which is consistent with the prior year. Figure 3P shows the debt to revenue ratio for the past three financial years by entity.

**Figure 3P**
**Debt to revenue ratio for water entities**



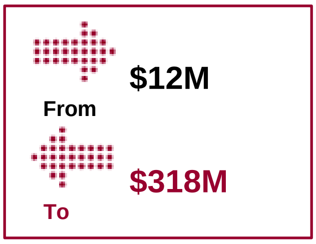

*Source: Queensland Audit Office.*

The debt to revenue ratio assesses an entity's ability to pay the principal and interest on borrowings, as and when they fall due, from the funds that the entity generates—the higher the ratio, the more difficult it is to service and repay debt.

Seqwater continues to have a significantly higher debt to revenue ratio than all other water entities, attributed to the loans it acquired from the merger with other bulk water entities.

The majority of loans held with Queensland Treasury Corporation have variable interest rates. The risk of interest rate movements can have a significant impact on interest payments and, therefore, the ability of Seqwater to pay other ongoing operating expenses in future. In terms of sensitivity, a movement of just one per cent in interest rates would result in a corresponding increase in borrowing costs of approximately $3.9 million per annum.

### Flows from and to government




Equity includes share capital held by the Queensland Government and the participating councils, transactions with owners (such as dividend payments and return of equity), asset valuation reserves, and retained earnings.

Flows to and from government affect an entity's ability to meet its expense commitments, replace and grow its asset base, and repay debt. Water entities pay dividends, income tax equivalents and competitive neutrality fees to the government, and receive community service obligations and state government grants for selected activities.

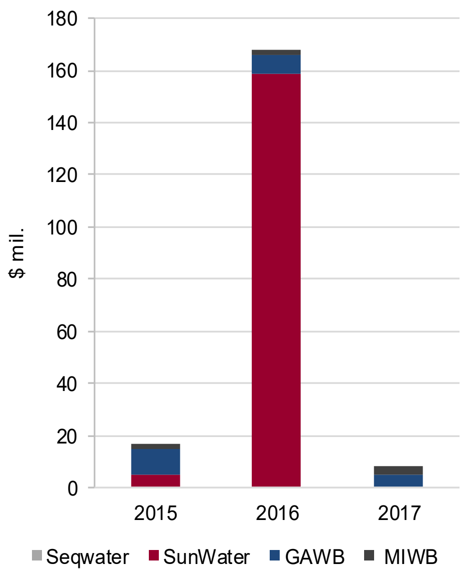
We assess the effect of net flows on the financial results of these entities. The water sector recorded net flows to the government of $306 million in 2016–17, a significant increase from the amount reported in 2015–16 ($98 million). The increase in the current year is primarily due to the special dividends paid in 2016–17 (declared in 2015–16).

### Declared dividends and participation returns

A total of $193 million in dividends was declared to the state government over the past three years of which SunWater contributed 87 per cent, the majority being a special dividend from retained earnings. Seqwater has not declared any dividends due to continued losses.

During 2016–17, two water entities declared dividends of $8 million ($168 million in 2015–16) for return to state government. Dividends declared in 2016–17 are significantly lower compared to the prior year, primarily due to SunWater retaining its 2016–17 earnings to contribute to the dam safety works for the Burdekin Falls Dam.

**Figure 3Q**
**Trend of declared dividends**



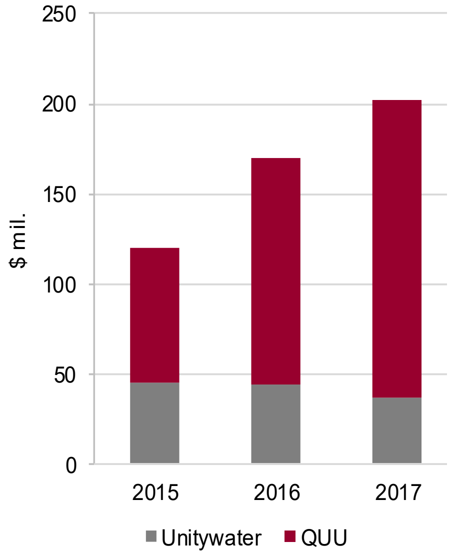

*Source: Queensland Audit Office.*

Participation returns are declared by Queensland Urban Utilities (QUU) and Unitywater to local governments in accordance with the participation agreements. Over the past three years, a total of $491 million in participation returns was declared.

In 2016–17, QUU declared participation returns of $164 million, an increase of $38 million from the prior year. The upward trend in the participation returns of QUU is mainly attributable to the increase in developer cash contributions received and recognised. Participation returns are based on a percentage of net profit after tax excluding any non-cash donated assets.

Unitywater's declared participation returns are consistent over the past three years, as agreed with participating councils. The participation returns declared are based on the five-year forward estimates provided to participating councils.

**Figure 3R**
**Trend of participation returns**




*Source: Queensland Audit Office.*

## Future challenges and emerging risks

### AASB 16 *Leases*

The introduction of the new accounting standard 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 leases being recognised in the statement of financial position as the distinction between operating and finance leases is removed. Under the new standard, most leases previously not reported as assets and liabilities will be brought on balance sheet. The timing of recognition of expenses will also change.

In 2016–17, the water sector collectively reported operating lease commitments of approximately $116 million in their future commitments as lessee and $20 million as lessor, some of which will be brought onto the statement of financial position as right of use when the new standard becomes effective.

## Local management arrangements

The state government legislated the *Water (Local Management Arrangements) Amendment Act 2017* to facilitate the future implementation of local management arrangements for SunWater's eight channel irrigation schemes. The arrangements will transfer distribution schemes, such as channels, pipes and drains out of public ownership to irrigator ownership. It will not consider bulk water supply assets, such as major dams.

Final terms are anticipated to be finalised by the end of the 2017 calendar year if the boards are satisfied with due diligence.

The transfer process will differ for each scheme and is likely to transfer the assets to the entities that are wholly owned and controlled by scheme customers commencing by mid-2018.

# 4. Internal controls

## Introduction

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

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

## Conclusion

We assessed that the control environment for each entity was suitably designed to prevent, or detect and correct material misstatements in their financial statements and non-compliance with legislative requirements. Therefore, the control environment supported our reliance on their internal control systems.

We identified two significant control deficiencies in the sector relating to internal controls. We are satisfied that management has implemented corrective action to rectify these deficiencies.

The risk of undetected fraud or errors within financial systems and entities' financial reporting remained stable from previous years.

## Our audit of internal controls

We assess the design and implementation of internal controls to ensure they are suitably designed to prevent, or detect and correct, material misstatements in the financial report. We also assess whether they achieve compliance with legislative requirements and make appropriate use of public resources. Where we identify controls that we plan to rely on, we test how effectively these controls are operating to ensure they are functioning as intended.

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

## Our rating of internal control deficiencies

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

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

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

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

## Control deficiencies categorised by COSO component

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

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

Figure 4A below shows control deficiencies categorised by COSO component reported to management at 31 August 2017.

**Figure 4A**
**Number and category of internal control deficiencies for the water sector**

| **Control environment**<br>*Structures, policies, attitudes and values that influence daily operations* | **Risk assessment**<br>*Processes for identifying, assessing and managing risk* | **Control activities**<br>*Implementation of policies and procedures to prevent or detect errors and safeguard assets* | **Information & communication**<br>*Systems to capture and communicate information to achieve reliable financial reporting* | **Monitoring activities**<br>*Oversight of internal controls for existence and effectiveness* |
|---|---|---|---|---|
| None | None | Two significant deficiencies<br>13 deficiencies | None | None |

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

## Control activities

We identified two significant deficiencies in manual and general information technology controls at SunWater. These deficiencies related to:

- conflicting roles accounts payable and finance staff are able to perform within the procure to pay process and processing into the finance system
- the number of users with privileged access within the finance system, with a lack of monitoring of processes and transactions.

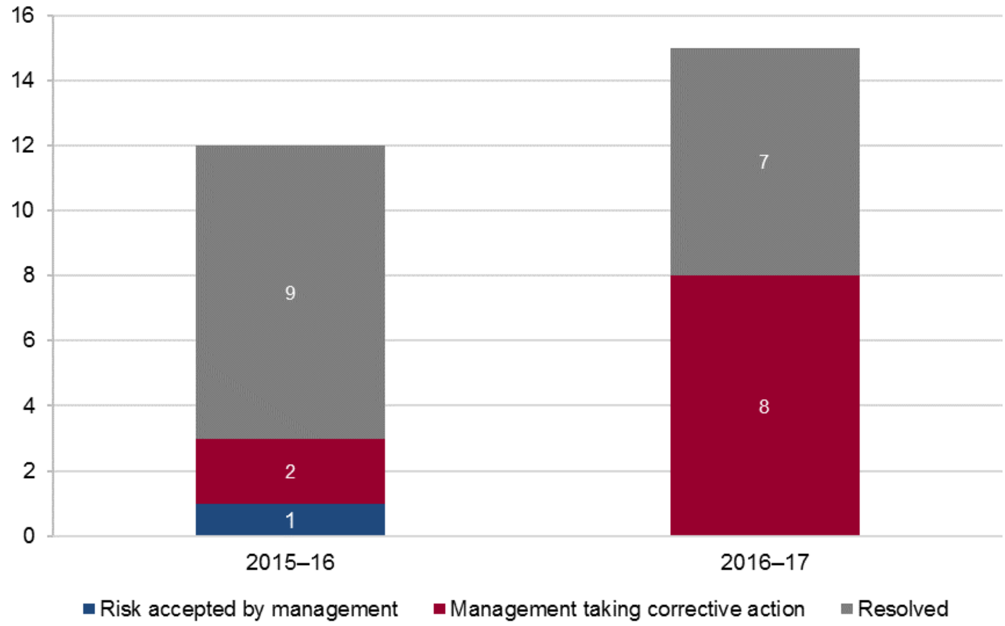
The company is addressing the two issues and is updating processes to identify and report privileged user access changes and to amend allocated responsibilities within the accounts payable and finance sections.

## Status of internal control deficiencies

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

We have analysed the appropriateness and timeliness of remedial action undertaken to resolve any audit matters we identified. Figure 4B outlines the status of internal control deficiencies reported over the last two years at 31 August 2017.

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




*Source: Queensland Audit Office*

All six entities either addressed their identified control deficiencies or are on track to do so by the agreed dates. Where corrective action is underway we urge audit committees to monitor whether management is meeting the agreed milestone dates for all issues reported. Proactive and timely resolution of control deficiencies indicates a strong control environment.

# Appendices

# Appendix A—Full responses from agencies

As mandated in Section 64 of the *Auditor-General Act 2009*, the Queensland Audit Office gave a copy of this report with a request for comments to the Minister for Main Roads, Road Safety and Ports and Minister for Energy, Biofuels and Water Supply; Minister for State Development and Minister for Natural Resources and Mines; the Director-General, Department of Energy and Water Supply; the Chief Executive Officer, Queensland Competition Authority; and the Under Treasurer, Queensland Treasury.

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

This appendix contains their detailed responses to our audit recommendations.

# Comments received from Director-General, Department of the Premier and Cabinet

Queensland Government

Department of the
**Premier and Cabinet**

For reply please quote: *ENV/ML – TF/17/14318 – DOC/17/187239*
Your reference: *Water RtP/Rachel Vagg 3149 6127*

15 NOV 2017

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

Dear Mr Worrall

Thank you for your letter of 16 October 2017 providing a copy of the Queensland Audit Office draft report *Water: 2016–17 results of financial audits.*

I understand that Queensland Treasury and the Department of Energy and Water Supply have already provided feedback on the draft report to your Office. The Department of the Premier and Cabinet has no further comments.

Thank you for bringing the draft report to my attention.

Yours sincerely

Dave Stewart
**Director-General**

1 William Street Brisbane
PO Box 15185 City East
Queensland 4002 Australia
**Telephone** +61 7 3224 2111
**Facsimile** +61 7 3229 2990
**Website** www.premiers.qld.gov.au
ABN 65 959 415 158

# Comments received from the Under Treasurer, Queensland Treasury

Queensland Government

**Queensland Treasury**

*Our Ref: 03902-2017*
*Your Ref: Water RtP*

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

Dear Mr Worrall

Thank you for your letter of 16 October 2017 regarding the Queensland Audit Office (QAO) draft report *Water: 2016-17 results of financial audits* (the Report) and the opportunity to provide comments.

The draft report presents a useful overview of the water sector entities in Queensland. I understand officers from Queensland Treasury (Treasury) and the Department of Energy and Water Supply have discussed the draft report with the QAO, and that the feedback has focused on the accurate presentation of current pricing and policy settings affecting the water sector.

I note that unmodified audit opinions were provided on all financial statements for 2016-17 for the water sector entities. I welcome the QAO's advice that all water entities are financially sustainable, noting that Seqwater's financial sustainability depends on the pricing methodology set by the State Government.

It is pleasing to see that Seqwater has improved its financial reporting procedures, met the statutory reporting deadline and improved the quality of their asset valuation process. I also note the report identifies that SunWater management is on track to resolve two deficient internal controls within SunWater, and that the SunWater Audit, Finance and Risk Committee is closely managing the situation.

Treasury considers it important to ensure the QAO's descriptions relating to bulk water prices and pricing policy (for South East Queensland and regional Queensland), the Local Management Arrangements project, and large-scale water infrastructure studies/investigations are accurate and reflect the policy and regulatory arrangements that are currently in place, and which are publicly available.

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

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

Yours sincerely

Jim Murphy
Under Treasurer
7/12/17

## Comments received from Chief Executive Officer, SunWater

Contact: Nicole Hollows
Direct Line: 07 3120 0055
Our ref: 17-000198/001 - #2259238
Your ref:

SunWater Limited
Level 10, 179 Turbot Street
PO Box 15536 City East
Brisbane Queensland 4002
www.sunwater.com.au
ACN 131 034 985

8 December 2017

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

Dear Mr Worrall

**Draft Report: Water: 2016-2017 Results of Financial Audits**

Thank you for providing a copy of the draft report: "Water: 2016-2017 Results of Financial Audits".

SunWater is pleased to have received an unmodified opinion for the 2016/17 financial year, confirming that it has complied with the Australian Accounting Standards and relevant legislative requirements within legislative timeframes.

SunWater continues to strive to achieve ratings of fully "Effective" in all areas in future audits and is working with the QAO to resolve the issues raised in the Closing Report dated 10 August 2017. SunWater has also undertaken an internal audit of all finance process controls to ensure that all controls are in place and effective. This was completed in October 2017. The two significant deficiencies referred to in the draft report relate to information technology general controls: excessive number of SAP privileged user access accounts and segregation of accounts payable duties. The segregation of accounts payable duties significant deficiency has been rectified and is now resolved. The excessive number of privileged users in SAP significant deficiency has also been mitigated by the implementation of a SAP system solution. The solution is going through a series of vulnerability tests to ensure there are no gaps in the solution. Testing will be completed and the issue will be closed by 31st of December 2017.

Further details of how the two significant deficiencies have been addressed and completed are below:

MAKING WATER WORK

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| Deficiency/ Issue | Consequence/ significant/ potential impact | Controls in place to mitigate | Actions undertaken to date | Outstanding to complete with due date |
|---|---|---|---|---|
| Excessive number of privileged users in SAP. | Identified a number of user accounts within SAP with full access to the system. User have the ability to amend system configuration and process, amend or delete financial information and transactions. | 1. Assign only required level of access to users<br>2. Monitor privileged user access activities.<br>3. Lock SAP user account when not in use.<br>4. Develop and implement formal procedures to secure privileged users from inappropriate use. | 1. Accountability for privileged tasks has been removed from all non-privileged users.<br>2. SAP user accounts are being locked when users are on leave.<br>3. Privileged Account Management solution has been implemented. | A permanent solution has been implemented. The solution is going through a series of vulnerability tests to ensure there are no gaps in the solution. Testing will be completed and the issue will be closed by 31/12/17. |
| Segregation of Duties – Accounts Payable | Observed that 6 standard SAP users have access to create/edit vendor bank details and also perform accounts payable roles. | Ensure appropriate segregation of duties is in place. Where duties cannot be segregated for practical purposes, monitoring controls should be implemented that detect the same user has made changes to the vendor master file and processed the invoices to ensure that they are genuine transactions. | The following field changes require a second approver (without AP access) for change:<br>• Vendor name change<br>• EFT/Cheque field<br>• Contact name<br>• BSB or Account number<br>• Contact name<br>• Contact phone number<br><br>Only Accounts Payable Supervisor has access to these vendor master file creation or change and does not have access to raise invoices. | No outstanding actions – completed |

MAKING WATER WORK

- 3 -

SunWater would like to reiterate it will ensure that all material issues identified during the 2016/17 audit will be resolved.

Yours sincerely

**Nicole Hollows**
Chief Executive Officer
SunWater Limited

MAKING WATER WORK

# Appendix B—Water entities

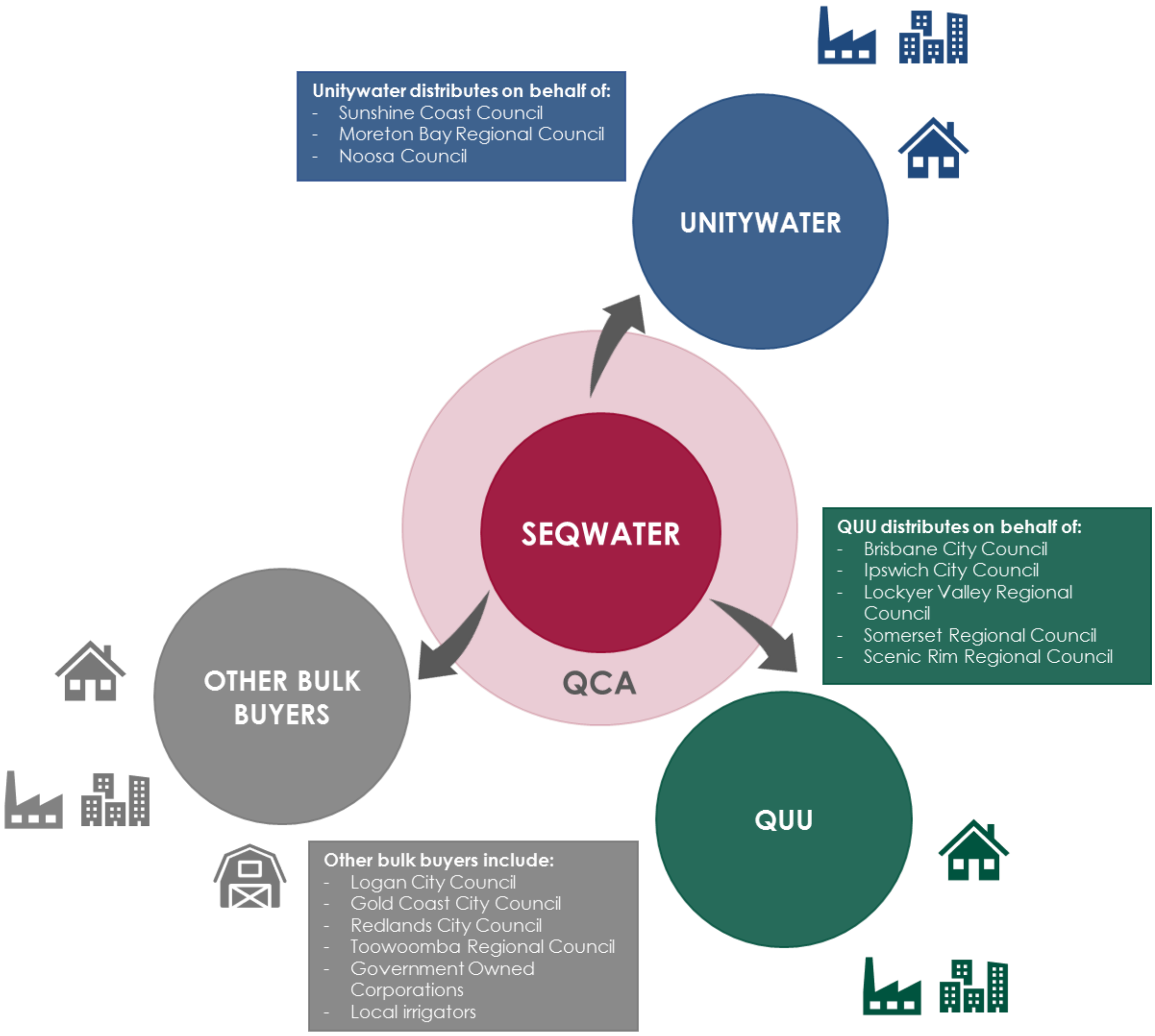
## Water entities

### South East Queensland

Within South East Queensland, Seqwater sells treated bulk water to 12 local council regions, either through Distributor-Retailer Authorities (Unitywater and Queensland Urban Utilities (QUU)) who then distribute on behalf of the councils to households or business, or directly to councils who operate their own retail operations. Seqwater also provides bulk water directly to certain large corporations and irrigators.

Bulk water prices are set by the state government, with oversight by the Queensland Competition Authority (QCA). The QCA calculates how much revenue entities can earn based on prudent and efficient operating costs and may also provide a return of, and on assets, where appropriate. Prior to 2015–16, the QCA monitored the prices set by the distributor-retailers. The QCA will not step into the process unless directed by the state government.

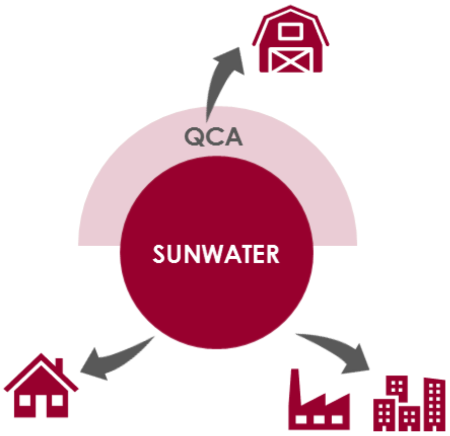
**Figure B1**
**South East Queensland water distribution**




*Source: Queensland Audit Office.*

## Outside South East Queensland

**Figure B2**
**Outside South East Queensland bulk water supply**

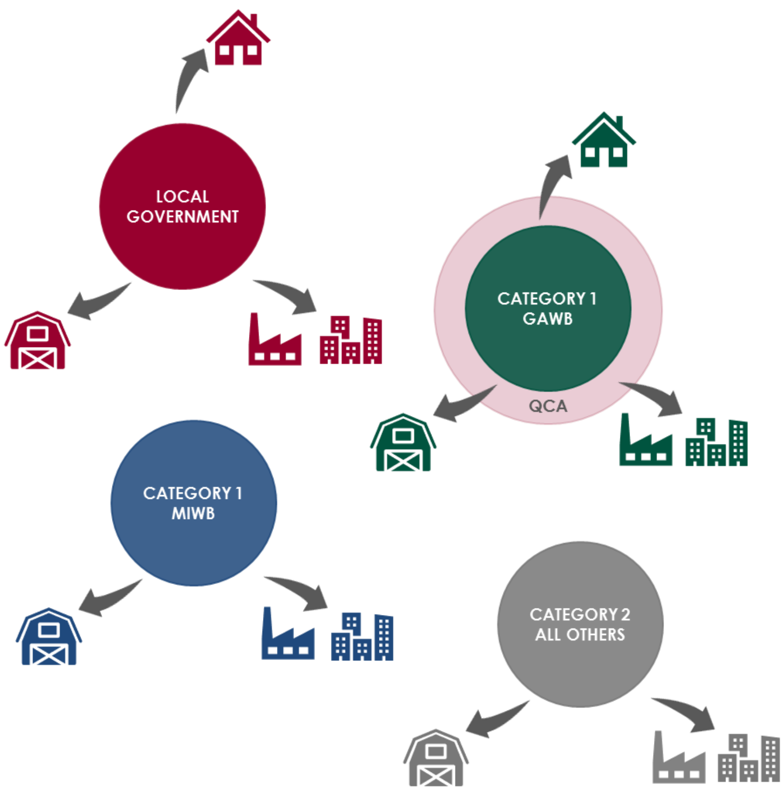



Outside of South East Queensland, SunWater operates much of the bulk water infrastructure that supplies councils, irrigators and industrial customers. Unlike Seqwater, SunWater does not retain exclusive rights to sell the water under management. Public and private sector entities purchase and sell water entitlements to one another. This passes the risk of drought and other water shortages onto the carrier of the water allocation entitlement.

*Source: Queensland Audit Office.*

For retail customers water is sourced, treated and distributed by local government owned infrastructure. These water boards are split into category one boards, which are for profit entities, and category two boards, which are not for profit. Category one boards include Gladstone Area Water Board (GAWB) and Mount Isa Water Board (MIWB); category two covers all others. These boards also provide bulk water to large irrigators and industrial customers.

**Figure B3**
**Outside South East Queensland retail water supply**




*Source: Queensland Audit Office.*

# Appendix C—The Queensland Audit Office

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

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

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

# Appendix D—Legislative context

## Framework

Water entities prepare their financial statements in accordance with the following legislative frameworks and reporting deadlines:

| Entity | Legislative framework | Legislated deadline |
| --- | --- | --- |
| Statutory bodies | | |
| ▪ Queensland Bulk Water Supply Authority (trading as Seqwater)<br>▪ Northern SEQ Distributor-Retailer Authority (trading as Unitywater)<br>▪ Central SEQ Distributor-Retailer Authority (trading as Queensland Urban Utilities)<br>▪ Gladstone Area Water Board<br>▪ Mount Isa Water Board | ▪ *Financial Accountability Act 2009*<br>▪ Financial and Performance Management Standard 2009 | 31 August 2017 |
| Government owned corporation | | |
| ▪ SunWater Limited | ▪ *Government Owned Corporations Act 1993*<br>▪ *Corporations Act 2001*<br>▪ Corporations Regulations 2001 | 31 August 2017 |
| Controlled entities | | |
| ▪ Eungella Water Pipeline Pty Ltd<br>▪ Australian Water Recycling Centre of Excellence Ltd | ▪ *Corporations Act 2001*<br>▪ Corporations Regulations 2001 | 31 October 2017 |

*Source: Queensland Audit Office.*

## Accountability requirements

The *Financial Accountability Act 2009* requires statutory bodies to:

- achieve reasonable value for money by ensuring their operations are carried out efficiently, effectively, and economically
- establish and maintain appropriate systems of internal control and risk management
- establish and keep funds and accounts that comply with the relevant legislation, including Australian accounting standards.

## Queensland state government financial statements

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

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

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

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

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

# Appendix E—Our assessment of financial statement preparation

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

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

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

# Appendix F—Financial snapshot

| Entity | Amounts in $'000 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | At 30 June 2017 | | For the year ended 30 June 2017 | | | | | | |
| | | | Total revenue | Total expenses | Profit (loss) after tax | Dividends declared / participating returns | Borrowings | | |
| | Total assets | Total liabilities | | | | | Finance costs | New borrowings | Repayment of borrowings |
| Seqwater | 11 386 146 | 9 892 007 | 880 294 | 1 029 246 | (105 513) | – | 538 936 | – | – |
| SunWater | 996 551 | 541 539 | 287 927 | 236 874 | 36 048 | – | 15 194 | 40 000 | 1 548 |
| Unitywater | 3 619 542 | 1 819 190 | 669 523 | 489 199 | 135 507 | 36 888 | 79 848 | 78 876 | 78 878 |
| QUU | 5 800 676 | 2 536 456 | 1 382 101 | 965 270 | 291 449 | 164 872 | 97 561 | – | – |
| GAWB | 721 748 | 339 938 | 59 689 | 50 437 | 6 870 | 5 496 | 8 902 | 11 500 | – |
| MIWB | 158 310 | 31 044 | 22 536 | 17 841 | 3 282 | 2 626 | 175 | – | 732 |

*Source: Queensland Audit Office.*

| Entity | Amounts in $'000 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | At 30 June 2016 | | For the year ended 30 June 2016 | | | | | | |
| | | | Total revenue | Total expenses | Profit (loss) after tax | Dividends declared / participating returns | Borrowings | | |
| | Total assets | Total liabilities | | | | | Finance costs | New borrowings | Repayment of borrowings |
| Seqwater | 11 538 627 | 9 938 975 | 818 347 | 1 093 077 | (195 593) | – | 551 814 | 114 364 | – |
| SunWater | 1 237 634 | 818 670 | 296 305 | 255 623 | 29 009 | 159 009 | 20 536 | – | 21 751 |
| Unitywater | 3 498 677 | 1 796 944 | 650 411 | 465 157 | 136 310 | 43 865 | 80 789 | 102 757 | 105 209 |
| QUU | 5 633 490 | 2 496 246 | 1 269 089 | 934 110 | 232 231 | 126 365 | 94 292 | 471 282 | 471 282 |
| GAWB | 672 322 | 317 271 | 60 917 | 48 531 | 9 110 | 7 289 | 8 831 | – | – |
| MIWB | 153 842 | 28 338 | 17 841 | 16 025 | 3 063 | 2 463 | 200 | – | 698 |

*Source: Queensland Audit Office.*

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

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

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

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

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

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

## Internal controls framework

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

The framework identifies five components for a successful internal control system. These components are explained below.

## Control environment

- Cultures & values
- Governance
- Organisational structure
- Policies
- Qualified & skilled people
- Management's integrity & 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, ensuring they receive the right information at the right time to enable informed decision-making
- policies and procedures are established and communicated so people with the right qualifications and experiences are recruited, they understand their role in the organisation, and they also understand management's expectations towards 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 agree risks should be identified, assessed, and managed.

To achieve appropriate management of business risks, management can either accept the risk if it is minor, or mitigate the risk to an acceptable level by implementing appropriately designed controls. Risks can also be eliminated entirely by choosing to exit from a risky business venture.

## Control activities

- General information technology controls
- Automated controls
- Manual controls

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

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

## General information technology controls

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

## Automated control activities

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

## Manual control activities

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

## Information and communication

- Non-financial systems
- Financial systems
- Reporting systems

Information and communication controls are the systems used to provide information to employees, and the ways that control how responsibilities are communicated.

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

## Monitoring activities

- Management supervision
- Self-assessment
- Internal audit

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

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

# Appendix H—Glossary

| Term | Definition |
|---|---|
| Accountability | Responsibility of public sector entities to achieve their objectives in reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws, and reporting to interested parties. |
| *Auditor-General Act 2009* | An Act of the State of Queensland that establishes the responsibilities of the Queensland Auditor-General, the operation of the Queensland Audit Office, the nature and scope of audits to be conducted, and the relationship of the Queensland Auditor-General with parliament. |
| Australian accounting standards | The rules by which financial statements are prepared in Australia. These standards ensure consistency in measuring and reporting on similar transactions. |
| Australian Accounting Standards Board (AASB) | An Australian Government agency that develops and maintains accounting standards applicable to entities in the private and public sectors of the Australian economy. |
| Capital expenditure | Amount capitalised to the balance sheet for contributions by an entity to major assets owned by the entity, including expenditure on:<br>▪ capital renewal of existing assets that returns the service potential or the life of the asset to that which it had originally<br>▪ capital expansion that extends an existing asset at the same standard to a new group of users. |
| Category 2 water board | Smaller water boards that source and sell water primarily to irrigation customers in designated areas throughout the state. |
| Community service obligations | Government payments to commercial entities to provide services that are not in the entity's commercial interests. |
| Depreciation | The systematic allocation of a fixed asset's capital value as an expense over its expected useful life to take account of normal usage, obsolescence, or the passage of time. |
| Discount rate | Interest rate used to calculate the present day value. |
| Drought assets | Assets that were constructed in response to the Millennium drought, such as the Gold Coast Desalination Plant and Western Corridor Recycled Water Scheme. These assets do not form part of the integral water source and/or core supply of water. |
| Emphasis of matter | A paragraph included with the audit opinion to highlight an issue of which the auditor believes the users of the financial statements need to be aware; the inclusion of an emphasis of matter paragraph does not modify the audit opinion. |
| Gearing | The level of an entity's debt related to its equity capital. |

| Term | Definition |
|---|---|
| Going concern | Means an entity is expected to be able to pay its debts as and when they fall due, and to continue to operate without any intention or necessity to liquidate or wind up its operations. |
| Impairment | When an asset's carrying amount exceeds the amount that can be recovered through use or sale of the asset. |
| Interest coverage ratio | Revenue generated to Queensland Treasury Corporation interest expense |
| Megalitre (ML) | One million litres. A standard Olympic-size swimming pool contains 2.5 ML or 2,500,000 litres of water. |
| Net assets | Total assets less total liabilities. |
| Net debt | Total Queensland Treasury Corporation borrowings less cash. |
| 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 2017–18

| Number | Title | Date tabled in Legislative Assembly |
|---|---|---|
| 1. | Follow-up of Report 15: 2013–14 Environmental regulation of the resources and waste industries | September 2017 |
| 2. | Managing the mental health of Queensland Police employees | October 2017 |
| 3. | Rail and ports: 2016–17 results of financial audits | December 2017 |
| 4. | Integrated transport planning | December 2017 |
| 5. | Water: 2016–17 results of financial audits | December 2017 |

# Contact the Queensland Audit Office